Tesla – A case study in growth expectations

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For centuries the world has often been unkind at first to true creatives and disruptors that question and challenge the status quo. Elon Musk and his teams at **Tesla** are creating, disrupting, questioning and challenging. Despite being widely ridiculed and running up cumulative operating *losses* of US$4.6bn between 2006 and 2019, the fact is Tesla sold US$24,5bn worth of their products in 2019, to paying and seemingly satisfied customers. Its share price reached an all-time high of US$962 last week. For an investor who bought at that price to make an annual 10% return over the next 5 years, this is what they would have needed to assume.

1. The global automotive industry's revenues grow by 3% p.a.
2. The electric vehicles sub-industry segment increases its market share from 4% to 15%.
3. Tesla maintains its 25% market share of the electric vehicles sub-industry segment.
4. Tesla's operating profit margins increase from 0,3% to 5%.
5. Tesla shares trade in 5 years' time at 4 times sales.

Assumptions 2 through 5 is aggressive, represents a high road outcome and can readily be challenged with basic logic. Perhaps the most critical one is assumption number 3. A fascinating case study to call up is **Nokia**, who saw its dominant 50% smartphone industry market share fade away to an inconsequential 3% between 2007 and 2013. Nokia was an early leader in a high growth industry that attracted lots of extremely well-funded, savvy competitors from both inside and outside its industry.

Circling back to the automotive industry, Tesla currently spends approximately US$1.4bn per year on research & development (R&D). There are 14 of its peers spending a combined US$70bn per year on R&D – granted not just on electric vehicle technologies. My point is to better frame what a belief in assumption number 3 entails, considering many automotive OEM's have already launched or will shortly be launching their own range of great looking electric vehicles with similar features.

Lastly, some pundits claim Tesla is a *technology products* company and should be valued as one. Allow me to present evidence from the most successful technology products company of all time, **Apple**. Between 2005 and 2020, the market traded in Apple shares at an average of 3 times sales, occasionally peaking at 4 times sales. There is an important difference; Apple consistently generates 30% operating profit margins and a 40% return on equity.

It will be fascinating to see the future unfold here. Any low road scenario will be disastrous for shareholders and looks probable. The high road scenario only delivers an okay-ish positive return and looks unlikely.

Our work continues…

Daniel Malan
Managing Director & Chief Investment Officer
daniel@perspectiveim.co.za

Perspective Investment Management
www.perspectiveim.co.za
