Tesla is not the next Apple

Tesla is poised to enter the S&P500 on December 21st and will likely be immediately the seventh largest company in the S&P500. Passive funds will buy millions of shares probably driving the share price further into the stratosphere. The rise in the share price of Tesla in 2020 has been truly astounding having begun the year around US$84 and now near US$650, a rise of some 675%. Well done to the Tesla bulls! However, despite CEO Elon Musk having seemingly achieved much of his mission to change the world in favour of electric vehicles and cleaner forms of energy it is fair to ask what are investors paying for when they buy Tesla shares?

Tesla is an amazing company that seems to be on a social mission with a strong brand to match. There are some similarities with the second coming of Apple after Steve Jobs gave the world the iPhone in 2007 and resurrected the companies fortunes to the point Apple is now the world's largest company by market value at US$2.1 trillion. The iPhone changed the world by putting the internet in your back pocket and Apple has reaped considerable profits (US$56b in the last 12 months on US$275b of revenues) from it and its suite of related products and services. Apple takes a large share of our wallets and mind space and its market position is well entrenched. Tesla now has a market value of US$605b so nearly a third the size of Apple and bears some similarities to Apple but there are some important differences.

Tesla is at the leading edge of change in electric vehicles, autonomous driving, battery, and other green energy technologies. The company represents what many see as the future and they are probably right about that. Buyers of Tesla cars and Tesla shares are often believers in the mission and there is positive social validation. Does anyone at a dinner party proudly say they own Exxon Mobil shares? There is a warm glow to owning Tesla but the numbers tell a different story so far. Revenues are growing but at US$28b the market value is 21 times revenues. Earnings are still minimal with a price to earnings ratio of nearly 1,300 years! At least the losses have been staunched and future profitability will likely improve but it needs to. The current market value requires decades of profitable growth to make any sense on any traditional valuation metric. This is not to say Tesla is not a great company and clearly Elon Musk is a visionary not unlike Steve Jobs, highly intelligent and driven. It is likely just a poor investment from where we are now.

Tesla is worth more than the ten largest car companies on the planet by revenue (Toyota, Volkswagen, Daimler, Ford, Honda, BMW, General Motors, Fiat, Hyundai, and Nissan). The top ten have combined revenues of US$1.42 trillion to Tesla's US$28b so 50 times more revenue and the top seven make as much actual profit as Tesla does revenue. Clearly there is a lot of blue sky priced into Tesla. It is not as if these traditional car companies that still make their money from internal combustion engine vehicles are standing still. Toyota and Nissan have been making electric vehicles for years, Hyundai is catching up fast and the Chinese owned Volvo are committed to making 50% of car sales volumes from electric vehicles by 2025. There are other Chinese manufacturers like SAIC, BYD and NIO among the nearly 400 (that is not a typo) companies pursuing the electric vehicle dream. Likewise, in the US there are higher end competitors like Rivian's SUV and Nikola's light trucks that will likely emerge as serious niche competitors in the next few years.

What seems likely is that Tesla will not own the future the way Apple has with the iPhone. Huge monopoly like profits are unlikely to await Tesla and the valuation at some stage will come to reflect that. Back in the 1910-1930 period there were hundreds of car companies in the US but after the Depression there were just a few profitable survivors that we know today. The Tesla valuation situation reminds me of the sage advice of Warren Buffett who said….

"The trick in investing is just to sit there and watch pitch after pitch go by and wait for the right one in your sweet spot. And if people are yelling 'swing you bum!, ignore them."

The companies mentioned above are named to further the discussion. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends discussed above.

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