

Tesla Motors

David Gardner | November 23, 2011

CURRENT PRICE: [TSLA](#) \$ 985.98 ↑ \$ 25.13 (2.6%)

The Porsche 911 Carrera revving its engine next to you doesn't know what it's in for. The light turns green and you stomp on the accelerator, leaping from 0 to 60 in just 3.7 seconds and leaving the Porsche in the dust. The handcrafted carbon fiber exterior of your ride, integrated with the lightweight aluminum chassis like the exoskeleton of some exotic beetle, sparkles red (oh yes, it's red) in the sun. Soon you're outside of town, hugging the curves, the wind in your hair, testing out the vehicle's top speed of 125 mph. And, because this is a fantasy, you decide this is the best \$128,500 you ever spent.

OK, owning a Tesla Roadster Sport 2.5 is a little beyond the means of most of us. But **Tesla Motors** ([NASDAQ: TSLA](#)) has plans to make its next luxurious, high-performance — oh, and zero-emission — vehicles more accessible to us mere mortals.

The young company faces its moment of truth next year when it rolls out its Model S, a premium sedan. Could a plug-in electric vehicle really be ready for the mass market? Judging by sneak peeks and preorders, we think it's a bridge Tesla will zoom across.

Gearing Up

Tesla is less Detroit and more Silicon Valley — in fact, that's where it got its original funding. It was founded in 2003 and delivered its first car — to co-founder, chairman, CEO, and product architect Elon Musk — in 2008. Tesla Roadsters can cruise about 245 miles on a single charge; they use a pack of 6,831 lithium-ion batteries to juice up an AC power transmission inspired by the design of electrical visionary Nikola Tesla.

So far, the company has produced 1,800 plug-in electric, zero-emission vehicles. Admittedly, that's a speck compared to the nearly 78 million motor vehicles sold worldwide last year. But this speedster has just pulled onto the highway. Tesla's sales accelerated 56% in the most recent quarter as it moved out 184 Roadsters.

Building a vertically integrated car company from the ground up is expensive, and Tesla isn't profitable yet. But we think the launch of the Model S next year will change that.

Unlike the Roadster, the Model S is aimed at eco-minded consumers who are in the market for a mid-range luxury car. With a target price of \$49,900 (after taking into account a \$7,500 government tax credit), the Model S will be priced on the cheaper side of a well-appointed BMW 5 Series or a Mercedes Benz E-Class. Shave off another few thousand in fuel savings over the lifetime of the vehicle, and it starts to look downright affordable. A beta version of the Model S was revealed on Oct. 1, and while the company was only allowing brief rides, it certainly seems to fill the expectations of a luxury vehicle, with a 17-inch touchscreen control panel, wireless connectivity, a premium sound system — and generally positive performance reviews ("it's a real car," *Motor Trend* said with approval).

Tesla has already filled its maximum 6,500 preorders for the 2012 Model S and it plans to expand manufacturing capacity to 20,000 vehicles a year in 2013. At that pace, we think the company will turn a profit two years from now.

WHAT IT DOES:

Tesla designs, manufactures, and sells high-performance plug-in electric vehicles.

WHY BUY:

- The 2012 launch of the Model S, a premium sedan, will transform the company and move it toward profitability.
- The entire 6,500-vehicle production run of the Model S is already sold out.
- A major increase in manufacturing capacity is under way, moving the company toward a mass-market, lower-priced electric vehicle.

KEY DATA:

- Headquarters:** Palo Alto, Calif.
- Website:** [www.teslamotors.com](#)
- Sign of a Breaker:** Smart Backing
- CAPS Rating:** 1 star (12 out of 100)
- Market Cap:** \$3,400
- Cash/Debt:** \$278 / \$226
- Revenue (TTM):** \$201
- Earnings (TTM):** (\$224)
- Revenue (2008/'09/'10):** \$15 / \$112 / \$117
- Earnings (2008/'09/'10):** (\$83) / (\$56) / (\$154)
- Recent Price:** \$32.60

Data as of 11/18/11. Dollar amounts in millions except recent price.

Alternative Fuel

The path to profit will be bumpy, however. Tesla has stopped taking orders for the Roadster as it gears up for its Model S launch. That means vehicle sales will likely decline in the first part of next year. Third-party supply sales are also likely to fall off. Right now, Tesla supplies certain electric powertrain components to Daimler, but Daimler has decided to produce its own, so this business — worth \$39.4 million of the \$115.9 million in revenue Tesla recorded for the first nine months of this year, or 34% — could be detoured. Luckily, a subsequent deal with Toyota to supply powertrain components for the RAV4, worth up to \$100 million, should take up the slack on the balance sheet.

These supply deals have helped Tesla scale up a world-class manufacturing facility. The company's gross margin has been at or above 30% for the past five quarters. Contrast that with Ford, which has run a gross margin of 10% to 16% over the past five years. Once Tesla starts selling cheaper cars, that margin will get squeezed, but higher volume will more than make up the difference.

Risks and When We'd Sell

Don't underestimate how much Tesla has riding on the Model S, or how vulnerable the launch will be.

In 2008, the popular British program *Top Gear* reviewed the Tesla Roadster and, while generally praising its performance, concluded that "in the real world, it doesn't seem to work." The review was highly misleading, making it look as though both test cars broke down, and Tesla has sued the BBC for libel. Three years later, Tesla is still citing the review for slow sales in the U.K. and inventory that won't move.

Wealthy Roadster buyers may be willing to risk reliability for the novelty of owning a high-powered, all-electric sports car. More mainstream customers are going to demand reliability, and they have little incentive to cut Tesla any slack. It makes sense to buy your stake in thirds and see how the Model S does before filling out your position. If we don't think it has what it takes to succeed in the marketplace, we'll pull over.

Because of Tesla's production transition and changes in its powertrain deals, revenue over the next three or four quarters will be very volatile. That means the stock price could be, too. We'll be watching Foolishly to make sure our thesis is intact, but Tesla could show smoother performance on the road than in your portfolio.

The Foolish Bottom Line

With the Model S clearing the way to profit, Tesla should get some separation from the pack. The Model X — the company's crossover vehicle for the SUV and minivan market — should be revealed before year's end and launched in 2014. A planning-stage family car, the Tesla BlueStar, is targeted for production in 2015 at a sticker price of \$20,000 to \$30,000.

Tesla is getting ready to pry open the electric-vehicle market for rank-and-file car buyers. Consider climbing in this sportster before it hits the open road.

See the team's holdings [here](#). The Motley Fool owns shares of Ford.



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Market data provided by FactSet and Web Financial Group.