

## Citron reverses opinion on Tesla. The story has become too compelling to ignore.

As much as you can't believe you are reading this, we can't believe we are writing this!

The most challenging part of being a short seller is to constantly check your thesis to make sure nothing has changed. You must let all predispositions and prejudices disappear and stay focused on only the facts.

It is in that spirit and with a great deal of analysis and due diligence that we can say for the first time, **Citron is long Tesla** as the Model 3 is a proven hit and many of the TSLA warning signs have proven not to be significant.

It has been almost 5 years since Citron published the following line:

“By the time this product is even approaching market, there will be multiple other 200-mile range plug-ins that have been out for years.”

Rumors of the Tesla killers have been as constant and unfounded as Bob Lutz's call for Tesla's bankruptcy.

While the media has been focused on Elon Musk's eccentric, outlandish and at times offensive behavior, it has failed to notice the legitimate disruption of the auto industry that is currently being DOMINATED by Tesla.

### **What has changed??**

Plain and simple -- **Tesla is destroying the competition**. These few charts illustrate what is happening in the car industry the past few months:

## 10 Top Luxury Cars in USA (Jan–Sept 2018)

Hover over a line for a moment to make it stand out.

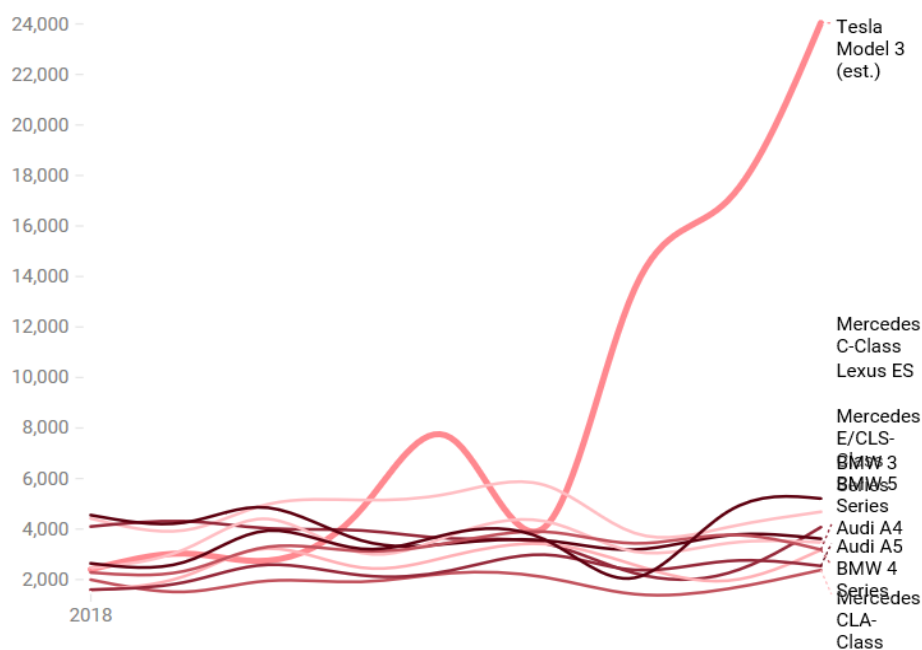
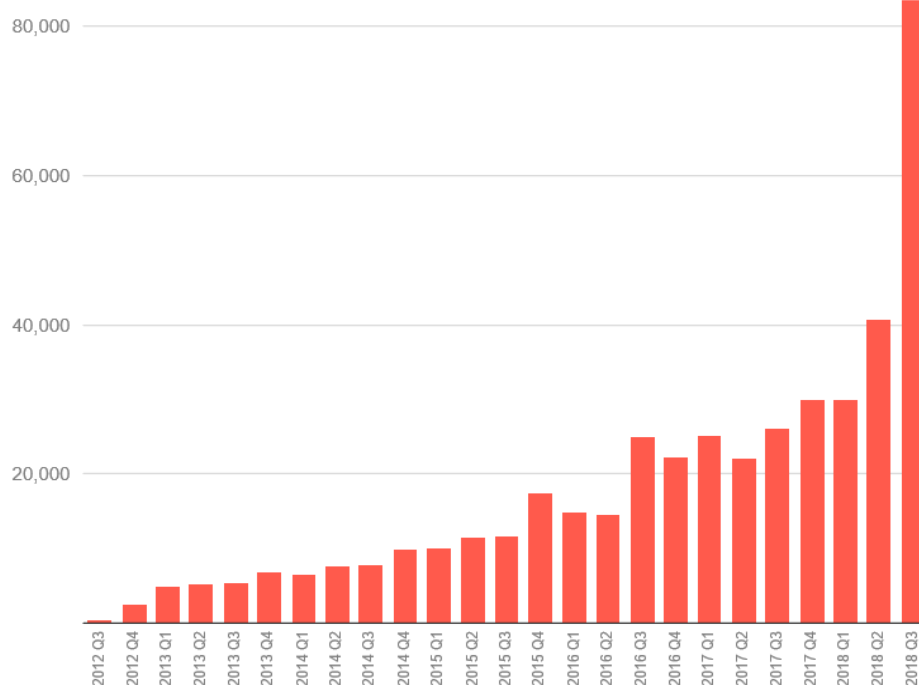


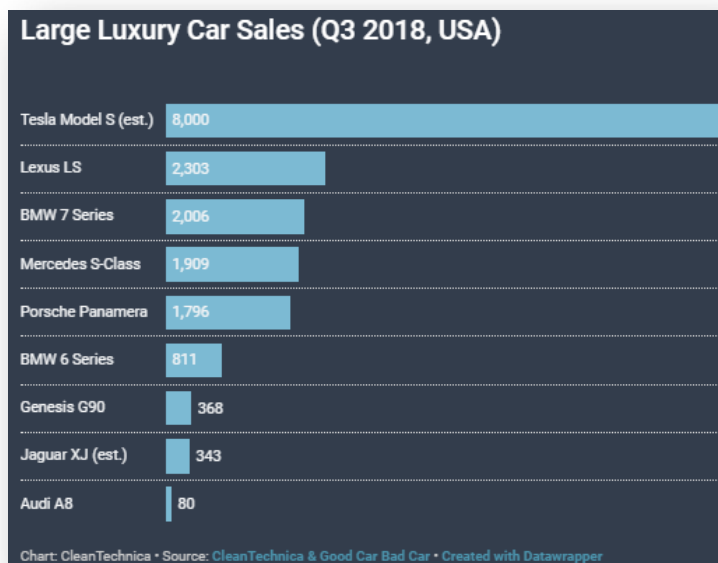
Chart: CleanTechnica • Source: [CleanTechnica](#) • [Get the data](#) • Created with Datawrapper

## Tesla Quarterly Deliveries

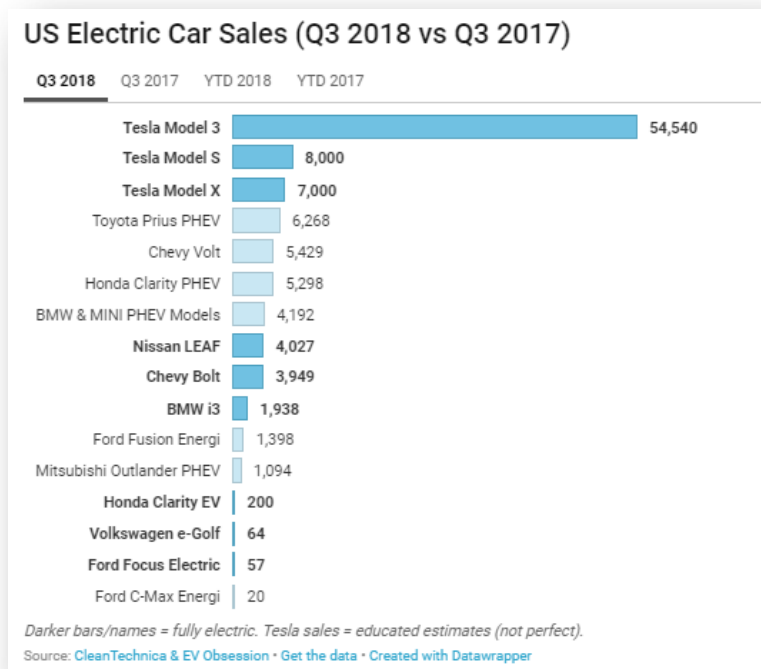


Source: [Tesla](#) | [CleanTechnica](#) • [Get the data](#) • Created with Datawrapper

While the model 3 is completely dominating its class amongst mid-size luxury, let us not forget the Model S, which is by far the largest seller in the large luxury car market.



Lastly, and this now seems obvious, but Tesla appears to be the only company that can actually produce and sell electric cars. If you would have shown us the below chart five years ago there is no way we would have ever believed it. It looks like it is the competition that is taking the Ambien.



Critics will say “of course Tesla is selling a lot of cars, there was a backlog of 2 years of demand.” **However, we’re seeing that demand is new this year and pulling directly from TSLA's competitors.**

Tesla announced that it had 450k reservations in June of 2017. So, anyone who put in a reservation and waited almost certainly did **not** buy a Mercedes / BMW / Audi last year. So we should have seen a decline in 2017. Yet, we see a decline in 2018, which means that people who are making their current car choices are moving away from other brands. Take a look at the chart below -- If TSLA demand is because of backlog, then why is the year over year declines for these brands accelerating every month in an economy that is booming?

Luxury Sedans	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
BMW 2 Series	848	976	1,242	1,331	1,036	938	879	822	930	634	589	630
BMW 3 / 4 Series	7,376	8,348	9,617	6,950	8,791	9,682	6,023	6,365	6,960	5,764	5,706	6,789
BMW 5 Series	3,113	3,677	4,068	3,713	3,587	3,718	3,056	3,762	4,311	3,104	3,439	3,470
<b>BMW 2,3,4,5 series</b>	<b>11,337</b>	<b>13,001</b>	<b>14,927</b>	<b>11,994</b>	<b>13,414</b>	<b>14,338</b>	<b>9,958</b>	<b>10,949</b>	<b>12,201</b>	<b>9,502</b>	<b>9,734</b>	<b>10,889</b>
YoY Growth (%)							-12.2%	-15.8%	-18.3%	-20.8%	-27.4%	-24.1%
Audi A3	2,104	2,116	2,228	2,300	2,033	1,929	1,593	1,700	1,962	2,011	2,078	1,759
Audi A4	3,246	3,011	3,022	2,652	2,746	2,585	3,126	3,472	3,893	3,433	3,768	3,185
Audi A5	1,007	2,047	2,374	2,255	2,603	2,360	2,169	2,364	2,985	2,381	2,732	2,539
Audi A6	1,508	1,358	1,425	1,218	1,380	1,210	1,172	1,131	309	157	146	95
<b>Audi A3, A4, A5, A6</b>	<b>7,865</b>	<b>8,532</b>	<b>9,049</b>	<b>8,425</b>	<b>8,762</b>	<b>8,084</b>	<b>8,060</b>	<b>8,667</b>	<b>9,149</b>	<b>7,982</b>	<b>8,724</b>	<b>7,578</b>
YoY Growth (%)							2.5%	1.6%	1.1%	-5.3%	-0.4%	-6.3%
Mercedes C Class	7,821	6,996	7,116	4,899	5,304	6,194	5,148	5,419	5,742	3,841	4,071	4,682
Mercedes CLA Class	1,067	1,310	2,118	2,181	1,972	2,034	1,910	2,257	2,094	1,424	1,631	2,377
Mercedes CLS Class	205	203	187	164	118	147	59	72	69	44	45	122
Mercedes E Class	3,854	3,865	4,129	3,712	3,592	4,019	3,886	3,553	3,366	2,208	2,206	3,950
<b>Mercedes C / CLA / CLS / E-Class</b>	<b>12,947</b>	<b>12,374</b>	<b>13,550</b>	<b>10,956</b>	<b>10,986</b>	<b>12,394</b>	<b>11,003</b>	<b>11,301</b>	<b>11,271</b>	<b>7,517</b>	<b>7,953</b>	<b>11,131</b>
YoY Growth (%)							-15.0%	-8.7%	-16.8%	-31.4%	-27.6%	-10.2%
Lexus ES	3,400	4,228	4,666	6,641	6,404	4,230	3,218	3,828	3,592	4,551	4,686	5,206
Lexus GS	597	615	646	652	689	666	651	672	602	470	549	451
Lexus LS	294	317	300	402	413	432	999	908	789	712	923	668
Lexus RC	522	517	499	522	665	737	369	434	328	259	327	258
<b>Lexus ES / GS / LS / RC</b>	<b>4,813</b>	<b>5,677</b>	<b>6,111</b>	<b>8,217</b>	<b>8,171</b>	<b>6,065</b>	<b>5,237</b>	<b>5,842</b>	<b>5,311</b>	<b>5,992</b>	<b>6,485</b>	<b>6,583</b>
YoY Growth (%)							8.8%	2.9%	-13.1%	-27.1%	-20.6%	8.5%
<b>Total Entry-Level Luxury Sedan</b>	<b>36,962</b>	<b>39,584</b>	<b>43,637</b>	<b>39,592</b>	<b>41,333</b>	<b>40,881</b>	<b>34,258</b>	<b>36,759</b>	<b>37,932</b>	<b>30,993</b>	<b>32,896</b>	<b>36,181</b>
YoY Growth (%)							-7.3%	-7.1%	-13.1%	-21.7%	-20.4%	-11.5%
<b>Model 3 Sales</b>			<b>30</b>	<b>75</b>	<b>115</b>	<b>145</b>	<b>3,875</b>	<b>6,259</b>	<b>6,062</b>	<b>14,250</b>	<b>17,800</b>	<b>22,250</b>
<b>Total Incumbents + Tesla Sales</b>			<b>43,667</b>	<b>39,667</b>	<b>41,448</b>	<b>41,026</b>	<b>38,133</b>	<b>43,018</b>	<b>43,994</b>	<b>45,243</b>	<b>50,696</b>	<b>58,431</b>
Model 3 Market Share (%)			0.1%	0.2%	0.3%	0.4%	10.2%	14.5%	13.8%	31.5%	35.1%	38.1%

The chart above implies that consumers are coming up for lease renewal or new car decision and opting into a Tesla – it is not just pent up demand from people on the reservation list. If it were pent up demand, those car classes wouldn't be exhibiting such sharp declines year over year.

Even more impressive, Tesla highlighted on its earnings call that three of the top vehicles being traded in for the Model 3 are the Toyota Prius, the Honda Accord, and the Honda Civic, which means people are spending more money to be a part of the “Tesla Revolution.”

**TESLA is not just pulling customers from BMW and Mercedes but also from Toyota and Honda.** Like a magic trick, while everyone is focused on Elon smoking weed, he is quietly smoking the whole automotive industry.

Mass-Market Sedans	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
Toyota Prius	9,708	10,022	8,735	9,384	9,551	9,286	7,420	8,672	7,844	7,265	8,111	7,378
YoY Growth (%)							-23.6%	-13.5%	-10.2%	-22.6%	-15.1%	-20.5%
Honda Accord	26,938	33,547	29,791	30,903	30,019	29,789	21,751	28,212	26,726	24,927	26,725	25,357
YoY Growth (%)							-19.3%	-15.9%	-10.3%	-19.3%	-11.0%	-14.9%
Honda Civic	31,211	31,989	30,909	36,683	36,482	35,452	28,399	34,349	31,345	26,311	27,677	24,806
YoY Growth (%)							-9.0%	7.4%	1.4%	-28.3%	-24.1%	-30.0%
Toyota Camry	31,428	32,547	29,463	33,827	37,051	34,732	29,848	29,965	28,215	26,311	30,141	27,670
YoY Growth (%)							-5.0%	-7.9%	-4.2%	-22.2%	-18.6%	-20.3%
<b>Total Mass-Market Sedans</b>	<b>99,285</b>	<b>108,105</b>	<b>98,898</b>	<b>110,797</b>	<b>113,103</b>	<b>109,259</b>	<b>87,418</b>	<b>101,198</b>	<b>94,130</b>	<b>84,814</b>	<b>92,654</b>	<b>85,211</b>
<b>YoY Growth (%)</b>							<b>-12.0%</b>	<b>-6.4%</b>	<b>-4.8%</b>	<b>-23.5%</b>	<b>-18.1%</b>	<b>-22.0%</b>

### Why be Long?

This is a critical quarter for Tesla and there are many reasons we want to be long (and would certainly not want to be short) into this print:

- Tesla will, finally, after 10 years of unprofitable existence, have the ability to prove that it can be a sustainable, highly cash flow generative entity that is no longer reliant on the capital markets.
- A strong quarter removes the overhang of a necessary capital raise – we suspect that Tesla will be generating more than enough cash to both fund aggressive growth plans and build cash on the balance sheet.
- It transitions Tesla from a “proof of concept” story to a “TAM / how much can this grow” story, attracting a whole new growth-oriented investor base.
- It makes the bear case solely about Valuation and Demand.
- Short interest is at the same (high) level as five years ago though risk is heavily skewed to the upside in the near-term.

Even if Tesla does not meet its profitability goals, it is well funded and long-term shareholders will look towards:

- Secured an agreement to build a wholly owned Shanghai facility (Note: this was the first time China let a foreign automaker open up shop without a Chinese company as its partner)
- The entrance of Model 3 in the European market
- New factory to be constructed in Europe
- Possible resolution to US / China trade war (and subsequent dropping of 40% tariffs)
- Tesla semi truck production announced
- **Tesla added to S&P** (likely an April 2019 event)

- **Model Y Unveil** (March 2019)
- Q4 deliveries and earnings far in excess of consensus
- Potential analyst upgrades given significantly negatively skewed consensus and positive Q3 performance
- The imminent release of the Tesla 9.0 autonomous software

Most importantly (as our readers' Twitter feeds show) we believe Musk is focused on a Tesla stock price above \$360, which would remove significant amounts of convertible debt (strike price \$330-\$360) and leave the Company with a very manageable debt load comprised of \$2B of senior notes.

### Shorts vs Longs

While the media parades around short sellers (yes, Citron has been one of them) attempting to make a piñata out of Tesla and Musk, the media rhetoric has been turbo charged to now include comparisons to Lehman Brothers and Enron, to mechanics liens implying that Tesla can't pay its bills.

The rhetoric doesn't seem to phase Tesla's long-term shareholders who evidently see lots of value here. Besides Musk, T Rowe Price, Fidelity (who owns it in multiple funds) and Baillie Gifford are Tesla's largest shareholders.

T Rowe Price has an estimated cost basis of \$290 and just bought more than 5.5 million shares last quarter.



Without much hoopla or television appearances, Ballie Gifford simply commented on the potential 420 takeout:

"Speaking to the *Times*, Anderson said that while he accepted Tesla's prospects were uncertain, its value was much higher than \$420 a share, probability-adjusted"

<https://citywire.co.uk/wealth-manager/news/baillie-giffords-anderson-questions-musks-tesla-valuation/a1145252>



While it might be easy to dismiss quiet shareholders as weak, Citron has learned from our mistakes and sought to see what these shareholders find attractive- and we have.

To address a few of the concerns that are common to Tesla skeptics:

- There is NO Tesla killer. Competition is nowhere to be found and no electric vehicle is slated to launch at the Model 3 price point until 2021.
- We've reviewed the mechanics lien documents and they are tiny (i.e., \$7.5M in aggregate) with none being "critical" suppliers by any stretch. Nothing for a company that will do over \$20 billion in revenues this year.
- Employee turnover- Yes, Elon is very difficult to work for to a fault, but that does not change the customer appetite for the product.
- Bad Manufacturing Process- Yes, much of Tesla was learned by trial and error and Elon should have listened to others. Again, that is in the past.
- From a technology standpoint, Tesla is **light years** ahead of the competition. No OEM is even close to having Tesla's level of connectivity and "upgradeability" in its cars.

Tesla is dominating the industry with no advertising, no unions, no dealer network. It has 1,100 charging stations and a Gigafactory. It also has a mobile repair service ("Rangers"). The Company has concluded that 80%+ of repairs can be carried out at the owner's house and are building out a fleet of technicians who can fix car issues without the owner having to take it to a service center.

Tesla has the most miles driven data by several orders of magnitude. Tesla has over 8 billion miles driven as every vehicle even if autopilot is not enabled operates in "shadow mode" (i.e. feeds data back to Tesla's central compute) and is accumulating data at a rate of billions per year (which will only grow as more Model 3s are produced).

Tesla's vision for the future of mobility is for consumers to be able to push a button on their phone, enabling their car to autonomously join the Tesla shared mobility fleet. In other words, when a consumer is not using their car, they can "rent" their car out (like Uber) to other consumers. Tesla will take a cut of the profits and the consumer will keep the rest. Citron is not a believer in the shared mobility- but we have been proven wrong in the past.

To anyone who thinks Tesla has fallen behind in technology, here is our favorite anecdote:

Consumer Reports ran a test on a Model 3 where they determined that the braking distance was sub-par for its vehicle class. Tesla was able to diagnose the issue that weekend (algorithmic braking control miscalibration) and issue an over-the-air update to all Tesla vehicles that weekend, sharply improving braking distances virtually overnight. **Consumer Reports remarked that this was the first time this has ever been accomplished in the auto space (an OTA update improving a car) and changed their recommendation to positive on the Model 3.**

No tequila, flamethrowers, or short shorts- just a revolution in the transportation industry.

### Profitability – Where the rubber meets the road.

Those who own TSLA stock believe the company can one day achieve over 30% gross margin. Those estimates are not from the wild mouth of CEO Musk, rather, they are from Munro Associates, a leading automotive consulting firm.

Munro began a tear-down of a Model 3 in April of 2018 and concluded that the Model 3 could generate over a 30% profit margin.

<https://electrek.co/2018/07/16/tesla-model-3-teardown-profitability/>

When Munro began tearing down the Tesla in April, it released comments saying that the vehicle was horrific, reminiscent of the build quality of a Kia from the 1990s. However, in a stunning turnaround, Munro completed its tear down and cost analysis in July and ultimately admitted that the final results of its Model 3 analysis were not at all what was expected.

Poking fun at his initial reaction, Munro stated “a lot of crow (was) being eaten around here.”  
**“The Model 3 is profitable. I didn’t think it was gonna happen this way, but the Model 3 is profitable. Over 30%. No electric car is getting 30% net, nobody,”**

### Where can \$TSLA trade?

Below is a sensitivity analysis of Tesla’s implied share price based on assumptions around auto deliveries and gross margin. At this point, demand is not a question. If Musk can deliver on supply and the demand stays intact plus the additional demand of international expansion, the upside in the stock is tremendous. Given that Tesla still has significant growth opportunities left in compact, crossover, and pickup, we don't see demand slowing.

		Earnings Per Share				
		Auto Gross Margin				
		20.0%	22.5%	25.0%	27.5%	30.0%
Auto Deliveries	500,000	\$29.97	\$32.92	\$35.88	\$38.83	\$41.78
	750,000	\$37.39	\$41.82	\$46.25	\$50.68	\$55.11
	1,000,000	\$44.81	\$50.72	\$56.62	\$62.53	\$68.44
	1,250,000	\$52.23	\$59.61	\$67.00	\$74.38	\$81.76
	1,500,000	\$59.65	\$68.51	\$77.37	\$86.23	\$95.09
	1,750,000	\$67.07	\$77.41	\$87.74	\$98.08	\$108.42
	2,000,000	\$74.49	\$86.30	\$98.12	\$109.93	\$121.74
	4,000,000	\$133.84	\$157.47	\$181.10	\$204.73	\$228.36
	6,000,000	\$193.20	\$228.64	\$264.08	\$299.53	\$334.97
	8,000,000	\$252.55	\$299.81	\$347.07	\$394.33	\$441.58
	10,000,000	\$311.91	\$370.98	\$430.05	\$489.12	\$548.20



		Price Target @ 20x P/E				
		Auto Gross Margin				
		20.0%	22.5%	25.0%	27.5%	30.0%
Auto Deliveries	500,000	\$599	\$658	\$718	\$777	\$836
	750,000	\$748	\$836	\$925	\$1,014	\$1,102
	1,000,000	\$896	\$1,014	\$1,132	\$1,251	\$1,369
	1,250,000	\$1,045	\$1,192	\$1,340	\$1,488	\$1,635
	1,500,000	\$1,193	\$1,370	\$1,547	\$1,725	\$1,902
	1,750,000	\$1,341	\$1,548	\$1,755	\$1,962	\$2,168
	2,000,000	\$1,490	\$1,726	\$1,962	\$2,199	\$2,435
	4,000,000	\$2,677	\$3,149	\$3,622	\$4,095	\$4,567
	6,000,000	\$3,864	\$4,573	\$5,282	\$5,991	\$6,699
	8,000,000	\$5,051	\$5,996	\$6,941	\$7,887	\$8,832
	10,000,000	\$6,238	\$7,420	\$8,601	\$9,782	\$10,964

Take the worst case in the below sensitivity analysis and we see 500k cars with 20% gross margins at a P/E of 20x and the stock is \$599.

### A Note to Our Critics

We know this note is going to have many critics, most being our fellow short sellers who might categorize us as opportunist. To anyone who challenges the integrity of Citron or our constant monitoring of the Tesla story all you have to do is look at the class action lawsuit recently filed against Tesla. In it you will see the principal of Citron was actively trading tens of millions of dollars of Tesla and the infamous "\$420" tweet resulted in a loss of almost \$2 million. By no means does Citron only trade on publishing stories. We actively manage a book that has been trading Tesla for five years.

Yes, we are still suing Musk and Tesla and this recent report has no bearing on the current lawsuit.

### Conclusion

As of the writing of this report, Tesla has just announced it has moved up its earnings release date to October 24. The last time TSLA reported Q3 earnings in October was in 2016 – when revenue beat the consensus by 21%. Does anybody think that Tesla decided to move up its earnings release date because of bad news?

Sometimes the truth is stranger than fiction. While we may not be fans of the overconfident CEO, we cannot dismiss what we are seeing in the marketplace.

### Cautious Investing to All