

Tesla Motors is on the slow boat to failure?

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But it's important to remember that Tesla has already consumed billions in start-up capital and has yet to turn that investment into a profit. The company's manufacturing plant has had its share of teething pains and production volumes still remain fairly low by broader industry standards. To start making the much-raved Model S, Tesla had to stop making the Roadster. It was too hard to concentrate company resources on the production of more than one vehicle.

Now that production has shifted to the Model S, bottlenecks have limited output, though management hopes to steadily ramp up production in coming months, eventually hitting a goal of a combined 30,000 units of the Model S and X by 2014. Based on current run rates and teething problems, it may be quite hard for Tesla to reach that goal. Tesla is currently making 200 vehicles per week, or about 10,000 vehicles per year. Even if the company can reach its 30,000 annual production target by 2014, that output is just a tiny fraction of what the major automakers produce.

In fact, investors will need to wait until 2017, when Tesla intends to launch its third-generation car, which will have lower price points in hopes of achieving much higher sales goals. And that's when we'll find out whether Tesla is a real car company, worthy of its current \$3.5 billion enterprise value, or merely a niche maker of specialized vehicles that cater to a select few.

After all, by 2017, you can surely expect to see other impressive electric or hybrid vehicles on the market that some of the big players will be offering. These manufacturers tend to target a profit of \$2,000 to \$4,000 per vehicle, so the only way they can overcome the big overhead expenses associated with running a car company is to generate high volumes. The gross margins are thin, but the overall profits can be impressive.

Millions of vehicles sold means billions in profits

For the next five years, though, investors will only be able to assess Tesla's prowess based on the high-end Model S and Model X. If the company can produce 30,000 of them annually, as noted above, then that translates into roughly \$2.7 billion in revenue, roughly \$600 million in gross profits and about \$250 million in operating profits. The current \$3.5 billion enterprise value is around 14 times that mid-decade operating cash flow -- which is quite rich for at least any U.S. automaker (Ford and GM, for instance, trade for about six times their cash flow.)

Yet here's the problem with that math: It assumes Tesla will be able to work out all of its production glitches and make all of those vehicles. It also assumes there will be enough demand for that annual output. As noted in my previous article, Tesla sold just 2,300 Roadsters in four years, mostly to wealthy citizens who wanted to own a unique vehicle. Are there really 30,000 more people (or 90,000, accounting for three years' worth of output) who will similarly want to own the company's newer halo cars? Perhaps, but that's a best-case scenario.

Here comes the competition

In coming quarters, get set to hear a lot about BMW's new "I" cars, the i3 and i8, which are all-electric vehicles being designed from a clean sheet of paper. The i3 will be a remarkably frugal small car, while the i8 is expected to deliver a previously unseen level of performance -- yes even better than what the Tesla Model S has to offer, according to BMW management.

About a year after that, the world's largest automaker -- the Volkswagen Group -- will be making a similar push for its Audi brand, known as "eTron." These cars aim to replicate the performance, style and charisma of Tesla's vehicles. The effort will eventually extend to the broader VW family of cars, and it's likely only a matter of time before Mercedes, Jaguar and other premium brands chase the well-heeled early-adopter auto buyer with their own all-electric offerings.

Suffice it to say, by the time Tesla has worked out its production bugs and works toward output of 30,000 vehicles a year, competition will be much fiercer. We're talking about companies with billions of dollars in resources compared to Tesla, which will have little cash on hand after the company's \$450 million U.S. Department of Energy (DOE) loan gets paid off. It received the loan after Congress passed the Advanced Technology Vehicles Manufacturing Loan Program in 2008, allowing the DOE to oversee the funding of projects by U.S. automakers to create fuel-efficient vehicles that meet strict requirements.

Risks to Consider: As an upside risk, Tesla's head start in terms of engineering prowess would make it an attractive purchase for a major global automaker.

Action to Take --> Shares of Tesla recently zoomed from \$28 to \$34 after the company got the DOE to hold off calling in that big loan. Indeed a recent fresh capital raise underscores the notion that Tesla could undergo deep financial distress any time soon.

In effect, shares are already pretty richly valued on a best-case, mid-decade scenario implying little further upside. And if Tesla hits yet another production glitch, as was the case only recently, then shares could quickly tumble back to the mid \$20s. So while Tesla is a pioneer in the electric car space, with such an upside/downside scenario in place, this stock looks a lot more like a "sell" candidate than anything else.

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