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Will Tesla Be The Next Apple?

“Buy Tesla’s Car, Not Its Stock.” That was the headline I used for my column in this space earlier this year. A lot has happened since at Tesla Motors (TSLA) and Tesla CEO Elon Musk’s world, characterized by its variegated projects, including space rockets and autonomous electric cars. And by now Tesla Motors has attracted not only electric-car aficionados but people who have become passionate believers in Tesla founder Musk’s innovative ideas.

One of them is Graham Tanaka, founder and Chief Investment Officer of the TANAKA Growth Fund, who bought not only a Tesla Model X car but loaded up on Tesla shares. TANAKA Growth Fund isn’t one of those run-of-the-mill funds: It was ranked No. 3 by Lipper in the Multi-Cap Growth category, and was up 12.2 percent last year, versus S&P 500’s 1.4 percent. In the past five years through Sept.30, 2016, TANAKA Fund generated annual returns of 14.9 percent versus 16.3 percent by the S&P 500.

Tanaka believes the stock has become even more undervalued at its current price of $196 a share. True, Tesla has had a record of missing quarterly delivery, sales and earnings expectations, which has hurt its equity valuation. But that’s over, as far as Tanaka is concerned.

He argues that Tesla's third-quarter results showing it delivered 24,500 units that doubled year-ago levels and beat estimates by 10-15 percent "may be ushering in a new era of meeting or besting expectations."

But so far, Wall Street isn't convinced. So there hasn't been a preponderance of buy recommendations from the Street's equity analysts. Even so, Tanaka insists that analysts are underestimating Tesla's assets and potential, convinced that Tesla has "turned the corner" on production, although expectations are still low, as reflected, he notes, in the short position of 31 percent of the float.

The "value intangibles" in Tesla will become more apparent when the Model 3 cars ship in late 2017 at a more moderate base price of $35,000. So in the next three to four quarters before the Model 3 debuts, says Tanaka, "we expect quarterly deliveries and revenues will continue to exceed expectations."

Tanaka is encouraged by several developments: The "strong demand for the refreshed Model S, apparent optimizing and ramping up of Model X production, and construction of the proprietary Gigafactory for battery production that's progressing ahead of schedule." Moreover, Tanaka believes the company's announcement that the lower-priced Model 3 design has been finalized is a big positive for the brand.

So in Tanaka's analysis, Tesla is a real opportunistic buy. "Finding companies that can surprise on the upside after several quarters of missed expectations has traditionally delivered favorable results," argues Tanaka, who holds huge expectations for Tesla's future despite the stock's weakness.

Now down from its 52-week high of $269.34 a share, Tesla could be "the next Apple," asserts Tanaka, which has appreciated some 30% per year in price over the last eight years. He predicts Tesla achieving the same heights of glory.

Tanaka suggests that "Tesla can become and perform like Apple over the next eight years for some of the same reasons that helped Apple rocket to phenomenal success." Here's why Tanaka thinks so:

(1) Tesla is delivering refreshing products that delight its customers by using new methods and technologies to deliver better performing, better looking, and easier-to-use products.

(2) Like Apple, Tesla sells its products through its own showrooms, which not only reduces selling and distribution costs but also moves Tesla closer to its customers.

(3) Apple updates its products and operating system software every year, but Tesla upgrades its products even more frequently with free “Over the Air” software enhancements to improve the performance and value of its products. Tesla customers know this which is another reason they are willing to pay a premium for the Model S and Model X —and why demand for Tesla will continue to surprise auto industry experts and analysts.

(4) And like Apple eight years ago, Tesla has an opportunity to grow at a high double-digit rate for several years, as it was early in addressing a very large multi-billion dollar global market which it could penetrate and expand by adding new categories. As consumers get increasingly aware of “Tesla’s higher safety, greater convenience, pleasure to drive, reduction of carbon pollution, and expectation of future product enhancements, it should drive double-digit growth in demand well into the next decade,” says Tanaka.

But Tanaka hastens to add that Tesla is also “different from Apple” in certain ways:

(1) Unlike Apple, Tesla manufactures its own products. “We believe that Tesla’s future growth will be gated more by how quickly it can ramp production than the rate of growth in demand.” argues Tanaka.

(2) Tesla has been producing electric vehicles for over four years, and its growing network of free charging stations will be a key differentiator versus the competition that will appear in the years ahead. Tesla will increase the dispersion and density of its Supercharger Network, reducing range anxiety and creating Tesla’s own “network effect” over time.

(3) Tesla indicates that its Gigafactory will reduce the cost of its batteries by one-third, which would be critical for a profitable launch of the moderately priced ($35,000) Model 3 electric car.

(4) Tesla has proposed to acquire SolarCity to integrate its solar power generating products and sales with its own power storage and the battery charging need of its growing base of its Tesla vehicle owners.

So far, there's little unanimity on Wall Street about Tesla stock's prospects, in part because of concern over how much funds Elon Musk needs to rise to pursue his novel dreams, including SpaceX that would in part enable the reuse of rockets, and preparing space flights to colonize Mars.

One Elon Musk believer who recently downgraded his recommendation on Tesla Motors is Goldman Sach's equity analyst Patrick Archambault, now raises doubts about the company's deployment of capital for potential acquisitions. He cut sharply his price target for Tesla to $185 a share from $240, when he downgraded his rating to neutral from a buy. The worry about Tesla and Musk's financial burden is weighing on investor sentiment about the "concept" stock, says Archambault. He sees increased risk to the business related to deployment of its cash, noting that production "volume ramp is slower and spending growing quicker."

TANAKA Growth Fund's Tanaka is resolute in his belief, however, that Tesla is on a path of improving its production numbers. "Many investors and analysts do not fully appreciate how Tesla offers more value per dollar than legacy auto companies," he says. And from the "first time I visited Tesla's plant four years ago in Fremont, California, 'kicked the tires' and drove a Model S, I could see the company was doing something special," says Tanaka. For Tesla owners, many "value intangibles" are reinforced frequently, including upgrades via free software downloads and additions to the free Tesla's Supercharging Station network, he notes.

"If Tesla surprises the Street and reaches 500,000 vehicles by 2020, (vs. 80,000 units in 2016), " Tesla will be on track to produce revenues of $9.1 billion in 2016, $14.3 billion in 2017, $21.8 billion in 2018, and $31.9 billion in 2019," estimates Tanaka. And assuming Tesla attains decent gross margins within that period between 22 percent and 29 percent, he figures the company can earn 13 cents a share in 2016, $4 in 2017 — and then leap to $9 in 2018, and to $15 in 2019.