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Why Tesla's Stock Rally Doesn't Make Sense—in Eight Charts

Wall Street's focus has moved from Tesla's price cuts to a more distant future of driverless vehicles. It may shift again.

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There are a lot of theories for why Tesla's market value has increased by about a quarter-trillion dollars over the past month. You have to go far down the list to find the thing investors usually pay most attention to: the foreseeable outlook for profit.

Even by Tesla's standards the recent rally has been dizzying. The stock will open after the long weekend above $260, a level last seen in September, before a disappointing third-quarter update started a run of bad news.

One commonly cited explanation is artificial intelligence. A record-breaking 13-day streak of gains in Tesla's stock started about the time chip maker Nvidia gave a punchy sales forecast based on booming demand for AI applications. Marco Iachini, senior vice president at Vanda Research, which analyzes investor flows, points out that small shareholders have bought into Tesla and the AI theme at broadly similar times over the past year.

"We think the market wants to believe Tesla is an AI name first, an auto company second," Morgan Stanley analyst Adam Jonas wrote last week.

Although the latest AI hopes have been focused on the "large language models" that power ChatGPT, some investors appear to see a read-across to driverless cars. RBC analyst Tom Narayan published a note last week with a new valuation methodology that attributed little value to Tesla's car making business but a lot to its promise of "robotaxis"—driverless vehicles for hire that one day might replace some cases of car ownership. This isn't a new idea, but it is getting fresh attention.

Pinning hopes on Tesla robotaxis today requires a double leap of faith because the technology is at an experimental stage and Tesla isn't even among the most visible experimenters. While Chief Executive Officer Elon Musk has talked about robotaxis, Alphabet's Waymo and GM's Cruise already operate fleets of them in cities including San Francisco and Phoenix, albeit in limited areas and conditions.

GM and Alphabet have moved forward with understandable caution. A mangled line from ChatGPT may not have big consequences, but a stray robotaxi would.

Uber found this out the hard way when one of its test vehicles hit a pedestrian in 2018, triggering a sector downturn. Slow progress has made the business very expensive: Cruise burned through $1.8 billion of cash last year. Wherever robotaxis are on their uncertain road to mass adoption, they offer a problematic explanation for the latest Tesla rally. Over the past month GM has underperformed Ford, which doesn't have a business like Cruise, while Alphabet's stock is broadly flat.

Tesla sees the potential to take drivers out of cars to create robotaxis as an extension of its existing driver-assistance package—so-called full-self-driving or FSD. This software offers another justification for the AI hopes swirling around the company.

Tesla now charges $15,000 for FSD, but doesn't book all the revenue because the product is still in testing or "beta" mode. After years of disappointment, its recognition of deferred revenue took a step up in the final quarter of last year, when it made FSD more widely available, and it was also higher than usual in the first quarter. This could be a sign—albeit one open to manipulation—that the technology is finally working better.

Still, putting a high value on FSD is problematic even if its performance turns a corner. Cutting-edge technology in the car industry has historically commanded a sales premium only for limited periods before competitors catch up. There is no reason to think FSD, which allows drivers to take their hands off the wheel but not their eyes off the road, will be different. Many big car manufacturers have released or are close to releasing something similar.

Leaving aside AI, the deals Ford and GM have signed to use Tesla's Supercharger network coincide with the latest rally. They should help Tesla wring better returns from its fixed assets, but the response seems disproportionate. Investors never really warmed to independent charging-network builders such as EVgo, given the capital intensity of their rapid growth. Suddenly seeing huge profit potential in Tesla's charging business smacks of cognitive dissonance.

All these threads can be woven together to depict Tesla as a technology ecosystem with multiple revenue streams, rather than as a car maker. Tech analyst Dan Ives of Wedbush Securities wrote of an "AWS moment" for Tesla, referring to the emergence of Amazon.com's cloud-computing business from the shadow of its financially less attractive internet retailer.

Such comparisons, while thought-provoking, are by nature imprecise. Tesla has interesting sidelines in charging and insurance—both mostly accounted for in its services division—and energy storage, which has been growing very fast recently. But nothing seems likely to generate revenues on anything like the scale of Tesla's car sales in the foreseeable future.

While much of the latest Street chatter once again recasts Tesla as a tech giant, there are more down-to-earth explanations for the recent rally. Ben Rose, an analyst at Battle Road Research, points out that it started when Musk appointed a new CEO at Twitter, alleviating worries about his getting distracted by the social-media platform he bought last year.

Tesla also updated its website this month to show that all its vehicles qualify for the full U.S. tax credit, which depends on complex battery sourcing requirements. Previously most of its models only got half the $7,500 subsidy. This change, which presumably reflects supply-chain adjustments, could help keep the company on its growth path without further price and margin cuts. If second-quarter earnings show signs of stabilization, analysts could start to increase earnings forecasts that they have spent the past six months or so cutting.

Distant hopes have a long history of trumping such fundamentals in determining the direction of Tesla’s stock price, making it notoriously difficult to call. But second-quarter sales and earnings next month could refocus minds on how things look in the more immediate future. Whether the news is good or bad, it is likely to bring a reminder that Tesla still depends overwhelmingly on selling vehicle hardware, and will do for many years to come.

After all the AI hopes, don’t be too shocked.