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HEARD ON THE STREET

Brother, Tesla Can't Spare a Dime

Elon Musk's electric-vehicle pioneer is running out of cash and out of time, even after a recent capital increase

Tesla raised a total of $2.7 billion in convertible debt and stock earlier this month. **PHOTO:** GIULIA MARCHI/BLOOMBERG NEWS

By Charley Grant

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Investors shouldn't expect much mileage out of Tesla's latest capital increase.

The electric car company raised a total of $2.7 billion in convertible debt and stock earlier this month, its first trip to the capital markets since August 2017. That nearly two-year stretch was the company's longest between raises since it went public in 2010. It would be a big surprise, however, if Tesla can wait that long next time.

Elon Musk's decision to shore up Tesla's finances was certainly the right one given its likely trajectory without fresh cash. The auto maker posted a 31% sequential decline in first-quarter vehicle deliveries and burned nearly $1 billion in free cash. That left Tesla with $2.2 billion in cash and $3.2 billion in accounts payable at the end of the quarter, putting its long-term growth story, and even its medium-term survival, very much in question.

The fresh infusion hasn't boosted Tesla's flagging stock price, though. It is down nearly 30% so far this year. In the past, issuing equity usually has sparked a rally. It didn't assuage debtholders either. Tesla's senior unsecured bonds due in 2025 yield about 600 basis points more than a comparable U.S. Treasury note—close to a record high.

One reason is that intense competition, both in the luxury and mass-market ends of the electric-vehicle market, is much closer. Most is coming from legacy auto makers able to absorb poor or no profits to meet environmental goals.

Another reason this time has been different: $2.7 billion won't go nearly as far as in the past. For starters, Tesla spent a net $300 million to hedge its dilution risk from convertibles it just issued. Repaying debts will eat up another large chunk of the fresh cash. A $180 million term loan comes due at the end of June, while about $566 million in convertible bonds mature in November.

Suppliers, too, will take their cut. Tesla could spend the entire remainder of the offering on paying down its bills and still owe vendors about $1.5 billion. Meanwhile, the auto maker says it will devote $2 billion to $2.5 billion this year to capital spending following a meager $280 million in the first quarter.

Tesla can certainly make that cash last longer by generating positive cash flow from its operations. Free cash flow in the final six months of 2018 was nearly $1.5 billion.

A repeat performance is unlikely, though. Tesla benefited from years of pent-up demand for the Model 3 sedan in those quarters. Now it faces a shrunken retail presence, reduced U.S. tax incentives and the aforementioned wave of competitors.

The company can conserve cash in other ways, like reducing capital spending or laying off more employees. But such moves risk further impairing its shaky growth prospects and suddenly fragile stock price. A recent flurry of IPOs shows that capital markets are, for now, still willing to fund unprofitable growth stories.

Given that backdrop, Tesla would be wise to sell more stock when it can, not when it must.

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