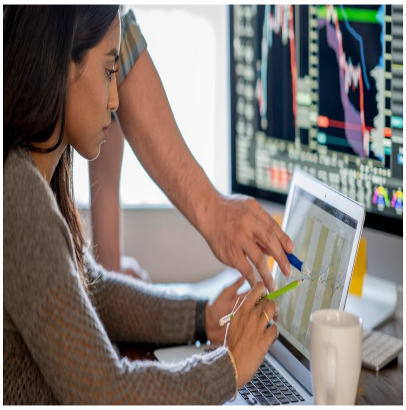

Why Tesla (NASDAQ:TSLA) Stock Fell 4%

Description

Tesla's (NASDAQ:TSLA) stock fell 4% yesterday after rising 14% last week. This dip and rally will continue for some time as Elon Musk, the CEO of Tesla, has initiated a stock-selling plan. Every CEO sells stocks, but this selling is automated so that the CEO does not get the undue advantage of knowing information not known to the general public. Musk, in his SEC filings, clearly stated that he will sell more shares.

Why is Elon Musk selling a 10% stake in Tesla?

To answer this question, you need to understand how CEO compensation works. A CEO's compensation is partly paid as salary and partly in stock options. By definition, stock options are contracts between two parties to buy or sell underlying shares at a predetermined price within a specified period.

Musk has many stock options and shares of Tesla. Unlike other CEOs, he does not take any salary or bonus. So, how does he get money? He has pledged 92 million shares of Tesla to lenders to borrow cash. This helps him withdraw cash from his wealth in a tax-efficient manner. But the tech genius has come under the tax claws.

In 2012, Musk was awarded options to buy 22.8 million shares at a strike price of $6.24 per share. These options expire in August 2022. So, either he exercises the options or lets them expire. The problem, is if he exercises these options, which means he buys 22.8 million shares at the rate of $6.24/share, he will foot a tax bill as high as US$15 billion on $28 billion capital gain, as per *CNBC*. This is because, when he buys the shares, the net value of the share (current trading price minus the $6.24 cost) will be considered for tax purposes.

As stated before, Musk does not take a salary. So, how will he pay the taxes? Hence, his financial advisor probably framed a stock-selling plan that's beneficial to all parties.

Elon Musk’s planned share sale

Under the plan, Musk will sell Tesla shares in a phased manner. The objective is to accumulate sufficient capital for the tax while mitigating the impact of Musk’s share sale on the stock price. He can’t dump his 10% stake in the market, as that would create excess supply and pull down the stock price, thereby impacting other long-term investors.

When Musk first went on a selling spree, he sold $6.9 billion worth of Tesla shares, pulling down the stock price by 17.6% between November 4 and 15. He then paused for some time, during which the stock surged 14%. On November 22 and 23, he sold another $1.05 billion worth of shares and exercised options to buy 2.15 million shares, pulling the stock down 4.14%.

More such stock sales are coming, as Elon Musk has over 15 million more stock options to exercise. So, you could see a 5-10% dip and rally in the coming few months. But don’t panic, as this is just a routine procedure, and it will not impact Tesla’s growth potential or earnings.

Should you buy Tesla shares?

Tesla is riding the electric vehicle (EV) wave, but Musk thinks the stock is overvalued. Some undervalued EV stocks are trading on the Toronto Stock Exchange.

Magna International (TSX:MG)(NYSE:MGA) stock has a 13.5 forward price-to-earnings (P/E) ratio. Comparing Magna with Tesla’s forward P/E ratio of 135 is not apt. Magna is an auto component supplier and mainly caters to automotive companies. Hence, when the semiconductor supply shortage pulled down the auto industry, Magna stock fell.

Tesla managed to work past the industry supply chain issues and flourish. It showed the potential of the EV wave when the stock surged over 55% in October. Magna can grow to such heights over time once the chip supply issue eases and it starts fulfilling pent-up orders. The stock has already surged 5.4% in November after falling 21% between June and October on the chip supply issues, hinting at the beginning of the EV rally.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:TSLA (Tesla Inc.)
2. NYSE:MGA (Magna International Inc.)
3. TSX:MG (Magna International Inc.)

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