



## Long \$NIO. Much more than the “Chinese Tesla”. Absurd short interest ignores the compelling product and patient investor base. Short term target – \$12

After years of battling the “Tesla Story” Citron learned to recognize the opportunities created by total industry disruption and to disregard today's numbers when considering the value of the disruptor. We also learned not to be short a disruptor with a cult-like following and a large outstanding short interest alongside a patient investor base.

With that in mind, we introduce NIO, and explain the real story that Wall St. has totally missed. Just like Tesla was not a simple U.S. electric car story, NIO is so much more than just a Chinese electric car story. NIO's visionary management is revolutionizing the high-end auto industry in China.

But first some background:

The Chinese government has made growing the EV market one of the country's top priorities. As a result, it is nearly impossible to get a driver's license for a combustion vehicle in major cities in China -- a person needs to obtain a special license through a lottery system where the odds of winning are well below 1% (and then pay over \$14K to purchase the license). In contrast, licenses for new EV are free and open to anyone.

This incentive structure has resulted in an obvious boom to the EV market and, in contrast to the overall slowdown in the Chinese economy; sales of luxury cars are seeing accelerating growth.

**Now here is the sexy part that the number wonks are missing.**

**NIO is not just a car company, it is a lifestyle and a brand that is ready to disrupt and the implications for the stock price cannot be ignored.**

NIO is a brand that is connecting with a new generation of Chinese consumers by creating a moat of which even Tesla would be envious. The dealerships -- called NIO Houses -- are not just places to buy cars. They are “trendy club” style spaces where NIO customers and prospects socialize and can utilize a variety of features dedicated to members (e.g., living room, lounge area, library, meeting space, work lab, open kitchen, and discovery area for children).

Watch this video to fully understand what auto disruption looks like:

<https://www.youtube.com/watch?v=Dfi5MWEQ8pE>

The brand recognition and customer loyalty that has resulted is beyond anything Tesla has been able to create in the United States in its early days. The excitement behind NIO was best shown when the company hosted its first ever “NIO Day” to unveil the ES8 in December 2017 and received over 110M views of the event. The 2018 event will only be larger.



This is not BMW or Mercedes. NIO's management recognizes the value of NIO as a lifestyle brand rather than simply another car brand and has looked for opportunities to reinforce brand loyalty beyond just cars. For example, take a look at the high-end clothing line NIO has launched with designer Hussein Chalayan.

<https://www.dezeen.com/2018/11/16/nio-clothing-hussein-chalayan-fashion-extreme-speed/>

## Citron's China Groundwork

After hearing the tagline “Tesla of China” too many times, Citron sent our own crew out to the NIO house to speak to owners to test the strength of the brand. These interviews became the real reason for this report. These 3 sample the general tone of the feedback.

*\*\*\*Note when Citron first shorted Tesla at \$125 critics of us asked “have you driven the car”. The answer was no and maybe we should have in order to understand consumer behavior better. We are not making that mistake here.*

### On the Ground Interviews in China



[NIO ES8 Interview](#)  
[Hannah Age: 27 years old](#)  
[Occupation: Teacher](#)  
[Annual Income: 150k-200k RMB](#)

[Link to Interview](#)

- **Reason for buying NIO ES8:** Seven-seater and saw performance at NIO day
- **Rating of NIO ES8:** 9 out of 10
- **Prior car brand:** Porsche Boxster
- **NIO ES8 compared to prior car:** NIO ES8 has better technology and acceleration
- **NIO ES8 compared to Tesla:** NIO has better service
- **Lifestyle benefit of buying NIO ES8:** Meeting new friends at NIO house and car can support different lifestyles for owners (e.g., camping, city, etc.)
- **Criticism of NIO ES8:** Interior could be improved
- **Recommend NIO ES8 to friends:** Definitely recommend
- **Thoughts on future of NIO brand:** Very bright



[NIO ES8 Interview](#)  
[Mr. Huang - Age: 33 years old](#)  
[Occupation: Finance](#)  
[Annual Income: 200k-300k RMB](#)

[Link to Interview](#)

- **Reason for buying NIO ES8:** Performance, technology, and looks of car
- **Rating of NIO ES8:** 8 out of 10

- **Prior car brand:** Lexus
- **NIO ES8 compared to prior car:** NIO ES8 has better technology (e.g., can switch battery)
- **Lifestyle benefit of buying NIO ES8:** Social life has improved and met lots of new friends through NIO
- **Criticism of NIO ES8:** Interior could be improved
- **Recommend NIO ES8 to friends:** Definitely recommend
- **Thoughts on future of NIO brand:** Very bright as it's the best domestic Chinese brand



[NIO ES8 Interview](#)

[Jude - Age: 35 years old](#)

[Occupation: Entertainment](#)

[Annual Income: 200k-300k RMB](#)

[Link to Interview](#)

- **Reason for buying NIO ES8:** Saw performance from online advertisements
- **Rating of NIO ES8:** 9.9 out of 10
- **Prior car brand:** Audi A8
- **NIO ES8 compared to prior car:** NIO ES8 has better performance and handling
- **NIO ES8 compared to Tesla:** Tesla is too expensive and almost double the price of NIO
- **Lifestyle benefit of buying NIO ES8:** Taking family to NIO house and going on trips
- **Criticism of NIO ES8:** Interior could be improved
- **Recommend NIO ES8 to friends:** Definitely recommend
- **Thoughts on future of NIO brand:** Very bright

For those who are thinking what about BYD or the plethora of Chinese electric car manufacturers hanging around, understand NIO is not a low end product and they claim that the NIO ES8 is the most technologically advanced car in the world

- The ES8 is the only car that uses aerospace grade aluminum architecture.
- Before delivering the first ES8, NIO completed over 3 million km in accumulated test mileage (i.e., the equivalent of 75 trips around the earth).
- The ES8 is the first car to feature the Mobileye EyeQ4 chip, which is 8 times more powerful than the EyeQ3 featured in the Audi A8.
- NIO is also the first car with built in AI technology (i.e., NOMI). NOMI (think “know me”) is to the NIO what Siri is to Apple. Just watch this video.

<https://www.youtube.com/watch?v=0XJK-oAcVvc>

## NIO's Second Mover Advantage

NIO has learned from the growing pains of other EV car makers (such as Tesla) and used this knowledge to its advantage. A perfect example of NIO's "Second Mover Advantage" is its accomplishment in developing the innovative battery-switch service.

NIO has built a battery swap system that can autonomously replace a battery pack on the ES8 in about 3 minutes.

NIO already has 18 battery swap stations up and running along the highway that connects Beijing, Hong Kong and Macau and plans to deploy 1,100 swapping stations by 2020. One of the first stations is actually being built right next to a Tesla Supercharger station!

<https://youtu.be/rmTePwW5HOQ>

<https://electrek.co/2018/11/01/nio-battery-swap-station-next-tesla-supercharger/>

In addition to NIO's innovative battery swap stations, NIO also has introduced power mobile (i.e., mobile charging service) which can give the ES8 100 km of range in just 10 minutes. NIO plans to roll out at least 1,200 power mobile service providers by 2020.

Another use of the Second Mover Advantage is the capital light approach has allowed NIO to reach a run-rate production level of 7,500 vehicles per quarter **six months after beginning ES8 production. For context, Tesla took two years to ramp to this level.**

This is not a knock on Tesla, but at the time there was no supply chains for electric vehicles.

OK...we know what you are thinking – "What is this a NIO commercial?" NOOOOOO....But we just do not understand how anyone can be short this stock. Haven't we made this mistake in the past???

### **Chew on this thought:**

As Tesla has proven, once you establish a high-end brand, it's easy to move down market. NIO just guided to ~7,000 deliveries in Q4, up over 100% sequentially from the 3,268 vehicles delivered in Q3.

**To put this into perspective, when Tesla produced 6,900 quarterly deliveries of the Model S in January 2014, the market valued Tesla at \$20B. Within a month, Tesla was valued at \$30B. At this valuation, NIO's stock price would be worth more than \$24 TODAY.**

<https://www.bloomberg.com/news/articles/2014-01-14/tesla-delivered-6-900-cars-in-fourth-quarter-executive-says>

NIO has taken a unique approach to its first vehicle launches where they pay a proven incumbent automaker (Anhui Jianghuai Automobile Co., Ltd. – "JAC Motors") in charge of producing the vehicle (NIO pays per vehicle fee to JAC). This will change soon but seemed to be the quickest

and most cost effective way to launch the car and avoids the delays, shortfalls and missed numbers that plagued Tesla in its early years.

**A management team that is as strong as we have seen come out of any Chinese company has strategized the NIO game plan.**

#### **William Li – Chief Executive Officer**

- Like Elon Musk, a charismatic serial entrepreneur who has founded several successful business ventures and is highly respected / connected among the Chinese business and political worlds
- Founder and Chairman of Bitauto, the largest online consumer vehicle research site in China

#### **Jack Cheng – EVP and Co-Founder of NIO**

- Former Chairman and CEO of Magnett Marelli China, Fiat-Chrysler's in-house auto supplier

#### **Padmasree Warrior – Chief Development Officer**

- Former CTO of Cisco
- Director of Microsoft and Spotify

#### **Jamie Carlson – Vice President, Autonomous Driving**

- Former architect of Tesla Autopilot Version 1

#### **Dongning Wang – Vice-president**

- Former CFO of Jaguar Land Rover China

#### **Feng Shen – Vice President & Chairman of Quality Management Committee**

- Former CTO of Volvo China

### **Lets Get Down and Dirty with the Numbers:**

Per Frost & Sullivan, total luxury car sales in China are estimated to be 3.1M units this year growing to 4.8M units by 2022.

**If investors believe that NIO could achieve 225k unit sales in 2022 (i.e., less than 5% share in the Chinese luxury segment and far below the 30-40% Tesla is currently capturing in the US), the stock should be at \$16 TODAY. \*\*\***

For some context, BMW and Audi currently sell over ~600K vehicles per year each in China.

NIO management has forecast long-term goals of 23-25% gross margins and 10-12% operating margins, which seem very achievable especially considering Tesla’s recent disclosure that the Model S and X gross margins have now eclipsed 30%.

\*\*\*The math behind that thought is at 225K vehicles sold and 12% EBIT margins, NIO could generate approximately \$1.30 earnings per share. At a 20x valuation, this implies an \$27 stock price. Discounting back at ~15% for 3 years implies a \$16 stock price today.

	Long-Term Goal (%)
Revenues	100
Vehicle Sales	90-92
Others Sales	8-10
Gross Margin	23-25
Research and Development	5-6
Selling, General and Administrative	7-8
Operating Margin	10-12
EBITDA* Margin	13-15

Below is an EPS / price target sensitivity table based on varying auto deliveries, gross margin, and discount rate.

		2022E Earnings Per Share				
		Auto Gross Margin				
		20.0%	22.5%	25.0%	27.5%	30.0%
Auto Deliveries	150,000	\$0.47	\$0.63	\$0.80	\$0.97	\$1.14
	175,000	\$0.55	\$0.74	\$0.94	\$1.13	\$1.33
	200,000	\$0.62	\$0.85	\$1.07	\$1.29	\$1.51
	225,000	\$0.70	\$0.95	\$1.20	\$1.45	\$1.70
	250,000	\$0.78	\$1.06	\$1.34	\$1.61	\$1.89
	275,000	\$0.86	\$1.16	\$1.47	\$1.78	\$2.08
	300,000	\$0.94	\$1.27	\$1.60	\$1.94	\$2.27

		Price Target @ 20x P/E Discounted Back To Today				
		Discount Rate				
		10.0%	12.5%	15.0%	17.5%	20.0%
Auto Deliveries	150,000	\$12.05	\$11.26	\$10.54	\$9.88	\$9.28
	175,000	\$14.06	\$13.14	\$12.30	\$11.53	\$10.83
	200,000	\$16.06	\$15.02	\$14.06	\$13.18	\$12.37
	225,000	\$18.07	\$16.89	\$15.82	\$14.83	\$13.92
	250,000	\$20.08	\$18.77	\$17.57	\$16.47	\$15.47
	275,000	\$22.09	\$20.65	\$19.33	\$18.12	\$17.01
	300,000	\$24.10	\$22.52	\$21.09	\$19.77	\$18.56

## This We Cannot Understand - Fellow Short sellers....do we not learn from our mistakes???

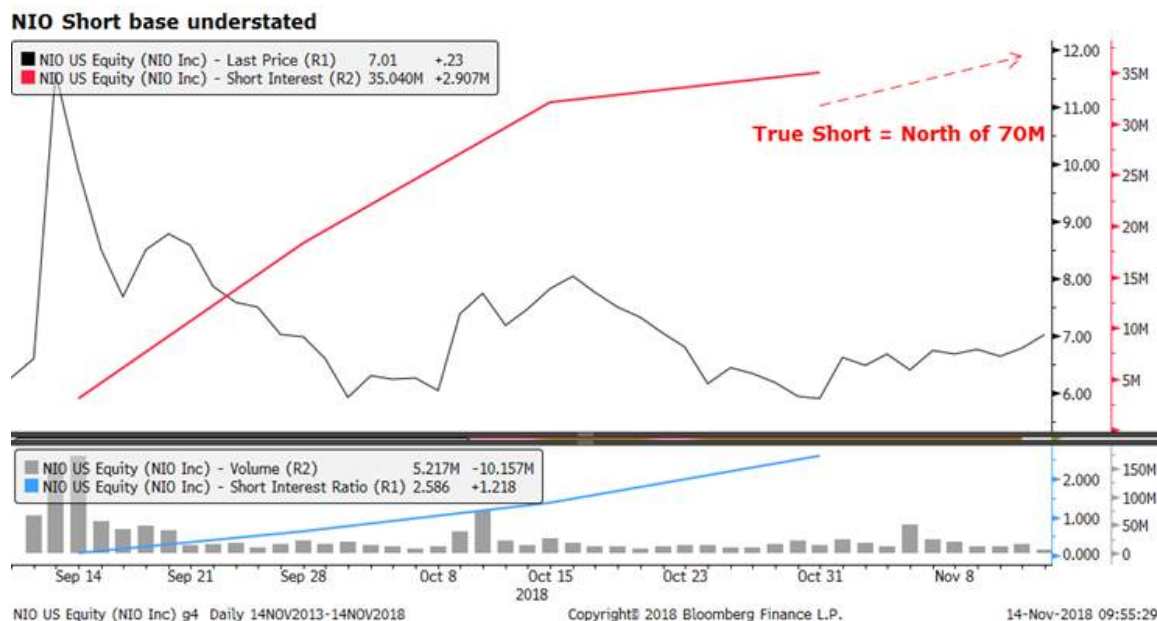
NIO's shareholder base includes the world's top investors in China and the EV market including Sequoia Capital, Hillhouse Capital, Tencent, Temasek, TPG, GIC, and Baillie Gifford.

There were 184M shares issued in the September IPO. Baillie Gifford then filed a 13G on 10/9 disclosing that they purchased 80M shares after the IPO. Vanguard and Morgan Stanley disclosed last week that they purchased 19M and 12M shares respectively during the most recent quarter. So, Baillie Gifford, Vanguard, and Morgan Stanley bought over 60% of the float.

**Therefore, the public float ex-Baillie Gifford, Vanguard, and Morgan Stanley is 72M shares, implying that short interest could stand at over 100%.**

This uniquely high short interest caught the attention of BAML's short specialist team as they stated with the attached chart:

*“Furthermore, if Shorts discount the top holders as passive or not part of what one would consider the “active float”....short analytics would consider the short base in this name to be better than 100% of the “ active” float (for this single listed ADR). Stock borrow fees are also trading at a premium and the lock up expiration is not until March 11, 2019. Short Analytics does not see a valuable risk return in the short right now. De-Risk NIO Short.”*



What we learned from Tesla is **DO NOT be short into a major positive catalyst**. NIO will unveil the ES6, their crossover vehicle, next month and production will begin in the first half of 2019. The ET7, their sedan vehicle, is set to be unveiled next year.



## Trade War is win/win for NIO

If tensions are eased with US and China then NIO stock will increase as confidence will come back to the Chinese consumer and it will rise with the basket of Chinese stocks.

However, if no progress is made, NIO is still a relative winner. Due to locally based manufacturing, NIO's ES8 is priced at a material discount to its competitors (e.g., the Tesla Model X is 2-3x more expensive). The chart below shows the difference in price between the NIO and other luxury vehicles including the Tesla.

Costs (RMB)	NIO ES8	Tesla Model X 75D	Audi Q7 45 e-tron(4)	Mercedes-Benz AMG GLS 63
Ex-Factory Price	386,207	594,150	655,922	732,192
Customs Duty(1)	—	237,660	98,388	292,877
Consumption Tax (>4L, (Ex-Factory Price + Customs Duty) / (1-40%) * 40%)	—	—	—	683,379
VAT ((Ex-Factory Price + Customs Duty + Consumption Tax)*16%)	61,793	133,090	120,690	273,352
<b>MSRP</b>	<b>448,000</b>	<b>964,900</b>	<b>875,000</b>	<b>1,981,800</b>
Purchasing Tax (Tesla is excluded in the EV White List, MSRP/(1+VAT 16%)*10%)	—	83,181	—	170,845
Vehicle and Vessel Use Tax(2)	—	—	—	4,245
Plate Fee	—	—	—	500
PRC National and Local Subsidies(3)	(74,067)	—	—	—
<b>Total Consumer Cost</b>	<b>373,933</b>	<b>1,048,081</b>	<b>875,000</b>	<b>2,157,390</b>

Notes:

- (1) Customs duty calculated as Ex-Factory Price \*15%; in the second half of 2018, the Chinese government applied an additional 25% customs duty to certain categories of vehicles, among other products, imported from the US.
- (2) As there is no nationwide uniform vehicle and vessel tax standard, the information above uses the average vehicle and vessel use tax in Beijing, Shanghai, Guangzhou and Shenzhen.
- (3) Average NEV national and local subsidies in Beijing, Shanghai, Guangzhou and Shenzhen.
- (4) As Audi Q7 45 e-tron is only produced in Europe, thus such tariff change has no impact on its price, it applies the customs duty of 15%.

If you don't want to be long China, the Chinese EV market or an exciting lifestyle brand in China, we understand.

But, from what we have seen before (and learned some painful lessons in the process), investors in disruptive companies such as NIO with a lot a blue sky ahead of them have a lot more patience than do the short sellers.

With NIO's management team, superior product, exceptional brand loyalty, and extremely high short interest, we know how this story ends for short sellers.

## Cautious Investing to All