Nikola Stock Answers the 'Chicken or the Egg' Question

Nikola stock hopes to capitalize where others have failed through unique approach

By Emmanuel Henson Jun 29, 2020, 4:00 pm EDT

Notwithstanding the most recent shakeout**, Nikola** (NASDAQ:**NKLA**) stock has made a splash with investors over the first few weeks after its IPO. Nikola's unique vertically integrated approach to the fuel cell trucking industry places it in a category of its own.

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For those who are not as familiar, it might be useful to have a recap of the Cowen Industrial Technology, Robotics & Sustainability Summit held on June 3, 2020.

During the summit, CFO Kim Brady, reiterated their approach to the "chicken and the egg" problem. Although the total number is growing, the U.S. Department of Energy reported that as of mid-2019, there were only about 41 retail locations at which you could get hydrogen fuel (which are mostly in California). It is kind of hard to operate a hydrogen vehicle without putting the thought into where you can go.

Their solution is rather innovative. Owners provide a hefty deposit within a year of their expected delivery. Leases are then securitized, and the proceeds are reinvested into hydrogen stations in areas conducive for short- and intermediate-length routes the vehicles will run.

A seven-year lease is signed, which in turn locks the lessee at a cost of $1 per mile. This rate provides certainty in the total truck acquisition, maintenance, and fuel costs.

Nikola Stock Will Divide And Conquer

Nikola will start on routes in and around southern California, and branch out accordingly.

This deliberate approach gives Nikola the chance to understand demand before supply is strategically allocated. Without burning through cash building infrastructure in places it won't work.

Regulatory requirements are also a tailwind to Nikola and its stock. Brad stated that by 2023, he believes emission standards may eliminate the ability for diesel engines to operate at all in certain places in Europe. It's a race to be first, and they may just have had the jump start.

Eating Elephants

Despite being the company that makes the profitable F-150, **Ford** (NYSE:**F**) can't eke out a profit with $35 billion in assets to leverage, so Nikola was smart not to fight losing battles. Margins are razor-thin in the diversified auto businesses even amongst established players. So instead of fighting, which past alternative fuel companies have done in the past, they have joined them.

Brad was firm in his strategy to focus on what they do best, which is innovation and design, and to partner with a manufacturer with deep pockets and a distribution network. They settled on a European joint venture with **CNHI Iveco** (NYSE:CNHI), a global commercial vehicle original equipment manufacturer (OEM).

Lastly, Nikola has completely skipped the car industry. Margins there are usually be in the low single digits. This means it has avoided the need to have armies of salespeople, which could get them to profitability sooner.

During the Deutsche Bank Global Auto Industry Conference held on June 10 and June 11, Nikola CEO Mark Russell announced a backlog of 14,000 fuel cell trucks, worth about $10 billion. For accounting, and other reasons, they do not have deposits, but Russell feels confidently theses indications will lead to orders. Mile for mile, they anticipate being at, or slightly better than, their diesel engine alternative.

There is a market need, and if they are the first to gain wide acceptance as a vertically integrated solution for a larger segment of the trucking industry it could be transformative.

The devil is in the details.

The oil market will dictate Nikola's cost argument against diesel, and cloud storms are forging for the credit markets. I mentioned in my prior article, for instance, that **Wells Fargo** (NYSE:WFC) is stopping certain arrangements between vehicle dealerships. Wells Fargo's plan wasn't directly, but it may be a sign of harbingers to come. The discount rate applied to the sales of these leases will be dependent on these factors.

It was evident in the stress test of the banks released last week, that banks could see losses as significant to those in 2008, if the trend in lower overall economic activity continues. All of the capital plans for the major banks were curtailed. It would be reasonable to expect some additional tightening of lending standards.

With every IPO there is a risk that original investors may take their winnings and go home after the lockout period. It appears that a number of their investors are at a minimum keeping their options open.

Nikola stock might be overvalued in the short term. I would wait for a pullback in the stock, after the lockup period, before buying. And remember that it will take a few years for the company's plan to pan out. But in the long-term, it just might be a major player.

At the time of the writing of this article, Emmanuel Henson did not own shares in Nikola.