

I am recommending a short of Toyota Motor Corp (TM), however picking the appropriate timing to enter will be difficult given its current upward momentum. The stock has been on a tear throughout the past year, up over 30% in that time. While I believe the overall company is sound and moving in the correct direction, I also think that the valuation has exceeded the fundamentals even accounting for good decision making by management. At a current stock price of ~\$244, TM is approaching my Upside price target of \$250 which uses a generous P/E multiple of 12.1 on FY27 forward earnings. Base case and Downside scenarios in my model reflect a \$228 and \$211 price target respectively.

There are three key reasons for my position:

- 1. U.S. Tariffs put a damper on upside potential.** With tariffs going into effect in late 2025 (August), we have seen a decrease in TM's operating margin over the past couple of quarters. They had previously seen low double digit operating margin in FY24, but in 2Q and 3Q of FY26 (which, for them, is July 2025 through Dec 2025) operating margins have dipped to mid-high single digits. **The upside scenario in my model has operating margin returning to previous highs over time**, but a more modest Base Case scenario keeps these margins flatter (but slightly increasing).
- 2. Fundamental valuation reveals that the market may be overly exuberant about TM's prospects.** As mentioned above, I believe TM has been making good decisions with their business. They are pivoting to Electric vehicles, and that has been reflected in sales as Electric sales have jumped to 46% of their sales up from mid-20% in 2022. That being said, most of this has been driven by HEV's (Hybrid Electric Vehicles) where they have operated for many years (think: Prius). Sales of their PHEV's, BEV's, and FCEV's (Plugin Hybrid, Battery, and Fuel Cell Electric Vehicles, respectively) have lagged quite far behind. I think the market is too optimistic on continued growth in this department and TM's move into attempting to create what they call "Next-gen" BEV's (driving ranges up to 1,000km and charge times of 20 minutes) comes with substantial risk as they take on more established competitors in the space such as Tesla. For reference, Tesla has a max driving range on their Model 3 Long Range vehicle stated at 750km (620km in real-world testing) and charge times of 15-30 minutes.
- 3. Competition in the electric vehicle space is intense, and TM has not been an early mover outside of Hybrids.** In addition to a company like Tesla who was mentioned above, TM faces competition from Chinese manufacturers such as BYD, NIO, and XPeng that can eat into their Asia business (currently 2nd behind their Japan business in terms of operating income given U.S. tariffs destroying profits in North America) as well as threatens their Europe business given, in particular, BYD's expansion into that area. On top of threats from China, there are also legacy OEMs

such as VW, Hyundai, GM, and Ford that are all entering the EV space and can capture share as they expand their offerings.

Overall, I don't think that TM is making any particularly poor decisions in their operation. That being said, they are fighting in a highly competitive space, and their stock price continues to elevate beyond what I see as the fundamental value. If the stock were to tank below my valuation, I would be happy to buy given what I see as a strong management team and good directionality in their business decisions. However, **the current situation is that the market is overconfident in TM** when you reflect on the current macro and competitive environment and I am looking to enter a short position. Given current upward momentum in the stock, ideally, I would look to enter my short closer to all time highs that were reached in 2024 of around \$250-255 a share. I will, however, likely average in from the current price of \$244 as there is no guarantee that it will reach ATH's again and I don't want to miss an already solid price to short. I will be targeting an exit toward my Base and Downside scenarios between ~\$230 and \$210 for a gain between ~5%-14% on my position.