

Q4 2015 Earnings Call

Company Participants

- Elon Reeve Musk
- Jason Wheeler
- Jeffrey B. Straubel
- Jeffrey K. Evanson
- Jonathan McNeill

Other Participants

- Adam Michael Jonas, Morgan Stanley & Co. LLC
- Andrea Susan James, Dougherty & Company
- Brian A. Johnson, Barclays Capital, Inc.
- Colin Michael Langan, UBS Securities LLC
- Colin Rusch, Oppenheimer & Co., Inc. (Broker)
- Dana Hull, Bloomberg
- Daniel V. Galves, Credit Suisse Securities (USA) LLC (Broker)
- Dee-Ann Durbin, Associated Press
- Emmanuel Rosner, CLSA Americas LLC
- Jamie Albertine, Stifel, Nicolaus & Co., Inc.
- John J. Murphy, Bank of America Merrill Lynch
- Mike Ramsey, The Wall Street Journal
- Patrick Archambault, Goldman Sachs & Co.
- Phil LeBeau, CNBC, Inc.
- Rod A. Lache, Deutsche Bank Securities, Inc.
- Ryan J. Brinkman, JPMorgan Securities LLC
- Tyler Charles Frank, Robert W. Baird & Co., Inc. (Private Wealth Management)

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and thank you for your patience. You've joined Tesla Motors Incorporated Fourth Quarter 2015 Financial Results Q&A Conference Call. At this time, all participants are in a listen-only mode.

I would now like to turn the call over to your host, Mr. Jeffrey Evanson. Sir, you may begin.

Jeffrey K. Evanson {BIO 1535168 <GO>}

Thank you. Latif, and good afternoon, everyone. Welcome to Tesla's fourth quarter and full-year 2015 Q&A webcast. I'm joined today by Elon Musk, Tesla's chairman and CEO; JB Straubel, our CTO; CFO, Jason Wheeler; and Jon McNeill, President of Global Sales, Service and Delivery.

Our Q4 results are announced in the update letter at the same link as this webcast. As usual, this letter includes GAAP and non-GAAP financial information and reconciliations between the two.

During our call, we will discuss our business outlook and make forward-looking statements. These are based on our predictions and expectations as of today. Actual events or results could differ materially due to a number of risks and uncertainties, including those mentioned in our most recent Form 10-Q filed with the SEC.

We're going to start today's call with some comments by Elon, and then Jason, and then we'll go into the Q&A session. And I would ask everyone, that during the Q&A session you try to constrain yourselves to one question and one follow-up, so we can give everyone fair time on the call. So, before we go to Elon, you might as well go ahead and press star one to get into the queue to ask your question.

And with that, I'll turn it over to you, Elon.

Elon Reeve Musk {BIO 1954518 <GO>}

Thank you. I think the newsletters largely speaks for itself, but I'll add some commentary on some of the lead points. Firstly, we had a huge increase in Model S deliveries year-on-year in Q4 last year, going up 76%. We had a huge change in our core operational cash flow, which you can really see on the chart. It's really quite dramatic. That's why I think it's interesting to look at in chart form, it goes from negative to significantly positive in Q4 last year.

And then we made modest improvements in Model S gross margin, gained about 25%, excluding one-time items, and I feel pretty good about where we're tracking to probably get close to 30% by late Q4 of this year.

And then something I'm personally quite excited about is that we expect to be positive cash flow starting next month and then continuing on into Q2 and beyond. And there's one caveat there, that's including the asset-back line, and the asset-back line is - that's just funding for cars that are en route to customers. So, particularly as sales to international markets increases, there's more finished goods inventory on its way to customers.

So, inclusive of the asset-back line, which I really, I think is most accurately regarded as a slight decrease in the gross margin of the car by about roughly 0.1% or thereabouts, far from that, it requires a cash flow.

And then we're expecting to be profitable for 2016 on a non-GAAP basis. And I personally think that that is actually the correct way to think, to look at it, because of the way that GAAP treats lease accounting. But nonetheless, despite the lease accounting stuff, we anticipate it being profitable by GAAP standards in Q4 of this year.

And we're really looking forward to the unveiling of the Model 3 at the end of next month. I think this is going to be really well received, and then getting into production and delivery at the end of next year.

Touching on a few things that are in the bulk of the newsletter, I think the chart on vehicle demand is really interesting, and to the degree that this represents a microcosm of how Tesla vehicles will be received in other vehicle segments, it augurs extremely well for the future.

The Model S was the best-selling premium sedan in the United States last year, of any kind. And our sales actually increased by 51%, whereas everybody else's sales declined and the overall market segment declined by about 1%.

So, I think this is, it's really rare to see situations like this. And I think this is despite us being really quite under-penetrated in the Northeast. I think there's a lot of room for growth in the Northeast, in particular, particularly of the U.S., and in international markets, in general.

But essentially getting to 25% market share of all premium sedans in the U.S. is, I think, a great achievement of the Tesla team. And I think it's also great for the world, because it means, I mean, that's 25,000 fewer gas guzzlers that are on the road.

We'd like to thank all the customers that went out and bought that car, because I think they're making a difference for the environment; and, of course, they're helping pay for the future development of the Model 3, which is the more affordable mass market car. That's where we put all of the revenue we received from the Model S and Model X. So, it's always a point to bear that in mind, that Model S and Model X (6:51) the Model 3.

And one additional note is that Tesla does not advertise. We don't pay for any endorsements. We do not discount our cars for anyone, including me. I pay the full retail price. Whereas, those actions are - all of our competitors take those actions. So that's, I think, quite interesting. We also have far fewer sales outlets than our competitors. So, essentially there's a lot of degrees of freedom that we are not exercising that we could in theory exercise.

And if you look at the text, it's worth noting that this is not just uniquely true in the United States, but in Switzerland, the Model S outsold the Mercedes S class, the BMW 7 series, Porsche Panamera, and the Audi R8 combined. And also outsold the Mercedes E class. And in Germany, we outsold the Porsche Panamera. So, I think these are pretty good situations. I mean, this is even in places that have no

incentives. Obviously, incentives are something helpful. They're a catalyst for sales. Tesla always appreciates the incentives, and I think they make a difference in accelerating the advent of electric vehicles. But sometimes, incentives are characterized as - it's sort of all about incentives, or not at all about incentives, and it's really important to appreciate that incentives are an accelerant. That's the reality of it.

Jason, do you want to add anything?

Jason Wheeler {BIO 19481227 <GO>}

Sure, absolutely. Thanks, Elon. First of all, I look forward to working with everybody. I'm super excited to be here, as excited as I was on the first day I walked through the door. Just three quick things I want to touch on real quick.

Number one, gross margin. Lots of moving parts this quarter, and let me walk you guys through it a little bit. We had over \$67 million in Model X ramp-up costs and non-recurring items in the quarter, as Elon mentioned. Correcting for these items, automotive gross margin, excluding ZEV credits would have been 25%. First thing, the major component here is labor and overhead and depreciation related to the Model X launch. The way for you all to think about this is towards the end of Q3 and into Q4, we had to bring the workforce into the factory to build these wonderful vehicles. Also as soon as starter production starts, the clock starts hitting on depreciation as well. So, that's what's going on there.

We also had some asset impairments, one with our old paint shop. And we've now got a state-of-the-art paint shop in place, which is going to give us the capacity that we need all the way through Model 3.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, that's 10,000 cars a week, too.

Jason Wheeler {BIO 19481227 <GO>}

Yep, 10,000 cars a week. So this is a good story. And these are assets that we had purchased, I'll go all the way back to the NUMMI days, so we got every bit of life out of those assets as we possibly could.

The other big piece here is, we had an E&O write-off, excess and obsolescence. This is a result of better production control and inventory management systems that we put in place. The place is moving really fast, and we took some time. Elon talked about this in Q2 on the earnings call during the shutdown, putting better systems in place to track this. We're moving to a place where we're tracking E&O on a real time basis, and bringing those facts to the table when we're making decisions. So, we shouldn't be in this position again.

Next thing, I wanted to talk about just real quickly was cash flow, and Elon covered this, and I think, the chart on the face of the shareholder letter really gets there. But, we were within striking distance of positive operating cash flows (10:50). And when you add back the leasing proceeds that we get of, \$209 million, it's a great step change in the right direction to getting us to net cash flow positive.

Also, CapEx, we guided at \$500 million last quarter on the call and we closed out at \$411 million for the quarter. That all resulted in the ending cash balance being at \$1.2 billion, which I think showcases our strong improvement in cash management and discipline in the company.

Finally, really quickly talk about capital structure. We closed the warehouse line that we previously had before and opened the ABL, as Elon mentioned. Think of this as a shift to lower cost financing. We've got a better deal on this line. So, I think it's a better way to think about that, intended uses; one, we'll continue to monetize our direct leases, as we did, with the warehouse line; but it also creates an option for us to finance our ramp in FGI as the Model X hits full production scale.

I'll just close by saying my mandate from Elon is clear. Cash is king. And there's some real steps that we're taking as a company to get ourselves to net cash flow positive for the year.

Elon Reeve Musk {BIO 1954518 <GO>}

And profitability.

Jason Wheeler {BIO 19481227 <GO>}

And profitability. One more is just capital efficiency and CapEx. CapEx in 2016, as we've said in the past will be less than it was in 2015. We started to see some of this in Q4. It will continue. We're also getting to a point where we have operating leverage in the business. We'll continue to aggressively manage our growth and expenses. And then finally, and I'll walk around and I'm on this every day, it's the relentless focus on automotive unit cost reductions. So, that's my mandate. Again, I'm happy to be here.

And Elon, if you've got nothing else, we go to Q&A.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, actually, I guess one other point that's sort of interesting to note is that Tesla is approximately doubling its cumulative sales every year. So, I'm not sure if this has happened in the car industry for maybe a century, but like we started at the beginning of last year with 50,000 cars on the road, then we ended with 100,000. This year, we're maybe 60% to 80%, we're at the high end of the range. Again, it sort of potentially doubles the size of the fleet. And I think that's pretty exciting and unusual. So thank you.

We can go to Q&A.

Jeffrey K. Evanson {BIO 1535168 <GO>}

All right, Latif, let's take the first question, please.

Q&A

Operator

Yes, sir. Our first question comes from the line of Brian Johnson of Barclays.

Q - Brian A. Johnson {BIO 21263539 <GO>}

Welcome, Jason. Just wanted to ask a couple questions revolving around the cash flow. I'm sure other will go into some of the Model X ramp and delivery numbers. First, you produced about 14,000 vehicles, you delivered 17,000 vehicles. That would imply 3,443 reduction in finished goods at least Model S inventory, which could generate \$250 million, yet your inventory is roughly flat quarter-over-quarter. What before we get the K and the Q, are the put and takes there?

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, I think you touched on it. We managed to do a really nice job of selling inventory cars at the end of the year.

Q - Brian A. Johnson {BIO 21263539 <GO>}

But on the balance sheet, the inventory number in cash and inventory stayed about the same.

A - Jason Wheeler {BIO 19481227 <GO>}

So, there's a couple of things going on in there. So, one is the finished goods, but also doing a nice job on the finished goods inventory, but also just the ramp-up of the parts that we need to get full production with Model X.

Q - Brian A. Johnson {BIO 21263539 <GO>}

Okay, so it's sort of the work in process on the Model X. Second, can you kind of just refresh, could you kind of update us given the change from the revolver to the ABL? What is currently drawn on the ABL? What's the available borrowing base? How much of that is, as you think about next year going to be used to support increased on-balance sheet leasing versus increases in finished goods inventory? And what's your remaining, if the banks were to come and kind of borrowing base that would be left unpledged?

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, sure. So, on where - we closed Q4, \$135 million fully drawn on it. And then, in terms of the borrowing base, there's a lot of detailed numbers behind that. I think

the most important thing to point out here is the increase to \$1 billion that we did with our banking partners. And then there's some restrictions there, and we don't want to max that out, so we're going to monitor it carefully and just make sure we do the things to do. We don't want to live on this drug.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. We have a collection of lenders. So, it's like - hypothetically, if one lender, we decide not to split the ABL, then it's distributed. So, it's not a (15:53) with lenders is very strong for the ABL, because it's a finished product that's going to a known customer. There's no channel to stuff, because there isn't a channel. It's just up in transit to customers, primarily overseas.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah. It grows with the inventory balance, against cars that have orders placed against them.

Q - Brian A. Johnson {BIO 21263539 <GO>}

But it sounds like you could draw it even if inventory - finished goods inventory was flat, could you still draw on it, or does it have to track to a direct increase in finished goods inventory?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yes. Yes, (16:36). Basically it's a finished goods (16:44).

Q - Brian A. Johnson {BIO 21263539 <GO>}

Okay. Thanks.

A - Jeffrey K. Evanson {BIO 1535168 <GO>}

No problem. Thanks for the question.

Operator

Thank you. Our next question comes from the line of Colin Rusch of Oppenheimer. Your line is open.

Q - Colin Rusch {BIO 15823117 <GO>}

Thanks so much. So you're coming to - in the next couple of quarters, to the end of some of the initial leases on the Model S. Can you talk a little bit about your preparations for that and your expectations as we move throughout this year, and what will happen with those cars, and how many of them are actually going to get returned?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Sure. Jon, do you want to talk about that?

A - Jonathan McNeill {BIO 4091220 <GO>}

Sure. So, we actually started on that early, and launched a campaign in the second half of 2015 to reach out to folks who had cars coming off of lease, and one of the attractive things to those folks who were coming off of lease is to have a car that's equipped with Autopilot, and Autopilot is certainly one of the core stories of what's going on here at Tesla. It's really exciting. And so, we're finding that folks are willing to upgrade their Tesla as part of this campaign, and so we've got a formal program where we're really providing a smooth transition period for these cars.

In addition to that, we're finding there's a very healthy aftermarket for these cars, and the trading values, or the trading values in the market, are significantly above our residual reserves on the cars, which is giving us some flexibility in terms of our financing partners offering very attractive monthly payments in loan terms, because the cars are holding - Teslas are holding value at a much higher rate than we thought.

So I think, the short answer is, we're out ahead of it, and we're getting really good reception and conversion from customers who are excited about the next generation of Tesla, which is an Autopilot-equipped car.

Q - Colin Rusch {BIO 15823117 <GO>}

Okay. Great. And then, just the follow-up, there's some pretty significant legislation updating the Toxic Substances Control Act that passed through Congress in December. As you guys look at a lot of the details in terms of ramping the Gigafactory, can you talk a little bit about where you're seeing its impact so far with the updated substances, and how they might be treated as we go forward here?

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

This is JB. I can jump in there. We haven't seen any immediate impacts from those results or changes. You know, the materials we're using at the Gigafactory are not particularly toxic substances.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. The Gigafactory has zero toxic output.

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

Yeah. In terms of large industrial factories, it's an incredibly clean one. There's really no air emissions, and the raw materials are largely base metals and things like that.

Q - Colin Rusch {BIO 15823117 <GO>}

Okay. Great. I'll follow-up offline. Thanks, guys.

Operator

Thank you. Our next question comes from Adam Jonas from Morgan Stanley. Your question, please.

Q - Adam Michael Jonas {BIO 3339456 <GO>}

Hey, everybody. Two quick ones. First, can you confirm reports that Jim Keller, kind of a legend in the microprocessor world, has joined the company to head some Hardware Engineering at Tesla Autopilot? If that's correct, does that signal that Tesla might be - moving to design some of their own silicone?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Well, I think it's public knowledge that Jim Keller's joined. We have a lot of talented people that join Tesla all the time. Jim is indicative of that. And just, some people get a bit more press than others, but I think the talent level that's joining Tesla is really incredible. With regard to the latter part of your question, we just - no comment, yeah.

Q - Adam Michael Jonas {BIO 3339456 <GO>}

Okay. Then just the follow-up. On test drives, outside of company-sponsored events, kind of surprised we haven't seen any full comprehensive independent test drives from the major magazines. Is there anything kind of preventing, and I think people on the call can understand if there would be, of the earlier produced units that maybe you wouldn't want released quite yet. But is there anything preventing the magazines from gaining access to the early vehicles, the Model Xs, and conducting a full road test of the vehicle? And if there is, when can we expect kind of some of the first reviews, you think? Thanks.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Well, we - I mean, I guess, we've not provided cars to the media, because the logic is, we - to the degree that we could suppress demand for the Model X, we did. So, we took basically every action we could to suppress demand for the Model X, because production wasn't - we need to get production up. There's no point in amplifying demand if production cannot meet that demand.

So, we did our best to really suppress demand, or simply not encourage demand. That'll obviously change in the balance of this year, as we get cars to stores, because there's been no Model Xs at stores, no Model Xs available for test drives. But in the coming months, I think probably next month, you'll start seeing some reviews in magazines and whatnot. The feedback from customers we've gotten has been very positive.

Q - Adam Michael Jonas {BIO 3339456 <GO>}

Thanks, Elon.

Operator

Thank you. Our next question comes from Emmanuel Rosner of CLSA. Your line is open.

Q - Emmanuel Rosner {BIO 16323493 <GO>}

Hi, good afternoon. Wanted to ask you first, can you give us a little more color on what exactly happened with the Q4 launch? I mean, in the letter, you sort of imply that it took maybe a little bit longer than expected. So, what issues have you encountered? And what have you learned that gives you confidence that, in your next launch, maybe the Model 3, you can actually ramp that up significantly quicker?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I think that's a great question. I think the mistake we made with the Model X, which I really think we've taken to heart at Tesla, is that we put too many new features and technologies, too many great things all at once, into a product.

In retrospect, it would have been a better decision to do fewer things with the first version of Model X, and then roll in the capabilities and features on new technologies over time, in subsequent years. So I do think that there was some hubris there with the Model X.

So the net result, however, is that I think the Model X is an amazing car. I honestly think it's probably the best – I mean, I think it's the best car ever. I'm not sure anyone's going to make a car like this again. I'm not sure Tesla would make a car like this again.

So, yeah, I mean, it's – I mean, I'd be surprised if somebody buys the Model X, and particularly as the software gets refined, if it's not the product they love more than any product they've ever bought, I would be surprised.

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

Yeah, maybe it's worth also just commenting that even some of the most innovative features on Model X that caused some challenges in Q4 have really been largely overcome today.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, that's true.

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

The operation of the falcon door, the sourcing and supply of the large glass wind screen, I mean, these things are working very well and are not a bottleneck at this point.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Exactly. Some of the things that cause us issues are somewhat counterintuitive. They're not the obvious things. I mean, for just a few weeks, maybe three weeks or

four weeks actually, the constraint was the chrome finish on the bright work around the window, the front window, okay? Maybe think, (25:12) a constraint? But it was.

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

Or seals.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Or seals, yeah. The seals. Yeah, the seals have been a huge pain. I mean, essentially the seals had to be redesigned, and then the seals that we did have had to be reworked by hand in order to sort of fit correctly. Yeah. Seals are a bane. We had a lot of issues with the second door seats, we have now in-sourced that capability. Yeah, we really don't see any fundamental issues.

Q - Emmanuel Rosner {BIO 16323493 <GO>}

Okay. You sounds like it's basically mostly behind you. So, as we move forward into the year, so you're talking about this Model X production rate of 1,000 vehicles a week in Q2. Is that an exit trade or is that an average for Q2? And can you just more generally give us how you see the overall mix for the year of Model S versus Model X play out in terms of deliveries?

A - Elon Reeve Musk {BIO 1954518 <GO>}

I mean, some of the stuff is - you have as good a crystal ball as we do. But, let's see, 1,000 a week would probably be a peak production week in Q2. Yeah, so like average - I don't know what the average is going to be exactly - but maybe 700 vehicles or 800 vehicles, something like that. So that's good for that. I think we feel confident of hitting 1,000 a week certainly towards the mid to end of Q2.

And then for the exact mix, I mean, I think we need to see how customers react when both cars are in the showrooms, and then we'll adjust accordingly. But, we expect to combine the delivery number average over the year of 1,600 per week to 1,800 per week.

Q - Emmanuel Rosner {BIO 16323493 <GO>}

Perfect.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah.

Q - Emmanuel Rosner {BIO 16323493 <GO>}

Thank you very much.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Thank you.

Operator

Thank you. Our next question comes from the line of Colin Langan of UBS. Your line is open.

Q - Colin Michael Langan {BIO 15908877 <GO>}

Great. Thanks for taking my question. Can you just kind of walk through what are the key short-term drivers of cash flow, sorry? You're kind of still burning \$200 million this quarter. Is it just really all volume to get back to get cash flow positive by Q2? Could you also touch on CapEx? You're saying it's going to be flat to down, but there seems like there's an awful lot of work going on in the company. I mean, how do you keep CapEx down as you have all these growth plans?

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, sure. So, the key drivers on cash flow positive. So, as I said in my earlier comments, it was a great step, and then operational too. The business is selling cars and energy products, is now producing enough cash for us to start to pay for our investments. And if you look at the Q4 dynamics, that cash flow from core operations as we're calling it produced 40% to 45% of the cash that we needed for the CapEx in the quarter. So, that is certainly a big piece of it, too.

Another piece of it as I mentioned is just going to be operating leverage. We need to be very diligent about how we grow operating costs certainly. And then the other big element to it is certainly continuing to drive cost downs on the vehicles.

And there's lots of ways to do that. We're getting better at our manufacturing processes, we're reducing scrap, we're reducing excess and obsolescence. As we talk about in the letter, the car continues to be more and more reliable. So, that reduces our warranty, and that actually has a cash impact when the cars show up less at the service centers.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. In fact, and can I? I'd just like to re-emphasize that. We're seeing dramatic improvement in reliability and reductions in servicing needs. This is important. Sorry. Go ahead.

A - Jason Wheeler {BIO 19481227 <GO>}

Yep. No, absolutely. And then the other piece you talk about CapEx and how can it be down. We made a bulk of the investments that we need for Model X in 2015. So, in 2016, we're going to continue to invest, but we're really towards the back half of the year, start to see some initial investment in Model 3. We continue to invest in the Gigafactory to get to where we want to be with production there. And then we'll continue to expand the service center, the retail locations, and the supercharger network as well. But there's a lot of the big pieces that we needed to spend in CapEx to get to where we are today were spent in the past.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yes. It's just important to bear in mind that the overall market for SUVs and the sedans is roughly the same. Globally, it's split, almost 50/50, and so, the Model X is kind of like half of our volume. So, if you set a company up to produce X, let me use the variable X.

If you set a company up to produce a certain amount of revenue and then it produces, you know, maybe just over half that amount of revenue, but has the cost basis associated with it, then obviously, the things will not be pretty from a cash flow and profitability standpoint, necessarily, is going to be true.

Then as Model X production rises, then that changes, and then we achieve the target revenue with the reasonable cost basis and the whole picture changes dramatically for profitability and cash flow.

A - Jason Wheeler {BIO 19481227 <GO>}

Absolutely. The only other last thing I would add, too, is we've had a significant run-up investment over the last couple of years. Now, it's time to absorb that and look for just greater capital efficiency.

Q - Colin Michael Langan {BIO 15908877 <GO>}

Got it. And just one final question. Could you just remind us, are you still on track for storage of \$400 million to \$500 million this year, and two to five next year? Or is that still on track?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Hey, JB, do you want to comment on that? I mean, one thing I say with respect to energy, we do see this being a very enormous market, but it's an exponential growth market, so exactly where the calendar falls on that S-Curve exponential makes quite a big difference on revenue. So, it will be heavily weighted to the fourth quarter. JB, do you want to add anything?

A - Jeffrey B. Straubel {BIO 16619298 <GO>}

Yeah. That's exactly right. It's not a linear extrapolation throughout this year at all, so, you know, I think we're being fairly cautious in trying to make sure that we don't overpromise here and understand what's going to happen in Q4. It's a little bit tricky to know how that will grow.

Production is in on track and we feel really, really good about that. Production start off as planned in the Gigafactory in Q4. Deliveries are on track. We're starting shipments of Powerwalls and Powerpacks worldwide, and we're growing out the sales operations and sales teams around the world. From an execution point of view, I think we feel really good with where we're at. It's early days to predict how exactly that exponential growth is going to really integrate.

Q - Colin Michael Langan {BIO 15908877 <GO>}

Okay. Fair. Thank you very much.

Operator

Thank you. Our next question comes from the line of Patrick Archambault of Goldman Sachs. Your line is open.

Q - Patrick Archambault {BIO 4638109 <GO>}

Okay. Yeah. Thanks. Good afternoon, and I guess, good evening from our end. Wanted to build just on Emmanuel's question. Can you just tell us, what is the current run rate of Model X production, you know, where we stand today, towards the middle of February? And can we talk a little bit about how you get to the ramp. It sounds 1,000 is the target that would obviously mathematically get you to think about half your production. So, that's pretty much full ramp, but it seems like that's a pretty big distance from where you are now. And maybe if we can walk through the pieces that get you there, you know, in terms of training employees, getting the supply base in order, getting some of the quality issues resolved. That would be my first question.

A - Elon Reeve Musk {BIO 1954518 <GO>}

I don't think we want to comment with that level of granularity. Unless people actually understand how production works, they reach incorrect conclusions. We stick to what our projections are, and leave it at that.

Q - Patrick Archambault {BIO 4638109 <GO>}

Okay. Just in terms of another ramp-oriented question, if I may, it does seem that given the forecast that you have for, I think, 16,000 deliveries this year, getting to...

A - Elon Reeve Musk {BIO 1954518 <GO>}

This quarter.

Q - Patrick Archambault {BIO 4638109 <GO>}

...for this quarter, excuse me, getting to 80,000 to 90,000 would imply a run rate that's about 40% higher than where you are in Q1. But you also made a comment that inventories - that a lot of that's going to be international, and there may be some, you know, in-process inventory being built out to service that so maybe we can talk a little bit about that ramp.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. The international stuff is mostly Q2, so that's really where the international ramp starts. There's still inventory in process for, of course, North America, because it takes longer to get a car to the East Coast, if there's like a blizzard or something. So,

that's a factor in finished goods. But finished goods necessarily ramps as we pull the pipeline for overseas sales, which is next quarter.

Q - Patrick Archambault {BIO 4638109 <GO>}

Okay. Thank you.

Operator

Thank you. Our next question comes from Dan Galves of Credit Suisse. Your line is open.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Thanks for taking my questions. First one has to do with operating expenses. Hopefully, I'm not getting the numbers wrong, but it seems like 20% growth in 2016 versus 2015 implies like, relatively flat, versus the Q4 run rate. Is that achievable to essentially keep the operating expenses pretty consistent throughout 2016?

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah. Certainly. This is Jason. We definitely believe that we can do that. There was a bit of a dog's breakfast in Q4. We had some things in there. I'll just give you a couple of examples. We had some aged receivables from some service revenues in Europe that we ended up having to write off. That was one thing.

We had some R&D tooling that had come to the end of its useful life, and we had to write-off as well. So, there's some noise in the Q4 number for sure, but I'm very confident in the projection in the forecast that we've given for 2016 relative to 2015.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Okay. Great. Yeah. No problem. One other, if I could. There's been a lot of negative chatter about Gigafactory related to signing up of other partners, precursor partners, supply agreements for access to raw materials, and just kind of the general size of the plan. I was wondering if you could give us an update on kind of where you stand, and if you see any challenges to get up to the, you know, 35 gigawatt hours of cell production by 2020, 50 of packs.

A - Jason Wheeler {BIO 19481227 <GO>}

Sure. In general relative to the initial forecasts and timelines, we feel pretty comfortable and where we're at. I think there has been a lot of drama and a lot of negativity in the reporting on this. Somewhere around the head count recently that I think a lot of people picked up on.

And maybe just to talk about that one in particular. That recent sort of hiring head count discussion queued off of numbers that we reported that were effective essentially in the middle of 2015. And then those were essentially compared against where we predicted to be at the end of 2015. So, they weren't even really apples-to-apples, and our very most recent report that we made with the governor's office of

economic development, we had reported, I think, around 272 net hires for the year at the end of 2015, against, we had a target of 300.

So, the general plan is executing actually quite closely to what we had laid out back in 2014. Because it's a fast growth, we have to be really careful at what snapshot in time you actually look at, and what you compare that against.

We still, you know, have the same confidence. We're still on track to produce 15 gigawatt hours of cells. I'm sorry, 35 gigawatt hours of cells, and 50 gigawatt hours of packs. 15 gigawatt of that going to Tesla Energy, the rest going to Model 3 and vehicles. That still is on track, and we're on track to start cell production towards the end of this year.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Thanks very much.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Basically, to the best of our knowledge, you shouldn't worry about the Gigafactory as a constraint in Model 3.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Yeah.

A - Elon Reeve Musk {BIO 1954518 <GO>}

That does not appear to be anywhere near the critical path for Model 3. So, yeah. If I can just sort of maybe say a few words about the Gigafactory like Nevada, and the incentives, and all that. One of the most (39:52) that I see in the media is over-representation of the Nevada incentives. The thing to bear in mind, for the \$1.3 billion in incentives for Nevada is that, in order for us to achieve that, we actually have to develop about \$100 billion in revenue from the Gigafactory. And those incentives occur over 20 years, representing approximately a 1% discount on the cost of the Gigafactory.

The reason it's a big number, and I should say a disproportionate - it is a big number in the absolute sense, but it is disproportionately small relative to incentives that, say, Boeing would receive for keeping an aircraft factory in Washington.

The reason it's this big is because the Gigafactory will be the largest footprint building in the world when it is done. I'll tell you, (40:54) the Fremont factory is currently number two; and, if you're curious, number one is a flower auction house in The Netherlands. And you can look this up on Wikipedia. So, it sort of makes sense that if something is kind of like the biggest thing on Earth, it's probably going to have incentives that are big in the absolute, but small in relative terms.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Yeah.

A - Elon Reeve Musk {BIO 1954518 <GO>}

And the fundamental driver of the decision that - not the exclusive driver, but the primary driver of the decision, was pace of execution for the Gigafactory. That was the primary reason for Nevada over other options. And I believe that this decision is bearing fruit, because we are seeing it move at a very good pace.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Okay. Thanks, guys. Welcome, Jason. Sorry.

A - Jason Wheeler {BIO 19481227 <GO>}

All of those incentives are also performance based.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, exactly.

A - Jason Wheeler {BIO 19481227 <GO>}

We don't receive them unless we execute along the path towards the milestones.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Right. And even some of those we do receive have clawback provisions.

A - Jason Wheeler {BIO 19481227 <GO>}

Exactly.

A - Elon Reeve Musk {BIO 1954518 <GO>}

I mean, essentially - I wrote a blog about this. There is no way for Nevada to lose. The way that Nevada set up the incentive structure is a no-lose proposition for them. So, they did an awesome job on behalf of their state. You can read the blog that I wrote called "the house always wins," which is true. And so, anyway, it's really annoying to see this stuff misrepresented in the press.

Q - Daniel V. Galves {BIO 16540648 <GO>}

Got it. Thank you.

A - Jeffrey K. Evanson {BIO 1535168 <GO>}

All right. Latif, next question, please?

Operator

Yes, sir. Our next question comes from the line of John Murphy of Bank of America Merrill Lynch. Your line is open.

Q - John J. Murphy {BIO 5762430 <GO>}

Good afternoon, guys. Just a first question, and Elon, you made a very interesting comment about the Model X being the best car ever produced, and it sounds like you think it might be better than the Model S. I mean, as you get...

A - Elon Reeve Musk {BIO 1954518 <GO>}

Maybe I'm biased. Obviously.

Q - John J. Murphy {BIO 5762430 <GO>}

Well, I mean, it's your newest car, so it makes sense. Or newest vehicle, I should say, so it makes sense. But I mean, as you look at getting that production ramped up and availability out there to consumers, what would the selling point be on the Model S, then? I mean, could you get this mix significantly above 50% crossovers or Model X, because the price premium is really not that great? Why wouldn't you sell a whole lot more Model X than Model S, and could you?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I think this is a question of owner preference. I mean, I personally still prefer to drive the Model S over the Model X, because I'm kind of a - I like the lower position of a sedan. And the Model S, in terms of performance, is about 10% better in an acceleration through handling or whatnot than the Model X. So, it really depends on owner optimization.

If you like sort of a high seating position, an amazing amount of room and functionality and just sort of a feeling of high visibility, I mean, because the - one of the best features, maybe the best feature of the Model X, is the cockpit style front windshield, which gives you this amazing panoramic view as you're driving.

And so if - which a lot of people like that in an SUV, and so that's what the reason that they buy that. So, I think it really depends on personal preference, and we'll see what the results are once we actually put the vehicle in stores and people take test drives.

Q - John J. Murphy {BIO 5762430 <GO>}

And when you think about all the content that you're putting in the Model X, and the upgradability of the Model S and the Model X over time, I mean, how do you think about planned obsolescence, which is sort of a real necessary part of almost any business, to generate incremental sales from your existing customer base?

A - Elon Reeve Musk {BIO 1954518 <GO>}

I guess, I mean, our view of planned - we don't plan to obsolete things. We just relentlessly make things better. So, for example, for the Model S, there's an average

of 20 improvements per week. Mostly, these are a little tiny nuance things that most people wouldn't notice. But, it is a continuous improvement process. That's why I say, when people say, when should they buy Model S? Like what model year? It's like, we don't really have model years. We keep improving the car. If you want to wait until the car stops improving, you'll be waiting forever.

Q - John J. Murphy {BIO 5762430 <GO>}

Okay. And then just one follow-up, just on the cash flow for 2016. Obviously, a lot of progress has been made more recently. As we think about the positive net cash flow and the increase in the cash balance on a year-over-year basis, will that include - I'm just trying to be clear - the potential draw on the ABL over time, as that's needed to run the business, or does that net cash increase not include whatever draw that happens on the ABL in 2016?

A - Elon Reeve Musk {BIO 1954518 <GO>}

That includes the draw on the ABL, the finance initiatives.

Q - John J. Murphy {BIO 5762430 <GO>}

Okay. Thank you very much.

Operator

Thank you. Our next question comes from Jamie Albertine of Stifel. Your question, please.

Q - Jamie Albertine

Great. Thanks for taking the question. On the Model 3, if I may, just I think a lot of folks are trying to do work as it relates on the margin trajectory over time. And it's clearly going to be volume dependent and sort of timing around the launch, but I was wondering if you could help us understand, just given that it's a third of the transaction price of roughly your initial Model X deliveries, what are some of the efficiencies you're hoping that you can sort of draw upon, maybe beyond just sort of the battery reduction, battery cost reductions? What are you leveraging in the Model 3 from investments you've already made, and sort of the knowledge you have around sort of initial launch costs on the higher priced vehicles at this point?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I think the way to think of the customers is really that the Model 3, being a sedan, is about 20% lighter than - and actually quite a bit less complex to manufacturer, than the Model S. Model S was really the first car we ever made ourselves. So, it was - we were designing to make it work, as opposed to designing it from ease of manufacturing, whereas the Model 3 is really designed for ease of manufacturing.

And then we expect through economies of scale and just general design improvements to get another 30% improvement. So that's where the 50%

improvement comes relative to the Model S. So, it's a sort of 35K versus 70K of Model 3 versus Model S is the way to think about the difference.

And our default plan as we've done in the past is that the initial sales are relatively highly optioned versions of the car. Because obviously, we've got to pay back the investment of all the tooling and everything, so that sort of makes sense to have the higher optioned versions first. So, that's what we did with the Model S and also again with the Model X.

Although, it was sort of unfortunate that the way the Model X pricing got reported that they reported the sort of fully optioned signature series as though it was the base price volume number in some publications. So, this is just a misunderstanding of how things work. I mean, and I think it's also normal to do this in many other industries. Like, if Intel comes out with a new CPU or faster CPU, or NVIDIA comes out with a new graphics card, in the beginning, it's a lot more expensive and then over time the price drops.

Q - Jamie Albertaine

Just a clarification, Elon, on the economies of scale. So, should I think about that in sort of the running through the paint shop as an example, given you said the 10,000 unit per week sort of goal there?

And then, separately, should we expect - when should we expect to start hearing about the Model 3 production line? Where do you, within the facility, plan to build it? At what point? Is it sort of going to be the same lead time as we saw with the Model X? Thanks.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. There will be a production ramp for the Model 3. It's always been tricky in the past to predict those production ramps. But yeah. Anything you want to add?

A - Jason Wheeler {BIO 19481227 <GO>}

Well, I think in the development plan that we have now, we have substantially more time, place holder put into the schedule to really refine the product ahead of the production ramp. To a question that came earlier, I think that's something we really take into heart in the launch of the Model X. As we look to higher volumes, and what we hope will be a steeper ramp with Model 3, I think we've learned some important lessons on how to do that well, and having a really robust pilot build in the plant and enforcing rigorous numbers there.

Q - Jamie Albertaine

Okay. Great. Thank you guys so much.

Operator

Thank you. Our next question comes from Andrea James of Dougherty & Company. Your line is open.

Q - Andrea Susan James {BIO 20758120 <GO>}

Thanks for taking my questions, and welcome, Jason. Just a practical one about the factory. You have different choke points at different points in time. It's been general assembly, it's been the cells, at last count it was Body Lines 1 and 2. So, I'm just asking about the status of Body Line 2? And when you hope to migrate maybe Model S production on to that Body Line?

A - Elon Reeve Musk {BIO 1954518 <GO>}

I think we're getting a bit too much into the internal decisions of Tesla. If we say something that's related to an internal decision in Tesla, then it can over-constrain our decisions, and we need to test some flexibility there. So, we'd rather not to comment on the details of when different production lines are moving around.

Q - Andrea Susan James {BIO 20758120 <GO>}

Okay. And then, maybe longer term, then. What is your updated thinking on your cost per kilowatt-hour by the end of the decade, especially as you source your raw materials at the Gigafactory?

A - Elon Reeve Musk {BIO 1954518 <GO>}

That's quite a sensitive number. It's less than what we see most people estimating. So, we see most people overestimating cost per kilowatt-hour, but that is a proprietary number.

Q - Andrea Susan James {BIO 20758120 <GO>}

And I think in the past you said you'd be disappointed if it was not below \$100.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, in the long-term. Yeah.

Q - Andrea Susan James {BIO 20758120 <GO>}

Thank you for taking my questions.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. Thanks.

Operator

Thank you. Our next question comes from Ryan Brinkman of JPMorgan. Your question, please.

Q - Ryan J. Brinkman {BIO 16417954 <GO>}

Yes, thanks for taking my call. A question for Jason, probably. Other automakers sometimes talk about what they call minimum cash, the amount of cash that they need to end the quarter with in order to fund inter-quarter working capital swings, even the event's total change in working capital during a quarter were negligible.

I'm curious what you think your minimum cash needs are, and is that something you can share with the investment community? And then just more broadly, what total amount of cash or gross liquidity do you prefer to run the business with? Thanks.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, sure. We don't go over the inner workings of how we do those calculations internally, but a billion dollars is a nice comfort level. And you see we're starting to make the moves on the ABL, and et cetera, to give ourselves more flexibility there. And it's reiterated, a comment I made at the very beginning, cash is king. And I'm walking around collecting it.

Q - Ryan J. Brinkman {BIO 16417954 <GO>}

Okay. Great. And then just last question on the Gigafactory. You've already given some updates, but maybe you could just talk about how much of the planned CapEx for 2016 relates to the Gigafactory, and then maybe an update on the relationship with your partners there, maybe Panasonic, or any others, how those relationships are progressing relative to their expected future contributions? Thanks.

A - Jason Wheeler {BIO 19481227 <GO>}

Sure. It's a great question, and like you said, we're really excited about the Gigafactory, and things are on schedule. We're not at this time going to break out the detailed CapEx plans. I gave it to you thematically earlier. Certainly, Gigafactory towards the end of the year will start to see some Model 3 investment and then throughout the year we'll see investment in sales, service, and the supercharger network.

Q - Ryan J. Brinkman {BIO 16417954 <GO>}

Great. Thanks.

A - Jason Wheeler {BIO 19481227 <GO>}

Maybe just quickly on the Panasonic piece they continue to be an excellent partner in the project, and I think you've seen probably in the recent months additional statements from them with ongoing capital commitments to the project. As planned, those are kind of happening in the right sequence. They've also started hiring for the project, and training people. So, things are going as well as we can hope there.

Q - Ryan J. Brinkman {BIO 16417954 <GO>}

Perfect. Thanks.

Operator

Thank you. Our next question comes from Ben Kallo of Robert W. Baird. Your line is open.

Q - Tyler Charles Frank {BIO 20108167 <GO>}

Hi guys. This is Tyler Frank on for Ben. Can you comment on the overall expectations for deliveries throughout the year? If we back out (55:16), looks like about (55:20) Q2 through Q4, which seems like you should be there with production given the Model X expectations and the Model S production expectations as well?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yes, like I said, I know you'd love to have sort of more granularity, but it's difficult for us to give you granularity that we ourselves don't have, that's excessive precision. I don't want to give false precision.

We feel good about, like, the overall number, but it might be around as to how it gets to that overall number. And there's always unforeseen things that occur. So, that's why we kind of need some flexibility that we don't provide false precision, and then people hold us to false precision.

Q - Tyler Charles Frank {BIO 20108167 <GO>}

Okay. Thank you. And then can you comment on what you're seeing for overall demand in the China market. And then what markets do you expect to move into next, which you (56:32)? And how that ramp will go?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, China is not a huge market for us and hasn't been historically. It is something we expect in the long-term will be a big market, and ultimately probably our biggest market. So I think there's a lot of long-term opportunity there. So, it's difficult to say what's going to happen with China in the short term, except that it doesn't really have a big effect on Tesla yet. I mean, long-term it will be.

In terms of new markets, I'm really excited to launch in Mexico this year. I'll be heading out to Mexico City. And I think there's actually quite a bit of opportunity there, and some of our customers - we actually do have customers in Mexico already, but having a significant presence there I think is going to be great. And so, our most supportive customers are actually in Mexico.

Q - Tyler Charles Frank {BIO 20108167 <GO>}

Okay. Then, a quick follow-up. There's been some rumors and commentary that the Model 3 launch may not be an actual full vehicle. Can you just talk about what we should expect at the launch event and at the end of March?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, we're trying to decide whether we should show all the cards or keep a few cards close to the vest, I haven't made decision yet.

Q - Tyler Charles Frank {BIO 20108167 <GO>}

Great. Thank you.

Operator

Thank you. Our next question comes from Rod Lache of Deutsche Bank. You question, please.

Q - Rod A. Lache {BIO 1528384 <GO>}

Hi, everybody. You commented earlier, Elon, on the Model S versus the Model X demanding personal preference on passenger car versus SUV. And I was just wondering if you have any thoughts on whether Model S demand would or could be affected once the Model 3 is revealed? Do you think that those vehicles ultimately go to different customers, or is there a plan to avoid cannibalization there?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I mean, I think there are different market segments. (59:02) BMW 7 Series and BMW 5 Series and BMW 6 Series, they're a different market segment from the Model 3 series.

You should think of the Model 3 as sort of really competing in kind of the BMW 3 Series or Audi A4 market. And so, if you want this sort of opulent machine, you'd really want to get the Model S. The Model 3 will be a great car.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, maybe also just as an anecdote. There was a lot of concern when we launched the Model X about cannibalization of Model S demand. And we actually saw just the opposite, which was the increased interest and awareness and just customer engagement actually drove higher Model S sales even as the Model X was launched. And those are actually much closer in terms of vehicle capability as we just talked about.

Q - Rod A. Lache {BIO 1528384 <GO>}

Yeah, yeah. It makes sense. And I was hoping just on the financial side, can you give us just a little bit of a sense of how challenging it will be to get to that 25% Model X gross margin? And can you comment at all on how you're expecting for the overall company gross margins would look this year? Are you expecting them to be able to stay above 25%, even with the Model X ramping?

A - Jason Wheeler {BIO 19481227 <GO>}

Sure. So, as we said in the letter, 25% by the end of the year for Model X. I'm sorry. I'm a little under the weather. And 30% for the Model S. So, you can do the math on what the blended rate will look like.

In terms of getting to 25% for Model X, we have to think about it is, we've got many years of history with the Model S right now, and that is learning that can certainly be applied to what we're doing with Model X. So, we're comfortable that we're going to be able to drive gross margin in the right direction with Model X significantly throughout the year.

A - Elon Reeve Musk {BIO 1954518 <GO>}

In the long run, we expect the gross margins of Model S and Model X to converge around the 30% number. They should, in the long run, both be around 30%. That's our target. It's just, as Jason was saying because the Model X is a newer vehicle, we're just earlier in the learning curve for the Model X than the Model S.

Q - Rod A. Lache {BIO 1528384 <GO>}

Okay. It sounds like it's not - you're benefiting from some learning curves, so the margins even initially could be okay north of the 20% range? Is that a reasonable expectation, then kind of ramping up to the level? Or is it a more challenging kind of ramp?

A - Elon Reeve Musk {BIO 1954518 <GO>}

I mean, I really look at where does it end up, as opposed to what happens in the very near term. And it's hard for us to predict exactly where it is in the near term. Just think of that sort of S-Curve and say like, where are you on the S-Curve? If you have a rapidly changing slope on a curve, it's really hard to say, okay, let's pick a date, because you could move that date by a week and have a huge difference.

Q - Rod A. Lache {BIO 1528384 <GO>}

Right.

A - Elon Reeve Musk {BIO 1954518 <GO>}

That's why it's hard for us to give you an exact number, but we kind of know where the S-Curve will end up. (62:35) then it gets much more predictable.

Q - Rod A. Lache {BIO 1528384 <GO>}

Okay. Great. Thank you.

Operator

Thank you. Our next question comes from Dana Hull of Bloomberg News. Your line is open.

Q - Dana Hull {BIO 18985841 <GO>}

Yeah. Hi. Thanks so much. So, as you think out four years to five years to 2020, when you want to produce 500,000 cars each year, can you get there without building another assembly plant or a second Gigafactory?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yes. Specifically, the Freon plant historically has produced almost 500,000 cars a year. So, whether it was at GM – sir, we can hear your keys quite loudly. When it was Toyota or GM plant, it produced almost 500,000 cars a year. We're comfortable that it can get back to that level. And then the Gigafactory is designed to support 500,000 cars a year with batteries plus have 15 gigawatt hours left over for stationary storage.

Q - Dana Hull {BIO 18985841 <GO>}

Okay. So, no need for a second Gigafactory (63:49)?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Correct, no need for a Gigafactory. Correct.

Q - Dana Hull {BIO 18985841 <GO>}

And then for Jason, the shareholder letter says you plan to open about 80 retail locations and service centers and energize about 300 new supercharger locations. Can you give us some commentary on where exactly those new service centers and retail locations might be? Is it mostly the Northeast of the U.S., or also globally?

A - Jason Wheeler {BIO 19481227 <GO>}

I think the general theme is two-pronged. We're densifying in markets where we already exist, and where demand has increased significantly, we've got to put service centers, and we try to actually predict ahead of that where we're going to need those.

But as Elon referenced, we're opening new markets this year. But I think in general, we're going deeper in markets where we are. And in addition, we're opening a significant number of stores in China and in the Northeast of the U.S. as we increase our awareness and our share in those markets. But, you'll see service centers and retail locations opening across all of our markets, including Europe.

A - Jeffrey K. Evanson {BIO 1535168 <GO>}

All right, why don't we go to the next questioner?

Operator

Thank you. Our next question comes from Mike Ramsey of The Wall Street Journal. Your line is open.

Q - Mike Ramsey {BIO 17642171 <GO>}

Hi. I was hoping maybe you could give me an encapsulating feeling on the quarter. It's sort of a mixed bag from an outsider's perspective. The losses were pretty high and maybe higher than what people expected; but you're giving a very aggressive forecast. Do you feel like the company is on the right track, and that you're past some of your hiccups? I guess I'm looking for a 40,000-foot analysis?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. I feel very good about things right now. I mean, it was - the last several months have been quite excruciating, I'd say. I mean, many late nights and weekends. But I think we're through the worst of it at this point.

Q - Mike Ramsey {BIO 17642171 <GO>}

Okay. And I had wanted to ask a little bit about also your plans for consolidation. Dana asked about whether the Gigafactory could handle the Model 3. I'm curious, I haven't been there. There's so many folks working over there now that aren't even building cars. You have engineers and stuff there. Can you give me a little idea about whether and when you might have to think about consolidating your operations in the Bay area? Excuse me. I'm a little under the weather as well.

A - Elon Reeve Musk {BIO 1954518 <GO>}

I'm not sure what you mean by consolidating. We are kind of spread out because, in addition to the Fremont factory complex and our headquarters in Palo Alto, we do have a number of other facilities in the Bay area. But man, I'm not sure how we'd consolidate.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah.

A - Elon Reeve Musk {BIO 1954518 <GO>}

We'd have to build a real big facility for that.

Q - Mike Ramsey {BIO 17642171 <GO>}

So you might just keep taking over buildings all around? Okay. All right. Thanks a lot, appreciate it.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I think [indiscernible (67:05) 7 million square feet of real estate at this point around the Bay area.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Something like that.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah, and we've seen the Gigafactory actually being a kind of helpful pressure outlet for some things in the Bay area.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Plus expansion in the Lathrop-Stockton area.

A - Jason Wheeler {BIO 19481227 <GO>}

Yeah. (67:24).

Q - Mike Ramsey {BIO 17642171 <GO>}

Yeah.

A - Jeffrey K. Evanson {BIO 1535168 <GO>}

All right, Latif. Next question, please?

Operator

Yes, sir. Our next question comes from Dee-Ann Durbin of Associated Press. Your line is open.

Q - Dee-Ann Durbin

Hi, thanks for taking the call. Considering now that the Chevy Volt is going to go on sale at the end of this year, so that'll be a full year that it's on sale before Model 3 arrives, I mean, has it taken any wind out of your sales, and/or do you think, again, that these are very different customers? If you're comparing to an Audi A4, for example, are people still going to be attracted to the Model 3 even though they'll have that option on the market quite a while before the Model 3 arrives?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Well, I mean, I would sort of point you to the market share of large luxury vehicles, or large premium sedan sales in the U.S. that I talked about earlier on the call. We're currently outsell everyone in that category. And had a 51% market growth last year, where everyone else declined, and the market as a whole declined. So, I mean, if Model 3 is at all similar in its market segment, it doesn't seem like we're going to be demand constrained.

Q - Dee-Ann Durbin

Okay. And I know you don't do any marketing, but I'm wondering if you would ever possibly reconsider that. It struck me when you were saying that you aren't where

you could be on the East Coast, and that may be because people need some more educating about how the car performs in the snow or whatever. Do you think there's ever a point at which you might reconsider and do some very targeted marketing in places where you think you could do better?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. I don't think it's in the near – I don't think we'll do that in the near-term; but in the long-term, I think I could see us doing advertising where that advertising was interesting, entertaining, and people don't regret seeing it, which unfortunately is not the case for most advertising. So, if there's sort of something interesting and artistic, or it's like you – it's entertaining, it's like – wouldn't waste people's time if they saw it.

And also, I think we need to have a more affordable high-volume car before that makes sense, like the Model 3, so that it's more accessible. So, if we do mass media, then it's more likely that somebody could buy the car. And that's kind of when it would be something we'd consider.

Q - Dee-Ann Durbin

Okay. Thank you very much.

A - Elon Reeve Musk {BIO 1954518 <GO>}

All right.

Operator

Thank you. Our next question comes from the line of Phil LeBeau of CNBC. Your line is open.

Q - Phil LeBeau

Thank you. Elon, I'm curious if you are noticing any impact in terms of reservations, orders, in terms of the market volatility that we're seeing, the growing questions about instability in our economy, elsewhere, fall off in the wealth effect, if you will, are you guys noticing any slowdown in the pace of orders?

A - Elon Reeve Musk {BIO 1954518 <GO>}

Jon, do you want to?

A - Jonathan McNeill {BIO 4091220 <GO>}

Yeah, I think, Phil, it's a great question. And actually the answer is no, the demand is very strong. We're up significantly over 2014 in the same period, and for both Model S and Model X. Both the order rate on Model S and the conversion rate orders on Model X has been very strong, and we're not seeing that impact at this point in time across really all of our markets, both domestic and international.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I mean, that said, we don't want to be complacent about demand generation. And, as we mentioned, there's a bunch of stores opening in markets where we really haven't had a store or any kind of meaningful store. I mean, our store in Manhattan, you basically need to be Sherlock Holmes to find it. So, unless you hunt us down, you won't find the store.

I think we obviously need to change that, and put stores where people are likely to encounter them. It's kind of like a fishing boat or something. It's like you want to be where the fish are, it's like not in terms of random, barren location. So, that's kind of what we're doing. So, we're not complacent about demand, and just in case, we see things take a turn for the worse, we want to overshoot on demand generation by our stores.

Q - Phil LeBeau

Thank you.

A - Jeffrey K. Evanson {BIO 1535168 <GO>}

All right, everyone, that concludes the Q&A session of the call. Thank you so much for joining us today, and we look forward to seeing you all in the future.

A - Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, thanks, everyone.

Operator

Ladies and gentlemen, you may disconnect your lines at this time. That does conclude your call. Have a great day.

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