

## Q4 2013 Earnings Call

### Company Participants

- Deepak Ahuja, CFO
- Elon Musk, Chairman & CEO
- Jeff Evanson, VP, Global IR

### Other Participants

- Adam Jonas, Analyst, Morgan Stanley
- Agidi Sagari, Analyst, FBR Capital Markets
- Andrea James, Analyst, Dougherty & Company
- Ben Kallo, Analyst, Robert W. Baird & Co.
- Brian Johnson, Analyst, Barclays Capital
- Colin Rusch, Analyst, Northland Capital
- Craig Irwin, Analyst, Wedbush Securities
- Dan Galves, Analyst, Deutsche Bank
- Elaine Kwei, Analyst, Jefferies & Co.
- James Albertine, Analyst, Stifel Nicolaus
- John Lovallo, Analyst, BofA Merrill Lynch
- Patrick Archambault, Analyst, Goldman Sachs
- Ryan Brinkman, Analyst, JPMorgan

### Presentation

#### Operator

Good day, ladies and gentlemen. Welcome to the Tesla Motors Fourth Quarter 2013 financial results Q&A call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. I would now like to turn the call over to your host. Jeff Evanson, please go ahead.

#### Jeff Evanson {BIO 17513488 <GO>}

Thank you, Patrick. Good afternoon, everyone; and welcome to our Fourth Quarter financial results Q&A webcast. I'm joined today by Elon Musk, Tesla's Chairman and CEO, and Deepak Ahuja, Tesla's Chief Financial Officer.

We announced the financial results of our Fourth Quarter and full-year 2013 results shortly after the close of trading today. The shareholder letter, financial results and

webcast of this Q&A session are all available at our Investor Relations website, at [ir.teslamotors.com](http://ir.teslamotors.com). A replay of this webcast will be available at the same site later today.

Please note that certain financial measures that we use on the call, such as revenue and income, are expressed on a non-GAAP basis and have been adjusted to exclude the effect of lease accounting on Model S sales and charges related to stock option compensation. Our GAAP results and reconciliations of non-GAAP to GAAP measures can be found in our earnings release.

During the course of this call, we may discuss our business outlook and make forward-looking statements. Such statements are predictions based on management's 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 SEC filings.

We'd ask you all to log in now for questions. So please press star-one on your phones. And with that, Patrick, let's turn it over to the first question.

Actually, before we do that, I do want to say, if you could please limit your questions to one question and one follow-up, we do want to try to end this call in about 45 minutes. All right, Patrick, let's have the first question, please.

## Questions And Answers

### Operator

Our first question comes from Adam Jonas with Morgan Stanley. Your line is open.

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

All right. Thanks, everybody. Elon, the stock price and results have been obviously performing very well lately.

You've got some great investment opportunities and some growth opportunities ahead of you, not only in the auto business, but also in the non-auto business == in the battery business. So I'm just wondering how you're thinking about being opportunistic and pulling in some fresh capital to help derisk the plan, plan for a force majeure, or to see some of these opportunities that you have. Thank you.

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

Yes, I think that's a good idea. I would agree with that. I think that would be the smart move.

We can talk more about that next week with -- and also discuss the giga factory plans. Unfortunately, I can't say anything right now --

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

As a follow-up to that --

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

-- except that I think your advice is good.

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

Okay. I don't want to (inaudible) here or anything, but as a follow-up to that, I guess, is would a capital raising be a prerequisite to launch the giga factory? Or is that an understatement?

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

I think it's necessary to have it occur in three years. It's not necessary, if we allow that time frame to expand.

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

That's very clear. Thanks, Elon.

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

All right. You're welcome.

**A - Jeff Evanson** {BIO 17513488 <GO>}

Thanks, Adam. Next question.

**Operator**

Next question comes from John Lovallo with Bank of America Merrill Lynch. Your line is open.

**Q - John Lovallo** {BIO 22386768 <GO>}

Hello, guys. Thanks very much for taking the call.

First question would be, Deepak, just on your outlook for free cash flow in 2014 and maybe in 2015, given the requisite investment that's going to go into the business. How are you guys thinking about that?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

I think in 2014 we certainly expect to generate significant cash flow from operations. And our CapEx then which then feeds into free cash flow will depend quite a bit how we continue to expand and what opportunities we see globally throughout the rest of the year. So it's a bit early for me to call and give you clear guidance for certainly

2015 and potentially all of 2014, but we certainly see this as really a great year for growth, as we look forward.

**Q - John Lovallo** {BIO 22386768 <GO>}

Okay. Thank you. That's very helpful.

If I could just follow up with you, Deepak, just thinking longer term, what do you think is an achievable kind of mid-term or long-term EBIT margin? Taking gross margin aside, how are you thinking about just from an operating profit, longer term?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

I think we have in the past, even since the time of our IPO, indicated that our long-term target is to get to an operating margin which is in the teens -- low to mid-teens. And I think that is still what our long-term goal is, to get there, as we continue to grow the business.

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

Yes. And we should emphasize that we expect the reinvestment opportunities to be very significant for a long time. So our actual profitability will be quite a bit less than that.

**Q - John Lovallo** {BIO 22386768 <GO>}

Right.

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

But if we were to sort of level out the business at any given point, I think something like the mid-teens type of number is very achievable.

**Q - John Lovallo** {BIO 22386768 <GO>}

Exactly.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

And that's how we've always communicated.

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

Right. Right.

**Q - John Lovallo** {BIO 22386768 <GO>}

Okay, guys. Thank you.

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

I mean, the car business is truly staggeringly big. It's over \$2 trillion a year in new car sales. That's just new car sales. That's not even taking into account servicing and used car sales and accessories and all the other things. So there's just a pretty big ramp ahead in terms of reinvestment.

**Q - John Lovallo** {BIO 22386768 <GO>}

Got it. That's helpful. I'm going to try to sneak one more in here. Jeff, I apologize.

But in terms of distribution licenses in China, from what we understand, they're pretty difficult to obtain, particularly without a local partner. How are you guys able to deal with this issue?

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

Actually, sales and service is not a problem in China. It's more local manufacturing, where there's an expectation that you partner with a local entity. And since we're really just at the early stages of -- very early stages of selling cars in China, and we're very far away from -- very far by Tesla's time frame standards -- away from manufacturing in China. But we do expect that in the long term -- at least for the short to medium term, there's not a need for a local partner.

**Q - John Lovallo** {BIO 22386768 <GO>}

Okay. Thank you very much, guys.

**A - Jeff Evanson** {BIO 17513488 <GO>}

All right, John. Patrick, let's have the next question, please.

**Operator**

The next question comes from Brian Johnson with Barclays. Your line is open.

**Q - Brian Johnson** {BIO 7256455 <GO>}

Yes. Good afternoon. Just want to look at the line of what you used to call reservations and now you call customer deposits, went from 140 to 163, last year 138 and they've been churning in the 130s.

Can we infer from that -- should we be inferring a unit order uptake? Or is it more mix of the reservations and the currencies and the products that people put down there to make orders -- deposits, not reservations -- for?

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

I think the biggest thing we can attribute that sort of growth to is that the Model X demand is very high. The number of -- obviously, we don't disclose that. But even though there's zero marketing for the Model X, essentially, if you were going fishing, it's like the fish are jumping in the boat. We're not actually trying to sell the Model X

at all, but the demand seems to be remarkably high; and we're seeing a steady accumulation of Model X deposits.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Which is on top of our ongoing Model S deposits coming, so that draws the overall part.

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

Yes.

**Q - Brian Johnson** {BIO 7256455 <GO>}

So if you look at your new guide for 35K units for 2014 and shared the comment a fair chunk of that will be in China and Europe. Just where it is, just directionally where does the order book stand in those geographies? What's trending better than you might have expected, and where do you still need some marketing or education work?

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

Well I think there's probably work to do in a number of locations in Europe. Mostly because we still have to sort out a number of charging issues. Because even though the EU is sort of one market economically, it's certainly not one market from an electricity standpoint. So we're sorting through a number of charging issues over there.

And I think that's slowing down our (inaudible) in Europe temporarily. But I feel confident about addressing those very near-term. And I expect that sales will pick up quite a bit over in Europe.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

At the same time, we see very good demand in China and in the emerging (vie) and drive markets.

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

Yes. Absolutely. Yes, I mean, it's -- based on current trends, it seems unlikely that we'll be able to satisfy demand in China this year. So there will be unmet-- likely to be, I think, unmet demand in China this year.

**Q - Brian Johnson** {BIO 7256455 <GO>}

Okay. Thanks.

**Operator**

Our next question comes from Ryan Brinkman with JPMorgan. Your line is open.

**Q - Ryan Brinkman** {BIO 16417954 <GO>}

Hello. Thanks for taking my question. Congrats on the quarter.

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

Thanks.

**Q - Ryan Brinkman** {BIO 16417954 <GO>}

I see that you're guiding to strong 28% gross margins by 4Q this year. Can you talk about some of the drivers of that margin expansion? Is it is more leverage of fixed COGS than higher revenue, or is it still the case that you're realizing significant supplier purchase price reductions as your volume ramps?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Yes. It's all of that. We are also continuing to make design improvements for the product, which is also helping us. And clearly, as we expand production, our suppliers see economies of scale and so do we.

In addition, there is efficiency, as we continue to stabilize and mature our production processes. So all of that, we feel, is a contributor to getting to that gross margin improvement.

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

It's not a huge difference from 25 to 28, and I think we can arguably achieve that just by scaling up. So in fact, the 28 number is assuming that the take rate of options decreases slightly. So we're not planning on lowering the price of the car.

But as we reach the broader market, the option uptake, for example, people ordering, say, performance-plus, we expect will decrease. And there will be more orders of the more affordable version of the car. So the 28% is assuming a lower average price because of lower option take.

**Q - Ryan Brinkman** {BIO 16417954 <GO>}

Great. Thanks. Then just last question in China.

There's been a lot of talk of government incentives there to spur clean vehicle sales to try to improve the air quality. Have you been able to determine whether or not Tesla can be eligible for these types of subsidies?

Then separate to that, I'm just curious what kind of volume assumptions do you have in China baked into that 35,000 delivery number? And what do you think China could do for you, over time?

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

I don't think we want to break out the exact market percentages. And I think it's difficult for us to estimate them with precision. Except that it appears that based on demand, since we announced pricing in China, that it seems unlikely that we'll be able to get everyone a car this year.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

And in terms of the incentives, we are talking to the authorities and we're working to see how the Model S can be included. Clearly, the initial round was -- or the expectation was this only applies to local manufacturers. But that is something we're working to include Model S in that list.

**Q - Ryan Brinkman** {BIO 16417954 <GO>}

Okay. Great. Thanks. Congrats again on the quarter.

**Operator**

Our next question comes from Andrea James with Dougherty and Company. Your line is open.

**Q - Andrea James** {BIO 6843557 <GO>}

Thanks for taking my two questions. Regarding the giga factory, are you guys prepared to say you've secured a partner yet? And can you give us a sense of what you mean by "major reduction" intact costs?

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

Well we actually expect there to be more than one partner in the factory. Obviously, Panasonic is currently our primary partner on cell production. And so a default assumption would be that Panasonic would continue to partner with us in the giga factory.

But there are also likely to be other suppliers in the factory that provide the precursor materials to the cell. So the anode and cathode materials, separator, electrolyte, that kind of thing. But I don't want talk too much about the giga factory, because we're going to talk about that next week and there's a lot of stuff to talk about, besides that, in this earnings release. Yes, so I think that we'll have to just to punt that answer and detail to next week.

**Q - Andrea James** {BIO 6843557 <GO>}

Okay. Fair enough. Then the next question, obviously, customer deposits are up 16%, so demand looks good. But I think it would be helpful if you could address the effect on demand that was caused by the vehicle fires last fall and the subsequent media firestorm regarding all that.

Then, is it measurable? What did you see?



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

Yes. So at first, we saw a significant drop in demand. And we were quite worried about it.

Then, as consumers came to understand that this was really kind of a media-driven thing and not a real danger with the car, our sales improved steadily since then. And have continued to improve since that initial news. Basically, consumers have come to understand that actually our car has a far lower propensity for fire than a gasoline car, and by reason of a half order of magnitude.

And so, yes, as consumers became aware of that, their fears have subsided. I think it's great that we live in an era where there's the internet and social media. So that when something is -- when the fans are flamed, literally, by the media, there is at least a path for consumers to understand what is really going on. I think in the absence of social media, I'm not sure we would have been able to correct the misperception.

**Q - Andrea James** {BIO 6843557 <GO>}

Do you need the NHTSA report then to come out then, or do you think it will have no effect when it does? I'm assuming it will clear the car completely.

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

We anticipate a positive result. And I think it will certainly help some number of people out there.

And it's worth noting that we've been cleared by the regulatory agencies in every other country, so Germany, Britain, Japan, China, everyone else. So it's actually just the US regulatory authorities are the lone holdout, at this point. But we've provided NHTSA with all the information that they've requested, and we're awaiting a decision from them, which hopefully would come soon. And yes, probably helpful to some number of consumers out there.

**Q - Andrea James** {BIO 6843557 <GO>}

Thank you, so much.

**Operator**

Our next question comes from Elaine Kwei with Jefferies. Your line is open.

**Q - Elaine Kwei** {BIO 16515027 <GO>}

Yes, hello. Thanks for taking my question.

First, on the production guidance for ending the year at 1,000-car-a-week rate. That sounds like it's two lines going full-time at roughly a 20,000-a-year type of rate, and

a pretty good step-up from, I think, some of the previous guidance. Could you help shed some light on what's getting you there? And is that pretty much where you'd be maxing out?

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

So we are constructing a new line in the factory. So it's a little -- the full answer is a little complex, because there are many pieces that go into making a Model S, some of which are production constrained and some of which are not. So to get to the sort of height, the sort of 1,000-plus production rate, we do need a sort of a new final assembly line, which we're in the process of constructing. Then we'll transition the final assembly to that, hopefully around the end of the Third Quarter, or thereabouts.

Then there's sort of separately a body construction line, which is where you create the body and welded assembly, welded and bonded assembly, that's also taking place. That's not needed to achieve the production rate, but will help with production efficiency. And will also be where the Model X is built. It will be a sort of a next-generation body assembly facility for the X, and then the S. So I'm not sure -- it's quite -- it would be quite a long answer to give you the full story, but that's -- maybe those are the highlights.

**Q - Elaine Kwei** {BIO 16515027 <GO>}

Sure. That's really helpful.

And with that 1,000-a-week with the new final assembly line, is that, with that I assume that's not with that maxed out? And that's sort of using part of the capacity, and then there would be additional capacity beyond that, once the construction is completed. Would that be fair to assume?

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

It's fair to assume that we would be able to go to higher numbers, if the demand is there to -- yes, yes.

**Q - Elaine Kwei** {BIO 16515027 <GO>}

Okay. Thank you very much, Elon.

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

All right.

**Operator**

Our next question comes from Ben Kallo with Robert Baird. Your line is open.

**Q - Ben Kallo** {BIO 16897436 <GO>}

Hello, Elon. Hello, Deepak. Hello, Jeff.

Just building on Elaine's question, you said if demand's there, can you just talk about the evolution of what you see in demand if you look back a year ago and where you think it could be two years from now, in 2016, just for the S? Then if you could loop that in with your production expansion and where that could get you with the two different factors that you mentioned to answer Elaine 's question?

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

It's difficult to predict where the demand really settles out with the S. But I can say, in relative terms, it appears that the X will see at least as much demand as the S. And if I was to guess -- I mean, it's just a guess -- I think the X demand may exceed the S demand.

This is very speculative. Don't hold me to it. But that's my best guess. I think X demand will exceed S demand.

And as far as S demand, of course, there are a lot of factors here, because it's not just demand for the S, but let's say the world were to go into a recession in 2016. It's difficult to say what the gas demand, how would we be affected and that kind of thing. So then you start to encounter macro factors.

But it seems like -- it seems pretty likely that we could sustain demand of around 1,000 units a week. That's my best guess for the S.

**Q - Ben Kallo** {BIO 16897436 <GO>}

Okay. Great. And I'm going to ask on the giga factory, try my best here.

You talked about partners, really supply partners. Should we expect also, I guess people that would use the cells, so customer off-takes or partners in that aspect of people that would use lithium ion batteries, in the announcement?

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

Yes. It's tempting to get into the giga factory stuff. But I could have the whole call talking about that, and we're going to have more of a dedicated call next week to talk about it. But I think that the giga factory would absorb all of the sales produced and that we would probably even need to bring in cells from other factories from around the world.

**Q - Ben Kallo** {BIO 16897436 <GO>}

Okay. Fair enough. Then, just housekeeping for Deepak.

Q1, as we flex it, we're right on the verge of profitability. How should we think about that and your guys' goal for Q1?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Sorry, could you clarify that further?

**Q - Ben Kallo** {BIO 16897436 <GO>}

If I flex the numbers in Q1 and what you said operating expenses and then your deliveries, I can be on the verge of being profitable or not profitable. So how are you guys leaning in that aspect as we model Q1?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

I see. We definitely should be profitable on a non-GAAP basis, even in Q1.

**Q - Ben Kallo** {BIO 16897436 <GO>}

Great. Thank you very much, guys. Great quarter.

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

I do want to emphasize something that, it would be -- we could have tried to aim for a higher delivery number in Q1. If we were to kind of gain deliveries and not try to sort of be a bit of a contortionist and enter the vehicles in transit. But I made a decision that we shouldn't try to do that, and we should just try to produce cars in the right way for the various markets.

And so our actual revenue number for Q1 is going to be less than it would be if we did try to play all sorts of games with delivery, delivery between domestic and international markets. So I think that it's the right decision for the long term, but it means that our Q1 actual recognized revenue will be lower than it might otherwise be.

**A - Jeff Evanson** {BIO 17513488 <GO>}

Patrick, we're ready for the next question.

**Operator**

The next question comes from Dan Galves with Deutsche Bank. Your line is open.

**Q - Dan Galves** {BIO 16540648 <GO>}

Good afternoon. Thanks for taking my questions.

Just thinking about your comment on 1,000 per week Model S's, and putting that together with your comment that Europe and Asia could be about double the US deliveries by Q4 this year. I guess if you think about 12,000 units like something approximately for Q4, four, four and four between the three markets, is that where you're seeing US demand now? Is that where you think it will settle out? Or is that basically trying to kind of balance getting vehicles to each region?

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

Yes, I sort of answered this question earlier. It's very difficult to predict with precision the exact division of sales.

Actually, the best fidelity that we can forecast right now is really that we think non-North American sales will be about twice the size of American sales, roughly speaking. This is not to say it will be exactly twice the size, but it's roughly. And -- yes -- yes.

**Q - Dan Galves** {BIO 16540648 <GO>}

Okay.

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

And I mean, something we try to do is to try to balance customer wait times. Because, for example, like last quarter, we actually did quite a few European deliveries, because customers in Europe had been waiting for a really long time to receive their car. And so we just had to balance that with slowing down US deliveries and try to make people as happy as possible, given the production constraints.

**Q - Dan Galves** {BIO 16540648 <GO>}

I imagine that's a difficult task. The second question is related to China charging. What's your view on -- in the US, most people are just charging at their home.

Is that a viable option, based on where Chinese consumers are living? What is an option for a Chinese consumer that may live in an apartment building, and how much work have you guys done on that?

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

We're working pretty hard on that and we believe we've got some good solutions. We're going to talk more about that in the coming months.

**Q - Dan Galves** {BIO 16540648 <GO>}

Okay. Thank you.

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

We're going to make sure that that's not a limitation.

**Q - Dan Galves** {BIO 16540648 <GO>}

Okay. Great. Thank you.

**Operator**

Our next question comes from Patrick Archambault with Goldman Sachs. Your line is open.

**Q - Patrick Archambault** {BIO 4638109 <GO>}

Great. Thank you. Just a couple from me, maybe starting with OpEx.

Deepak, you said that OpEx is, I believe, up 15% Q1, and I think increasing thereafter, based on the investments. And can we put some parameters around that? Is there still, as we think about, operating profit, is there still some leverage, some ability to leverage OpEx? Or is investment costs next year really kind of offsetting this -- this fixed cost component for now?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

We're very mindful of OpEx. We continue with our culture of being frugal, but investing where it makes sense for the business. So I think it's a bit early or premature for me to give you sort of longer-term guidance beyond Q1. But our approach really is to be focused in the most cost efficient manner to achieve our growth.

And also trying, over time, bring our percentage -- our OpEx percentage of revenue down and contribute to the bottom line. So I think that's the longer-term trend that you will continue to see.

**Q - Patrick Archambault** {BIO 4638109 <GO>}

Okay. Just, I guess, one quick housekeeping one for me. I don't know if I missed it, but did you give the US/international split on the 6,829 Fourth Quarter and 22,000 and change for the full year, in terms of deliveries?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

No. We didn't provide that. We haven't done that in the past. And we have -- for Europe, more than -- I think -- I would just put it this way, most of the growth that came in Q4 is from Europe, though US and North America continued at the same pace as Q3. I think that's the more relevant information.

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

Q3 to Q4, US deliveries were very similar, but the increment went to Europe.

**Q - Patrick Archambault** {BIO 4638109 <GO>}

Can I squeeze one last one in? It sounds like your expectations for the X are perhaps higher than many of us had thought. How can we, from a profitability standpoint, how can we think about the accretion of that platform?

It sounds like the volume's going to be pretty high. You're leveraging infrastructure that's in already. Presumably, there's things you've learned in the manufacturing process of the S that you can apply, and that your suppliers have learned, as well. So how should we think about that as kind of a tailwind or impact on the overall mix?

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

I'm not sure I totally understand the question, but --

**Q - Patrick Archambault** {BIO 4638109 <GO>}

I can rephrase it. It's just that you're launching a new vehicle having garnered considerable efficiencies and learnings through the process of the S. And presumably also, your suppliers have done, as well. So in addition to just the leverage, is there kind of a margin tailwind that you can expect just from launching the X and having applied all the stuff that you've learned in the process of developing the S?

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

Okay. So basically, do we expect gross margins to be higher with the X, and maybe flowing back into the S, as well?

**Q - Patrick Archambault** {BIO 4638109 <GO>}

Yes. That would be -- and I'm not talking about just on a fixed cost. I'm talking more on a variable cost basis, actually.

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

Right. You know, there could be. Although, as I said, we do expect the option take rate to reduce, so that's why we're being, we're saying 28% gross margin. But if the option take rate doesn't reduce, obviously it will be higher than that.

**Q - Patrick Archambault** {BIO 4638109 <GO>}

Okay. Then what about, like I know we're looking out to 2015 for when the X is going to be -- well, in launch mode and have some volume on it. But from -- is there some kind of mix tail wind to be garnered just from the launch of that product, just applying, again, all of the efficiencies that you've learned and supply relationships. And all those benefits that you've accrued through the launch process of the S?

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

I'm sure there will be efficiencies, yes. We don't want to predict something better than a 28% gross margin, but I think there probably will be efficiencies. It seems likely.

**A - Jeff Evanson** {BIO 17513488 <GO>}

All right. Pat, we've got to get on to the next question, please.

**Operator**

Our next question comes from Colin Rusch with Northland Capital. Your line is open.

**Q - Colin Rusch** {BIO 15823117 <GO>}

Thanks so much. Can you guys give us an update on the tack time that you're seeing right now, and the transition towards running two full shifts? How do you see that playing out, just in terms of hiring and how many people are you going to have to add to do that?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Colin, so just to clarify, we are running a two-shift operation in one of our factories. And again, the factory is very complex, as Elon said, in different shops, run under different operating patterns, and there is no single tack time, per se, that we can share with you. Our focus is just to continue to improve efficiencies.

Then, through the significant ramp-up in the second half will come, as Elon indicated, with the move to the new final assembly line and the body construction line. So I think there are broader factors which help us get there. And tell me if I'm answering your question satisfactorily?

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

And you would need to add a ton of people to achieve the 1,000 car per week rate? Is that what you're asking?

**Q - Colin Rusch** {BIO 15823117 <GO>}

No. More what I'm thinking about is standardization and the leverage that you guys are going to get off of the process improvement. It seems like you've done an awful lot of prep work, in terms of setting a foundation for the process. and then are making ongoing improvements to that and then potentially locking in processes that then just basically speed up, and you're going to get more leverage out of that. So that's what I'm trying to get after.

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

Yes, I think we'll be able to ramp our production rate quite a bit with a fairly small increase in hiring. So yes. Our labor efficiency, essentially, is likely to improve a lot over the course of this year.

**Q - Colin Rusch** {BIO 15823117 <GO>}

Okay. Great. I can take some of that off-line.

Can you just give us a bit of an update on the trend line for shipments into North America from 3Q into 4Q and your expectation into the First Quarter?

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Yes, I think as going from Q4 to Q1 -- sorry, or is it from Q3 to Q4? Could you clarify that?



**Q - Colin Rusch** {BIO 15823117 <GO>}

I'll have both, if you don't mind.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

I think Q4 to Q1, as we indicated in the shareholder letter, and as Elon mentioned, we are ramping up even further into Europe and China. And we could have played games and tried to shift the mix and delivered more cars in the US to hit a higher delivery number in Q1. but we decided to smoothen the flow of cars in our operational issues. And that's why you see the small reduction in Q1 deliveries and the mix shift little bit more into Europe and Asia and from a production point of view.

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

I wouldn't try to read too much into it, essentially.

**Q - Colin Rusch** {BIO 15823117 <GO>}

Great. Appreciate it.

**Operator**

Our next question comes from (Agidi Sagari) with FBR Capital. Your line is open.

**Q - Agidi Sagari**

Thank you. My first question is on China.

So currently, China is pretty unique, first of its kind. Do you expect any kind of competitive response in the market, and maybe if you could elaborate on how that pricing is translating into demand for the vehicle?

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

Well I mean, hopefully other manufacturers will adjust their pricing to not exploit Chinese consumers. I think that's the right thing for them to do, and it's what they ought to have been doing from the beginning. I don't know that they will do that, but that's what they probably should do.

And we are seeing really strong demand, which hopefully will continue. But it's been very strong since we announced pricing. And I think our bigger challenge will be trying to satisfy that demand.

**Q - Agidi Sagari**

Got it. My second question was on the Model X. So if we think about the Model X coming out with an improved power train, more capabilities, should we expect some of those improvements to be translated into the Model S also, when that gets launched?

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

Actually, I'd rather not comment too much on future Model S changes, except to say that obviously, we add features to the vehicle all the time. With every month, there's something that's been added or improved. It's sort of a continuously improved vehicle.

**Q - Agidi Sagari**

All right. Thank you. That's all I had.

**A - Jeff Evanson** {BIO 17513488 <GO>}

Thanks.

**Operator**

The next question comes from James Albertine with Stifel. Your line is open.

**Q - James Albertine** {BIO 17420845 <GO>}

Thanks for taking the question and good afternoon, everyone. Just wanted to get a sense for -- really, a clarification first -- on the commentary you made with respect to the construction you're undertaking at the facility in California. Will any of that construction be leverageable for the third generation car, or is this primarily dedicated to the X and S, at this point?

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

It's dedicated to the S and X. So the third generation vehicle -- certainly, we'll learn from those lines, but third generation vehicle will have a completely separate production process.

**Q - James Albertine** {BIO 17420845 <GO>}

Okay. Thank you for that.

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

It's geared to a higher volume -- so, yes.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

And the Fremont factory is big enough to accommodate --

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

Absolutely. I should mention that we do anticipate being able to do the third generation vehicle production in that Fremont facility. When it was owned by Toyota and General Motors, it was able to produce half a million vehicles a year. And I feel like we could get there with our vehicles, as well.

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**Q - James Albertine** {BIO 17420845 <GO>}

Understood. Then sort of a related question or follow-up.

Over the course of the next three years, you've alluded to -- and I guess we'll hear next week more about the giga factory. Obviously, that overlaps with what we had understood the expectation for the third generation timeline. Is it fair to say there's been a shift, or a reprioritization, above and beyond the third generation car that's, again, more focused on the importance and relevance of the giga factory and its contribution?

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

The giga factory is really there to support the volume of the third generation car. And yes, that's really -- so it's happening in parallel with development of the third generation car. And we want to have the vehicle engineering and tooling come to fruition at the same time as the giga factory. And yes, so it's all really part of one strategy, one combined effort.

**Q - James Albertine** {BIO 17420845 <GO>}

So there's no movement, in other words, on the expectation for a 2017 launch on that third generation?

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

No.

**Q - James Albertine** {BIO 17420845 <GO>}

Okay. Appreciate it. Thanks for taking the question. Good luck.

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

All right. Thanks.

**Operator**

Our next question comes from Craig Irwin with Wedbush Securities. Your line is open.

**Q - Craig Irwin** {BIO 6209023 <GO>}

Most of the things that I wanted to ask have already been pretty thoroughly raked through. But maybe, Elon, if you could clarify for us what you said, I think on the last call, where you discussed a preference for battery manufacturing technology with a significantly lower environmental footprint than what's conventionally used today. Are you possibly referring to maybe some of the solvent-free manufacturing approaches, or are you referring to some of the more advanced recovery systems? Maybe could you clarify for us little bit what you're referring to and what you prefer, as far as technology approach?

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

Sure. First of all, I don't think it's the case that current lithium ion production is particularly bad, environmentally. But I think if you visit, say, the Panasonic cell factories in Japan, they're super-clean, and they don't have terrible emissions or waste or anything like that.

But I think we can also take it a step further with the giga factory and have a plant that is heavily powered by renewables, wind and solar. And that has built into it the recycling capability for all battery packs. So you can really look at the whole life cycle of the battery pack and be in the best possible situation, from an environmental standpoint.

And I should point out, also, though, that lithium ion battery packs are recycled today. There's a recycling facility in Vancouver and one in Belgium, for US and Europe. And they have quite a bit of value.

So it's not as though they are sent to a landfill, even as it is. But with the giga, factory we'd like to combine the whole thing. Yes.

**Q - Craig Irwin** {BIO 6209023 <GO>}

Okay. Then one other clarification.

So your ASPs have been trending positive the last couple of quarters. You seem to be conservative about the progression in 2014. Do you expect the sequential increases in the ASPs to continue for the next couple quarters and then abate? Or when you look at your current order book, are you seeing a flattening out of the curve already?

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

It's definitely flattening out, in terms of the purchase price. Flattening out to, I'd say maybe slightly reducing, but I mean it's -- I mean it's within like a cent or two.

But we do -- I mean, I do think -- it seems like the prudent thing is to assume that there's a reduction in the option take rate as we get to more of a mainstream market and fewer people take the high-performance options on the car, which generate quite a bit of margin. So we're just trying to be conservative on this front, and maybe that -- maybe the average selling price doesn't decline, but we want to protect for a scenario where it does.

**A - Jeff Evanson** {BIO 17513488 <GO>}

Okay. Thank you very much, everyone, for joining us this afternoon. We look forward to seeing many of you in early March at the Barclays BNP Paribas Auto Conference in Geneva or on any of our upcoming investor events. Have a great day.

**A - Deepak Ahuja** {BIO 15935173 <GO>}

Thank you.

## Operator

Ladies and gentlemen, thank you for participating in today's program. This concludes the program. You may all disconnect.

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