

Q3 2018 Earnings Call - Q&A

Company Participants

- Andrej Karpathy, Director of Artificial Intelligence
- Deepak Ahuja, Chief Financial Officer
- Elon Reeve Musk, Chairman, Product Architect and Chief Executive Officer
- Jeffrey B. Straubel, Chief Technical Officer
- Laurie Shelby, Vice President, EHS
- Madan Gopal, Principal Safety Engineer
- Martin Viecha, Senior Director-Investor Relations
- Peter Bannon, Director
- Stuart Bowers, Vice President of Engineering

Other Participants

- Adam Michael Jonas, Analyst, Morgan Stanley & Co. LLC
- Antonio M. Sacconaghi, Analyst, Sanford C. Bernstein & Co. LLC
- Daniel V. Galves, Director - Automotive Equity Research, Wolfe Research, LLC
- George Galliers, Managing Director, EVERCORE ISI
- James J. Albertine, Analyst, Consumer Edge Research LLC
- Maynard Um, Senior Equity Research Analyst, Macquarie Group
- Phil LeBeau, Auto & Airline Industry Reporter, CNBC LLC
- Pierre C. Ferragu, Global Team Head, New Street Research LLP (US)
- Romit Jitendra Shah, Analyst, Nomura Instinet

MANAGEMENT DISCUSSION SECTION

Operator

Good day, ladies and gentlemen, and welcome to the Tesla Q3 2018 Financial Results and Q&A webcast. At this time, all participants are in a listen-only mode. Later, we will conduct the question-and-answer session and instructions will follow at that time. As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Mr. Martin Viecha, Senior Director of Investor Relations. Mr. Viecha, you may begin.

Martin Viecha {BIO 17153377 <GO>}

Thank you, Sherry, and good afternoon, everyone. Welcome to Tesla's third quarter 2018 Q&A webcast. I'm joined today by Elon Musk, JB Straubel, Deepak Ahuja and a

number of other executives. Our Q3 results were announced at about 1:00 PM Pacific Time in the update letter we published at the same link as this webcast.

During this call, we will discuss our business outlook and make forward-looking statements. These comments 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 filings with the SEC.

During the question-and-answer portions of today's call, please limit yourself to one question and one follow-up. But before we jump into Q&A, Elon has some opening remarks. Elon?

Elon Reeve Musk {BIO 1954518 <GO>}

Thanks, Martin. So I'll make some opening remarks, and then we're going to talk about vehicle safety, autopilot and factory safety. And we have a number of people from Tesla here to elaborate on that. I think there's just a lot going on that you would find interesting.

But I want to start by thanking all of our customers, employees and shareholders. This was an incredibly historic quarter for Tesla. Model 3 production stabilized. We delivered a total of 84,000 vehicles globally, which is more than 80% of the vehicles that we delivered in all of 2017.

In fact, we delivered more cars in this quarter than we did in all of 2016 in a single quarter. Model 3 became the best-selling car in the U.S. in terms of revenue and the fifth best-selling car in terms of volume. We saw higher revenues and significantly better profitability in our energy business. In fact, I think for solar it may have been the best quarter ever for solar.

We achieved GAAP net income of over \$300 million, increased cash and equivalents by \$731 million, and achieved a greater than 20% gross margin for Model 3. And, moreover, we expect to again have positive net income and cash flow in Q4. And I believe our aspirations I think will be for all quarters going forward.

I think we can actually be positive cash flow for all quarters going forward, leaving aside quarters where we may need to do a significant repayment; for example, in Q1 next year. But I think, even in Q1, I think we can be approximately flat in cash flow by end of quarter.

This quarter was made possible by the incredible execution of our employees across the board, from sales, production, delivery, service, energy, engineering, finance and all of our G&A teams. Really every part of the business executed incredibly well. I want to thank everyone again for your incredibly hard work. I especially want to thank customers who helped.

It's like - I've never even heard of this. Maybe this has happened before, but I've never heard of a case where a company's customers actually cared about the future of the company so much that they volunteered their time to help the company succeed. I think that's amazing. You don't see that anywhere. So, yeah, it really chokes me up actually.

This quarter, we started rolling out Version 9 of our software, which is our biggest software upgrade in two years. And Model 3 received a five-star safety rating in every category and subcategory. And it got the lowest probability of injury of any car that the U.S. government has ever tested.

Looking ahead, we expect to produce and sell even more Model 3s in Q4, and expect that trend to continue into Q1. And we're excited to bring Model 3 to Europe and China early next year, given that the market for midsize premium sedans in those regions is even larger than in North America.

I've said before that we must prove that Tesla can be sustainably profitable. This quarter was an important step towards that and I'm incredibly excited about what lies ahead. So this is, yeah - just so proud of the Tesla team, our customers. Really appreciate the support of our long-term shareholders. And I just want to say on behalf of the Tesla team, we're super appreciative of your support to what has actually been a really difficult time.

All right. Now, let's start off with the vehicle safety. Madan, who's our lead vehicle safety engineer; been with the company for a long time. Madan, how many years has it been that we've been working together?

Madan Gopal {BIO 15428791 <GO>}

It's my 10th year. 10 years.

Elon Reeve Musk {BIO 1954518 <GO>}

10 years. Wow. So, yeah, I've been working with Madan for 10 years. We've had so many conversations on vehicle safety. Wow. And you know what, we're really going to try to go the extra mile with vehicle safety, not just - like there's a series of government mandated tests, but what some companies do is they game the system. So they know where the side pole impact is going to be. They strengthen it right in that position. At Tesla, we're like, okay, what is the weakest point in the car? Let us test it at that position. So the actual safety is not fully captured in the test because we anti-game the system.

Madan, if you could?

Madan Gopal {BIO 15428791 <GO>}

Thank you, Elon. Just want to give you a very quick background about myself. Like I said, joined Tesla 10 years. I'm extremely really happy to mention working with extraordinary set of very passionate and very hard-working individuals, and that essentially shows in our product. So that's very important for us.

And also important is our principal mission statement on safety, because what we want to do is, safety has been – is probably the important factor for our vehicle. It's not just for electric vehicle; any vehicle period. And that fundamentally differentiates us, which essentially helps us to keep adding new features and new safety technology. And that's very important and that shows in Model 3; latest things that we have.

Also, the fact that we have electric vehicle, the design and architecture gives us a fundamental benefit over traditional vehicles. And that takes care of, for example, whether you have a block of engine in the front, where we can work with using pretty much open architecture in the front and the whole fact that you have all the electrical and high-voltage and motors and all of that almost below the center of gravity of the vehicle gives lowest probability to produce a lower risk. It significantly benefits.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, I think architecturally we have Newton on our side. And having Isaac Newton on your side is definitely the way to go.

Madan Gopal {BIO 15428791 <GO>}

Exactly. So in the latest series of tests, I would like to specifically talk about Model 3. Alexa did a series of tests, actually four tests, for one front door, two side and one rollover test. And if you look at it, we've been calculating how can we distinguish within the five-star. There are so many vehicles that already gets five-star. And if you look at within the five-star.

Elon Reeve Musk {BIO 1954518 <GO>}

They're just all the same. They're all the same.

Madan Gopal {BIO 15428791 <GO>}

Exactly. So if you look there, there is a metrics we came up with which is a part of US-NCAP rating itself, has the lowest probability of injury, and Model 3 has the lowest. And just to give you a context, there are total of 900-plus vehicles since 2011 which have been rated. So the fact that Model 3 is the best among all the 943, to be exact. So that speaks to volume. And I'm very happy to say that Model 3 has achieved.

We are not stopping right now. What we would like to do next is how we can make use of the active safety and autopilot features and make it even more improvement so the next area that we are focusing on how to integrate active and passive safety. That's our next area of challenge, which we will improve for sure.

Elon Reeve Musk {BIO 1954518 <GO>}

Yes. Regarding that the safety extends to not just people in the car, but also pedestrians.

Madan Gopal {BIO 15428791 <GO>}

Correct.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah. So not having a big engine block in the front of the car is really helpful simply because if the car were to hit a pedestrian - we'll get to active safety next, because the best thing is obviously not to hit a car or a pedestrian. The fact that the hood can dent so far in is really helpful, because it ends up being sort of like a trampoline, or like a - you don't have a rock underneath it. It's very helpful. So it's helpful for pedestrian safety and for the safety of the people in the car.

And then, even if you have like a head-on collision with another car, the extended sort of crumple zone of a Tesla Model S, Model X or Model 3 is helpful to the people in the Tesla and the people in the other car. So it's not just the people in the car.

Madan Gopal {BIO 15428791 <GO>}

I'd like to add one item, which is essentially how we look at real-world safety, which has always been an important for Elon. So if you look at our block post, we showed how we handle the center pole impact in the frontal. By the way, that's not part of NCAP rating. It is just to show how we go over and above the NCAP rating to make sure it's real-world safety. Yes. That's very important for us.

Elon Reeve Musk {BIO 1954518 <GO>}

Exactly. That's what I meant by we, like, anti-game the system. Like, what is the worst way that the car could be hit? Not just sort of strength where we know this test will happen and that kind of thing. So, obviously, we're all in these cars, our friends are in these cars, our families are in the car, so we care about safety. And a lot of people think safety is boring, but not Tesla.

So thanks, Madan.

Madan Gopal {BIO 15428791 <GO>}

Thank you.

Elon Reeve Musk {BIO 1954518 <GO>}

Thank you for your decade of hard work and the rest of the safety team. And with that, let's move on to autopilot. And you guys could just give an update on sort of autopilot software, AI and hardware. Yeah.

Stuart Bowers {BIO 20627575 <GO>}

That's great. This is Stuart Bowers. We will soon begin to roll out the team's most advanced autopilot feature ever, Navigate on Autopilot. In our last release, we launched a new set of neural networks that, combined together, provide a view of everything happening around the car. With Navigate on Autopilot, we'll use information to understand exactly where the car is on the highway system and to automatically change lanes, handle forks and take high-curvature exits to follow a map route.

Initially, it will require drivers to confirm lane changes using the turn signal before the car moves into an adjacent lane. Future versions will allow customers to waive the confirmation requirement if they choose to.

One area that I'm personally really excited to build on this improvement is active safety. With the advancement in neural networks covering 360 degrees of view around our car, we can provide a level of constant vigilance that humans just can't. Ultimately, this shall allow us to warn or even intervene for an enormous percentage of modern accidents and to ship these improvements as software upgrades to our existing customers.

Elon Reeve Musk {BIO 1954518 <GO>}

We see this all the time in the data, where the car will do an automatic braking event and save a pedestrian or another car from impact. This happens all the time.

Stuart Bowers {BIO 20627575 <GO>}

All the time.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, all the time. Usually, every day but very briefly.

Stuart Bowers {BIO 20627575 <GO>}

Yeah. The team has done an incredible work here. And by bringing up more of the cameras around the car, we can detect things as they come toward us, not just directly in front of us.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah.

Stuart Bowers {BIO 20627575 <GO>}

Pete?

Peter Bannon

Hi. This is Pete Bannon. The hardware 3 design is continuing to move along. Over the last quarter, we've completed a qualification of the silicon and qualification of the board. We started the manufacturing line and qualification of the manufacturing line. We've been validating the provisioning flows in the factory.

We've built test versions of Model S, Model X and Model 3 in the factory to validate all the fit and finish of the parts and all the provisioning flows. So we still have a lot of work to do, and the team's doing a great job. And we're still on track to have it ready to go by the end of Q1.

Elon Reeve Musk {BIO 1954518 <GO>}

Great. And that'll be on roughly a 1,000% increase I trust and capability compared to the current hardware. And so, it's obviously a giant improvement despite being about - it costs about the same. Cost volume and car consumption are approximately the same as the current hardware, but it's a tenfold improvement in frames per second. And improved redundancy as well.

But very important to emphasize is that the only thing that needs to change between a car that's produced today and a car that's, say, produced in the second quarter of next year is swapping out the autopilot computer. And this is a simple change that takes less than half an hour in service to upgrade the computer. And so, anyone will be able to upgrade their car to full self-driving capability with a simple service visit. So we expect all cars with the hardware to sensor suite. Basically, anything made in the last, roughly, two years will be upgradable to full self-driving.

Peter Bannon

Yes. In fact, a lot of the cars we're using for testing today have, in fact, been upgraded from hardware too.

Elon Reeve Musk {BIO 1954518 <GO>}

Right. So it's very important to emphasize, like people shouldn't wonder who would want to wait until that comes out. But there's no need to wait until that comes out because it's just a very simple plug-and-play change to get to full self-driving. And anyone who's paid for the full self-driving option will just get it done for free. And anyone who still wants to order full self-driving at this point, it's just an off-menu item. You can still order it, but we took it off the order menu just because it was creating a lot of friction in the sales process and people didn't understand the difference between enhanced autopilot and full self-driving.

So just to simplify the order process, we took that off, but anyone who asked for it can certainly get it. And it really ends up being a discount on future capability. But to be clear, there's definitely no need to wait until Q2 to order a car. We want to make it just a completely seamless process, so there's no advantage ordering now versus Q2.

Andrej, do you want to...

Andrej Karpathy {BIO 20228714 <GO>}

Yeah, absolutely. Hi, everyone. My name is Andrej Karpathy. I'm the Director of AI here at Tesla, and my team trains all of the neural networks that analyze the images streaming in from all the cameras for the autopilot. For example, these neural networks identify cars, lane lines, traffic signs and so on.

The team is incredibly excited about the upcoming upgrade for the autopilot computer, which Pete briefly talked about. This upgrade allows us to not just run the current neural networks faster, but more importantly it will allow us to deploy much larger computationally more expensive networks to the fleet.

The reason this is important is that it is a common finding in the industry – and we see this as well – is that as you make the networks bigger by adding more neurons, the accuracy of all of their predictions increases with the added capacity. So in other words, we are currently at a place where we've trained large neural networks that work very well, but we are not able to deploy them to the fleet due to computational constraints.

So all of this will change with an acceleration of the hardware and it's a massive step improvement in the compute capability. And the team is incredibly excited to get these networks out there.

Elon Reeve Musk {BIO 1954518 <GO>}

Great. Thank you. And I've said this before, but I think I was talking a bit about the kind of longer term future. We absolutely see the future as sort of a shared electric autonomy, so that you'll be able to do ride-hailing or share your car in any way, sort of long-term model that's probably some combination of like Uber, Lyft and Airbnb. In other words, there'll be Tesla-dedicated cars for ride-hailing and any customer will be able to share their car at will, just like you share your house on Airbnb.

So it's the combination of those two models, I think, is pretty obviously where things are headed long-term. The advantage that Tesla will have is that we'll have millions of cars in the field with full autonomy capability, and no one else will have that. So I think that will end up putting us in the strongest competitive position long-term.

And then, Laurie, can you finish it off with the talk about factory safety? And thank you for the hard work of you and your team, and I think we've made great strides.

And, yeah, please go ahead.

Laurie Shelby

Yes. Thanks. Yeah, we have the safest cars made by the safest people. So it's exciting time here at Tesla. All car and manufacturing factories have injuries. At Tesla, we have a commitment to zero injuries and our target is actually on good reporting. So we have good reporting of injuries, good reporting of near misses, good observation and lots of improvements. So to be the safest company in the world, we have to be committed to that; and everybody here is. So we're actually steadily getting there and we're not going to stop till we're there.

Elon Reeve Musk {BIO 1954518 <GO>}

Absolutely. So you were mentioning like, for example, we have some sort of, for example, we do get these like quite unfair accusations. For example, one of them was like that we were under-reporting injuries, and it's worth noting that OSHA completed their investigation and concluded we have not been doing anything of the sort.

Laurie Shelby

Correct. Correct. The factory here had a four-month long Cal/OSHA investigation and it basically proves that we are recording properly and doing as we should be. So it's much different than what you would read about in the press.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, this is true.

Laurie Shelby

Yeah, yeah. I'm very proud of the team for that. One point I think people don't know is, I've been here about a year now. Time flies when you're having so much fun.

Elon Reeve Musk {BIO 1954518 <GO>}

Feels like 12 years.

Laurie Shelby

I know. But when I joined, we were already really a fraction - our injury rate was a fraction of what it had been when Toyota and GM ran the factory in the newbie days. So what we're all about is really continuing to make improvements from there. And what's also important is not to have serious injuries, and that's extremely rare here at Tesla. We have really strong focus on prevention and also mitigating controls so that these types of injuries don't occur. I mean, most of the injuries that we have are muscular sprains and things like that.

Elon Reeve Musk {BIO 1954518 <GO>}

Yes. So essentially it's muscle strain and getting scratched. That's most of it.

Laurie Shelby

Exactly. Hand and finger cuts and sprains. So I kind of just want to break down a few things that my team is been working on along with all the leaders here. First, it's people engagement. So one of the first things is meeting with you, Elon. We meet with you on a regular basis. We meet with all the production leaders. So it's full on engagement on improving safety. We have built a really strong EHS team, the best and the brightest.

And our EHS team is actually embedded into the line on the factory because we learn the process and we learn the people. You don't know how to improve unless you're out there on the line, on the process, engaging with the associates, listening and learning from our associates.

So we have really strong engagement, health and safety committees. We do find it, fix it walks. Our leaders are out there walking and also looking for improvements. And actually just this quarter, we had over 15,000 improvements. I mean, that's like amazing. So very exciting about that.

We also look at risk reduction and human performance. People are going to make mistakes, so we're going to design in so we fail safely. We have an Early Symptom Intervention program. This is where we have industrial athletes go out on the line and work with our associates before anything happens. Like if you have a pain, let's work it out, let's strengthen and really get our employees fit. So we're doing that.

We've also just opened a new and improved health clinic, so when injuries do occur, we get the absolute best care for our associates. And it's actually overseen by one of California's leading orthopedic surgeons, and we did that because most of our injuries, like we said, like 80%, 85% are either sprains and strains. So now, they get that best care here on-site. And we have 24/7 care. It's actually staffed by three full-time doctors and nurses, and I'm really super happy with the care they're giving and I think the employees are as well. And the third...

Elon Reeve Musk {BIO 1954518 <GO>}

Yes, we're going to expand on that, so Tesla's sort of health clinic both at Fremont and at Giga. We have a really immediate first-class healthcare available right on the spot when people need it. And this is not just for workplace; this is for workplace and non-workplace.

Laurie Shelby

I know, that's super exciting. We're (23:03) the world.

Elon Reeve Musk {BIO 1954518 <GO>}

Yeah, if you become injured or ill for any reason, then there's healthcare immediately outside.

Laurie Shelby

That's where we plan to go. Exactly. And then, finally, just being proactive because that's what we're about, innovation and proactive. I mean, we join national safety organizations, we partner with many leading universities including California Berkeley, Center for Occupational and Environmental Health. We do presentations there. We work with the automotive industry and do benchmarking all the time. We're always looking and bringing people in to look for things that we can do better and for new technology and innovations and safety.

And with all of that, we have made improvements in our injury rates, we are more than 10% better year-over-year in our lost workdays and our days away, but the most important thing is we're also getting all those good engagement observations, they're moving up. So injuries down, observations engagement up.

Elon Reeve Musk {BIO 1954518 <GO>}

All right.

Laurie Shelby

Thank you.

Elon Reeve Musk {BIO 1954518 <GO>}

Thanks, Laurie. And we will provide regular updates on workplace safety. And our goal unequivocally is to have the safest factories in the world, where people look forward to coming to work in the morning. So it's like, yeah, that's our goal.

All right. With that, can we move to questions?

Martin Viecha {BIO 17153377 <GO>}

Cool. Well, thank you very much. And, Sherry, let's go to the first question, please.

Q&A

Operator

Thank you. Our first question comes from Dan Galves with Wolfe Research.

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

Hey. Thanks for taking my questions. Congratulations on the quarter. It's really amazing to see this landmark quarter after covering the company for so long. And thanks for bringing some of your team onto the call. It's very interesting. My question is about cell supply. There has been some noise about tight cell supply and sparks and tight labor supply. In the short-term, could you just talk about whether demand is outpacing supply of battery cells and kind of what's your plan for long-term expansion, including cell supply in China?

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

JB, do you want to take that?

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

Sure. I can speak to that. This is JB. We have had a period where the supply was fairly tight for Model 3, but it did not really constrain the Model 3 production in any significant way.

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

Well, like for a week.

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

Yeah, maybe for a few days.

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

Yeah.

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

The impact was larger felt on the energy products. And that still is somewhat tight, but we do, as we pointed out in previous discussions, we do have third-party supplies of energy cells. So that production can continue even independently of the Panasonic supply in sparks. So that's been very helpful. And that is expanding in future quarters. And also, the Panasonic supply is expanding. The productivity of existing lines is continuing to improve with a lot of hard work from the engineering teams and just operational stability. And we continue to bring online new production lines.

So even just in the last several weeks, we've started off yet another cell production line with Panasonic. And through the end of the year, there's another line coming on, and then one shortly after that. So there's a steady increase in the total supply that should keep us ahead of even Model 3 growth and also should let us have a larger percentage of energy supply be sourced from Giga, locally.

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

Yeah. We are making a pretty nutty amount of the world's lithium-ion batteries. And, Martin, I think we're about a 60% or something...

A - Martin Viecha {BIO 17153377 <GO>}

Yes. So at the moment, if you'd look at, for example, for Q3, all electric vehicles made around the world, their total battery capacity was about 20-gigawatt or 19-gigawatt hours; and what we produced in Q3 was about the same or a little bit higher. So about half of world's batteries basically.

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

Well, that's because we also saw cells from Japan and elsewhere. Is that (27:13)...

A - Martin Viecha {BIO 17153377 <GO>}

Yeah. So just the Giga itself is about 20 and on top of that S and X is, I don't know, another four or five ?

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

Got it. No, it's a huge advantage. Is there plans that you can talk about for cell supply in China? Will that be produced in China? I'm assuming so.

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

Long-term, it would be produced in China. Short-term, we are not certain of the short-term situation, but long-term certainly.

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

Got it. Okay. Thanks very much.

A - Martin Viecha {BIO 17153377 <GO>}

Thank you. Let's go to the next question, please.

Operator

Thank you. Our next question comes from Pierre Ferragu with New Street Research.

Q - Pierre C. Ferragu {BIO 15753665 <GO>}

Hey. Thank you for taking my questions. I was very surprised with the numbers you reported today by - that your gross margin performance on the Model 3. So if I remember correctly, you were expecting more like a 15% target margin for this quarter and you actually did better than 20%. So can you take us through what improved like faster and better than you had initially anticipated in the manufacturing line and where these improvements came from?

A - Deepak Ahuja {BIO 15935173 <GO>}

Deepak here, and Jerome and others, please feel free to join. Our improvements on the cost side were in every aspect of costs. So, clearly, our manufacturing labor hours improved significantly. Our overall manufacturing costs dropped almost 30% sequentially Q2 to Q3. We produced more volume, so we had better fixed cost absorption. We had far less scrap. Our yield on each of the lines across both factories improved significantly. And as we look forward, we see even more opportunities. We are going through this phase where we are now stabilizing production, and the team can now intensely focus on cost optimization. And that trend will just continue in Q4.

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

Yeah. I think we're also being relatively on the conservative side when we predicted - when we said like 15%, we were being...

A - Deepak Ahuja {BIO 15935173 <GO>}

Right. Our expectation was we would do better, but we want to be conservative. You're right in terms of our guidance that we gave for Q3.

Q - Pierre C. Ferragu {BIO 15753665 <GO>}

Okay. Thanks. That's great. And then, as a quick follow-up, you've announced over the weekend like a mid-range car with a smaller battery bag. And I was wondering as you are looking at expanding collection of the Model 3. I think about it as you have two options. One was to grow and to keep producing higher and higher ASP cars; and the other one was to go forward - lower-cost car and stick to the U.S. So how did you decide the sequencing of these two things? Why is lower car now and going abroad only early next year?

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

Well, we try to provide the most affordable electric car options that we can. And since we can't - we just don't have the ability to get to the \$35,000 car right away, we thought this might be a way to offer it as an intermediate step. And that's really it. We expect to start producing at significant volume for Europe in January. And obviously take some time to ship, so deliveries - pretty significant deliveries in Europe kind of in the late February, March timeframe because cars have to ship away from California to a customer in Europe. And for us, a car only count as delivered if it reaches the end-customer and all the paperwork is completed correctly. So it's the highest possible standard for considering a sale a sale.

Q - Pierre C. Ferragu {BIO 15753665 <GO>}

And also to the APAC you'd start delivering cars.

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

Yeah, but, we may or may not deliver cars in APAC in Q1. But certainly in Q2. It will be kind of borderline as whether a car is delivered in APAC by the end of Q1. So I can't say it for certain. Definitely in Europe. But, and then, definitely in APAC in Q2.

A - Martin Viecha {BIO 17153377 <GO>}

Okay. Let's go to the next question, please.

Operator

Thank you. Our next question comes from Romit Shah with Nomura Instinet.

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

Yes. Thank you. I guess just along those lines, you indicated that you're going to bring Model 3 to Europe early next year. Where would you like to see production in order to support that ramp overseas?

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

Well, initially production will occur. I mean, in the next several months all production is, vehicle production will take place at our car plant in California.

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

Sorry, I meant to ask where would you like to see that production rate on a weekly basis go to in order to support that ramp?

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

Yeah, it's hard to predict with accuracy. And there's also - like all the tariff wars and everything. So long term we are not talking about next quarter. So like what it is likely global demand for Model 3? It's probably on the order of anywhere from 500,000 to 1,000,000 cars a year, I'd say, good global demand for Model 3. If you look something like say the 3 Series, Martin, that's around 0.5 million.

A - Martin Viecha {BIO 17153377 <GO>}

0.5 million.

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

The BMW 3 Series is about 0.5 million a year globally. And generally, we find that we outcompete the BMW 3 Series quite well. So it seems like logical, therefore, that we would want to have a higher production - or higher demand. Maybe it's somewhere between the - kind of the BMW 3 Series and the Volkswagen Golf, which is about 1 million units a year. So yeah, that's right. It's anywhere from 500,000 to 1 million units a year long term.

Q - Romit Jitendra Shah {BIO 16865852 <GO>}

And do you have to add new lines to support that, or are - just going to continue to remove bottlenecks in the existing lines?

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

No. We're definitely going to do local production in China. We are moving rapidly on that. So we're striving to have Model 3 production for the China market, for the Greater China market active certainly next year; it will be happening next year. But it will be done with – in a very capital-efficient manner. Much more akin to the way we did general assembly line four versus general assembly line three. And then we will also have a factory in Europe long term because it's pretty silly to make cars in California and ship them all the way to Europe that's far.

A - Martin Viecha {BIO 17153377 <GO>}

Especially in high volumes.

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

Yeah, exactly. Especially if it's a – I'm not talking about S and X; I'm just talking about the Model 3. So S and X will continue to be made in California. I think probably exclusively here. But for cars we're trying to maximize affordability, it makes a lot of sense to produce those cars at least in the continent where they are consumed (35:18)

A - Martin Viecha {BIO 17153377 <GO>}

Okay. Let's go to the next question, please?

Operator

Thank you. Our next question comes from George Galliers with Evercore.

Q - George Galliers {BIO 21095133 <GO>}

Thank you. Maybe just following up on the previous question. Is the target still to produce 10,000 Model 3s a week in Fremont? And I think you mentioned in the past that once you got to a run rate of around 5,000, you'd be better placed to assess what CapEx is required to get that. So as of today, do you have a better idea of what CapEx is required to get to that kind of level at Fremont?

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

I think we're not prepared to speak to that right now, except that it will be considerably less than money that we spent to get to 5,000 in the first place, like quite – I think quite dramatically less. So I like probably see a path to like 7,000 units a week for Model 3 with really minimal CapEx.

A - Deepak Ahuja {BIO 15935173 <GO>}

Very minimal.

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

Yeah, very minimal to get to 7,000 a week. And then that's really just basically slowly improving the uptime of the existing lines and we can do 7,000 a week.

A - Deepak Ahuja {BIO 15935173 <GO>}

Exactly.

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

So - and then it gets a little harder as we start to go above 7,000. We need to at least bring lines down in Fremont for significant upgrades to get to 10K, but also just not - we're not talking about massive amounts of CapEx. But I would say like long-term, it's - again, long-term, it's - predicting things on a quarter by quarter basis is very difficult because when you have an exponential growth rate like we do - I mean if you look at Tesla cumulative deliveries over time, that's like the cleanest exponential curve that I've ever seen.

So - but small movements in calendar time can look like a very large hit or miss, one way or the other, because it's such a steep curve. That's why it's always tricky to predict things on a quarterly basis. But a lot easier if you go out a year or so. Yeah. I mean probably long term, it's at least sort of 7,000 to 10,000 cars from Fremont of Model 3 and then - I don't know - 5,000 to 8,000 in rest of world. Something like that. This is a guess.

Q - George Galliers {BIO 21095133 <GO>}

Okay. Thank you. And then just as a follow-up, in the letter you do point out that the size of the European market for premium midsize sedans is roughly twice that of the U.S. Could you also maybe just comment to what your expectations are for mix in Europe based off Model S and Model X? Do you expect richer mix in Europe versus the U.S. or is it fairly similar?

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

We've given that zero thought. I mean, it's just like it's not - I have no idea. I don't know. Martin, do you have any idea?

A - Martin Viecha {BIO 17153377 <GO>}

No. All I'm aware of is that because of cold weather, probably all-wheel-drive and long battery range will be highly demanded in Europe, but apart from that - we ultimately have to start selling the car to see what the demand is, so.

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

Yes, it seems like it's likely to be comparable to - pretty much midsize sedans market is like twice as big in Europe, then - well, it's likely to be at least as much demand in Europe as there are in North America. Like, that's a pretty safe bet. But our goal really is to make electric cars that everyone can afford, not to sort of mine high option value cars. It's like if we could produce the \$35,000 car today, we would do it. We need more work. There's more work to do before we can make a \$35,000 car and have it be part of the gross margin. We're probably less than six months from that, but that's our mission.

A - Martin Viecha {BIO 17153377 <GO>}

Great. Let's go to the next question, please.

Operator

Thank you. Our next question comes from Maynard Um with Macquarie.

Q - Maynard Um {BIO 1972683 <GO>}

Hi. Thank you. Congratulations on a great turning point for Tesla. As you continue to scale the business, can you talk about how we should think about how you balance profits versus reinvestments? You're targeting sustainable GAAP profitability and cash flow, but I'm curious if there's a level of GAAP profitability or GAAP operating margin or cash flow you want to hold and then take the excess to fund new growth or accelerate opportunities?

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

Sure. Maybe to characterize that question would be like are we starving new vehicle development in order to achieve GAAP profitability and cash flow positive? Would that be an accurate - is that essentially - the answer is no. So we've made significant progress on the Model Y, so in fact, I approved the prototype to go into production recently. So it will be 2020 before that's in volume production, but we made great progress there. Also continue to make progress on the semi and the newer Tesla Roadster. And then actually product I'm personally most excited about is the Tesla pickup truck.

I think that's going to reach some next level stuff there. And I should not forget to mention the solar tile roof. We'll also start getting into volume production of the solar tile roof next year. That's quite a long development cycle because anything that's roof has got to last 30 years. So even if you do accelerate lab testing as fast as possible, there's still a minimum amount of time required to do that and there's a lot of engineering that goes into how do you put on the solar tile roof and not be really labor-intensive in doing so.

So there's a lot of engineering, not just in the tile but in the way it's done. And then we've got continued improvements in Powerwall, Powerpack, other energy products. I think we've got the most exciting product roadmap of any company on earth by far. I'm not even sure like probably twice - I don't even know who would have - which company would have a better product roadmap or even close. Maybe they do but I don't know about them.

Q - Maynard Um {BIO 1972683 <GO>}

Great. And when you talk about Tesla having its own ride sharing fleet or giving people the ability to loan out their car like an Airbnb model, I'm curious if your long-term plan is to build a platform that's going to enable companies to write applications to turn the car directly into an application. And then can you also maybe just talk about that business model? Should we be thinking more about like a

revenue sharing model sort of like how Apple takes a piece of revenue generated for applications from iPhones? Thanks.

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

I don't know about turning the car into an application exactly, but I mean, maybe. But I try to do the thing that maximizes usefulness, and so if there's a way where third parties could do something, then that could make sense. But I do know for sure that Tesla will operate its own ride hailing service. We'll compete directly with Uber and Lyft, obviously, and but then also have the ability for customers to offer their car and add or subtract their car to the fleet at will. There will be a company-owned fleet and the company-owned fleet will just be where there aren't enough customer cars to be lent out.

So if we find a particular metro there aren't enough customers who are willing to add their car to the shared fleet, then that's where we'll supplement it with a Tesla-owned fleet. So that's why it's sort of a combination of the Uber/Lyft thing and Airbnb and then we would charge something probably comparable to how the App Store works or I don't know, we'd charge 30% or something in order for somebody to add their car to the fleet. I think that's like a pretty sensible way to go. Yeah.

A - Martin Viecha {BIO 17153377 <GO>}

Great. Let's go to the next question, please.

Operator

Thank you. Our next question comes from Adam Jonas with Morgan Stanley.

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

Thanks, everyone. First question is on governance. As the company conducts its search for a new Chairman, what are the attributes and experiences of that person that you think would be a best fit or best value for Tesla?

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

Actually, on this call we're going to restrict questions to operational topics. Do you have another question?

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

No problem. Yes, I do. Can you tell us about the folks who are taking deliveries of Model 3? What are the top cars, car models or brands that they're trading in or switching out of? How many are new to the brand? Anything you're prepared to share, and then I have a follow-up.

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

Sure. Absolutely.

A - Martin Viecha {BIO 17153377 <GO>}

Hey. This is Martin. So I've done the analyses of all the trade-ins that we've received and really the only pattern that I've seen is that it sort of all across the board and the vast majority is non-premium brands. I think that is the number one message is just that more than half of the trade-ins we received were priced at below \$35,000 when new. But other than that, there is no real pattern. I haven't noticed anything worth highlighting other than it's just a lot of people upgrading their cars quite dramatically.

A - Operator

Which is a huge upgrade.

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

Yeah. For most people - well, maybe for most, but for many people it is the most expensive car they've ever bought. So they're clearly demonstrating with their money that they're willing to spend extra money to get a Tesla. So Tesla seems like mass-market premium.

A - Martin Viecha {BIO 17153377 <GO>}

The price lock is way beyond the Federal tax credit. So clearly there is value on top of what they're receiving whether it's cost of ownership or the sustainability, whether it's the brand or the source. (46:37)

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

Safety.

A - Martin Viecha {BIO 17153377 <GO>}

And safety. All of the above is making a large number of customers jump up significantly in the purchase price.

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

Again really I could say, honestly, the top reason to refer a friend to buy Tesla is it's going to keep your friend safe.

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

That's a good reason. If I can just squeeze in, since I couldn't ask the first one that you could answer, do you think that the third quarter is a milestone, Elon, where you think Tesla becomes sustainably self-funding and perhaps not in need of outside capital? Thanks.

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

Yeah, that is our goal. We do not intend to raise equity or debt, at least that is not our intention right now. That may change in the future, but the current operating plan is

to pay off our debts and not to refinance them, but to pay them off and reduce the debt load and overall leverage of the company. And I actually almost forgot one quite important thing. This is quite helpful, why it's helpful to have these sort of crisis situations with logistics, for example, as I look into the inventory, like basically finish part inventory from factory to the customer, I was quite surprised to see how long that took and that it was quite expensive in a lot of cases to get the cars to customers.

This was something I didn't fully appreciate before and we really have a major initiative at Tesla to get the average time from a car exiting the factory to receiving a check from the customer or being in the customers' hands, just to be clear we only get the check when we give the car to the customer. So getting a car from factory to customer to get that to be as short as possible.

In August, the average time in North America to get a car from the factory to the customer was 30 days, which is embarrassingly long. By the end of the quarter, we had reduced it to around 22 days and our goal in Q4 - this is a goal, not a promise - but our goal is to get the average time of a car from the factory to the customer under 10 days. This was a giant improvement in the capital efficiency of the company. Because we're making on the order of \$75 million worth of products per day, of cars per day, so every day it requires \$75 million worth of capital. So every 10 days it's \$750 million. And, obviously, we have a loan from the bank that we can make use of, but the banks will only loan us 85% of the cost of the vehicle, which translates to about 70% of the price of the vehicle.

And then, we've got this loan outstanding, which effectively increases the COGS of the car. And it dilutes the company to the tune of 30% of whatever the inventory - of the finished goods in transit is. So this is really like tightening that and getting that below 10 days in North America and then also improving dramatically the transit time to Europe and Asia. This is where having local factories is actually very important for the capital efficiency of the overall system, because I think over time we want to get the time from a car going from factory to customer under 7 days worldwide. And then, the terms that we have from our suppliers are on average just over 60 days.

Now, our parts inventory management also there's a lot of room for improvement there, but I think we'll probably cut that down to a few hundred million dollars or so, Deepak, something like that. Maybe \$200 million or \$300 million of parts at the factory. So effectively, what we're going to do is reverse the working capital requirement for the company quite dramatically to the point where the faster we grow, the more capital we have. This is incredibly important for capital efficiency of the company. It's night and day.

Deepak, is there anything you'd like to...

A - Deepak Ahuja {BIO 15935173 <GO>}

No. I think we are totally - we are reducing our raw material inventory on one hand by keeping the production stable, finding efficiencies in warehouse management

and supply chain, and at the same time reducing the time to deliver the car and convert that car into cash, and that significantly improves working capital leads.

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

Yeah, it's really quite dramatic. So yeah, I think it sort of profoundly changes the financial effectiveness of Tesla.

A - Deepak Ahuja {BIO 15935173 <GO>}

We reduced our inventories in Q3, which helped. And although we had higher receivables because the quarter ended on a weekend, we won't have that in Q4. So all of this should continue to help us in Q4 and beyond, the working capital game.

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

Yeah, I mean, it occurs to me that even if the only thing - even if this was the only thing that Tesla did different was to shorten the time from factory to the end customer, and any given company that did that would out-compete all other companies over time. It would not be a contest.

A - Martin Viecha {BIO 17153377 <GO>}

Great. Thank you very much. Let's go to the next question, please.

Operator

Thank you. Our next question comes from Toni Sacconaghi with Bernstein.

Q - Antonio M. Sacconaghi {BIO 21226758 <GO>}

Yes. Thank you. I have one for Deepak and then a follow up, please. Deepak, the OpEx expense management was very strong in the quarter. I think it was down 13% sequentially and OpEx was only up 5% year over year, despite revenue growing 71%. So on that front, I mean, in hindsight, did you get too bloated and needed to get more rightsized? And looking forward, how do we think about OpEx growth versus revenue growth on kind of a more normalized basis?

A - Deepak Ahuja {BIO 15935173 <GO>}

Yeah, Toni, so excluding onetime items, our OpEx decreased sequentially by 5%, to just clarify that, first of all. And a lot of that was driven by the actions we took in Q2 to be more efficient with our employee head count, how we benefited from that in Q3. And we were really careful in terms of all of our spending.

The other piece that helped us is a lot of our Model 3 spending on expensed sort of R&D is reducing because Model 3 is going into production, so Q2 to Q3 we saw a reduction there. And it just gives you the sense of the leverage our operating expenses can have, while our revenue is growing dramatically. So our OpEx will increase in the future, but at the far slower rate, and we will continue to be really,

really careful about the spending. And I think there're actually more efficiencies that we can find.

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

We already find them. Absolutely.

A - Deepak Ahuja {BIO 15935173 <GO>}

Right. So we'll continue down that path.

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

Definitely.

Q - Antonio M. Sacconaghi {BIO 21226758 <GO>}

Okay. Thank you for that. And then to follow up, I was just wondering if you could help us a little bit on the – back to the gross margin on Model 3 and the \$35,000 car. So this quarter, I impute that Model 3 ASPs were maybe \$59,000, and that might suggest that gross margins on a \$35,000 Model 3 might be about zero. And Elon, I think you alluded to the fact that the goal is really to get positive gross margins on a \$35,000 car before shipping. Are those all fair assessments? And I guess the question is where would a \$35,000 Model 3 be in terms of gross margins today? And where does it need to be before you want to offer it broadly to consumers?

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

The challenge with answering questions of that nature in detail is that it is a rapidly changing situation. So literally, if you had asked us in a month, it would be different. Another month, it would be different. There's no question we need to get to a point where we can sell a \$35,000 car and where the full accounted for COGS of the car is, let's say, on the order of \$30,000 or slightly less than \$30,000. So I think we'd want to ideally get the COGS of the car, of that configuration of the car, under \$30,000. That's our goal. That's what we're pushing very hard to achieve.

A - Deepak Ahuja {BIO 15935173 <GO>}

Exactly. And it's a matter of time. It's (56:32-56:43) there's a significant material cost reduction that comes. You have a smaller battery packs, or a fewer amount of cells. It's not the same cells that we have in the existing cars.

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

Well, it's the same cells, but it's not the same.

A - Deepak Ahuja {BIO 15935173 <GO>}

The same amount of cells. Cell cost.

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

It has fewer cells in it, and then the non-cell portion of the pack is also cost-reduced.

A - Deepak Ahuja {BIO 15935173 <GO>}

Exactly.

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

With the current mid-range pack, it still has basically about the same non-cell portion of the pack cost.

A - Deepak Ahuja {BIO 15935173 <GO>}

Exactly. And we are achieving massive reduction in all of our manufacturing cost per car, which will continue. And as volume grows, that also helps us lift fixed cost absorption. So it's the same factors that have helped us so far will continue to help us going forward, to get us there. Anything you want to add, JB? No?

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

Yes.

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

Great. Let's go to the next question, please?

Operator

Thank you. The next question comes from James Albertine with Consumer Edge.

Q - James J. Albertine {BIO 17420845 <GO>}

Great. Good afternoon, and thanks for taking the question. Congratulations.

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

Thanks.

Q - James J. Albertine {BIO 17420845 <GO>}

Wanted just a point of clarification, Elon, you mentioned in August the time to get the car from the factory to a customer was 30 days down to 20 at the end of the quarter and your goal is under 10 by the end of 4Q. Where do we see that flow through from a COGS perspective? Is that in automotive gross margin? Or was that in services and other at this point?

A - Deepak Ahuja {BIO 15935173 <GO>}

It's all in automotive gross margin, our logistics costs are found.

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

Outbound logistics.

A - Deepak Ahuja {BIO 15935173 <GO>}

In COGS are found in automotive.

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

I think we'd see a reduction in inbound logistics as well as outbound logistics. Maybe the question is, for the debt that is carried for that period of time, is that getting into COGS? Or is that not...

A - Deepak Ahuja {BIO 15935173 <GO>}

The interest expense...

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

Yeah.

A - Deepak Ahuja {BIO 15935173 <GO>}

Of the debt that's in the interest expense line. That is not in COGS.

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

Okay. Yeah, that's like, anything like the difference in COGS should probably be important to include anything that's directly driven by volume essentially. That affects the marginal cost of the vehicle. So although that is not officially in COGS, in my opinion, it probably should be. It's to take the ABL interest expense and apply that effectively to the cost of the car.

A - Deepak Ahuja {BIO 15935173 <GO>}

And from a broader sense, you're looking at it as the cost of doing business which can be avoided.

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

Yeah, essentially cash flow ability increases quite dramatically, dilution or leverage outside of the ABL line improves dramatically and then the de facto cost, the effective cost of the car also reduces because you do not have the interest expense. If you have the interest expense over 22 days versus 10 days it's a big difference.

Q - James J. Albertine {BIO 17420845 <GO>}

Understood. And I appreciate that clarification. Sort of what I was trying to get at, you've been running a negative gross margin in services and other for the past several quarters now, and wanted to get a sense for when that could maybe drop and start to turn a corner and to generate some profit for you? I understand there's a lot of building out going on for sales, service, and charging infrastructure. But if you can give us some kind of clarification there, that would be I think helpful. And if

you're willing maybe to provide an update on where you stand today in terms of battery costs? I know your goal of parity with ICE vehicles, but maybe an update if you're willing to provide and where you stand in that trajectory. Thanks.

A - Deepak Ahuja {BIO 15935173 <GO>}

I think over time every quarter progressively we will see an improvement in the service and other business as our revenue continues to grow and as the size of our fleet grows, it's as simple as that.

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

Yeah, long-term I would expect the service to be a significant revenue item and to be a positive margin contributor. And it's going to be a function of our fleet size.

(01:00:41)

Exactly. We're under warranty. There's a lot of stuff that's under warranty, but as the warranty expires so there's non-warranty items then we would expect service to positive gross margin.

A - Deepak Ahuja {BIO 15935173 <GO>}

Yeah, and that also includes our used car sales.

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

Yeah, a good point.

A - Deepak Ahuja {BIO 15935173 <GO>}

And our used car sales is continuing to grow and they have a healthy margin. And so that overall business for mature companies is in some cases more profitable than new products. I'm not just talking about OEMs, car part OEMs. And we are at the early stage of our growth here and as our fleet size grows, there are just so many opportunities in that business, but it's a matter of time, simply said.

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

Yeah.

A - Martin Viecha {BIO 17153377 <GO>}

And on the battery cost, there was a question?

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

Well, that is a key sort of competitive metrics, so I think it's safe to say we are much better than anyone else by a lot. But we prefer not to give a precise number.

A - Martin Viecha {BIO 17153377 <GO>}

Okay. And now let's go to the last question, please.

Operator

Thank you. Our final question comes from Phil LeBeau with CNBC TV.

Q - Phil LeBeau

Thank you, guys. Elon, quick question. In terms of as the federal tax credits starts to be phased out as your sales crossover the threshold, what kind of an impact have you guys modeled into how much that might slow down potential sales?

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

We don't expect this to result in - I mean, yes, the sales tax or the tax incentive in the U.S. drops in half at the end of this quarter, but then we also start shipping to Europe, and then start shipping to Asia and we certainly do not expect anything that would cause our productions to drop below let's say a minimum of 5,000 cars a week.

Q - Phil LeBeau

But in terms of in the United States, do you expect that it will slow down demand and sales within the U.S.?

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

I think as we are able to offer lower cost versions of the car, we would expect demand to sustain in the U.S. But I want to be clear, it's not like we're holding back this lower-cost version of the car intentionally. Just like with is there anything we can do to provide a lower-cost car now and that's where we came up with the depopulated long-range pack, it's just like basically taking, having long-range pack with fewer cells.

We really care about providing the end customer with the most affordable car that we can possibly produce, the best viability, and if we could do the smaller pack now we absolutely would, it's just is going to take us, I don't know, at least three months to get the production going and (01:03:39) our production. And then that production's going to go to - we've got to make packs, the packs got to go to the vehicle factory, the cars have to get delivered to customers, so that's why customers probably see the smaller battery pack on the order of March or something or February maybe, but it's something on that order.

Q - Phil LeBeau

Okay. Thank you.

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

And one thing, these do trigger kind of maybe points that are worth bearing in mind. As our quarterly letter indicates, the Model 3 is the most efficient energy per mile

electric vehicle out there. It's got the best efficiency, so we've got the best in terms of miles or kilometers per kilowatt hour and we also have the lowest cost per kilowatt hour. This makes it very difficult for other companies to compete with Tesla, because we are the most efficient car and the lowest cost of batteries.

So I do encourage our competitors to really make a huge investment, and we've been saying that for a long time, and then they're only in this competitive disadvantage because they didn't - we tried to help them as much as we could and they didn't want to take our help, so they can use all our patents for free. They can use our supercharger network if they can just have an adapter for our connector or something.

We want to be as helpful as possible to the rest of the industry, but the fact of the matter is we made the investment in the Gigafactory and other companies didn't, and we put a lot of effort into having extremely efficient cars, having the most efficient powertrains and the other companies didn't, but I'm sure they will over time, but that's what has put us in quite a strong competitive position right now.

A - Martin Viecha {BIO 17153377 <GO>}

Fantastic. I think that's all we have time for today. Sorry, go ahead.

A - Deepak Ahuja {BIO 15935173 <GO>}

I'm just going to add a comment in closing, and Elon started with it and I wanted to say that from myself personally here, I want to personally thank all the Tesla employees that have worked incredibly hard this quarter and in prior quarters in each and every part of our business. Our results really are a reflection of the execution done by the company and the passion that our employees have to deliver such results despite all odds. And I also want to thank all our customers and all our investors who have believed in us, in our product and our vision of us leading the world's transition to sustainable energy. So thank you from my side.

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

No, I'm good.

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

All right. Anybody have any additional comments or anything? All right. Thanks, everyone. And, yeah, look forward to the next call. Thanks.

A - Martin Viecha {BIO 17153377 <GO>}

Thank you, goodbye.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect, and have a wonderful day.

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