

Tesla, Inc. NasdaqGS:TSLA

FQ3 2015 Earnings Call Transcripts

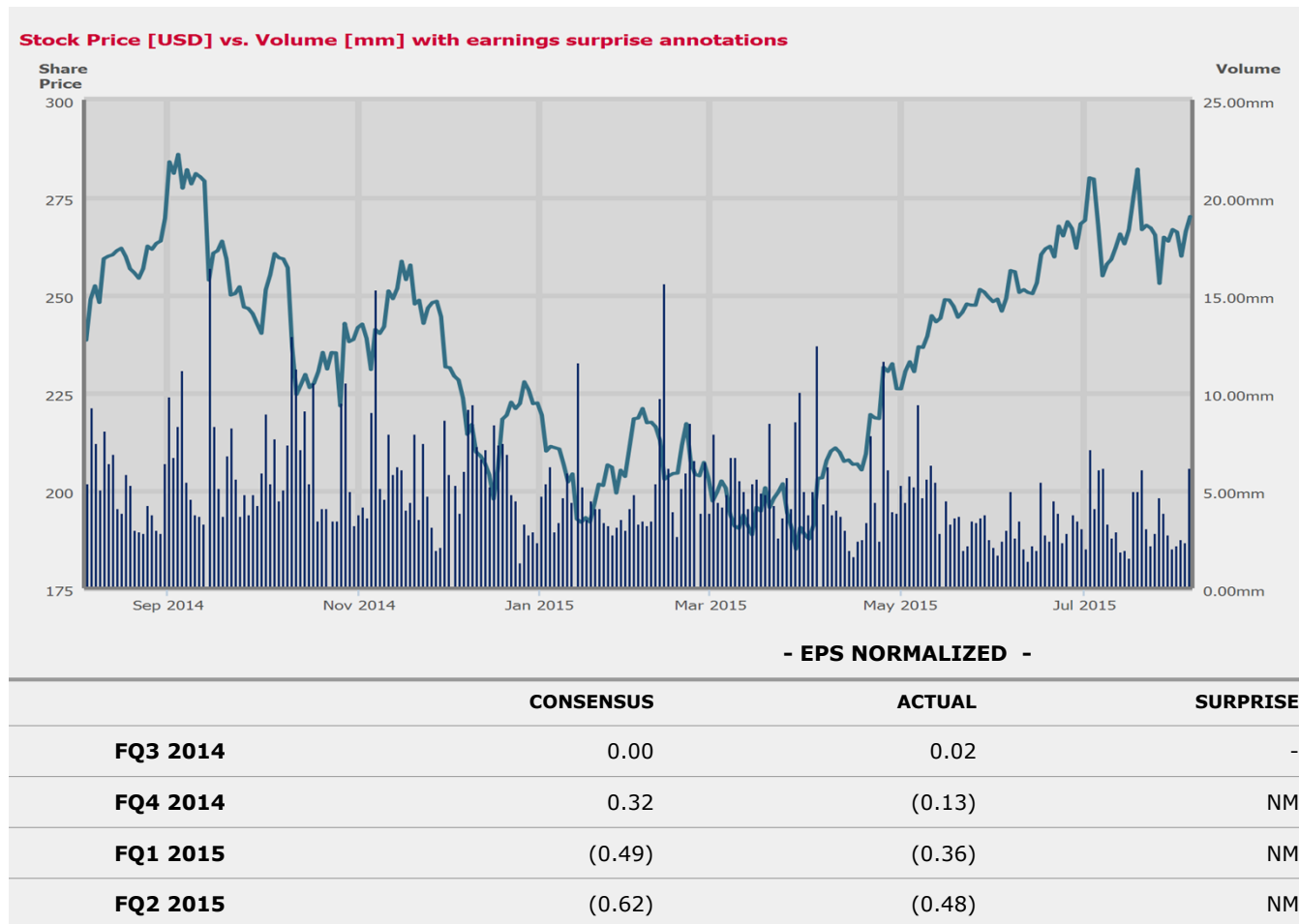
Tuesday, November 03, 2015 10:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.59)	(0.58)	NM	0.57	(0.72)	2.19
Revenue (mm)	1260.18	1243.84	▼ (1.30 %)	1880.50	5408.53	8772.06

Currency: USD

Consensus as of Nov-03-2015 10:20 PM GMT



Call Participants

EXECUTIVES

Deepak Ahuja

Chief Financial Officer

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Jeff Evanson

Vice President of Investor Relations

Jeffrey B. Straubel

Chief Technology Officer

Daniel Galves

Crédit Suisse AG, Research Division

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James Joseph Albertine

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ANALYSTS

Adam Michael Jonas

Morgan Stanley, Research Division

Andrea Susan James

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Benjamin Joseph Kallo

Robert W. Baird & Co. Incorporated, Research Division

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Pacific Crest Securities, Inc., Research Division

Brian Arthur Johnson

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Colin Langan

UBS Investment Bank, Research Division

Colin William Rusch

Oppenheimer & Co. Inc., Research Division

John Joseph Murphy

BofA Merrill Lynch, Research Division

Joseph Robert Spak

RBC Capital Markets, LLC, Research Division

Patrick Kenehan Archambault

Goldman Sachs Group Inc., Research Division

Rod Avraham Lache

Deutsche Bank AG, Research Division

Ryan J. Brinkman

JP Morgan Chase & Co, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Tesla Motors, Inc. Third Quarter 2015 Financial Results Q&A Conference Call. [Operator Instructions] As a reminder, today's conference is being recorded. I'd now like to introduce your host for today's conference, Mr. Jeff Evanson, Head of Investor Relations. Sir, please begin.

Jeff Evanson

Vice President of Investor Relations

Okay. Thank you, Liz, and good afternoon, everyone. Welcome to Tesla's third quarter Q&A webcast. I'm joined today by Elon Musk, Tesla's Chairman and CEO; J.B. Straubel, our CTO; and Deepak Ahuja, Tesla's CFO.

Our Q3 results are announced in the shareholder letter at the same link as this webcast. As usual, this letter includes GAAP and non-GAAP financial information and reconciliations between the 2.

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

And now Liz, let's go to the first question, please.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Sure, I can probably...

Jeff Evanson

Vice President of Investor Relations

Oh, do you have some...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I can [indiscernible] to make some comments.

Jeff Evanson

Vice President of Investor Relations

Yes, actually, Liz, we'll have our CEO, Elon, make some initial comments. Go ahead, Elon.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I just wanted to note that we've made 2 fairly significant hires, the first of which is Jason Wheeler. He will be our CFO starting next month. Deepak and Jason will be working closely together for the first few months to have a smooth transition. And once again, I'd like to thank Deepak for his awesome contribution to Tesla.

Deepak Ahuja

Chief Financial Officer

Thank you, Elon.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

And so Jason comes to us from Google, where we was basically #2 finance guy at Google responsible for their global finance function, and I just thought he was the super smart guy and really understood what we're doing and was like a very cultural fit with the company. So I think that's going to be great.

And then, in addition, Jon McNeill has joined as Head of Global Sales And Service. And Jon is the former CEO of Enservio. He's been named sort of Most Admired CEO in the small and mid-size company category. In fact, I believe, this is the first time in maybe a decade or more that Jon actually has not been head of the company that he was working at, so -- and before Enservio, he co-founded Sterling Collision, which -- where, he was able to reduce industry repair times by 90%. So the average repair time went from 18 days to less than 2 days while growing the business at 40% a year. So I think Jon's an awesome addition to the team as well. And he's actually -- he's been doing great. He's been working now part time at Tesla for a few months and just started full time and has already done a lot of good.

So I'm pretty excited about those 2 people joining the team, and we expect to have some additional announcements in the months to come as we add bench strength to the Tesla management team.

Jeff Evanson

Vice President of Investor Relations

Okay. Thank you, Elon. All right, Liz, why don't we go to the first caller, please?

Question and Answer

Operator

Our first question comes from the line of Colin Langan with UBS.

Colin Langan

UBS Investment Bank, Research Division

Oh, great. In the press release, you seem to address this a little bit, but there has been a lot of chatter about cancellations for orders for the X, I mean -- and I think the press release says Signature Series. Is that across the models? And how should we think about the different versions of the X rolling out over the next couple of quarters?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

You want to talk to that?

Deepak Ahuja

Chief Financial Officer

Yes, I don't think there's been anything fundamentally different. I mean, so far, on the Signature Series Model X, we've seen a much higher -- or a higher conversion rate than we had seen on the [indiscernible] launched S. So overall, the demand for the X, after the launch of the X, and -- has been higher. So I -- we don't see any fundamental issues.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, I mean, as we've talked about before, really, the main thing with the X is just scaling up production. We're making steady progress with each passing week. Actually, I -- 7 days a week, every day, I get an update on manufacturing progress and what the issues are. And we see no fundamental issues on the production ramp. It's just a question of how quickly we can solve each issue. And they're really down to like the little things, like the placement of the seal on the door and whether that results in the bright trim [ph] alignment being correct. This is quite nuanced. So we feel very confident at being able to get to several hundred vehicles per week by the end of the year.

Colin Langan

UBS Investment Bank, Research Division

Okay. And can you give an update on stationary storage? Is that still trending to your target of 2 to 5 billion [ph] by 2017? And I think the release mentioned that there are some institutional orders. I mean, are there any noteworthy orders that you would want to call out in -- on the storage side that we should kind of look at as being big drivers? And are you still confident in your sort of 15% gross margin for that [indiscernible]?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

So that was like a whole bunch of questions. The -- with respect to stationary storage, I mean, the -- that is, again, sort of a production limited thing. So we're trying to scale our production as much as possible. I mean, we've -- by almost any metric -- we're -- if we imagine the most we could possibly make in 2016, we've already sold out of that. Or at least, if you were to take even a small fraction of the number of people that have placed orders and assume that those orders are valid, even if a small portion of those are valid, we would be sold out of all of 2016 production, maybe well into 2017. So it's really mostly about predicting our production rate, and yes, we expect very dramatic increases in the stationary storage production. The reason I feel a bit cautious about giving exact estimates is that when you have an exponential increase, the exact calendar window over which the -- that you place that

exponential, has quite a big impact on the numbers. So -- and in fact, in general, at Tesla, I want to be a little more cautious about giving quarterly numbers, particularly when we have very dramatic ramps, like the example is with the Model X. You can imagine, if you have strict calendar windows and you place them over the beginning of an exponential, or slightly to the right or slightly more to the right, the actual differences are quite dramatic. So like you know where it's going to end up, but not what it looks like in that rapidly changing S curve situation. Yes, so...

Colin Langan

UBS Investment Bank, Research Division

And then, on the margins side, is that still on target? And that's it.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Sorry, on the -- you're breaking up a little bit. On the margins?

Colin Langan

UBS Investment Bank, Research Division

The gross margin, is it still at your -- or is it still trending to the 15% target I think you mentioned on the last call?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Oh, 15%, yes. Mostly -- we -- yes, I don't think there's going to be any problem hitting a 15% margin target. Obviously, the margin improves as the production ramps up, so yes.

Jeffrey B. Straubel

Chief Technology Officer

Yes, I don't know if I want to discuss the specific margin targets, but it should be in excess of 15%. That is our internal target.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, I mean -- Yes. once you get away from the very early stage of production, I think, long term margin 15% is no problem.

Operator

Our next question comes from the line of James Albertine with Stifel.

James Joseph Albertine

Stifel, Nicolaus & Company, Incorporated, Research Division

Great. Just a point of clarification, first, on the announcement of the 40,000 vehicles that you rolled the Autopilot feature out to over the air. Can you just clarify, once rolled it's out over the air, is there, then, a point at which the consumer has to determine to spend, I think it's \$2,500, to activate it? And is there any detail you can provide us on those that are paying to activate the Autopilot feature at this time?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Most people who ordered the car actually ordered with the Autopilot convenience features. So the Autopilot safety features are default on -- in all vehicles. This is automatic emergency braking, side collision avoidance, forward-collision warning, that kind of thing. The convenience features like Autosteer, Autopark, are \$2,500, but like most people have actually -- had actually already ordered that. So those that hadn't -- haven't ordered it can actually turn it on for -- it's actually slightly more if you get it after

the fact, for -- turn it on for \$3,000. And that's something that we'll be allowing people to do at some point in the coming months, sort of like an in-app purchase, I guess, yes.

James Joseph Albertine

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay, great. Then I wanted to ask a question as it relates to -- now that we're past sort of the, as I understood it, the peak spending period in advance of the Model X launch, how should we think about capital expenditures and -- or cash flow models for the fourth quarter? And maybe it sounds like you've reiterated the positive free cash flow guide you had originally stated earlier this year. But just some thoughts as it relates to the cash flows in the fourth quarter would be great.

Deepak Ahuja

Chief Financial Officer

Yes, I mean, Q4, we are still in the peak of our Model X investments. A lot of our equipment and tooling is being paid off in Q4, as the production are proving out their production -- sorry, suppliers are proving out their production tooling as well as the equipment is getting installed and getting signed off in our factory. So Q4 is going to be a peak for Model X. Clearly, 2016 our CapEx should be less than 2015, and then, we'll provide you further guidance on that in the next earnings call.

James Joseph Albertine

Stifel, Nicolaus & Company, Incorporated, Research Division

And -- oh, sorry, go ahead.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I was going to say like, we do have a -- like a very strong push towards free cash flow. I mean, that is -- our aspiration is to be positive -- I need to emphasize, this is an aspiration, not a promise. But our aspiration is to be positive cash flow in Q1.

James Joseph Albertine

Stifel, Nicolaus & Company, Incorporated, Research Division

Understood. Deepak, best of luck, and we look forward to meeting Jason when he's fully ramped and onboard.

Deepak Ahuja

Chief Financial Officer

Thank you, James.

Operator

Our next question comes from the line of Adam Jonas with Morgan Stanley.

Adam Michael Jonas

Morgan Stanley, Research Division

Elon, just thinking longer term here. Assuming Tesla establishes itself as a leader in autonomous transport, do you see a business case for selling autonomous cars to ride-sharing firms? Or can Tesla cut out the middleman and offer on-demand electric mobility services directly from the company's own platform?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I think we'd have to say no comment.

Adam Michael Jonas

Morgan Stanley, Research Division

I mean, Elon, it's kind of unusual for you to punt on strategic questions of a long-term nature. Is this a dumb question? Or a funny question?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

No, I think it's quite a smart question, actually, but there's still no comment.

Adam Michael Jonas

Morgan Stanley, Research Division

Why -- all right, okay, I won't antagonize. Let's move on. I mean, it's just odd because you normally -- or I've never heard you punt like that, that's all. But in any case, is it because of a competitive sensitivity? Or is it because the concept itself is just too in-flux?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I think there's a right time to make announcements, and this is not that time.

Adam Michael Jonas

Morgan Stanley, Research Division

Fair play. All right can I ask one on Autopilot?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

And nor -- I mean, nor is our strategy fully baked here. So to -- for us to state what it would be, it's not fully baked. So there's no -- we'd prefer to announce something when it's -- when we're -- we think we've got the full story understood.

Adam Michael Jonas

Morgan Stanley, Research Division

So saying it's not fully baked implies there's something in the oven, but just, okay.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Okay, can we -- we kind of need to move on.

Jeff Evanson

Vice President of Investor Relations

Next question.

Adam Michael Jonas

Morgan Stanley, Research Division

Let's move one. J.B., all right, let's go to J.B. real quick, then. On Autopilot, can you share any early data you might have collected with us post the automated driving software update? How many miles have been driven with Autopilot engaged? How many accidents prevented? Things like that would be really interesting and, I think, illuminating.

Jeffrey B. Straubel

Chief Technology Officer

Well, I don't think we want to share any particular details on specifics around user feedback on that. But certainly, people are using it in a variety of situations. This has gone out to the whole fleet of Autopilot-

enabled cars, and those are racking up miles extremely quickly. At this point, I don't have the exact number at the tip of my tongue, but it's I believe, several hundred thousand miles of driving, so.

Deepak Ahuja

Chief Financial Officer

It's 1 million a day, at least.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

It's almost 1 million a day of cars that are -- have Autopilot hardware. So I mean, the early data -- this is early data, I would emphasize, is that it's very positive. So we're aware of many accidents that were prevented from Autopilot, and we're not aware of any that were caused by Autopilot. That's -- but this is still early, and -- but it's a good indication. So it appears to be quite beneficial from a safety standpoint, and I believe, some of our customers have posted videos to this effect.

Operator

Our next question comes from...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

And -- but I do want to emphasize, we discourage -- there's been some fairly crazy videos on YouTube. We are -- this is not good. And we will be putting some additional constraints on when Autopilot can be activated to minimize the possibility of people doing crazy things with it.

Operator

Our next question comes from the line of Joseph Spak with RBC Capital Markets.

Joseph Robert Spak

RBC Capital Markets, LLC, Research Division

I guess, it's been a while since I've heard anything about this, but I just wanted to get a better sense of how you feel you're set up to deal with the potential issues on the cars on the hardware side, where a fix can't be OTA-ed to the vehicle booth [ph]. Because when you look at the coverage like in the U.S., the ratio of service centers to stores and galleries is still trailing a little bit. So how does that buildout look going forward? And how would you potentially handle a hardware situation at this point?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I'm not sure I fully understand your question. So you mean -- can you give an example of...

Joseph Robert Spak

RBC Capital Markets, LLC, Research Division

If you had a hardware recall for...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Oh, like, just like -- you mean like -- sure. I mean, we've handled recalls in the past with our service team. It's gone quite well. In general, we try to be proactive, so if we -- without -- well before we're sort of forced to do a recall, we proactively try to fix things in the cars that we think might, in the future, be an issue. And the customer happiness is -- as measured by the -- really, the key question that I think people should be concerned about, which is, will your next car be a Tesla? That's like the key question on consumer reports. 97% of respondents said that their next car would be a Tesla. Frankly, this is the only question people should care about.

Joseph Robert Spak*RBC Capital Markets, LLC, Research Division*

Okay. And then, the -- one more, I guess, sort of hardware question. As it relates to Autopilot, where this is clearly stage 1, and you could add sensors over time and maybe some new features as well, so how do you think about managing the brand and the vehicles when that happens? Because as the sensor suite changes, it can create 2 potentially different experiences when -- and I guess, it's a little bit more -- the reason I think it's a little bit more of an issue for a Tesla is just you don't have the strict sort of model-year nomenclature. So you're not -- so I guess, I just wonder like how you think about that, and maybe some thoughts on how -- on your current sensor suite, and how you see that evolving as well.

Elon R. Musk*Co-Founder, Chairman, Chief Executive Officer and Product Architect*

Okay. I think those are pretty open-ended questions, but we have a philosophy of just continuous improvements. So every week, there are approximately 20 engineering changes made to the car. So it's not really -- it's not as -- it's not nearly as discrete as you're alluding to. With other manufacturers, they tend to sort of bundle everything together in a model year. In our case, it's a series of rolling changes, so model year doesn't mean as much. There are cases where that step change may be a little higher than normal as, for example, with having the Autopilot camera, radar and ultrasonics. But we try to actually those step changes as small as possible, and so that -- I mean, essentially, like the kind of questions that I get is -- from friends is, "Hey, when should I buy a Model S?" And my answer is always, right now, because -- and they say, "Well, aren't you going to make a better one in 6 months?" I'm like, yes, of course. But if their goal is to only buy a Model S when there aren't significant improvements happening, then they will never buy one.

Operator

Our next question comes from the line of Patrick Archambault with Goldman Sachs.

Patrick Kenehan Archambault*Goldman Sachs Group Inc., Research Division*

Okay. Yes, great. A couple of questions, just one on the battery side. I think a lot of us were surprised at the GM Analyst Day. They put a slide up which said that they were working on a battery that was \$145 a kilowatt hour. That probably didn't include the pack cost, but even adjusting for that, that seemed like a pretty low number. And I don't know, maybe J.B., how did you guys react to that presentation? Is it realistic? I mean, are you worried about the threat of a large form-factor battery being the same cost as yours within kind of a 1- to 2-year time frame, would be my first question.

Jeffrey B. Straubel*Chief Technology Officer*

Well, we definitely read the report and we're not terribly concerned about it. I think, also, there was a lot of confusion in that particular report and some of the comments following about sell price versus pack cost. And in general, we're quite comfortable in our position with the type of cells and the form factors we're using. And we think that's going to be the best cost position and cost road map in the future.

Elon R. Musk*Co-Founder, Chairman, Chief Executive Officer and Product Architect*

And -- sorry, I apologize, buddy [ph]. I mean, we are constantly agonizing about cell costs and pack costs. And we don't think anyone is on a path to be even close to us. If they are, I would be the first to congratulate them.

Patrick Kenehan Archambault*Goldman Sachs Group Inc., Research Division*

Got it. Well, that's very helpful and quite reassuring to know. My second question just was on -- in the press release, you talked about orders having increased 50% year-on-year. And maybe just a little color

on that. I mean, that's obviously impressive, given the model that's been out there for a few years. Just any additional color on regional breakdown or what that's being driven by.

Deepak Ahuja
Chief Financial Officer

We haven't provided that in the past. I think all -- maybe the way to put it is that Europe and APAC were really strong, and...

Elon R. Musk
Co-Founder, Chairman, Chief Executive Officer and Product Architect

And so was North America.

Deepak Ahuja
Chief Financial Officer

And North America. Well, North America has always been strong, and Europe and APAC being strong, too. We were at 50% year-over-year.

Elon R. Musk
Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, I mean, I'd maybe, quite frankly, look at it the other way around. I think we were actually relatively weak in APAC and...

Deepak Ahuja
Chief Financial Officer

That's another way to look at it.

Elon R. Musk
Co-Founder, Chairman, Chief Executive Officer and Product Architect

And relatively weak in most countries in Europe, and we're fixing those fundamental weaknesses by ensuring that we've got a good supercharger infrastructure, a good service center infrastructure, that any perceptions about the company are addressed. And in a lot of places, it takes time to build consumer confidence. They need to hear the -- they need to hear about Tesla a lot before they're comfortable making a significant asset purchase. So...

Deepak Ahuja
Chief Financial Officer

Yes, it's a matter of the execution by the team, brand awareness and our expansion of our global network.

Elon R. Musk
Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, so it's -- but I wouldn't say, it's not like, really -- I mean, all regions have improved quite significantly.

Deepak Ahuja
Chief Financial Officer

Yes.

Patrick Kennehan Archambault
Goldman Sachs Group Inc., Research Division

Got it, helpful. If I can squeeze one last one in really quickly. On the topic of Autopilot, there were some reports of the car like taking exits and stuff when it wasn't told to and things like that. And I don't -- I just didn't know if there was much validity in any of that stuff. I mean, have you guys -- are any of these things true? Because, I mean, you sound very confident about the technology, yet initially, there were some reports of errors and things like that.

Elon R. Musk*Co-Founder, Chairman, Chief Executive Officer and Product Architect*

I don't think it should be a surprise that there are reports of errors. I mean, we described the Autopilot as a beta release, and one -- and that the system will learn over time and get better, and that's exactly what it's doing. So I think it's exactly what we described is occurring, and the system is getting better with each passing week. So I would expect that learning to accelerate, and for it -- I think it'll start to feel quite refined within a few months.

Operator

Our next question comes from the line of Rod Lache with Deutsche Bank.

Rod Avraham Lache*Deutsche Bank AG, Research Division*

I had a couple of questions. Just first on Model X, I just wanted to confirm, did you say you thought you can get a few hundred produced and delivered by year-end? And just so that we understand what's been happening here, is it just the seat at this point? Or are there other unique challenges that you think prospectively affect the ramp of the vehicle?

Elon R. Musk*Co-Founder, Chairman, Chief Executive Officer and Product Architect*

No, to be precise, I said several hundred per week, that we expect to reach the production rate of several hundred per week next month. And it's difficult to predict the exact number that will be developed, because it -- because of what I was mentioning earlier of like we're on kind of an exponential ramp. So exactly -- one week this way or that can actually make a significant number -- significant impact in the absolute number of vehicles delivered. But we do feel comfortable, at this point, of reaching the several hundred per week production rate before the end of the year, i.e., next month. And the issues are a bunch of little things. I mean, doors seals right now is a challenge, for example. The monospace seat in the second row is still a challenge, but less of a challenge. It's not the gating factor. There's basically going through a series of constraints, and those constraints can change from one day to the next. But the important point is that we see -- we don't see any fundamental obstacle to achieving a production rate of several hundred per week sometime next month.

Rod Avraham Lache*Deutsche Bank AG, Research Division*

Okay. And it sounds like the target that you laid out, the 1,600 to 1,800 a week, it sounds like you might think that, that's achievable in early 2016, and I wanted to confirm that. You didn't provide CapEx for next year. But also, if you can just confirm, is that what you're sort of thinking you need to achieve that free cash flow breakeven?

Elon R. Musk*Co-Founder, Chairman, Chief Executive Officer and Product Architect*

Yes. We -- I think it's likely that we can be in that 1,600 to 1,800 range -- per week range in Q1. I mean, I'm guessing, we'll probably be towards the lower end of that range, but then, maybe exceed that, the high end of that range, towards the end of next year, if things go well. I mean, there are some caveats there like it depends on what macroeconomic conditions are like around the world next year. But right now, we do see that 1,600 to 1,800 per week on average as occurring in Q1.

Rod Avraham Lache*Deutsche Bank AG, Research Division*

Great. And just lastly, if I can slip one last one in. You ramped up your CapEx, presumably in part to achieve some increased targets for Tesla Energy. Could you just give us some high-level thoughts on what you might be able to ramp up to for that business line maybe in 2016?

Jeffrey B. Straubel**WWW.SPCAPITALIQ.COM**

Chief Technology Officer

Well, the CapEx requirements for Tesla Energy are not that significant as a percentage of the total [indiscernible].

Deepak Ahuja

Chief Financial Officer

Yes. I mean, I think, just to sort of provide a broader perspective, the -- about the CapEx increase. So let's talk 2016. The CapEx in 2016 is primarily going to be for Model 3 and the Gigafactory, as we are looking at 2016 and beyond. It's not necessarily for much of the capacity required in '16. Clearly there is a little bit of CapEx there for Tesla Energy, but that's not the driving factor. Much of that CapEx has been put in place by end of this year for our needs next year.

Operator

Our next question comes from the line of John Murphy with Bank of America.

John Joseph Murphy

BofA Merrill Lynch, Research Division

Just a first question on in-sourcing. Obviously, you guys are pulling the second-row seats in-house for the Model X, and there have certainly been some acquisitions and work you've done on forging and casting. I'm just curious, as you look at production going forward for the Model X, and even the Model 3, if there would be opportunity to in-source more parts to really kind of solve the issues you're facing with some of these suppliers. And as you think about that, how you make that decision around cost and capital intensity? And if you get that right and can in-source more, if you could potentially increase the cadence of your product introductions and the product launches themselves.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, I totally agree with that. That's exactly -- that's the reason -- like we've only, actually, in the whole history of Tesla, only done one tiny acquisition, and that was Riviera Tooling in Michigan. And we're planning to use that as a hub to recruit top tool and die manufacturers, so basically tool and die engineers, to Tesla Michigan, and with that exact goal, which is, how do we reduce our critical path to -- our time to market for new products? Because we end up being constrained by, basically, tools and molds. And anything we can do to tighten that time frame, organically-wise, an acquisition is a good thing. I mean, the crazy thing is that, that \$10 million or so that we spent acquiring Riviera was less than what we spent on expediting our stamping dies. So it's like a no-brainer. And -- but we want to do that in general. We're like looking at all of our critical path items and saying, okay, how do we execute faster on -- and reduce the critical path for new product introductions, obviously with an eye towards Model 3 and making sure that Model 3 happens as soon as humanly possible.

John Joseph Murphy

BofA Merrill Lynch, Research Division

But is this significantly just around tool and die? Or are there other parts like, I mean, where you could actually be doing all the seating internally or start doing -- thinking about wiring harnesses or stuff that would be that intensive and -- as far as in-sourcing?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

We actually are -- we have substantially in-sourced the seats at this point. So Tesla is producing its own seats, yes. So that's actually something we've already done.

John Joseph Murphy

BofA Merrill Lynch, Research Division

Okay. And then, just a second question on the fourth quarter. You're talking about 17,000 to 19,000 units being delivered. I mean, is the -- just is sort of the low end and the high end of the range really dependent on the ramp on Model X, and you sort of see 17,000 at the low end as sort of your base with your Model S? Just trying to understand that -- the range and sort of how we should think about mix in the fourth quarter.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes. The big variables are what -- technically, in which week do we -- are we able to really spool up Model X production? And a few weeks movement, one way or the other, has quite a big impact on Model X production. And then, of course, we still have to get those cars delivered. So -- and at the end of the year, there can often be logistical challenges because it's like Christmas and New Year's, and all the logistics channels are jammed and people are not home. So and there can also be adverse weather events like blizzards and things. So that's what -- it's sort of logistical challenges at the end of the quarter and when exactly does the -- and what exactly does the Model X production ramp exponential look like, that's what introduces the uncertainty.

John Joseph Murphy

BofA Merrill Lynch, Research Division

Okay. So we shouldn't think of the 17,000 as sort of a base level for Model S? There's a lot of variables that are going in here in addition to the Model X ramp, right?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, end-of-quarter logistical challenges around Christmas sort of -- or is, for us, is a bit of a wild card.

John Joseph Murphy

BofA Merrill Lynch, Research Division

Got you. Okay. And then just lastly, real quick, I mean, with everything that's going on with Dieselgate, obviously, your ZEV credits might be a lot more desired by a lot of folks out there. I know you guys are talking about no ZEV credits in the fourth quarter as far as the sales -- or actually, at all for sales or gross profit. But I mean, over time, I mean, is there an opportunity to maybe sell them at a much higher price if you -- as they become available? I know it's not a big part of the business and -- but I mean, it does seem like an opportunity to maybe, in the short run, to make a lot of money on some increasing demand.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I mean, it really depends on what happens with zero emission vehicle regulations over time. You'd think, given Dieselgate and all that, that there should be a tightening up of zero emission requirements like -- but we're not seeing that yet. Frankly, the -- we do not think that the California Air Resources Board is being sufficiently stringent in this regard. I mean, if we can't sell ZEV credits, then it's obviously not -- the regulations are not strong enough.

Operator

Our next question comes from the line of Dan Galves with Crédit Suisse.

Daniel Galves

Crédit Suisse AG, Research Division

You made a lot of changes to the plant in Q3. Do you have any metrics to share with us in terms of improved production and efficiency? And how does it make you feel about kind of the ability to hit production numbers and margin in 2016?

Deepak Ahuja

Chief Financial Officer

Dan, I'm not sure what changes are you referring to in Q3.

Daniel Galves

Crédit Suisse AG, Research Division

Well, what you guys did during the shutdown to final assembly and the body shop.

Deepak Ahuja

Chief Financial Officer

Oh, well, that was essentially, at that point, to put in additional capacity in our -- for Model X, and it sets us up for our production needs in 2016. Overall, clearly, we'll provide further guidance in the next call, but our goal is to keep on working on manufacturing-cost reductions on S and X. We see the opportunities, and the team's going to be focused on that while also working on Model 3. So we're truly a multiproduct company and working on several directions.

Daniel Galves

Crédit Suisse AG, Research Division

Okay, great. And then, just one question on Autopilot. I mean, a lot of automakers talk about mapping as a key constraint to getting to higher levels of vehicle automation. Does your -- does the experience of miles being driven by Model S Autopilot help you guys in that regard at all? I mean, are you planning to come up with your own mapping?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I think this is not -- I think it's [indiscernible] the time for future product announcements in general. This is not meant to mean anything. So in general we're going to punt on making product announcements in earnings calls.

Daniel Galves

Crédit Suisse AG, Research Division

Okay, maybe just to squeeze in one more. The newer drive unit, how is kind of the quality level been on that versus -- I think you had kind of a bigger drive unit that you used initially for the first couple of years.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, right now, we're actually very, very happy with the quality of the drive units. I mean, internally, our goal -- we changed the goal of the drive unit endurance from being approximately 200,000 miles to being 1 million miles. Just basically, we want drive units that just never wear out. That's our goal. And I think we've made really good progress in that direction. So driving that's going out now are -- and for the last several months, have been excellent.

Jeffrey B. Straubel

Chief Technology Officer

Yes. We should probably note that, I mean, we've also made improvements to the large drive unit, and those issues were really limited to early-population large drive units. So today, we hold the same standard on both units that are being built.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, exactly. There was like this one period of time where we had -- I mean, it was like there was -- getting into the weeds, like the -- we transitioned from a manual. Just before we transitioned to automatic grease injection into the spline of the large drive unit, we had variation in how much grease was put into this spline. And if not enough grease was put into the spline, it would have premature wear. So like one example. But other than that, the large drive units have been great.

Operator

Our next question comes from the line of Andrea James of Dougherty & Company.

Andrea Susan James

Dougherty & Company LLC, Research Division

A year ago, you guys had been targeting 28% to 30% gross margins by around this time. But clearly, the world changed on you with currencies and so forth. So what's the right way to think about gross margin over the next 18 months?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, we -- our goal is to steadily improve gross margin, and hopefully exceed 30% on the S and X vehicles within 18 months, hopefully sooner than that. But it is -- it does require quite an intense effort to -- for every fraction of a point of gross margin. So -- and that assumes current -- there's not some radical shift in currencies that happens again. So the -- so yes, if according to our plans, at least, we would exceed 30% gross margin within 18 months on the S and X line.

Andrea Susan James

Dougherty & Company LLC, Research Division

Okay, that would be without a meaning -- go ahead.

Deepak Ahuja

Chief Financial Officer

Yes, it's a combination of various initiatives of the company, from material cost reductions to manufacturing production efficiencies and the labor-hours-per-unit reduction, combined with economies of scale that as our volume goes up, our cost allocation is more efficient, which brings our labor and overhead costs on a per-unit basis down. So clearly, as we act on all of those directions and add volume, we see a path that we can achieve that. And it's a lot of hard work, and we need to do it.

Andrea Susan James

Dougherty & Company LLC, Research Division

Okay. Maybe you'd prefer to shrink [ph] up the model a little bit low and let you guys get there?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes. Yes, absolutely. And we're just -- we're describing that this is our goal, and we believe we've got a plan to get there. But we -- there could be unexpected issues along the way that prevent us from getting there. But I mean, I think, we'll certainly be better than where we are today.

Deepak Ahuja

Chief Financial Officer

Yes.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I mean, that's like quite certain.

Deepak Ahuja

Chief Financial Officer

Assuming constant dollar. Some if these external things [ph].

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, yes.

Andrea Susan James

Dougherty & Company LLC, Research Division

Okay, and just 2 more. When -- can you give us...

Jeff Evanson

Vice President of Investor Relations

Andrea, we've really got a lot of people that want to ask questions yet. So maybe just one more?

Andrea Susan James

Dougherty & Company LLC, Research Division

Just one more. Okay. So I guess, I'll -- then I'll take a step back. It seems like in the Silicon Valley-centric world view, Autopilot's where driving is going and all the cars are going to be driving themselves. But I'm -- I just really want to know, is that Tesla's view? And how central is Autopilot to your long-term revenue profit and vehicle electrification goals?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, I'm actually on record of saying that I think that all cars will go fully autonomous in the long term. I think it'll be quite unusual for -- to see cars that don't have full autonomy let's say, in -- for new car production, in the 15- to 20-year time frame. And for Tesla, it'll be a lot sooner than that. So I actually think in the -- if at the point in which cars are being made that have full autonomy -- that any cars that are being made that don't have full autonomy will have negative value. It will be like owning a horse. Well, not -- you're really owning it for sentimental reasons.

Operator

Our next question comes from the line of Emmanuel Rosner with CLSA.

Emmanuel Rosner

CLSA Limited, Research Division

I wanted to first ask, just put a finer point on the fourth quarter. So deliveries of 17,000 to 19,000 units seems like not a huge contribution from Model X within this. How do you ramp up the Model S deliveries sequentially so fast? I mean, it doesn't look like in the, I guess, in the Model S history, we've seen sort of like such a sequential increase in deliveries like so. What are you doing, I guess, better in this particular quarter?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, it's not as big a leap as it might seem from Q4 to Q3 because there's a whole week missing from Q3. And we continue to ramp the rate all the way from beginning of Q3 through end of year for Model S. So it's actually not too much of a stretch, or less of a stretch than it may seem. And certainly, we've had much bigger sequential jumps before than this. It's worth noting that 2015 -- in 2010, Tesla was delivering 500 cars per year. We now deliver 500 cars in just over 2 days.

Emmanuel Rosner

CLSA Limited, Research Division

Okay, that's helpful. And then, just on -- again, a final point just on the Model X for this particular quarter. It sounds like your -- have you actually started production? Sounds like you're still working out some issues there. And what has essentially surprised you as you sort of like ramped this up, which is causing maybe the actual production in larger numbers to be maybe slightly later than it would have been?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

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Well, I mean, the thing about a car is because there's several thousand unique components in the car, the production can only move as fast as the slowest component. So even though 99% of the Model X is ready for high production, less than 1% of the parts are not, but those are what drive the rate. So that's the thing that makes a car -- vehicle production really, really challenging and the vehicle ramp really challenging. And you don't know in advance what those issues are going to be or you would do something about it. So that's the -- yes. And then, you can basically think of it like the production will move as fast as the least lucky supplier that we have in our network, so yes. Most -- and there are sort of fires, floods, issues of various kinds around the world. And yes, so there's several thousand parts, and respectively, if you go down to Tier 2 and Tier 3, several thousand suppliers, it moves as fast as the thousandth worst supplier.

Operator

Our next question comes from the line of Ryan Brinkman with JPMorgan.

Ryan J. Brinkman

JP Morgan Chase & Co, Research Division

Just maybe going back to the Dieselgate issue again, but from a bigger-picture perspective. I'm curious what impact you see to the electric vehicle market from these revelations at VW. Could it increase the demand for electric vehicles to your benefit? Does it maybe make nonelectric vehicles more expensive to produce to truly comply with the emission regulations? Does that help the Model 3 be more cost-competitive? I'm just curious what impact you see overall to the industry, and then to Tesla specifically.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, I mean, the -- this has really shined a spotlight on the whole emissions testing process. And I mean, it's now obvious to consumers that gasoline and -- well, especially diesel, but also gasoline cars have real-world emissions that are substantially greater than what's experienced in the tests, when they go through testing. And I think that what one would naturally expect from this is that regulators will no longer turn a blind eye to these things, and so the cost of producing gasoline and diesel cars that actually meet the legal emissions requirements is going to be quite a bit higher. So I would expect the car companies to accelerate their plans for electric vehicles, which is great, and there might be some near-term benefit to Tesla. But I mean, thus far, we haven't actually seen it, but there might be one.

Ryan J. Brinkman

JP Morgan Chase & Co, Research Division

Okay, great. And then, just last question. I understand that deliveries for the Model X initially are clearly a function of how many you can build, given your large backlog of orders. But in trying to estimate what demand might look like, more medium to long term, is there anything more that you can say now or that can be shared about the pricing of the vehicle beyond Signature Series?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, just what I'd mentioned publicly, which is that we expect the similarly equipped Model X to be no more than \$5,000 greater than the price of a Model S.

Operator

Our next question comes from the line of Colin Rusch with Oppenheimer.

Colin William Rusch

Oppenheimer & Co. Inc., Research Division

Can you talk a little bit about the acceleration in the ramp of the Gigafactory? What are you seeing at this point in terms of your ability to fully accelerate in 2016? And when do you think, we might see cells coming out of the factory and into cars?

Jeffrey B. Straubel
Chief Technology Officer

Well, in particular, as we have mentioned, we've accelerated the production of Tesla Energy products at the Gigafactory. So that's what has started just recently there, and that was quite a bit ahead of plan. That's happening in a separate section of the factory from where the cells will be produced, but also, as we discussed, we do expect that cell production will start up the second half of next year, which is, again, a little bit ahead of plan. And some of those cells would initially be allocated toward Tesla Energy products. And we still are targeting around 2017 for the first cell production that would be going into vehicles and into the Model 3. So that remains on target.

Colin William Rusch
Oppenheimer & Co. Inc., Research Division

And then, just in terms of the dynamics around leasing. Are you seeing any real meaningful changes in terms of overall lease take rates? Or a change in ownership kind of dynamics at this point?

Deepak Ahuja
Chief Financial Officer

We are seeing a slight increase in the lease take rate in North America. And as we indicated in the letter, that increase has been fully consumed or taken up by our bank leasing partners rather than Tesla direct leasing. So whether we do resale value guarantee or leasing, from our perspective, it's no different and it's a consumer preference. So there's nothing deep or significant that we are seeing in that trend.

Operator

Our next question comes from the line of Brian Johnson with Barclays.

Brian Arthur Johnson
Barclays PLC, Research Division

Yes, kind of 3 quick questions, or 2 quick ones, one more philosophical. First, again, on the 4Q, you talked about building up finished goods inventory. We don't have the file numbers yet, but for the last quarter production outpaced deliveries, and you're guiding to that for 4Q. So what's going to be different in terms of hitting that ramp-up on deliveries for Model S in 4Q vis-à-vis drawing down that inventory?

Deepak Ahuja
Chief Financial Officer

You're referring -- so for model S?

Brian Arthur Johnson
Barclays PLC, Research Division

Yes, for Model S.

Deepak Ahuja
Chief Financial Officer

Yes, I mean, as we indicated in the letter, we were carrying higher finished goods inventory that was in transit at end of Q3 to support those higher deliveries in Q4, and it's the drawdown of that extra inventory that allows us to do that. Our ending inventory at Q4 is going to be no different than what we have had a few quarters back. So it's still a fairly good level to support all our -- all of our marketing and sales and service activities. So overall, the increase is demand-based, and it's fully doable. I think I've answered the questions fully. Yes, go ahead.

Brian Arthur Johnson
Barclays PLC, Research Division

Yes, and to clarify just the Model X pricing, is that based on range and features? Or is it just based on battery size, the \$5,000 difference?

Deepak Ahuja

Chief Financial Officer

For a comparably equipped car with greater [ph] features.

Brian Arthur Johnson

Barclays PLC, Research Division

Okay. And there's -- so equipped would mean battery or range or...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, yes, so with the same battery and the same number of seats and that kind of...

Brian Arthur Johnson

Barclays PLC, Research Division

Yes, and final question, and maybe this is one for Jason and Deepak. Elon, conversation is autos are a very capital-intensive business. I mean, as much as you're pursuing a different model on the battery side, it looks like there's a lot of capital going into tooling and all these complicated mechanical things, not to mention service. As you kind of think forward 3 years, is that, more or less, the way you're going to spend capital? Or is there anything you could do to kind of be more asset-light in the process?

Deepak Ahuja

Chief Financial Officer

I mean, I think, stepping back, maybe the better way to look at it is that at Tesla our CapEx spend for what we are achieving, in my mind, has been really efficient in the industry.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Right, and it's worth noting that Deepak spent a huge part of his career at Ford, so you have a good basis for comparison.

Deepak Ahuja

Chief Financial Officer

Right. And so -- and as we look at every year, and as we add incremental capacity and the CapEx related to that, we are continuing to increase on that efficiency in terms of CapEx dollars per unit of production. So fully agree this is an asset-intensive business, and the key here, in terms of a dollar [ph] investment, is how efficient we are with that capital, and that's what we are focused on.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, and we're still -- yes, absolutely. We certainly believe in capital efficiency and getting better with that over time. But we also believe that companies build value by doing hard things, not outsourcing those hard things to other people because, then, they deserve the value.

Deepak Ahuja

Chief Financial Officer

That's the key point.

Operator

Our next question comes from the line of Brad Erickson with Pacific Crest.

Bradley D. Erickson

Pacific Crest Securities, Inc., Research Division

Great. I guess, consistent with a lot of your commentary recently, you called out in the shareholder just wanting to emphasize quality on the Model X, and it sounds like it's warranting a little bit slower ramp here in the near term. With what you've gone through over the past few years in bringing this car to market, does this change your thinking at all over the longer term when you think about the pace at which you'll bring Model 3 to market relative to longer-term targets that are out there?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, I think we're still aiming to have Model 3 in about 2 years. So but I think the cadence of future products should improve, as we have more resources to shorten the critical path on things that, like I was mentioning earlier, like stamping tools and molding dies and the things that tend to drive our schedule. Because from the point which the car is designed, it can take almost 2 years to get fully tooled up. That seems like a crazy amount of time to us, and we want to try to reduce that significantly.

Operator

Our next question comes from the line of Ben Kallo with Robert W. Baird.

Benjamin Joseph Kallo

Robert W. Baird & Co. Incorporated, Research Division

Elon, could you talk a little bit, as you guys have increased your sophistication around the market, what you think the addressable market is for the S going forward? And then, could we talk a little bit about getting to 20%-or-above gross margin on the X? What kind of volumes we need? And then third, can we touch on the energy storage industry? One thing that I hear a lot in the marketplace is that it's a commodity business. J.B., could you touch on that, and anything you're seeing there? And Elon, last time on the call, you threw out some pretty big numbers for energy storage.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

No.

Benjamin Joseph Kallo

Robert W. Baird & Co. Incorporated, Research Division

Oh, okay, I don't...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

How many questions do we talk about here.

Benjamin Joseph Kallo

Robert W. Baird & Co. Incorporated, Research Division

And I don't think that people really gave you a lot of credit there. So could you just talk about what backs up those numbers?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

I mean, I think it's just basically, as we mature in various markets around in the world, then, sort of the question's how long does it take to mature in these markets? Some markets are a lot harder to solve than others, and then, there's also macro economic conditions. Will there be a recession or whatnot? Will there be -- when will there be a recession? And so these all will obviously make a difference. But I mean, I think, in the long term, there's probably close to \$100,000 a year -- sorry, 100,000 vehicles a year of S demand and maybe something comparable to -- for X, holding economic conditions constant and assuming full market maturation, which could take like quite a long time in some markets.

Jeffrey B. Straubel

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Chief Technology Officer

And maybe to your energy storage question, I mean, obviously, energy is a commodity market, but I don't think that in any way really changes the opportunity there. In some ways, that's sort of what creates it and creates the...

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

It makes it bigger.

Jeffrey B. Straubel

Chief Technology Officer

Exactly. It's what creates the opportunity for us to ramp much faster. And we still see a lot of technical differentiation amongst these different products. Just because energy itself is a commodity, it doesn't mean that the ways that you create it are the same. And the storage technologies and how well they're integrated and how plug-and-play they are for customers to just use them to solve problems and do that very quickly is quite different amongst all the different people trying to address this.

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Yes, I mean, if you could -- if you can sell a dollar for -- I mean, if -- basically, if you can provide \$1.00's worth of value for \$0.80 compared to your competitors in a commodity business, that's amazing. That's like, you want to be in a commodity business.

Benjamin Joseph Kallo

Robert W. Baird & Co. Incorporated, Research Division

Got it. And then, on the margins on the X volume?

Elon R. Musk

Co-Founder, Chairman, Chief Executive Officer and Product Architect

Well, I think they're going to be comparable to the S over time. But it's -- it'll -- but it is important to bear in mind that the S is a much more mature product, and so we've been in production with the S for 3 years. I would expect the margins to be within a few points of one another over the long term.

Deepak Ahuja

Chief Financial Officer

Which is what we indicated in the letter.

Jeff Evanson

Vice President of Investor Relations

Okay, everyone. Thank you very much for joining us today. We look forward to talking with you next quarter. Bye, bye.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.

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