J.P.Morgan

North America Equity Research
24 January 2011

Tesla Motors

Mgmt. & Plant Visit; Model S On Track; Reiterate Overweight

We recently met Tesla's senior management and toured its facilities in both Northern CA and Southern CA including the recently acquired Freemont assembly plant for Model S production. Nothing we heard substantively altered our bullish view on Tesla though our findings made us, at the margin, more comfortable on many fronts including overall Model S launch timing, manufacturing ramp at Freemont, organizational development, and the future of Tesla beyond the Model S. We continue to believe the majority of the investment community (and the majority of the automotive industry) is substantially underrating Tesla's potential, not just on electric vehicle power-train technology (where converts arguably have been made of Toyota and Daimler) but more broadly on its ability to deliver world-class non-powertrain related vehicle engineering and to eventually grow into a full-line premium carmaker with atypical cost competitiveness. Reiterate Overweight with a DCF-derived $30 Dec 2011 price target and see a three year upside potential to $40-50. It is worth noting that our DCF uses a 8.3% terminal value operating margin assumption (German luxury carmakers typically achieve 6-9%); while it is too early to see if TSLA can establish a mid-teens operating margin structure sustainably as per management guidance, it is worth noting that each 1 percentage point higher operating margin assumption adds $4 to the stock's fair value in our DCF.

- **Model S timing update.** Everything we heard continues to support mid-2012 timing for first customer deliveries of the Model S sedan. Major design freeze has occurred, and an Alpha version was just very recently released to internal executives for testing. From here onwards, a Beta version is expected to be available on Sept 1, 2011, manufacturing start-of-production is expected in mid-March 2012, implying full commercial start-of-production should occur sometime in Q2.2012 assuming no bumps along the way. On a side note, a video of the Alpha version engaged in real world road driving was released earlier this week, an event that apparently sparked 85,000 website hits in just the first few hours. It is difficult to read too much into this figure, but at the margin, it does suggests TSLA's 20,000 unit Model S volume target could be handily beaten if final production version remains true to its originally promised design, specs, and price point.

Overweight

TSLA, TSLA US

Price: $23.04

Price Target: $30.00

Automobile Manufacture

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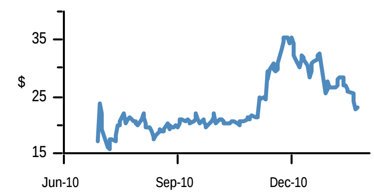
Price Performance



	YTD	1m	3m	12m
Abs	-13.4%	-28.6%	11.0%	35.5%

Tesla Motors, Inc. (TSLA;TSLA US)

	2010E	2011E	2012E	2013E	2014E	2015E
EPS Reported ($)						
Q1 (Mar)						
Q2 (Jun)						
Q3 (Sep)						
Q4 (Dec)						
FY	(1.38)	(1.88)	(1.46)	1.51	1.07	3.12

Source: Company data, J.P. Morgan estimates.

Company Data	
Price ($)	23.04
Date Of Price	21 Jan 11
52-week Range ($)	36.42 - 14.98
Mkt Cap ($ mn)	2,149.63
Fiscal Year End	Dec
Shares O/S (mn)	93
Price Target ($)	30.00
Price Target End Date	31 Dec 11

See page 6 for analyst certification and important disclosures.

- **Future Vehicle Beyond Model S:** Beyond the Model S, it appears TSLA's next focus will be on a crossover (generically referred to as "Model X" internally) of the same footprint roughly as the Model S (i.e., a top hat of the Model S). CEO Musk has started discussing this in public, and Tesla's design head estimated that he spends about 85% of his time today on Model S, and the remaining 15% on the Model X (the CUV) and some non-model specific creative responsibilities he has for the corporation. The Model X is obviously planned to be on the same platform as the Model S – while common platform usage is a regular theme across the global auto industry, it is worth stepping back and remembering that most global OEMs are trying to harmonize existing different platforms down to a few common platforms while Tesla is going the other way (trying to proliferate a single model's platform). The execution of this strategy is probably easier for Tesla, suggesting its top hats may be considerably more profitable than what is typical for most OEMs.

- **Freemont Plant Manufacturing Ramp Observations.** The site is breathtaking in its scale, and equally so in how little TSLA paid for it and some of its key assets. NUMMI was contractually obliged to fully exit the Freemont facility by March 31, 2011, but it has already done so and Toyota/GM seem to have done an impressive job of fully clearing out the old equipment within the facility. The factory floor is clutter free for large swathes except for pieces of equipment TSLA has specifically chosen to buy from NUMMI, and except for a staging ground area for the on-site re-assembly of five massive stamping presses bought from Tower Automotive and recently relocated to the Freemont plant from Detroit. Tesla plans to use about 15% of the square footage of the NUMMI facility for its immediate needs, although this could be expanded if Toyota asks TSLA to do partial/final electric RAV4 assembly at NUMMI (to which TSLA management seems largely agnostic). As an outsider, it is hard for us to fully understand all of the work being done behind the scenes on the manufacturing side. But we could observe that the in-ground metal structural foundations of the five presses were lowered into their respective concrete pits in just the past few weeks, and the above-ground portion of these stamps were being prepped to be assembled in the coming weeks. Manufacturing head Gilbert Passin's organization currently has 80 employees (all white collar) and it plans to add another 500 (largely blue-collar workers) by Dec 2011. When fully ramped, TSLA expects the Freemont facility to be a fully integrated manufacturing site which, in addition to vehicle assembly, does powertrain assembly, plastics, and critical sub-component work on-site.

- **Freemont Plant Economics –** Tesla paid $42MM for the Freemont facility (which built nearly 500k units at peak under NUMMI's ownership) and another $17MM for the factory assets within the Freemont plant it chose to purchase. The $17MM included critical high cost items such as two paint shops (bought by TSLA for about $7MM excluding some refurbishment costs yet to be incurred) which would typically cost $150-250MM each to build from scratch. On top of the $42MM and $17MM, TSLA has agreed to contribute $15MM into an environmental liability claims fund, and NUMMI has agreed to put in that much as well. However, TSLA's portion of the contribution is not required for four years and NUMMI will lend Tesla funds for environment claims up to that $15MM amount during that four year period. Should environment liabilities exceed the fund's $30MM size, all such costs beyond that are 100% Tesla responsibility, although there appear so far to be nothing more than modest soil and ground water contamination clean up costs.

- **OEM Partnership Update – 1) *Daimler* –**Daimler has recently expanded its order of Smart battery packs to 1,800 now (the figure has been steadily rising since it was originally announced at 1,000 units). The new order size was not revealed but it appears we will hear this on the next quarterly conference call. **2) *Toyota*** continues to aim for an electric RAV4 powered by Tesla's electrical powertrain (not just its battery pack) in 2012. It seems like the electric RAV4 assembly job could be shared between Toyota's Canada plant (the home of ICE RAV4 production today) and Tesla's Freemont plant. Beyond the electric RAV4, we sense the two companies are discussing one or two other vehicles (an electric luxury SUV has been reported in the media). On a separate note, the Magnesium battery chemistry Toyota was recently reported to be studying was characterized by Tesla as being largely for HEV (not EV) applications. On balance, both the Daimler and Toyota strategic partnerships seem to be progressing well, and we did not sense any conflicts of interest (at least not yet) between the two.

- **Panasonic Relationship Update –** Tesla and Panasonic continue to have a deep technical alliance, and are jointly developing a somewhat customized 18650 form factor battery for use in Tesla's electric vehicles. Management estimated that Tesla's eventual volume needs with the Model S could account for 20% of Panasonic's 18650 battery capacity today although this figure is rapidly changing as Panasonic is expanding capacity. The timing of Panasonic's investment in Tesla seems to have been partly driven by encouraging progress Panasonic saw on Model S development (though Panasonic apparently approached Tesla to make such an investment a few years ago as well and Tesla rebuffed at that time) and Panasonic's own internal initiatives to refocus the company on green initiatives.

- **Organization Observations –** The organization has grown by several hundred people since we last met the company face to face in CA immediately before the IPO. One of the things perhaps most under-appreciated about Tesla by outsiders is the simple fact that it continues to attract some of the highest quality professionals from both automotive and non-automotive backgrounds. The credibility CEO Musk brings to Tesla in terms of engineering and technical prowess is likely one of its most critical assets. Anecdotal observations from executives suggests recruiting efforts reached some type of tipping point about six months ago when the supply of candidates looking to work for Tesla now seem to vastly exceed the company's hiring pace.

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- **Revisiting the Tesla Investment Thesis –** We continue to be highly bullish on Tesla shares. While there are many electric company upstarts, we think TSLA stands unique in that it is focused on so much more than the electric powertrain which itself seems years ahead of anything we have seen so far in the global auto industry. At its heart, Tesla is a hardcore technical firm that strives for excellence in multiple areas of vehicle engineering (e.g., safety, suspension, paint finish, manufacturing cost efficiency, etc.). On the electric powertrain front, we continue to believe Tesla's cost per kWh for the Model S will likely be in the $200-300 range, about 50% better than all other carmakers. Lower cost per kWh in the electrified vehicle business translates into either a lower priced car (fewer batteries) or greater range (more batteries) – TSLA has effectively chosen the latter approach with the Model S and its impressive range. While other carmakers, who are largely working with large format prismatic batteries, are likely to see about a 50% improvement in their cost per kWh /energy density over five years, TSLA believes its 18650 form factor pack still offers 8% per year energy density improvement potential, suggesting its range/cost advantage with the competition may not necessarily narrow until the end of this decade. The strategic imperative for TSLA, therefore, must be to establish itself as a premium vehicle brand that just happens to make electric cars, hence why we believe the early focus on best-in-class vehicle engineering, service, distribution, etc. will pay long-term dividends.

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Valuation

We get to our $30 Dec-11 price target using both a DCF (11.7% discount rate, 4% terminal growth, exclusive of 2011 burn) and price/sales (1.4x which is the 1.5x average 2012 p/sales of A123, Ener1, BYD discounted one year as we apply it to Tesla's 2013 sales). Our $30 price target implies a somewhat lofty 26.1x P/E on tax rate adjusted 2013 EPS, although implied P/E is 16.5x if 10% EBIT margin is used (our margin forecast may be conservative at least in the initial years (guidance is 14-16%)). Since its 2003 start, Tesla has been singularly focused on developing pure electric vehicles (EVs). We think EVs and plug-in hybrids (PHEVs) both hold strong long-term promise given tightening environment regulations and an increasingly green global consumer. Maintain Overweight.

Risk to Rating

Downside Risks: (1) Established luxury carmakers introduce competing vehicles that eventually prove performance and cost competitive to Tesla's technology. Audi, for example, is targeting a 2012 launch of its E-tron EV ultra luxury sports car, and Mercedes and Porsche have pure EV sports car plans in the works as well. ***(2)*** The manufacturing ramp of Model S is delayed notably. ***(3)*** Model S sales start cannibalizing Roadster sales. ***(4)*** Elon Musk (CEO) is a key executive whose loss to the company could potentially be fairly detrimental (he has a history of moving on once companies become successful). We see him as a visionary who drives Tesla to high technical and commercial targets.

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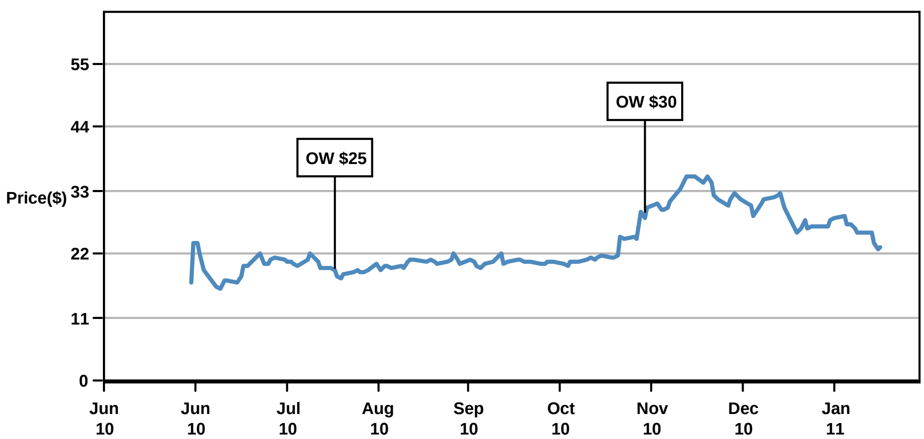
Tesla Motors (TSLA) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
09-Aug-10	OW	19.60	25.00
10-Nov-10	OW	29.36	30.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Aug 09, 2010. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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