Morgan Stanley

MORGAN STANLEY RESEARCH
NORTH AMERICA

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Stock Rating
Overweight

Industry View
In-Line

Tesla Motors Inc.

Catalyst Roadmap

How do we get there? Our recent Tesla upgrade "America's Fourth Automaker" (March 31, 2011) is based on top-line assumptions that are >3x above consensus longer-term. Investors are asking us what is the path to unlock value nearer term? We identify six catalysts that we believe can move the stock in 2011:

1. **Capital raise**: We estimate Tesla's gross liquidity troughs at $146 MM in 2013, *after* a $150 MM equity raise. Without the capital raise, Tesla may need to slow expansion plans. We model the equity raise in 2H11.
2. **Oil price moves.** A $1 rise in gas price per gallon costs US consumers $130bn (approx 1% of US GDP), improving the economic and social rationale for EVs. We estimate a $10 move in oil price is worth around 5% to Tesla's stock.
3. **Powertrain wins.** Daimler and Toyota use Tesla's powertrain in current or future EVs. Additional models with these or other OEMs serve as further validation of Tesla's technology and as well as a source of cash.
4. **Detail on Model X and Gen 3.** We expect a Model X design study released by the LA auto show (Nov '11). We forecast the "Gen 3," a $30k higher volume EV to launch in 2017. Most analyst models reflect little value for this project.
5. **Road test reports of the Model S** could be on newsstands as early as 4Q11. Such opinions carry significant weight with prospective car buyers and can impact stock sentiment.
6. **1Q earnings,** expected the first week of May. Key metrics are Model S reservations, Roadster units and ASPs, Model S production ramp, R&D and capex, and rate of cash burn.

We don't expect Tesla to hit $70 overnight, nor in a straight line. Our forecasts and valuation approach are radically different from the prevailing view. Our thesis requires a combination of near-term execution and long-term industry developments to come to fruition.

Key Ratios and Statistics

Reuters: TSLA.O Bloomberg: TSLA US
Autos & Auto-Related / United States of America

Price target	**$70.00**
Shr price, close (Apr 5, 2011)	$26.70
Mkt cap, curr (mm)	$2,541
52-Week Range	$36.42-14.98

Recent Reports

Title	Date
Tesla Motors Inc.: America's Fourth Automaker Adam Jonas, CFA / Joshua Paradise, CFA / Ravi Shanker / Yejay Ying	Mar 31, 2011
Cree, Inc.: Market Likely Overestimates Earnings Power Joshua Paradise, CFA / Smittipon Srethapramote / Timothy Radcliff	Apr 5, 2011
Tesla Motors Inc.: The Natural Oil Hedge Adam Jonas, CFA / Joshua Paradise, CFA / Ravi Shanker / Yejay Ying	Apr 4, 2011
Global Auto Monitor Adam Jonas, CFA / Noriaki Hirakata, CFA / Stuart Pearson, CFA / Kate Zhu, CFA / Sangkyoo Park / Binay Singh / Jeremy C Chen	Mar 31, 2011

(1) Capital raise: We estimate that Tesla's gross liquidity bottoms at $146 MM in 2013, after a $150 MM equity raise, which we model in 2H11. A key positive catalyst could be the completion of a sufficient capital raise to diminish concerns that Tesla would have insufficient capital to produce and ship the Model S, fund the design of the Model X, and build a distribution network. Without the capital raise, we believe Tesla would have to slow expansion plans.

We would also view as an incremental positive if strategic partners Daimler, Toyota or Panasonic invest additional capital. Note that foreign entities would have to file Hart–Scott –Rodino (HSR) if their investment exceeded $66 MM.

(2) Oil price moves. On our calculations, a $10 rise in global oil prices is worth ~5% to Tesla shares. A $1 move in US gas prices could be worth ~13% to Tesla shares as higher gas prices increase the attractiveness of electric vehicles and reduce the payback period. Tesla offers a hedge against rising oil prices, the function of an EV costing around 3 cents per mile of electric energy usage vs. around 15 cents per mile for a typical internal combustion vehicle. The typical US driver buys 480 gallons of gas per year. The burden of a $1 increase in gas price has an NPV cost of $3,500, equal to 25 to 30% of the cost of a 100-mile-range EV battery ($12,500). Seen another way, $1 rise in gas price reduces the payback period of an EV battery from 9.5 to 6.9 years at $500 per KWh and 25mpg for internal combustion engine.

(3) Powertrain wins. Daimler currently uses Tesla's battery packs and chargers in electric versions of the Smart ForTwo and the A-class. Toyota plans to use Tesla's entire electric powertrain including the motor, battery pack, power management system, and charger in a new electric version of the Rav4 small SUV, which Tesla is developing with Toyota. Toyota is paying Tesla $69 MM over 5 quarters for development of the Rav4 powertrain, accounting for 35% of 2011e revenues. To date, the anticipated volumes on the Daimler and Toyota powertrain agreements are small, typically below 2,000 units, but they serve as validation of Tesla's technology. Higher volumes and/or additional OEM agreements would be a significant positive catalyst, in our view.

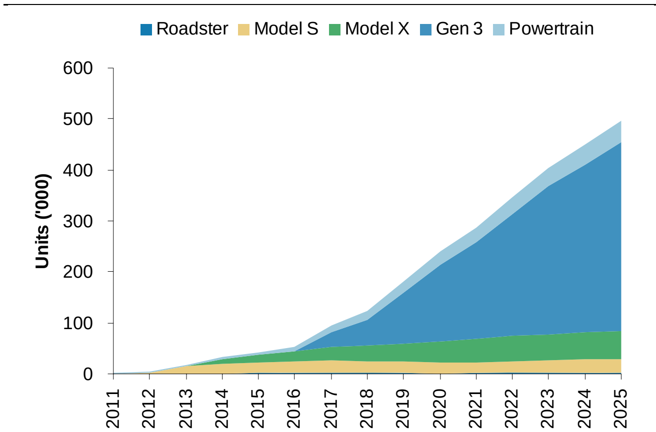
(4) Further detail on upcoming models, esp. the Gen 3: We expect TSLA could show a concept version of its Model X crossover as early as the LA Auto Show this November. We believe any glimpse into the future model pipeline at TSLA could soothe investor fears about over-reliance on the Model S. This is especially true of the "Gen 3," a lower-priced higher volume Tesla which we forecast to launch in 2017 with 30,000 units, and grow to 370,000 units by 2025, accounting for over 80% of Tesla's vehicle volumes.

Exhibit 1
Tesla Model X

Source: Motor Authority

TSLA itself has made few public statements about the Gen 3 and we believe most analyst models reflect little value. There is significant skepticism that battery costs will come down quickly enough to sell an electric vehicle around $30,000. If management shares more details about the Gen 3 with investors, the market could start to incorporate Gen 3 volumes into forecasts, potentially driving upside in the shares.

Exhibit 2
Gen 3 Volumes are over 80% of Unit Sales in 2025e



Source: Company data, Morgan Stanley Research

If we exclude Gen 3 from our forecast, our DCF-based value and our 2025e EPS would each be about 55% lower; our DCF without Gen 3 falls to $32 per share and our EPS in 2025e falls to $5.85.

As management starts planning the Gen 3, and the market starts to incorporate Gen 3 volumes into forecasts, we see upside to the shares.

(5) Road test reports of the Model S could be on newsstands as early as 4Q11. A positive review could reduce skepticism that deliveries will begin on time in mid-2012 and would likely increase the pace of reservations. We forecast that by the time Model S production begins, Tesla will have over 6,500 reservations, creating a backlog of nearly six months of production.

(6) Quarterly earnings, expected the first week of May. Key metrics are Model S reservations, Roadster sales volumes and ASPs, progress on Model S production ramp, R&D and capex spending. We expect 400 new Model S reservations in the quarter, equal to the run rate in 4Q10, bringing total reservations to 3,800. For Roadster sales, we expect forecast 145 units at an average ASP of $126k, also in–line with 4Q10. Our EPS forecast of ($0.57) is below consensus of ($0.52) as we expect higher investment in R&D near-term. In our view, disappointing quarterly earnings would likely drive the stock lower, but a positive earnings surprise is less likely to be a major catalyst than those detailed above.

Valuation methodology and risk discussion. We argue Tesla cannot be valued on near-term multiple metrics like traditional auto companies given that we expect Tesla to multiply revenues by over 20x from 2010 to 2015e, by more than 80x by 2020e and over 150x by 2025e. We have thus chosen a 15-year time horizon for our DCF which captures the full utilization of Tesla's manufacturing capacity in Fremont, the full maturation of the Model S, Model X (and top-hat derivatives) and also the ramp up of its mass market electric vehicle (the Gen 3). We have applied a 12% WACC with a range of 10% to 14%. The terminal value accounts for around 60% to 70% of the total DCF value across the range of methodologies we have applied to arrive at our $70 PT. The risks of lagging EV adoption, launch delays and balance sheet difficulties make Tesla a highly speculative investment.

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of March 31, 2011)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1195	42%	469	47%	39%
Equal-weight/Hold	1153	40%	406	40%	35%
Not-Rated/Hold	114	4%	22	2%	19%
Underweight/Sell	389	14%	108	11%	28%
Total	2,851		1005		

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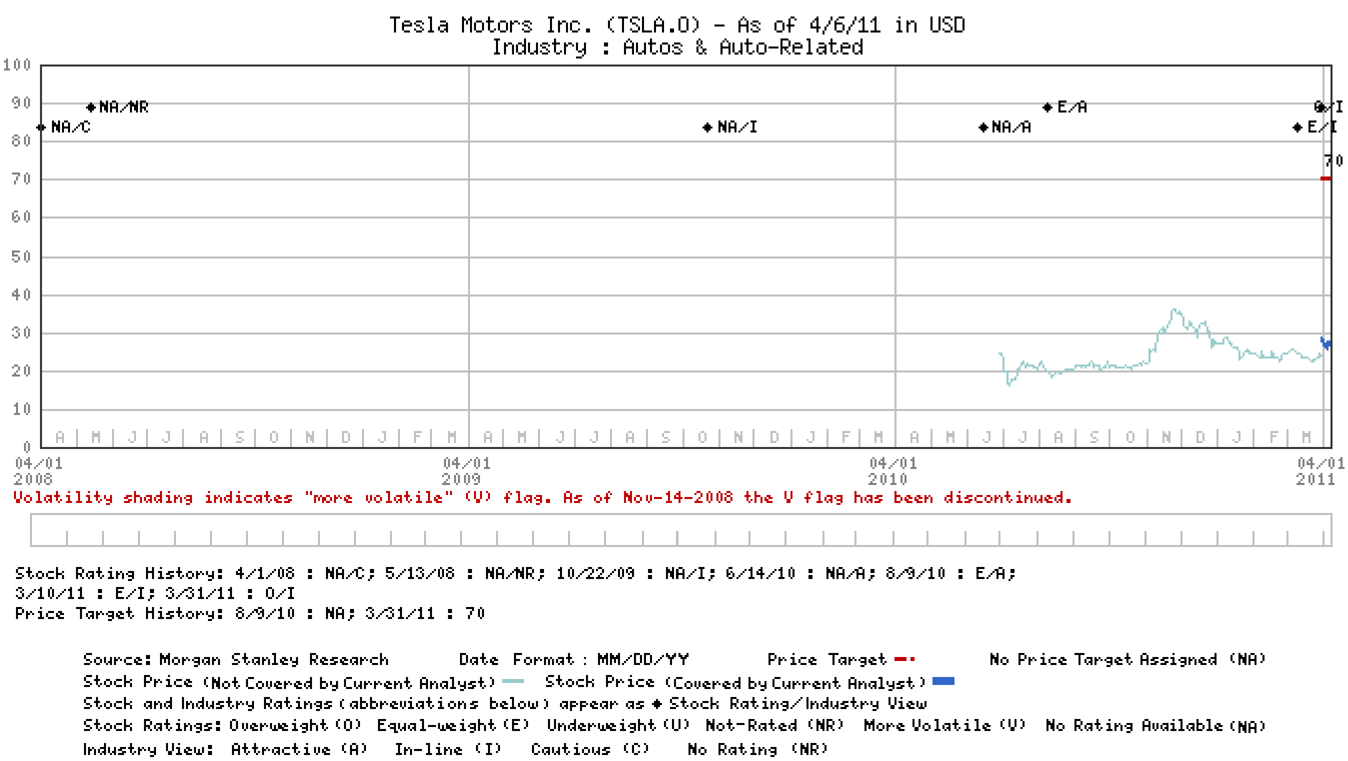
Stock Price, Price Target and Rating History (See Rating Definitions)



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Industry Coverage:Autos & Auto-Related

Company (Ticker)	Rating (as of)	Price* (04/06/2011)
Adam Jonas, CFA		
Ford Motor Company (F.N)	O (10/04/2010)	$15.73
General Motors Company (GM.N)	O (12/28/2010)	$32.87
Tesla Motors Inc. (TSLA.O)	O (03/31/2011)	$26.49
Ravi Shanker		
AutoNation Inc. (AN.N)	U (03/10/2011)	$35.22
BorgWarner Inc. (BWA.N)	O (10/22/2009)	$77.76
Cooper Tire & Rubber Company (CTB.N)	O (03/16/2010)	$25.34
Goodyear Tire & Rubber Company (GT.N)	O (03/10/2011)	$15.2
Group 1 Automotive, Inc (GPI.N)	U (10/22/2009)	$43.51
Johnson Controls, Inc. (JCI.N)	O (06/14/2010)	$41.36
Lear Corporation (LEA.N)	U (09/23/2010)	$48.47
Magna International Inc. (MGA.N)	U (03/10/2011)	$48.69
Meritor Inc (MTOR.N)	O (09/23/2010)	$17
Penske Automotive Group, Inc (PAG.N)	U (10/22/2009)	$20.93
TRW Automotive Holdings Corp. (TRW.N)	O (09/10/2010)	$54.83
Tenneco Inc. (TEN.N)	U (09/23/2010)	$42.32

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