

Tesla Motors

Model S On-Track; Panasonic Tie-Up Further Validates TSLA Technology

Summary: Tesla's Q3 financials were largely uneventful, but the combination of multiple qualitative developments and comments serve to 1) support the view that the Model S launch is progressing in a timely fashion and 2) that TSLA does have a unique technology that is being increasingly recognized by others (most recently, Panasonic). We leave future period estimates largely unchanged, and establish a Dec 2011 price target of \$30 using DCF (prior \$25 target was a Dec 2010 target). While positive earnings are still a couple of years away, we are bullish on TSLA as we believe it is at the vanguard of improving battery costs/durability which should support the creation of a well-received Tesla-badged product line up in this decade but also what seems like an increasingly viable powertrain supply revenue stream. Reiterate Overweight.

- 3Q:10 Details:** Roadster sales increased +7% y/y to 151 (vs. 141 in 2Q:10) in 3Q:10 with half of the deliveries made outside the US, mainly Europe. Revenues, however, were lower despite sequentially flat ASP due to higher lease mix in the US and one-time catch-up in options. Company stated that balance of the leasing revenues will be recognized in 4Q. Gross margins improved to 30% (vs. 22% in 2Q:10) driven by higher Development sales (+78% q/q) during the quarter. Automotive gross margin, net of Warranty costs, was 16.7% in the quarter (vs. 15.5% in 2Q), while margins at Development business were 68.5% in 3Q:10 (vs. 57.6% in 2Q:10). Further, TSLA reported that Model S reservation increased to 3K units at 3Q-end (vs. 2.8K at the end of 2Q).

Overweight

TSLA, TSLA US

Price: \$24.63

▲ **Price Target: \$30.00**

Previous: \$25.00

Automobile Manufacture

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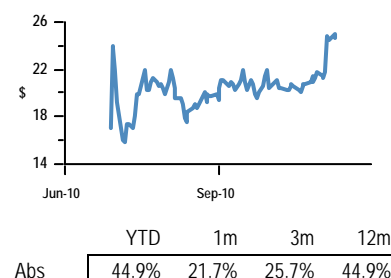
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Price Performance



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 (\$)	24.63
Date Of Price	09 Nov 10
52-week Range (\$)	30.42 - 14.98
Mkt Cap (\$ mn)	
Fiscal Year End	Dec
Shares O/S (mn)	
Price Target (\$)	30.00
Price Target End Date	31 Dec 11

See page 7 for analyst certification and important disclosures.

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- **Panasonic's \$30MM Investment in Tesla:** The recent \$30MM investment by Panasonic in TSLA equity offers yet another (in addition Daimler's and Toyota's) piece of a strong TSLA technology validation in our view. Panasonic is the world's leading supplier of small format lithium battery cells, and Panasonic (starting with its Sanyo subsidiary) has had deep commercial links with Tesla for six years. It is interesting to note that despite the investment, TSLA is not required to sole source batteries from Panasonic (the Model S batteries will be dual sourced, and we suspect TSLA is searching for another non-Japanese supplier, partly to limit Yen exposure). The CEO described the Panasonic investment as an endorsement of TSLA's technology and a sign of "friendship" between the two companies. Practically speaking, Panasonic was already TSLA's preferred battery vendor, and Panasonic batteries will be the primary source for batteries to the Model S, and the packs for the EV versions of the Daimler smart, Mercedes A-Class, and the Toyota RAV4. More strategically, having Panasonic directly invested in TSLA's future provides a greater level of confidence that TSLA will be able to further reduce battery cost per kwh, particularly relevant for the third-gen car to follow the Model S.
- **TSLA could announce partnership with one more global automaker:** Management mentioned that TSLA is in discussions with several automotive companies for potential commercial relationships, but stayed away from specifics except to say that at least one additional relationship (in addition to Daimler and Toyota) was likely. We think this is a positive, as it would indicate that up to three traditional carmakers are seeing the virtues of Tesla's low cost battery technology.
- **Model-S vehicle and launch updates:** A few incremental points discussed in the call regarding launch of Model-S in mid-2012 are listed below: (1) Mgmt. seemed confident on the mid-2012 launch timing and 20K volume in 2013 of Model-S vehicles and suggested that final systems integration (particularly related to crash testing) was one of the major areas of risks to launch timing. (2) Nearly 100% of supplier sourcing decisions are expected to be done by end of 4Q:10. (3) Management suggested that TSLA is making good progress towards an 80kW fast charger (the default chargers with Model S will be a 10kW or 20kW charger) which will require *just* 45 minutes of charge Model-S (70kWh battery pack to be charged up-to 85%). Company is expecting to make these chargers available with the launch of Model-S and is now planning to install these chargers in public roadways. (4) TSLA signaled it made some modest design tweaks to the Model S in recent months (eg, a Panoramic roof option, and the use of NVIDIA graphics chips for the IP and center console) which broadly reinforces the view that this EV-powertrain focused company is striving for equally high/impressive vehicle engineering attributes for the Model S.

- **Toyota RAV4 Details:** Toyota earlier announced to plan to jointly develop a EV power-train for its future RAV4. TSLA mentioned that this contract will generate \$60MM of development revenues and that it will be realized over 6 quarters after the commencement of the contract (which we suspect is sometime early next year). TSLA will also derive an additional \$9MM of revenues to develop a prototype RAV4 for Toyota. Mgmt. suggested that there are a lot of similarities between Model S and RAV4 power-trains but with a different systems integration challenge. Core IP in RAV4 development will be owned by TSLA and system integration related IP will generally be owned by Toyota. Company also mentioned that RAV4 will have a 40kWh battery pack (smaller than Model-S' 70kWh), similar to Mercedes A-class. It was suggested that RAV4 may initially be manufactured in NUMMI plant and may eventually be moved to Toyota plant depending on the volumes.

Table 1: DCF Based Valuation Yields Dec-2011 Price Target of \$30

	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues	112	109	147	628	1,846	2,173	3,672	4,971	6,590	7,209	8,346	8,420
EBITDA	-46	-135	-182	-119	196	149	472	610	686	619	749	748
Less: D&A	-5	-10	-16	-35	-43	-45	-45	-50	-50	-50	-50	-50
EBIT	-51	-145	-198	-154	153	104	427	560	636	569	699	698
Interest Expense	-2	-3	-10	-14	-13	-10	-9	-7	-6	0	0	0
Taxes	0	0	0	0	0	0	-100	-133	-151	-137	-168	-167
Net Income	-54	-148	-208	-168	140	93	318	420	479	433	531	530
Add: D&A	+5	+10	+16	+35	+43	+45	+45	+50	+50	+50	+50	+50
Add: Stock based compensation		+17	+14	+16	+19	+20	+22	+24	+26	+28	+30	+30
Change in Working Capital	0	36	17	25	87	35	101	96	117	59	91	27
Capital Expenditure	-68	-100	-136	-83	-136	-180	-360	-100	-138	-158	-195	-213
Free Cash Flow to Equity	-117	-185	-297	-175	153	13	126	490	534	412	507	425
PV of FCF to Equity		-185	-266	-141	110	8	73	255	250	173	191	144
Terminal Value												5,919
Implied Terminal Growth rate												14x
PV of Terminal Value												1,999

DCF Assumptions	Comments
(1) Risk-free rate*	2.656%
(2) Beta	1.0
(3) Risk Premium**	8.5%
(1)+(2)*(3) = Cost of Equity	11.5%
LT Growth Rate	4.0%

* US 10-yr Treasury yield

** Source: Bloomberg's US Country Risk Premium

Equity Value Calculation	
PV of FCFs	1,064
PV of Terminal Value	1,999
Equity Value (fully distributed)	3,062
Implied Stock Price	30

Source: Company reports and J.P. Morgan estimates.

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.

Tesla Motors: Summary of Financials

Income Statement - Annual	FY09A	FY10E	FY11E	FY12E	Income Statement - Quarterly	1Q10A	2Q10A	3Q10A	4Q10E
Revenues	112	109	147	628	Revenues	-	-	-	-
Cost of goods sold	102	84	115	520	Cost of goods sold	-	-	-	-
Gross profit	10	25	32	108	Gross profit	-	-	-	-
SG&A	-	-	-	-	SG&A	-	-	-	-
D&A	-	-	-	-	D&A	-	-	-	-
Operating income	(51)	(145)	(198)	(154)	Operating income	-	-	-	-
EBITDA	(46)	(135)	(182)	(119)	EBITDA	-	-	-	-
Net interest income / (expense)	-	-	-	-	Net interest income / (expense)	-	-	-	-
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	-	-	-	-	Pretax income	-	-	-	-
Income taxes	-	-	-	-	Income taxes	-	-	-	-
Net income - GAAP	-	-	-	-	Net income - GAAP	-	-	-	-
Net income - recurring	-	(141)	(194)	(152)	Net income - recurring	-	-	-	-
Diluted shares outstanding	-	102	103	104	Diluted shares outstanding	-	-	-	-
EPS - GAAP	-	(1.38)	(1.88)	(1.46)	EPS - GAAP	-	-	-	-
EPS - recurring	-	(1.38)	(1.88)	(1.46)	EPS - recurring	-	-	-	-
Balance Sheet and Cash Flow Data	FY09A	FY10E	FY11E	FY12E	Ratio Analysis	FY09A	FY10E	FY11E	FY12E
Cash and cash equivalents	-	-	-	-	Sales growth	-	-	-	-
Accounts receivable	-	-	-	-	EBITDA growth	-	-	-	-
Inventories	-	-	-	-	EPS growth	-	-	-	-
Other current assets	-	-	-	-	Gross margin	-	-	-	-
Current assets	-	-	-	-	EBIT margin	-	-	-	-
PP&E	-	-	-	-	EBITDA margin	-	-	-	-
Total assets	-	-	-	-	Tax rate	-	-	-	-
Total debt	-	-	-	-	Net margin	-	-	-	-
Total liabilities	-	-	-	-	Net debt / EBITDA	-	-	-	-
Shareholders' equity	-	-	-	-	Net debt / capital (book)	-	-	-	-
Net income (including charges)	-	-	-	-	Return on assets (ROA)	-	-	-	-
D&A	-	-	-	-	Return on equity (ROE)	-	-	-	-
Change in working capital	-	-	-	-	Return on invested capital (ROIC)	-	-	-	-
Other	-	-	-	-					
Cash flow from operations	-	-	-	-					
Capex	-	-	-	-					
Free cash flow	-	-	-	-					
Cash flow from investing activities	-	-	-	-					
Cash flow from financing activities	-	-	-	-					
Dividends	-	-	-	-					

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

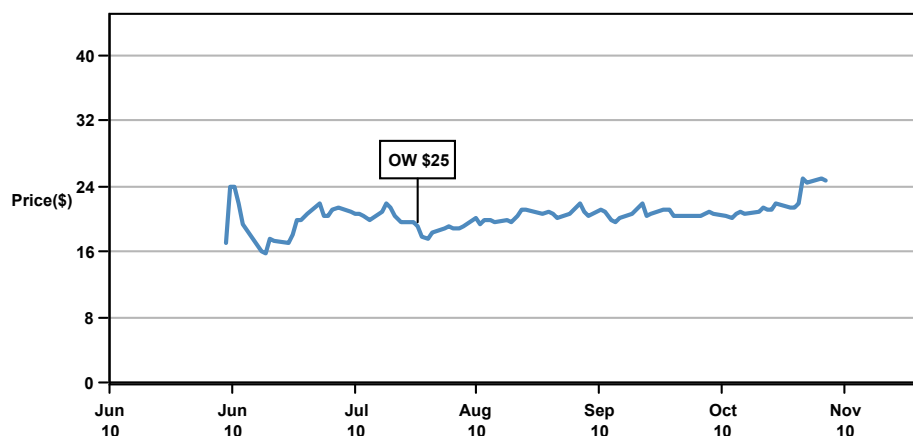
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Tesla Motors (TSLA) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
09-Aug-10	OW	19.59	25.00

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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