

Corrected Note

## Tesla Motors

### More on Model X; 2011 Guidance Comments; Model S Launch Updates

**Stock view:** We retain our Overweight rating on TSLA, with a DCF-derived Dec-2011 price target of \$30 and what we believe is three-year upside potential of \$40-50. We remain bullish on this hardcore technology company that commands excellence in multiple areas of vehicle engineering and has notable cost advantage vs. peers on battery cost per kWh (about as much as 50% currently). We highlight that our price target is based on 8.5% terminal operating margin, which is significantly below "midteen" operating margin guidance long term. Higher margins could provide further upside to our DCF-based valuation; each percentage point in margin adds \$4 to fair value. Reiterate Overweight.

#### Key conference call takeaways:

- **Details on Model X:** TSLA seemed to indicate that the Model X, a 3-row CUV variant built on the Model S platform, would have comparable pricing to the Model S (i.e., ~\$60K). TSLA expects production volume of the Model X to be twice that of other premium luxury vehicles (in line with Model S) and will likely unveil a prototype by year-end. We note that the Model S was first revealed in March 2009 and an alpha prototype was launched in late 2010; however, the time to market for the Model X should be notably shorter given an already established platform and functioning manufacturing facility.
- **Thoughts on required funding for development of Model X:** Given the available liquidity of \$566MM (cash + untapped DoE loan), launch costs related to Model S in 2011-2012 (2011 capex excluding Model X development cost guided to \$190-215MM) and an incremental \$100-150MM of capex required for the Model X vehicle, we suspect available liquidity may not be enough and Tesla may need to access external equity capital.
- **Model S launch update:** While reiterating that Model S is on track for mid-2012 launch, TSLA mentioned that the Fremont manufacturing facility will be fully up and running by year-end and the beta prototype of Model S will undergo intensive safety testing at the end of summer. Meanwhile, it was encouraging to see that Model S advance registrations popped up (to 3,700 vs. 3,400 at year-end) in the last few months after release of alpha version of the vehicle. Marketing campaign for Model S will be launched in H2:2011, but automotive media may or may not get beta version of the vehicle by year-end. Further, it seems that TSLA may have more range on the highest-range version (300 miles on a single charge) of the Model S.

#### Tesla Motors, Inc. (TSLA;TSLA US)

|                   | 2010A  | 2011E  | 2012E  | 2013E | 2014E | 2015E |
|-------------------|--------|--------|--------|-------|-------|-------|
| EPS Reported (\$) |        |        |        |       |       |       |
| Q1 (Mar)          |        |        |        |       |       |       |
| Q2 (Jun)          |        |        |        |       |       |       |
| Q3 (Sep)          | (0.37) |        |        |       |       |       |
| Q4 (Dec)          | (0.47) |        |        |       |       |       |
| FY                | (2.54) | (2.14) | (1.56) | 1.45  | 1.15  | 3.10  |

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

## Overweight

TSLA, TSLA US

Price: \$24.73

Price Target: \$30.00

#### Automobile Manufacture

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#### Price Performance



*Please note that we changed our EPS estimates across the board following 2011 revenue, SG&A, and R&D guidance from TSLA coupled with a slightly higher share count (109MM vs. 103MM earlier): 2011e: -\$2.14 (vs. -\$1.88 earlier); 2012e: -\$1.56 (vs. -\$1.46 earlier); 2013e: \$1.45 (vs. \$1.51 earlier); 2014e \$1.15 (vs \$1.07 earlier); and 2015e \$3.10 (vs. \$3.12 earlier)*

#### Company Data

|                       |               |
|-----------------------|---------------|
| Price (\$)            | 24.73         |
| Date Of Price         | 16 Feb 11     |
| 52-week Range (\$)    | 36.42 - 14.98 |
| Mkt Cap (\$ mn)       | 2,330.56      |
| Fiscal Year End       | Dec           |
| Shares O/S (mn)       | 94            |
| Price Target (\$)     | 30.00         |
| Price Target End Date | 31 Dec 11     |

See page 4 for analyst certification and important disclosures.

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- **2011 guidance commentary:** Management guided 2011 revenues to be \$150-175MM (+40-50% y/y), and noted that Development Services will have the same run rate as 4Q while Powertrain revenues will be roughly flat with 2010; we estimate this implies a +10-15% increase in Roadster unit volumes in 2011. Gross margins in 2011 could be below 4Q (31.2%), largely a function of revenue mix. Development Services carry a high 50-70% gross margin, whereas Roadster and Powertrain have similar gross margins of ~20%. Further, SG&A and R&D are expected to moderately increase from Q4 run rate. Similarly, management guided 2011 capex to be in the range of \$190-215MM, slightly higher than what we would have expected, likely explained by: a) incremental insourcing (i.e., stampings and plastics); b) newer technology in paint/body shop; c) more automation to produce 3,000 units in single shift (earlier plant required 2 shifts), and d) under-running of capex in 2010 (\$105MM vs. \$100-125MM guidance). We note that this year's capex will be largely funded by TSLA's DoE loan.
- **4Q:10 details:** Roadster volumes declined slightly q/q to 149 units (vs. 151 units in 3Q:10), likely due to seasonal reasons. Roadster ASP, however, grew sequentially and the increase was attributed to: higher Asian mix, higher option take rates in Europe, and favorable foreign exchange. Gross margins improved to 31.2% in 4Q (vs. 29.8% in 3Q) due to lower labor and overhead costs. R&D expenditure spiked up to \$38MM (vs. \$27MM in 3Q) on account of building the alpha version of Model S, relocation of employees from Los Angeles to Palo Alto, and higher headcount.
- **Expansion in Chinese market:** TSLA mentioned that it will enter the China market in 2013, at the earliest, as an anticipated strong demand for Model S in existing markets, which should outpace production in 2012, would make entry into new markets less attractive phenomena in the 2012 time frame. Further, mgmt. stated that it will not make significant modifications to Model S for Chinese market consumption, a strategy similar to the one used by German luxury OEMs. Also, TSLA is not looking for any partner with which to penetrate the Chinese market.

## Valuation

We derive our \$30 Dec-11 price target using DCF analysis (11.5% discount rate, 4% terminal growth, exclusive of 2011 burn). Our price target reflects a price/sales multiple of 1.4x, which is in line with the 1.5x average 2012E p/sales of A123, Ener1, BYD, discounted one year as we apply it to Tesla's 2013 sales. However, our \$30 target does imply a somewhat lofty 27x P/E on tax rate-adjusted 2013E EPS (versus its current multiple of 21x), although implied P/E is 17.1x 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 environmental regulations and an increasingly green global consumer. Maintain Overweight.

## Risks to Price Target and 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.

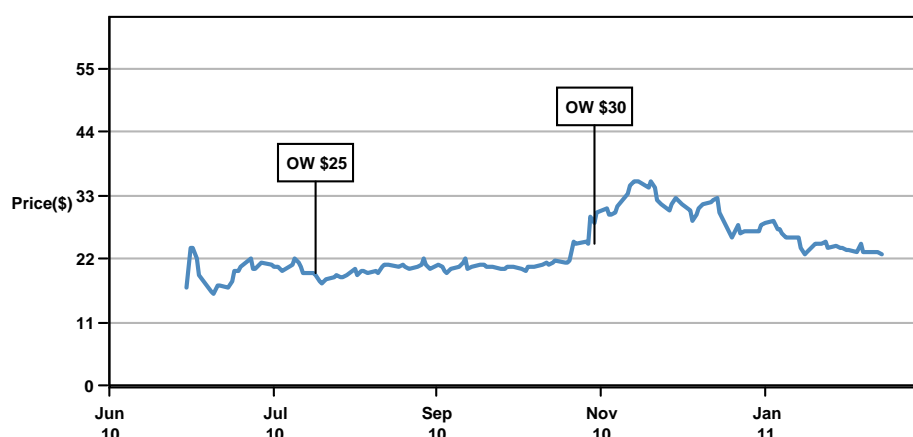
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### Tesla Motors (TSLA) Price Chart



| Date      | Rating | Share Price (\$) | Price Target (\$) |
|-----------|--------|------------------|-------------------|
| 09-Aug-10 | OW     | 19.59            | 25.00             |
| 10-Nov-10 | OW     | 24.63            | 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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