

Our first question comes from John Lovallo from Merrill Lynch.

John Lovallo - Merrill Lynch

A few questions for you here. Starting with developmental services revenue, was that \$5 million in the quarter all Daimler revenue?

Deepak Ahuja

Yeah, it is all Daimler revenue. You're right about that.

John Lovallo - Merrill Lynch

And would you say that that \$5 million would be a good run rate over the next six quarters?

Deepak Ahuja

It's going to vary by quarter, because our overall program with Daimler is based on delivery of certain milestones, and there are different revenues associated with it. We have indicated that it's going to be total close to \$30 million and it will be spread over the next six quarters roughly.

John Lovallo - Merrill Lynch

In terms of model S deliveries in the quarter, did you guys disclose how many were actually delivered?

Deepak Ahuja

We delivered in the quarter 10 model S. We produced a few more, and our focus was primarily providing those for our marketing activities, so that we could have more ride and drive events, the Get Amped tour that we kicked off. So we really wanted to make sure we had a lot going on for our test drives.

Elon Musk

And if I could probably preempt a question that if you weren't going to ask it, somebody probably would. We've made a total of 40 production vehicles so far. And the production is ramping quite well actually, so it actually steps up in a sort of geometric or exponential fashion. It's not linear. So we'll see quite a dramatic increase in the production rate in the coming months.

John Lovallo - Merrill Lynch

In terms of the power train units for Toyota, how many units were actually produced this quarter?

Deepak Ahuja

We produced roughly 100 units in this quarter. And it's a combination of battery packs and drive units, but it was in that ballpark. It's, again, a start of the ramp in terms of our production, as we've indicated. And we'll continue to see some growth there.

John Lovallo - Merrill Lynch

How many roadster vehicles actually remain to be sold throughout the remainder of the year?

Deepak Ahuja

We have about 130-140 vehicles left to sell, and we expect to have those sold out by the end of the year.

Operator

The next question comes from Dan Galves from Deutsche Bank

Dan Galves – Deutsche Bank

In terms of the ramp - and congratulations on launching the vehicle on time and the great reviews it's been getting - wondering if you could talk about what are the key challenges to come in terms of making this exponential jump in production rate at some point in the quarter, whether you're making last minute tweaks in the vehicle, or supplier issues, or the process at Fremont. If you could just kind of take us through what the challenges are ahead in that.

Elon Musk

First of all, it's worth learning that it is actually normal in the auto industry for there to be an exponential growth in production. So this is not unusual. Ours is maybe going over a slightly longer potential than is normally the case for gasoline cars, because in our case we've got probably something like 97-98% of the components of the Model S are new. They're not in any other vehicle. And you can only make cars as fast as your slowest component. And we want to make very sure that every car that comes off the line is as close to perfect as possible. In fact, I'm personally inspecting every car whenever I can.

I think it makes sense to take that approach and ensure that when customers receive a car it is as close to flawless as possible, and only grow the production ramp to the degree we're able to maintain an exceptional

quality standard rather than to sort of rush into things and then have a great deal of customer unhappiness.

And when we looked at our cash flow forecasts, whether we did a bunch more deliveries in the third quarter or basically if we moved several hundred deliveries from third quarter, one way or the other, it doesn't change our cash low point. And we are optimizing for our cash low point, from a cash flow standpoint. And then on the other side, making sure that our customers are ecstatic when they get their cars.

And so I actually changed the production ramp to slow it down at the beginning and then ramp it up faster toward the end. And I think it's the right decision. Time will tell, but I think it's the sensible decision. It certainly what I would wish somebody did if I was a shareholder in the company, and I am. [laughter]

Dan Galves – Deutsche Bank

And that makes sense. And just to follow up on your comments on the cash flow, it looks like liquidity went down by \$120 million approximately in the quarter. You have \$265 million of liquidity available. It seems like the cash low point - I guess I don't understand what you mean by the cash low point doesn't change. It would seem like the longer it takes until you get to the higher production rate, the lower your cash balances would go. So if there's any way to kind of gauge whether the cash burn will slow in the third quarter and if you have a targeted year end level that you could provide to us, that would be helpful.

Deepak Ahuja

Dan, I think if this is a managed slowdown, then you can manage cash, and that's what we have done. We've deliberately, up front, planned to do 500 units. The worst thing you can do is plan for 1,000 and then deliver 500. That's when you have the excess cash burn. So this is a planned approach, which helps us manage our cash. And as we've indicated in the shareholder letter, our expectation based on our plans is that we will achieve pretty close to free cash flow breakeven in Q4. And in Q3, we will see a burn roughly along the same lines as Q2, maybe slightly higher. But considering all of that, and given our cash resources, we feel pretty comfortable that we have sufficient liquidity to get to profitability next year.

Elon Musk

If you move several hundred cars from one quarter to the next, it actually does not change our cash low point. That's actually driven more by working capital requirements at the end of the year, when we're producing almost a

couple thousand cars a month. So why try to push a product on customers that is not as perfect as possible if it doesn't actually yield anything tangible?

Dan Galves – Deutsche Bank

It seems like, different than most auto makers, you recognize revenue when the vehicle is delivered to the customer, not when it's shipped off the factory to a dealer. So I guess what I'm getting at is you probably, if you're going to deliver 500 in the third quarter, you're probably going to produce quite a bit more than that? Is that true? And then where do you expect inventory to be once you get to close to your targeted run rate of 5,000 a quarter?

Elon Musk

I think it's probable that we'll produce more than 500, but it's always a little tricky to - essentially, if you imagine the production ramp is this quite sharp S curve, and as you pick an arbitrary point on a steep portion of that S curve, you can actually see quite significant movement of units. It's hard to predict exactly where things will be on that steep portion of the S curve.

But I'm not sure it's relevant, because you get to the flat portion, but at the high portion of the S curve, at that point it's much more predictable, and that's sort of a point we feel really confident about getting to in the fourth quarter. And I think it's the more relevant thing. Like, if you were to present value the cash flows, and move the stuff around, it actually doesn't change the effect of the market cap of the company if one is doing the analysis correctly.

So I think it's probable we'll do that, but it's not certain. But one way or the other, it's not going to make much of a difference.

Deepak Ahuja

And Dan, to your specific question, although we recognize the revenue when the customer gets the car, the gap is not much. At least in the beginning. A lot of our customers are in California. Deliveries happen immediately. And even if it is long distance, it's just a matter of a couple more days, or three days. It's not that dramatically different.

Elon Musk

And one thing I wanted to reemphasize, if people recall, one of the things that I've been really emphatic about is that in 2013 we'll produce at least 20,000 units, and that our gross margin will exceed 25%. And I also said that we'd start deliveries no later than July. And those are the three things that I said I was highly confident that we would do. There are other things

that are sort of nice-to-haves, and you'd like to do, and maybe this will happen, but those are the important ones. And it's worth noting that we started deliveries in June, so we're ahead of July. And I think we're going to exceed 20,000 units next year and exceed 25% gross margin. And those are the things that I think you should really hold me and Tesla to.

Deepak Ahuja

And that's the flat portion of that S curve.

Elon Musk

That's the thing that really matters, yes. Absolutely.

Operator

Your next question comes from Ben Schuman from Pacific Crest Securities.

Ben Schuman – Pacific Crest Securities

Elon, you talked about changing the ramp a little bit. Can you specifically address what is driving that in terms of the quality control factors that you're focusing on with that revised timeline?

Elon Musk

I can talk a little bit about it, although it's easy to get lost in the weeds. Because it's not as though there's any one big thing. It's like a couple hundred little knick-nacky things. One example is the supplier who's doing the chrome plating of the door handles just couldn't meet our quality standards. There were little tiny pits in the plating that were just unacceptable to us. So we had to switch that to a different plating supplier. Things like the banana leaf interior trim, when I was shown a sample of that, it looked good, but when I saw it on the car, it did not look good, so I canned it.

We're not going to deliver an option that doesn't look good, and unfortunately that was not clear until we saw it in a car, which was late in the game. So there's some sort of things like that. We have to do last-minute maneuvering. But decisions are made absolutely with respect to ensuring that the product is the best possible product. That's what we're aiming at. Great companies are just built around great products or services, and so we have to be super-focused on ensuring that we have a product that is not slightly better, but substantially better. And I think we have that actually. The reviews, that's the response we're getting.

Ben Schuman – Pacific Crest Securities

Can you address how cancellations are trending now that more and more of those finalize your order emails are going out?

Deepak Ahuja

I think overall we're finding that cancellations as a percentage of our reservations is holding fairly steady the last few months. So clearly customers have to make that decision, but we're not seeing anything which raises any red flags in our minds.

Elon Musk

Quite frankly, the thing that I get bugged about is not cancellations, it's people who want their car sooner. A day does not go by when I don't get several requests from quite senior people, or celebrities, saying isn't there some way they could move up on the list. It's not the cancellations that are a concern. We do not have a demand problem. We obviously do not have a demand problem.

One of the biggest reasons people do not put down a reservation payment for a Model S is because you have to wait a year almost, or 10-11 months. And if you need a car, you need a car. So we actually need to focus our energies heavily on the production ramp and maintaining quality, and achieving gross margin. Those are really our issues. It's not demand generation. George is doing such an awesome job, I don't even have to worry about that.

Ben Schuman – Pacific Crest Securities

We've seen some concept cars from other manufacturers, high performance EVs, things like that, but nothing really close to production that compares to the Model S in terms of performance characteristics, things like that. Who do you think from a competitive standpoint is closest to Tesla, especially on the power train side of things, and how far behind are they?

Elon Musk

Well, the next best power trains are the ones that we provide to our partners. Then, after that, then you're at the Leaf, I suppose, which obviously has some range issues and is not sort of a fun car to drive. I actually think that Nissan should double down on their electric vehicle investment and just need to improve the product. It's not where it needs to be.

But the way to think of the Model S is really not from the standpoint of how does it compare to other electric cars. That's not really why people are

buying our car. They're buying our car because it's the best car. When you look at the characteristics of the vehicle, whether it's aesthetics, safety, handling, performance, the user interface and the functionality and the technology in the car, fit and finish. All those things I mentioned, against which you would evaluate the car's product, including taking all those characteristics and integrating them into a Gestalt and saying does this, as an integrated system, work? Because sometimes you have a mixture of ingredients that don't come together into a good product.

Really, people are buying our car because they think it's better than buying any other car in that price range. They're selecting against cars in that price range, not electric cars.

Operator

The next question comes from Adam Jonas from Morgan Stanley.

Adam Jonas – Morgan Stanley

I'm going to go back to the point about the Model S S curve ramp from Q3 to Q4. So you're at 10 cars a week now. I guess you'll be averaging just over 40 a week in Q3. And then to ramp to an average of 375 a week in Q4 to kind of make the 5,000 full year number. So I totally take on board your point about the shape of the S curve, and it's more like a switch than a ramp, if I'm not mistaken.

But in order to make sense of this, I think, that vertical portion of the S curve would have to happen not only pretty quickly but really very early in the fourth quarter. Or else you'd be implying an exit rate that would be way, way over 375 a week, which would be implying, I guess - maybe this is what you're implying - that you'd be doing way over a full-year clip of 20,000 a year. So is there any other way you can kind of give us an idea - and if you can't, I understand - what your exit rate might be in the third quarter, or your entry rate in the fourth? Or am I right to be thinking that in order to do your 5,000, that geometric switch has to be pretty damn early in Q4?

Elon Musk

I think you're essentially right about counts. We will be at a higher production rate than 20,000 a year at the end of the year.

Adam Jonas – Morgan Stanley

Would that, then, level off? Is that something that would be sustained in like a horizontal portion of that curve?

Elon Musk

That depends on how demand is looking. If demand is looking good, why level off?

Adam Jonas – Morgan Stanley

I agree 100%. So that is part of the implication, is that it makes the 20,000 next year - with that "at least," you're emphasizing that with what you're implying.

Elon Musk

Yep. When I say "at least" I mean higher.

Adam Jonas – Morgan Stanley

Yeah, you don't mean 20,001. Understood. And then my last question is given the enormous interest in the Model S, and also the very strong interest in the Model X, and what looks like the opportunity to launch the Gen III - at least according to some comments Franz made - maybe as early as 2015, earlier than many expected, this might accelerate some of your capital needs to give these products their full resources. So you throw in some uncertain economic conditions and can you see the rationale for potentially raising a bit more equity capital as sort of an insurance policy to make sure all this hard work and great work and momentum isn't necessarily put at too much risk due to events outside of the company's control?

Elon Musk

Yeah. Actually, I think that there is arguably some merit to raising incremental funding just to protect against an unforeseen event. I do want to emphasize that our cash flow projections require no funding raise at all. If we do not raise any funding, we can reach cash flow positive with decent margin. That's not to say that there isn't some merit in raising a little bit funding maybe, just to increase the cushion. That's something that we're debating internally, and something that we may do. But I do want to emphasize it's not something we have to do.

Adam Jonas – Morgan Stanley

Right. So it's a cushion, it would be for risk management, and more opportunistic, to kind of fuel even greater growth opportunity. Is that how you'd pitch it?

Elon Musk

Yeah, exactly. And in order for us to not raise any funding, we would probably spend at a suboptimal rate on future programs. I believe we'd want to spend at the optimal rate.

Adam Jonas – Morgan Stanley

Would you say that it would be more the early feedback and opportunity on the Model X that would potentially drive that opportunity? Or is it the timing and opportunity on the Gen III? Or is it a bit of both, or all of the above?

Elon Musk

Well, the only two things we're considering are raising zero money or a small amount. There's not some third option. Then if we raised a small amount of money, it would be probably half of it for cushion value and then half of it for future projects which would be the Model X and the Gen III. We've got to come up with a better name than Gen III by the way. [laughter]

Operator

The next question comes from Carter Driscoll from Capstone Investments.

Carter Driscoll – Capstone Investments

Do you imagine you will disclose the ramp - maybe, say, throughout the third quarter - so we can get comfortable that you're going to be at that 375 pace in the fourth quarter? How do you expect to communicate with the Street that you're progressing along the lines that you're hoping for?

Deepak Ahuja

I think we'll continue to have investor visits here. And clearly, as deliveries progress, you will get a sense of it.

Elon Musk

There will be cars on the road. That will be a huge clue. [laughter]

Deepak Ahuja

We'll definitely make sure over time we are communicating how things are progressing.

Elon Musk

I think actually people could track it by figuring out what serial number car has just been delivered. And there you go.

Carter Driscoll – Capstone Investments

Can you talk about your fast charging initiative and any developments there?

Elon Musk

We're finishing up some construction activity on that. It's looking like probably a September event, but that's contingent on finishing some construction and getting all the permits and whatnot for the [super] chargers. But I'm really excited about that announcement. I think it's way cooler than anyone realizes. I think it's going to have a profound effect on how the public sees electric vehicles. There's going to be a few surprises there. Almost no one knows the full story. There will be some cool things there.

Carter Driscoll – Capstone Investments

Could you talk about the warranty? There's been a lot of discussion. I myself have had discussions with some of your sales people. And I don't think people fully understand the warranty side for battery versus the vehicle itself. Could you just remind everyone what the battery and the vehicle warranty contains right now?

Elon Musk

Sure. For the battery warranty, it essentially merges language that Nissan was using, and I think maybe the Volt is also using similar language. Which is to say that the battery is warrantied for eight years, and the amount of miles you can really put on it. Actually, depending on which version - it's unlimited for the 300-mile range version. Unless you torture yourself, you won't be able to put enough miles on that to matter. So for the 160-mile version, you'd really have to be doing a lot of traveling within the city to do 100,000 miles in eight years.

In terms of where the pack energy level will be at that point, it's going to vary depending on what sort of environment the pack is experiencing and what sort of driver the person has been, in much the same way as an engine, after eight years, is going to depend on whether someone was driving it hard or not, and what sort of environment it saw. It will still be a very usable pack. And we're expecting the packs actually have a useful life that's somewhere around double the warranty level.

People will probably want to replace it sooner than that, but these really last for a long time. Even our first generation pack on the Roadster, one customer in Europe just passed the 200,000 km mark, and he's not

someone who drives the car slowly. In fact, he passed the 200,000 km mark in a race.

Carter Driscoll – Capstone Investments

That kind of leads to my next question. It's the relationship you have with Wells. And because of what you just stated, you believe the battery pack's going to last twice what it's currently warranted for, I'm assuming that the residual value of that price point, given there just aren't a whole lot of comparable vehicles to be able to set what the residual value is going to be, and therefore the leasing terms. But you feel comfortable that's not a sticking point, as you suddenly saw people wanting to lease the vehicle, even though you don't expect that to be the case for probably 12-18 months at the minimum.

Elon Musk

Right. We don't need to lease a single car until maybe the second half of next year at the soonest. We could just be all sales. But we have had many discussions about residual value. The thing that supports residual value is just to make sure that the depreciation of the battery pack essentially matches that of the rest of the car. And if you had a gasoline car, after 10 years, it's on the order of 10-15% of its original value. So it's depreciated down to almost nothing.

Carter Driscoll – Capstone Investments

Do you expect that to be comparable? Or do you expect residual value to be higher?

Elon Musk

I actually think it will be higher. Because the other thing is once you put a new pack into the car, it will actually be better than new from a range standpoint.

Deepak Ahuja

Because you continue to recognize the savings versus fueling your car with gas for the next 10 years, or whatever. So you get huge benefits of that.

Elon Musk

Gasoline's probably not getting cheaper in the long run. I mean, the price of gasoline is an upward sloping sine wave.

Carter Driscoll – Capstone Investments

I agree with that. Have you guys actually booked any warranty expense in anticipation of having to replace any of the batteries?

Elon Musk

Yeah, with each car there's a warranty reserve.

Deepak Ahuja

We're booking a warranty reserve for each of the cars, and that's related to the entire vehicle, not just to the battery. And just to clarify your other point, with Wells Fargo, we're not offering lease financing. It's traditional retail financing. So residual values or leasing is not really an issue in our present offering with Wells Fargo.

Elon Musk

With Athlon it is.

Deepak Ahuja

Athlon is offering their own lease program in Europe for corporate clients.

Elon Musk

Yeah, we did sign our first Model S leasing deal in Europe.

Carter Driscoll – Capstone Investments

Have you seen the mix of reservations change as 2012 has unfolded? Are you still seeing a similar rate of the signature series versus the other range models? Or has that stayed fairly consistent? Can you talk about your expectations about how that may change over time as well?

Elon Musk

I think it's fortunate that the signature series has been sold out for several months now. Not only is the signature series is sold out, we have a long waiting list for people to get on [unintelligible], and arguments about what place they are on the wait list.

Carter Driscoll – Capstone Investments

[You were sold out in year two.]

Elon Musk

And we're sold out in the EU on the signature series as well.

Deepak Ahuja

So basically, all the reservations that we are getting now are for general production and our customers, when they make a reservation, are basically just getting into the queue for a car. They're not locking in which battery pack size they're getting. So that we will find out over time when they start to lock in their specific order.

Elon Musk

It is tending to be on the higher end than we expected, I think. That could change. It's hard to say, as you can see, whether it's general production, whether people are going to go to cars with fewer options. But certainly the trend has been that they're picking more options than we expected.

Carter Driscoll – Capstone Investments

I was just trying to get at, you know, given that you have a fairly significant amount of your cash in reservation payments, just trying to understand how that mix has potentially shifted over time.

Operator

Your next question comes from Amir Rozwadowski from Barclays.

Amir Rozwadowski – Barclays

Just touching on the production ramp a bit more, Elon, just want to clarify, in the past you had said really that 20,000 production line is really focused on sort of one shift operating at one point in time. What type of flexibility do you have to either add additional personnel, overtime, or anything along those lines, in order to meet your production targets?

Elon Musk

It's almost entirely on one shift. There are a few areas where we had some cap intensive equipment, where it's on two shifts. But that's easily addressed to expand volume. I think in principle we could comfortably have a production rate next year that's 50% greater than 20,000. I hesitate to predict when in the year we'd be sort of confidently maintaining that at a steady pace. Look at it this way, at the end of next year, I think that there's a pretty good likelihood that we're at least at the 30,000 unit a year run rate at the end of next year.

Deepak Ahuja

I think maybe more generally we have flexibility. And the flexibility allows us to do a lot of things. That's overtime, add a second shift. We can do a lot. So I think whatever the targets, it will be what they are, and depending on demand, we have that flexibility.

Elon Musk

It's not totally willy nilly. You do need to hire a second shift. You need to get them trained, and you need to make sure you maintain the quality on the second shift. You don't want to have cars that are made on the second shift that are worse than cars made on the first shift. So it doesn't require a significant capital injection - minuscule capital injection to increase the rate, which is great. So there's certainly upside to opportunity there. But I don't want to trivialize how easy it is to find good people and get them trained and make sure everything's good and you don't have, like, the B team on the second shift. That's very important.

Amir Rozwadowski – Barclays

And then if we're thinking about the demands on your cash for the near term. I was wondering when do you expect to start paying back the DOE loan?

Deepak Ahuja

We start paying that back in December of this year.

Elon Musk

We're required to pay it back in December. We'll start paying it back no later than December.

Deepak Ahuja

And then there's quarterly payments thereafter.

Amir Rozwadowski – Barclays

So in terms of the demands on your cash, that's factored into your expectations for where you will end fourth quarter cash in terms of a relatively okay position?

Deepak Ahuja

Yes.

Amir Rozwadowski – Barclays

And then lastly, if I may, we've certainly seen a number of new stores open up in terms of building retail points for you folks as well as building brand awareness. How should we think about the trajectory for opex over the course of perhaps this year and the duration of 2013? What's the plan at this point?

Deepak Ahuja

I think as we indicated in the shareholder letter, certainly R&D expense will drop as a lot of those costs move into cost of goods sold. And on the SG&A side, as we open stores, and there is an acceleration there, we will see a moderate increase in our sales expenses. I would say in the 10-15% range or so, as we are adding more stores.

Elon Musk

The stores are really kicking butt. George, is there any color you'd like to add to the stores? We just opened the Third Street Promenade store on Santa Monica Boulevard, if people are in the L.A. area and want to get a sense for the latest in Tesla store technology.

George Blankenship

I think our goal with the stores the rest of this year is to try to address some new markets. One of the markets that we really haven't solidified up until now is that Northeast corridor. And our goal is to open several new stores in that corridor in order to hit one of the most densely populated areas of the country and try to do it in sort of an accelerated way. Because we think there's lots and lots of potential up there.

And what's really nice is we already have an embedded number of people there. I mean, the beauty of our model is that we already know where the first 12,000 cars are going. We know where customers who are interested in us live.

So we can use that data to open up stores, because if there's certain people there who are already, with very little effort, already reserving our car. Think what happens if we actually do put some effort in there. And that's what we're doing this year is we're hitting the hottest spots where we have really strong demand already in order to leverage that and that word of mouth from customer to customer.

And the people who have already gotten their car, they're like kids in a candy store with their car. They can't wait to drive it. They can't wait to take people to dinner. They can't wait to take people out. So when we put more

stores in and amongst where those people are and they have a place to gather and share stories and stuff.

That's what we're doing with the store growth this year. We're focusing on places where we know there's existing demand in order to leverage it more. A lot in the Northeast. We're going to open another one down in Miami Beach.

And the traffic through the stores has been incredible. I think you probably saw in the shareholder letter that year to date we've had over a million people go through the newly designed stores in North America. I mean, that's an incredible number. And they keep bringing more people, more friends and stuff like that.

So the stores are really performing well, and I think by going after the Northeast corridor, we will subsequently make a difference by year end. I have a goal this year that in the month of December we could have a million people go through our stores in one month. It's that crazy of a number. So that's the kind of thing we're shooting for.

Elon Musk

Tesla is not a demand constrained company. [laughter] We're production constrained. So that must be our focus. But not at the expense of quality.

Operator

The next question comes from Patrick Archambault from Goldman Sachs.

Patrick Archambault – Goldman Sachs

I just had, unfortunately, a couple more questions on the ramp. I was wondering whether we could get just a little bit more color on sort of how that process is going to work. It sounds like from what you've said already so far that one of the things you're sort of hitting to get to the next stage is really having to lock down decisions on certain components.

Elon Musk

Not really decisions. It's ensuring internal production quality and supplier quality. But we're not changing the product for change's sake. If there's a change, it's because we had to redesign to improve manufacturability in a few cases here and there. But we're not iterating on the product, the physical product. Of course, from a software standpoint, we will continue to provide updates, because in terms of [zoning] company that does wireless updating of the car's software and firmware. Customers get their car, and

they'll find that new functionality and improvements have been uploaded overnight while the car was in their garage. So that will continue, but we are really on lockdown on any physical changes that aren't absolutely required.

Patrick Archambault – Goldman Sachs

Yeah, I understand that the software piece can be sort of continuous, but it sounds like there are still some components that are being made with pre-production tooling by some of your suppliers, and I guess the process of getting those finalized and with the right fit and finish is what helps you kind of accelerate. Maybe you can just give a little bit of color. Is there kind of a percentage in terms of components of the car, where there's still some improvement to be made and a benchmark on that you might be able to sort of think about as a guidepost for when that acceleration will take place?

Elon Musk

There are several thousand parts in the car. Probably 97-98% of them are fine. There's a couple percent that needs to be addressed. But you cannot ship a car that is 98% complete, or where there's sort of 2% of the components are not of consistently high quality. So there's probably a couple dozen suppliers where we have some challenges, where we've got to fix the supplier, bring it internal or get a different supplier.

These are not big things. That's very important. Honestly, sometimes the most ridiculously silly things. Like it could be a piece of carpet or a bit of interior trim that doesn't have a flush condition or like there's a piece of bright molding on the dashboard which doesn't exactly follow where it has an intersection with another piece of bright molding. That intersection doesn't have the right press. So there are these little things that are extremely annoying. [laughter] But we just can't be delivering cars that don't have an outstanding fit and finish.

Of those sort of couple dozen parts, almost all of them are like interior soft trim issues. So it's not like there's some important fundamental technology thing. Like our battery pack and power train is in great shape. Chassis is in great shape, and body and paint. Obviously we want to keep refining it and make sure that the gaps and fits are as close to perfection as physics will allow, but obviously the vexing things are a bunch of seemingly trivial interior components.

Perhaps though it's just because we assumed those things wouldn't be problematic, and they were more problematic than we realized. We've since beefed up our interior trim engineering group considerably, and [unintelligible] in the future.

Patrick Archambault – Goldman Sachs

In the shareholder letter, you also said that you'd received all the dies. Maybe we can talk a little bit about that. Is everything pretty much approved now? And are you essentially at the stage where you're stamping all the components in house at the right specs? Or is there still some importing of components while you kind of fine tune some of these remaining dies?

Elon Musk

We're able to stamp everything in house at this point. We're still tweaking some of the gaps and how well things shut. We really want to set a new industry benchmark for the accuracy of body fit. We don't want to be second to anyone in this regard. And actually we're going to keep iterating on that to the limit of what is physically possible. And most people won't even notice these changes unless they have a very discerning eye. So stamping's not a problem.

Maybe this is a flaw in my character, but I tend to be pretty perfectionist about these things, and the goal is that we want the car to be so accurate you could use it as a yardstick. You can use it as a calibration device. That's how I want the car to be.

Operator

The next question comes from Ben Kallo from Baird.

Ben Kallo - Robert W. Baird

Going back to the capital raise question, Bloomberg is already reporting that you guys might do a small capital raise. Can you talk about price sensitivity since the stock's trading near where your last secondary was done, and you've created significant value since then in the company? And also around timing, a lot of the questions here are focused on the ramp, so would you do a capital raise after that ramp was proved out?

Deepak Ahuja

I think it's best we don't comment on any of these. I think as Elon said, we'll just opportunistically pursue at the right time, and I think that's probably the best way.

Elon Musk

But I'd like to exclude the very near future. We will not be raising money in the very near future.

Ben Kallo - Robert W. Baird

And can you give me any color on what that means?

Elon Musk

No. [laughter] I might get some color from the SEC if I gave you that.

Ben Kallo - Robert W. Baird

[laughter] Can you give us an update on the leasing program here in the United States?

Deepak Ahuja

I think as Elon alluded to, that's something we'll look into next year. We're continuing to evaluate that, and I think at this point our focus is on the key priorities of production.

Elon Musk

But I can maybe just give my views on leasing long term, which is I'm a huge proponent of leasing, particularly for electric vehicles. As is the case with solar, with SolarCity, leasing has proven to be extremely effective as a way to encourage solar adoption. And it sort of seems like it shouldn't be that effective, because if you told someone, hey, this system is going to pay you back in five years, and they said, oh, five years, that sounds like a long time. Like, do you know how long your savings account's going to take to pay you back? You'll be dead. [laughter]

And so people seem able to do the math on that. It's like, excluding compounding, a 20% return if it pays back in five years, and with certainty. Where do you get something like that? And yet amazingly, SolarCity had trouble getting people to act. So we're basically going to go to people that understand, people who are sophisticated in finance, and are looking for yield, and say, okay, let's go talk to people who really understand yield and take that problem away from the consumers so they don't have to think about it, and they can just look at it like their electricity cost went down.

Why is that relevant to Tesla? Because the cost of operation on the Model S is much less than the cost of operation of any other premium sedan, by far. It's going to feel like you have a car for free. And particularly in places like Europe. It's, like, \$9-10 a gallon in Europe. You can spend a couple hundred dollars filling up your gas tank. Or you can spend some negligible amount recharging your car.

So it really amounts to a huge effective discount on the cost of operation of the car relative to other premium sedans. But the best way to make that apparent is through a lease. So we're going to be very big on leasing in the future. We just haven't needed to do that because there's enough demand for the car where we just tell people you've got to buy the whole thing. You can't have leasing. [laughter] If we have sufficient demand to do that, then we should turn our attention to the key thing, which is production, and then next year we'll get to leasing.

And we do have data from the Roadster that I think is helpful to leasing companies. And by the way, the Roadster's got really good residual value. I think it's significantly better than a Porsche, actually. Maybe it depends on which Porsche you consider, but it's certainly got much better residual value than the Porsche I bought about five years ago. [laughter] Thing's worth like a peanut.

Ben Kallo - Robert W. Baird

And my last one, on deliveries. Deepak, you mentioned that there isn't much risk around timing, around production, deliveries. Maybe if you could just expand upon that, how people are ready to accept their cars. And then also, is it safe for me to infer from your comments about the quality issues and getting to your target quality that you're not currently delivering? And then when do you expect to actually start delivering vehicles?

Deepak Ahuja

My comment earlier was especially in the early part, there's a bigger percentage of deliveries in California, which significantly reduces the gap between production and delivery. And as we go further out, there is going to be a few days, but it's not dramatically different from the traditional OEM model. That was my point. So hopefully that's clear.

And in terms of deliveries, we are making deliveries. We are also making a lot of cars for marketing and sales, even in Q3, so that we continue and show as many cars to our potential customers and folks who have made reservations that are locking in their cars. So it's not as if we're not making deliveries. We're just going slow on the ramp to sort out the issues before we go up the S curve.

Jeff Evanson

I just want to make a quick comment on timing here. We have about five minutes left for the scheduled call. We'll add another five minutes on top of that. So analysts, if you could please keep your questions short and

management your answers brief, we'll get through as many as we can.
Thanks.

Operator

The next question comes from Sanjay Shrestha from Lazard Capital Markets.

Sanjay Shrestha - Lazard Capital Markets

Can you talk about how are reservations converting into the final order for you guys? And obviously, reservation numbers have been good, but what would you say is the final order number at this point in time? Do you have 500? 5,000? How should we think about that?

Elon Musk

How many people have locked in their options? Is that what you mean?

Sanjay Shrestha - Lazard Capital Markets

Exactly.

Elon Musk

We have 12,200 net reservations. George is saying we've had about 1,000 people lock in. But we only asked them to lock in...

Deepak Ahuja

A few months. We haven't gone to all the folks. We've only gone to a small percentage of people.

George Blankenship

We have invited the signature reservation holders in the U.S. only to configure. And then we went out about 10 days ago, give or take, to our first group of general production people, sending out the email saying it's time to build your Model S. And then this week we'll go out to the next tranche of general production U.S. And then we'll proceed from there to Canada signature, then Canada general production. So just to be clear here, we haven't gone out to 12,000 people and said, configure your car. We're doing it in sequential order based upon when they made their reservation. And as of today, we'll be about 1,000 fully configured cars that people have finalized their options and everything on.

Sanjay Shrestha - Lazard Capital Markets

So you're more than covering what you plan to ship in Q3. And then Q4 you think about that as you go.

Elon Musk

Oh, by far, yeah.

George Blankenship

By far.

Operator

The next question comes from Andrea James from Dougherty & Company.

Andrea James – Dougherty & Company

Just quickly on the ramp, obviously Elon when you chose to slow production in Q3 you had to make a decision to ramp even faster to make up for it in Q4. What preserved the previous step function? So what went into that decision, and why not push some of the 5,000 for this year into next year and build in some more contingency time?

Elon Musk

I never made a hard commitment that we were to do 5,000 units this year. There was effectively a soft implication that we would do 5,000 units this year. The hard one was like the 20,000 next year and 25% gross margin and to start deliveries no later than July. Those are the three hard ones. The others stayed relatively soft. But I still want to aspire to meet something even if it's a softer commitment. And it's going to mean that we'll have to work pretty hard over Thanksgiving and Christmas and New Year's and all that, but we want to try to do it for our investors.

Andrea James – Dougherty & Company

And then I hate to go here, but there's commentary on blogs and message boards. You have people with low reservation numbers saying, I'm not told I'm going to get my car until October or Q1. And I guess just what do you make of that commentary? I imagine some people on your team are looking at it as well.

Elon Musk

Sometimes things can go a little awry on message boards. I wouldn't read too much into the message boards. I think sometimes people can get the

wrong information and they can sort of panic or assume the worst or something like that. George?

George Blankenship

I monitor them. I watch them on a regular basis. I watch them on a daily basis. And I saw one the other day where somebody came out and specifically said, I have it on good authority that there are 200 founders series cars and everybody's going to be pushed back. And it's a blatant, factual inaccuracy. And so I went and I shut it down. Those kind of things happen all the time. I try to not contribute to the message boards much at all, but sometimes things just run awry.

Early on, we had gone out with a more firm date, whenever people would configure their cars early on, in early April and May configuring their cars. And our system kicked out a date. There was sort of a projection. And then we sort of left it there as a placeholder. And some of those people have thought that was a firm date. And it never really was. And so we're correcting that.

But I watch the boards all the time. You can't go by what's on the boards. You just can't go by what's on the boards. I don't know how else to describe it.

Elon Musk

I think just sort of judge things by what serial number of cars are being delivered and that will give some sense of how we're tracking to actual deliveries. And you'll see that number rise quite dramatically. And then I think we'll see some of this activity on the boards just die down. Because in the absence of information, you can get rampant speculation that's just not based on anything.

[unintelligible] say anything about short selling. [laughter]

George Blankenship

Restrain yourself. [laughter]

Elon Musk

I think we are one of the most short-sold stocks on the stock market, and there's certainly people with means, motive, and opportunity to say things that are negative and untrue. I'm not saying that there are, but there's means, motive, and opportunity to do so.

Andrea James – Dougherty & Company

I think that's helpful, thank you. One final, what leads you to say you'll have 20,000 reservations by the end of this year? And George, you have talked about it a little bit, but I was just wondering what gets you there?

Elon Musk

I don't think we ever said we will have 20,000 reservations by the end of the year. We might have that. I wouldn't say it's out of the question. Inclusive of deliveries, I think that's likely that we would have a cumulative, essentially, 20,000 sales. There's a pretty good chance of that.

Andrea James – Dougherty & Company

What does 2013 sold out mean then?

Elon Musk

I actually think that 2013 is likely to be production constrained again. I don't think it's going to be demand constrained.

Andrea James – Dougherty & Company

So you're saying that over the course of 2013 you'll have more reservations, or more demand, than you can produce cars? That's what you mean when you say it will be sold out?

Elon Musk

Yes. I think there will be more orders for cars than we are reasonably able to produce at high quality next year.

George Blankenship

We will not have inventory.

Elon Musk

We will not have inventory, yes.

Andrea James – Dougherty & Company

And so you're not saying, though, that you'll get to the end of 2012 and you'll be sold out on 2013? You're just saying over the course of 2013 you expect to be sold out. Is that kind of what you meant by that?

Elon Musk

Yeah.

George Blankenship

I think the way to look at this is that we never plan to have inventory. And what will happen is demand - we have a plan in place with stores and marketing etc. to get up to a demand rate by month that will always stay ahead of production, and we can adjust production depending on where demand goes. And what will happen is we don't expect to have 20,000 reservations on an ongoing basis, because that's way too far out. Our goal is to have three to four months of active reservations at any given point in time ahead of production, whatever the production rate is. So the idea is to get a run rate of reservations that's three to four months ahead of whatever the production rate is so that we never have the expense of inventory, we never have any of those things. We just have a run rate of three to four months of ongoing reservations.

Deepak Ahuja

That's fundamental to our retail model. And so that model continues. And we always expect that pipeline to be there ahead. We don't want it to be too long, because that's a detractor from more reservations.

George Blankenship

Right, as we get closer to being able to deliver cars faster, our reservation demand will be stronger, because it will be more predictable, and people will be able to say, okay, I have a lease that's coming up in three or four months, now's the time to reserve. And another thing that happens is refunds at that point go almost to nothing because someone will reserve a car, and literally go right into the configuration process within the next 30 days. They'll configure their car, and then we'll deliver it in another couple of months. And so that's the business model. And that's why it works so perfectly.

Operator

The next question comes from Michael Lew from Needham.

Michael Lew – Needham

With regard to the ongoing nationwide tour, how much incremental demand has that generated?

George Blankenship

The tour is going really well, and what's happened is, I think our end of June and July demand has increased for a couple of reasons. One is the news that

we're delivering cars. One is because of the incredible reviews that we've gotten on the cars. And I think the third is that we're putting a lot of people behind the wheel for the first time, and they're getting out of the car and saying incredible things. They're then going home and telling their friends, and coming back and getting their friends involved.

So we're seeing incremental demand because of the tour, but I want to keep a focus on the fact that the tour is really designed for our reservation holders that currently have reservations. We haven't actually gone out and started having lots of test drives, lots available for new customers.

So again, that's another opportunity for us in another month or so when we actually take the test drive cars we have, and the ones we're building now, and we go out and we say, okay, now we've gone out, we've done 5,000-6,000 test drives of reservation holders, and then we start actually giving people who don't have reservations test drives for the first time. And that's part of the kick that we will get on new reservations.

Elon Musk

Yeah, this is actually an important point that George has just made. All these test drives, almost all of them are just for existing customers. Essentially, we could generate more sales if we wanted to. We could grow the rate faster. But there's not much point in growing the rate faster if it's nine or ten months before you get the car. There's just not much point really in trying to add additional orders.

George Blankenship

And we have an incredibly loyal base. We have an incredibly loyal customer base. And if you look at the people who have already received their cars, and you look at the videos they're putting together and posting, and the people they're talking to, we are getting incremental reservations already from the cars we have out there from the people who are driving them and going to dinner, or going to a show, or whatever, with other people who are then calling us and saying, I need to have one like Steve. I want a car like Steve's. I want a car like Nancy's. And so we're getting incremental from having the cars we have out there already. When that starts escalating and we start doing new test drives with people who don't have reservations, that's...

Elon Musk

Essentially, we're seeing demand acceleration without trying. If we really tried harder it would be more than this.

George Blankenship

You don't have the visibility into where all of our cars are. Here's something to think about on the demand side. We had the Get Amped test drive tour, which has the marketing cars out there that are doing test drives. We don't have a Model S at all in Europe or Asia. We don't have a component tour, we don't have anything at all in either one of those major markets, and we're sold out in signature in EU. And so we're not doing anything outside of North America. And yet we've got the backlog we have now. So as we go into the end of Q3 and into Q4, we're going to start transitioning those markets to Model S, and at that point trying in Europe and Asia for the first time.

Elon Musk

I think a reasonable definition of trying would mean you've got at least one car in the market. [laughter] It's a little surprising to me that I see articles out there questioning whether there's demand for the Model S. There may be demand issues with other electric vehicles. There's certainly not a demand issue with Model S.

Michael Lew – Needham

And so if I understand correctly, there will be a slight pause and then possibly another tour, let's say going into the Northeast markets, since you had mentioned that's on tap, and possibly the Midwest?

Elon Musk

Absolutely.

George Blankenship

The Get Amped tour?

Elon Musk

Yeah, just in terms of markets that have not been tapped. We've barely touched the greater New York area.

George Blankenship

Yeah, we are opening more stores this year, this fall. In fact, one of our next stores will be in the New York metropolitan area, and then we'll come back with another two. And then we'll go further north from there into the Massachusetts area and down into the DC area. We think that market holds lots and lots and lots of potential because we already have the number of reservations we have there without a lot of presence. When we have

presence, my retail history tells me that there is lots and lots of untapped potential there that we are going to begin tapping starting in September.

Elon Musk

Actually I think a lot of people on the call are probably from the greater New York area, so maybe it would be worth just listing the stores that we've opened in the greater New York area, and the ones that will be opening in the next few months.

George Blankenship

Sure. For those of you in the New York area, you're probably aware we have the store on 25th Street. It's been there for a while. And then we opened up into Westchester, up in Westchester County. And it's doing very, very well. Very, very nicely. And you know, we see where all the reservations are coming from through each store. And it's actually increased the reservation flow in the West 25th Street store. So having two stores in the market has helped.

For those of you in North Jersey, we'll be opening up in Garden State Plaza and Short Hills Mall. And then for you in Long Island, we'll be looking to open up in Roosevelt Field. So going from one store on West 25th Street to having two in Northern Jersey, one in Westchester County, and one in Long Island, it's a pretty good capture of the New York metropolitan area with those particular centers surrounding the city.

Elon Musk

And our store in Chelsea, we got that lease because it was the only lease we could afford back in the day, and it's still basically a version 1.5 of store technology. If you want to see the latest in store technology - and I'm not using that word facetiously; there really is store technology - you want to go to the Westchester or the stores that are opening up in New Jersey or Long Island. That will show you the latest and greatest in the retail experience.

But it just gives you some sense. I count the store in Chelsea as like a half store. And we had a half store until a few months ago in the entire greater New York area. A half store.

George Blankenship

And like I said, what's happened is when we opened up the Westchester, we got that additional awareness and a little bit of publicity and media. We now have two full stores. Because we took the half store and made it into a full

store with reservations. And not from a technology standpoint, but from a productivity standpoint.

Jeff Evanson

Okay, I think we'll take one more question, operator, please.

Operator

The next question comes from Jesse Pichel from Jeffries.

Jesse Pichel – Jefferies

Deepak, for modeling purposes, what is the targeted cash cycle days conversion we should be thinking about at full ramp? Can we assume sub-20?

Deepak Ahuja

I'm not sure what your question is exactly. Are you referring to our inventory turns? Or working capital needs? I'm not exactly sure.

Jesse Pichel – Jefferies

If we take days inventory, days receivable, and days payable, and basically add them up, how quickly can you turn it into cash.

Deepak Ahuja

I think the way we look at it is that fundamentally we have zero receivables. We deliver the car within a few days of production and we get full payment. But our supplier payment terms are on average about 45 days. So we tend to deliver and receive money before we have to pay to our suppliers. So I think from your point of view, more focus is working capital usage, and our needs for working capital don't increase as we ramp up production. It actually helps us from a cash flow perspective.

Elon Musk

The asked question is a good one, because if a business needs to raise equity or something to build working capital as it grows, the effective return on investment for an investor is much lower than if it's the other way around. In our case, it is the other way around. The faster we grow the business, the more cash we have available.

Jesse Pichel – Jefferies

That's what I thought, and why I kind of questioned the Bloomberg article. Are you breaking out X reservations in the quarter?

Elon Musk

No, we're putting zero attention on X reservations. It's not really a metric we want to call people's attention to. That's something that we'll turn our attention to next year.

Jesse Pichel – Jefferies

Do you think some of the reservations for S and X are U.S. delivery from European or Asian clients?

Deepak Ahuja

Definitely we have reservations. As George mentioned, our Model S reservations include European signature series, where we are sold out. We have reservations from all over the world for both S and X.

Elon Musk

But I think also some people who just can't wait and they've ordered a U.S. car and they're just going to ship it to Europe.

Jesse Pichel – Jefferies

Yeah, that's what I was kind of wondering, if the launch in Europe and Asia is really going to increase the reservations that much, or if they are already reserving today.

Elon Musk

Oh yeah, it will increase it massively.

George Blankenship

Your question is appropriate in that do I think there are five people, ten people who have bought U.S. cars that are going to take them to Europe? Yes. But we have hundreds of reservations in EU, and we're getting more and more every month. And so that's going to impact not at all. There will be no impact.

Jesse Pichel – Jefferies

I guess it not quite as exotic as picking up your Mercedes from Stuttgart, but I guess you can give them a burger and send them on their way. But you made an interesting comment, Elon, about battery pack replacements

allowing the car a better range versus today. You said this before. When can we expect the next battery chemistry improvement, and what's your roadmap for that?

Elon Musk

I think it's probably with the Gen III that we'll see a change in the fundamental chemistry, as we did with Roadster. With Roadster we went from a cobalt cathode to a nickel-cobalt aluminum cathode, and effectively a few percentage increase - roughly [50%] increase in both gravimetric and volumetric [energy density]. And then also a drop in cost, because of the much lower cobalt content. I can't comment on the specifics of some of the technologies that I'm aware of, because of confidentiality agreements, but I can say I'm highly optimistic about seeing substantial reductions in cost per kilowatt hour in the three to four year timeframe.