Thanks, Martin. Last year was definitely the most challenging year in Tesla history, but also the most successful. Thanks to the incredible work of the Tesla team, Model 3 became the best-selling premium vehicle in the U.S. for 2018.

And in fact, when considering battery electric vehicles, Tesla achieved an 80% market share of U.S. sales in the last year. I think this point is perhaps not well appreciated. All other electric vehicles combined were 20% of sales in the U.S. in last year. So I think that's not so bad.

We also delivered - also made vehicles last year as we did in all prior years combined, which is tremendous achievement by the Tesla team. The - if you track Tesla vehicle production year-over-year, cumulative sales and deliveries year-over-year, it is about the cleanest exponential I've ever seen.

We've basically almost doubled our fleet every year. Every year, we make as many cars as we did in all prior years. So this is a very unusual thing to see for - especially for a large complex manufactured object, I think maybe the fastest that a complex manufactured object like a car has grown in history or at least I'm not aware of anything that is faster. Martin, are you…?

Martin Viecha

I'm not sure. I think Model T was a little bit slower, but I'm not 100% sure.

Elon Musk

Okay. And we expect that exponential to continue. So with the deliveries this year being - even in the face of - if there's a global recession - even if there's a global recession, we're expecting deliveries this year to be about 50% higher than last year. And this - it could be a lot more than that. But even with tough economic times, to see 50% growth is pretty nutty.

For Q4, we achieved GAAP profitability, the second quarter for the first time in the company history, and we increased our cash on hand by more than $700 million, even after paying debt [in EMEA] [ph] with the total of $3.7 billion of cash. This means we have enough cash to settle our convertible bond that will mature in March.

In addition, our operating margin remains strong at 5.7%. Operating margins in the fourth quarter are usually lower in the automotive industry, but this was not the case with Tesla.

2019 is going to be an amazing year for Tesla. As I mentioned, we are expecting to increase sales by 50%. Perhaps could be a lot more than 50%,

but I think 50% is a very reasonable number. But that's crazy growth for the automotive industry.

I want to note that one of our major priorities this quarter is improving service operations. So really, from my standpoint, when I think about what my priorities are this quarter, it's improving service in North America. That's number one. And I think we have very exciting [indiscernible] we're going to roll out with the [indiscernible]. We're going to get cars to China and Europe and make sure that we have good logistics for the whole delivery process, from factory gate to the customer.

That's obviously pretty far from California to get to Europe and China and make it to - get the car to customers. So we're working every aspect of that logistics chain, and I think we've - I think it's going to be good. I'd say at this point, I'm optimistic about being profitable in Q1. Not by a lot, but I'm optimistic about being profitable in Q1 and for all quarters going forward.

So let's see, we've opened 27 new store and service locations, bringing out our total locations worldwide to 378. And we increased our Mobile Service fleet to 411 vehicles. Mobile Service fleet is something we can scale up very rapidly, because we don't need bricks and mortar, we can get more vehicles, hire people and deploy rapidly.

It also actually results from higher customer satisfaction, because we can actually send one of our service vans to your work or home and fix the car without you having to bring it into the service center or do any paperwork or anything like that. It's really seamless and invisible. The customers love it.

And we're also increasing the functionality of the Tesla App for service, so that instead of having to make an appointment - to call and make an appointment, you just open your Tesla App, say you want to make a service appointment, and it was the top 10 most frequently requested service items, and you can - with a couple of taps, you've made yourself an appointment.

And we're going to make it easier for the car to be picked up and dropped off as well. So if you want - if you prefer not coming to the service center at all, you can just request that the car be picked up and delivered. That's something that we'll be - so that's already - we're going to roll it out and have a big improvement to customer satisfaction. It rolled out two or three weeks ago.

But the next thing we're going to add is, if a car detects something wrong, like a flat tire or a drive unit failure, that before the car has even come to a halt, there is a tow truck and a service loader on the way.

The car has already notified Tesla emergency services, and a service loader, a tow truck, are on their way before your car has even come to a stop. I think this will be immense in improving customer happiness.

[Indiscernible] call it and you have to tap the center screen to cancel it. So you can cancel it if you want. We just have to - it's like automatically going to happen. You just press cancel.

We're also improving parts distribution. So I think we made a strategic error in the past about not having service parts located at our service centers. We had them in parts distribution warehouses, which basically meant it was impossible to have a fast turnaround on servicing a car, because the car would come in, then the parts will be requested, they come to the service center, this would basically - even if they're very simple, repair could take days.

So we're going to be able to stock in all common parts at the service centers, so that it's possible to - - get your car serviced in 20 minutes or 15 minutes, even if it's a simple matter. I mean, it should be like eight minutes or whatever, eight minutes. It should be like lightning fast. But in order to - we have to have the parts located at our service centers.

Also, it's going to make sense for our service centers to do basic body work or essentially to replace a front or rear fascia, it makes sense to just prestock the front and rear fascia in the common colors. So unless you have an unusual color, we can literally replace your fascia in 15, 20 minutes, and this is not like, weeks at a body shop stuff.

In terms of the new products, with Model Y, we've completed ensuring of ensign of Model Y, and the parts are - [indiscernible] for production Model Y. Three quarters of the Model Y is common with the Model 3, so it's a much lower CapEx per vehicle than Model 3. And the risk is also quite low.

This is in contrast to Model S versus Model X where the theory was - I think Model X, we just - it's sort of Model X to be like the sort of the Fabergé egg of cars. It's an incredible vehicle and probably one - probably nothing like it will ever be made again, and maybe it shouldn't. But it is a work of art. It's a special work of art.

But the commonality with the Model S is limited. It was only about maybe 30% in common with the Model S, whereas Model Y is, I think, 76% was what it got in common with the Model 3. And we're most likely going to put Model Y production right next to - in fact, it's part of our main Gigafactory in Nevada.

So it will just be right there. Batteries and powertrains will come out and go straight into the vehicle. So that also reduces our risk of execution and reduces the cost of having to transfer parts from California to Nevada. It's not a for sure thing, but it's quite likely, and it's our default plan.

I would expect Model Y will probably be - the [indiscernible] Model Y will be maybe 50% higher than Model 3, could be even double. The - as I understand it, the midsized SUV segment is the - worldwide is the most popular type of vehicle. So we'll probably see a higher volume of Y than 3.

And earlier this month, we saw the construction of our Gigafactory in Shanghai, and by the end of this year, we expect to be producing Model 3s using a complete vehicle production line. That's body paint, final assembly, general assembly and module production.

So it basically would be - this will be extremely fast. I get like daily updates of progress of the Shanghai Gigafactory, and those factories are going to go up like lightning.

So we do feel quite confident at this point, at least for the factories that are in our control, that we can achieve volume production in Shanghai by the end of the year. And that should allow us to get to the 10,000 vehicles a week rate or very close to it by the end of the year.

And yes, I think that's it.

Martin Viecha

Okay, great. So we're going to take the first questions from our retail investors who have been submitting their questions on say.com. So the question that has been submitted has been about service, which I think you already spoke at length about. So let's go to the second question.

The second question would be, how are you feeling about demand right now across the product line? Is 500,000 to 700,000 units at 42,000 ASP still a realistic annual target for Model 3, even considering Model Y and its impact on demand? And do you continue to see S and X demand of 100,000 annually?

Elon Musk

I mean, my best guess, this is just a guess, my best guess for demand of Model 3 worldwide is something - in a strong economy, it's something on the order of 700,000 or 800,000 units a year. That's my best guess for demand of Model 3 in a strong economy.

If the economy goes into a recession, then I think that could be something under 40% less. But I think even in a recession, worldwide demand is still something in the order of 500,000 for Model 3.

For S and X, we did eliminate the 75 [indiscernible] of S and X and product model differentiation relative to 3 and then Y that's coming out. I think we could see a slight decline in total vehicles, but I think the net cash flow from S and X is likely to be very similar. So probably no major change in net cash flow for S and X.

Martin Viecha

Okay. The next question from Alex is, can you please share an update on full self-driving and Tesla Network development? When will customers start to see full self-driving features? What's the best case time line for a Tesla Network to go live?

Elon Musk

Sure. We have - we already have full self-driving capability on highway. So from highway on ramp to highway exit, including passing cars and going from one highway interchange to another, full self-driving capability is there.

In a few weeks, we'll be pushing update that will allow the option of removing stock confirmed in markets where regulators approve it, which we believe that will be the case in the U.S., for example. And over time, we think probably all regulators will approve it.

But we kept talking from there just to make sure that we took care of like - of any strange corner cases. And it's really quite sublime if you have stock confirm of and like the car goes from highway on ramp, passes slower cars, change - takes an interchange and then takes the exit and then comes to a stop after the exit. So it's really quite profound to have that experience.

Then the next part of full self-driving will really be to - is traffic lights. It's hard. So stop streets are pretty easy because you can essentially geocode those and is recognized at all times.

Traffic lights and intersections will be the next really tricky one. And then navigating complex parking lots and like - sort of like if you're underground in a mall parking lot with a lot of traffic and pedestrians and it's on multiple levels, that kind of thing is what gets tricky.

With the release of enhanced or advanced Summon, you'll see the first indications of the car being able to navigate complex parking lots, and that's also coming up fairly soon, probably next month. And in development mode,

the car does all the things that I just mentioned in development mode. It recognizes traffic lights and stop signs and basically has all the functionality in development mode. It's really just a question of getting your reliability of recognizing traffic lights to several names.

So I guess like, I don't know, 98% good right now, but we need it to be like 99.999%, really extremely reliable. So - and the capability will be there for - when will we think it's safe for full self-driving? It's probably towards the end of this year, and then it's up to regulators to decide when they want to approve that.

Martin Viecha

Okay. Let's go to the next question, which is, if and when will Tesla switch Model S and X to 2170 battery cells? What percent range improvement do you expect?

Elon Musk

We have no plans to switch S and X to 2170 and can't comment on huge product developments.

Martin Viecha

Okay. So maybe we'll take the last question from retail investors, which was, where will Tesla Semi and Model Y be produced? Can you share a time line on expected production ramp of these products?

Elon Musk

As I mentioned earlier, the Model Y, we think, most likely will be produced at Gigafactory, but that's - unless we encounter some obstacle - that's the default plan that we're proceeding towards. And it's fast, low risk and also low CapEx. In terms of the - I mean, probably there's like initial production of Model Y, very low volume, probably next year.

But then it always takes time to ramp up any production system, and that's difficult to predict the shape of that S-curve. So we feel confident in saying there will be production volume of Model Y by the end of next year, but in between beginning of next year with low volume, it always starts with very low growth exponentially - from beginning of last year to end of next year, it's difficult to break that ramp. So that's our expectation for Y. For Semi, we're - I don't know if you want to comment on that, Jerome.

Jerome Guillen

I want to start next year as well.

Elon Musk

Yes.

Jerome Guillen

But the first units will be - this is Jerome. Well, first units will be for our own usage. So depends how many trucks we'll use for our own usage to move the parts and the vehicle in different location, and then we'll start delivering to outside customers.

Elon Musk

Yes, that's good. And then the Tesla pickup truck, we might be ready to unveil that this summer. It will be something quite unique, unlike anything else.

Martin Viecha

Okay. Fantastic. So operator, we can start taking questions from participants on the call.

Question-and-Answer Session

Operator

Thank you [Operator Instructions] Our first question comes from Ryan Brinkman with JPMorgan.

Ryan Brinkman

Thanks for taking my question. I think - the amount that you've spent on lands for Gigafactory Shanghai in the classification operating cash flows, is there any guidance you can provide us in terms of how to think about CapEx for this facility going forward? And can you discuss the source of funds for the project?

I think you've spoken in the past about the potential to raise that locally in China. Is that still your thinking? And what kind of terms might you be able to raise that capital?

Deepak Ahuja

Yes, Deepak here. You're right. The purchase of the land is a 50-year lease with the government of China. So it's not CapEx, but it's operating lease, that shows up as cash flow from operations. However, the CapEx that we will

invest is our equipment, and we fully own it. So that will show up as capital expenditures.

The plan, as we have indicated in the letter, is still to get funding for majority of that capital spending from local China banks. And we expect pretty attractive rates based on the dialogue we've had. And there's a lot of interest. And we hope to finalize that and then share the details at that point.

Elon Musk

Yes. I mean, as a ballpark figure, probably it's something about - something in the order of $0.5 billion in CapEx to get to the 3,000 vehicle rates in Shanghai, ballpark figure. And as Deepak was saying, [indiscernible] very competitive debt financing in China, really extremely compelling interest rates, and we do not expect that to be a capital drain on the company.

Deepak Ahuja

Yes. These are the biggest banks in the world, and for them, $500 million is not a large amount of money on the scheme of things.

Operator

Thank you. Our next question comes from Gene Munster with Loup Ventures.

Elon Musk

Sorry perhaps - if you're in the automotive industry you'll understand how significant this is but maybe it's not as obvious to everyone is Tesla has the first wholly owned manufacturing facility in China for any - of any automotive company. So this is profound, and we're very appreciative of the Chinese government allowing us to do this. I think it is symbolic of [indiscernible] open the market. And if I - and you know, it [indiscernible], so like a note of appreciation for the Chinese government in allowing us to do that. It's a very significant thing.

Gene Munster

Question I have is related to Waymo and the autonomous driving opportunity. Morgan Stanley recently valued Waymo at $175 billion. And my question is, what do they have that you don't have? And separately - so what do they have that you don't have?

And then separately, how important is the timing in the Tesla story longer term? Is this nice to have? Is it really about EVs and renewable energy? Or

is the autonomy kind of one of the foundational parts of the story longer term?

Elon Musk

[Indiscernible] goodness of Tesla, yes, so like the why of Tesla, the relevance, what's the point of Tesla, comes down to two things: acceleration of sustainable energy and autonomy. The acceleration of sustainable energy is absolutely fundamental because this is the next potential risk for humanity.

So actually, that is, by far and away, the most important thing. But also, very important is autonomy. This has the potential to save millions of lives, tens of millions of serious public injuries and give people their time back, so that they don't have to drive, they can - if you're on the road, you can spend time doing things that you enjoy instead of being in terrible traffic.

So it's extremely important. We feel confident about our technical strategy, and I think we have an advantage that no one else has, which is, that we have, at this point, somewhere in the order of 300,000 vehicles on the road, with a 360-degree camera sensor suite, radar, ultrasonics, always connected uploads, especially video clips with the customer [submission] [ph] when there is intervention. So effectively, we have a massive, massive training fleet.

Our - the amount of training that we have - if you add everyone else up combined, they're probably 5%, I'm being generous, of the miles that Tesla has. And this difference is increasing. A year from now, we'll probably go - certainly from 18 months from now, we'll probably have 1 million vehicles on the road with - and every time the customers drive the car, they're training the systems to be better. I'm just not sure how anyone competes with that.

Operator

Thank you. Our next question...

Martin Viecha

Sorry, do you have a follow-up question? Okay, no follow-up question. Okay. Let's go to the next participant.

Operator

Thank you. Our next question is from Colin Rusch with Oppenheimer.

Colin Rusch

Thanks so much. Can you talk a little bit about the geographic dispersion for the guidance for 2019, where you're expecting the Model 3s to sell through as well as the other models?

Elon Musk

Well, I think we did, actually. Yes, it's clear in our letter.

Deepak Ahuja

We indicated in Q1, we will start delivering Model 3s in Europe and China. And we also shared a chart showing the potential market size for midsized premium sedans in North America, Europe and Asia, suggesting those markets could be even bigger. So I think that gives a good sense of where we'll be. And we'll launch the right-hand drive version at some point to go to the other markets.

Elon Musk

Yes. Maybe in the order of 350,000 to 500,000 Model 3s, something like that this year.

Colin Rusch

Okay. And then just in terms of the cost reduction road map and rework post-factory, can you talk a little bit about your expectation for reducing that in the next couple of quarters and what the order of magnitude is on that in your model internally?

Elon Musk

Jerome, do you want to answer that?

Jerome Guillen

This is Jerome. Well, our manufacturing is improving quarter-over-quarter. Actually, week-over-week, we take fewer hours, both here in Fremont or at the Gigafactory, to assemble the Model 3 and S and X as well. And then we track the quality very closely.

We review that carefully with the engineers and the supply chain and the manufacturing team. And the quality in the field and the number of incidents is also improving week-over-week, every week. So there are fewer and fewer need for cars to be in service, yes. So we'll keep going. There's no end in sight. And we'll try to make sure that the car never breaks down.

Elon Musk

Yes, I think there's like some confusion about rectification. Like I said - like - for us to drive the Model 3s that come off the line, all that happens is like some slight adjustment of drawer gaps and panel gaps and that kind of thing, and that's all that's done. There's nothing more than that.

Operator

Our next question comes from Colin Langan with UBS.

Colin Langan

Thanks for taking my question. Just a follow-up on the comments around you said about 700,000 to 800,000, you think, is the normal demand. I mean, any color on what price you're expecting that to be? Because I think there's a lot of chatter that demand is already weak in - of the midrange, at least, already in January. I don't know if that's true as well.

Elon Musk

Yes. I mean, - there are multiple factors at play here. First of all, there's a lot of seasonality to automotive purchases. Most people do not buy a new car in the middle of a blizzard. So January and February tends to be seasonally low and then picks up significantly around the early to mid-March time frame. In the U.S., we obviously have a pull forward of demand from the tax credit.

And yes, there's - so there's all those factors. But I feel very confident about Model 3 demand. The customer happiness level with the car is incredible and I think probably the highest of any car in the world right now, I think. And so you can tell like, basically, nobody wants to sell their car.

Colin Langan

But the target price point is, I think, in the past, you mentioned mid-$40,000. Is that where we're thinking or a long-term range?

Elon Musk

Yes, this is really just a guess. So it's not like I got some huge crystal ball or something. But at volume, I would expect, this is totally a guess, I want to be clear, probably an average of $42,000, probably at that volume level. I'm not certain on it.

Colin Langan

And just as a follow-up. You commented that you expect China to be online by the end of the year, but there's a lot of articles that the battery supplier -

you're looking at different battery suppliers. But, I mean, do you have a battery supplier? Because it seems kind of close to when production is supposed to start.

Elon Musk

Well, there's really three things: the cell, the module and the pack. We will be making the module and the pack. So it's really just a question of cell supply. And we can essentially use any [high density] [ph] 2170 chemistry. And we expect to be a combination of cells produced at our Gigafactory in Nevada and cells produced in Japan and cells produced locally in China. And we feel confident to have a sufficient supply to hit the 3,000 units.

Operator

Our next question comes from Emmanuel Rosner with Deutsche Bank.

Emmanuel Rosner

First, I wanted to ask you about the short-range Model 3. What are your latest thoughts in terms of timing of introduction? I think at some point, you had in mind to do it in the - maybe the first half of this year. And just to clarify, when you're sort of talking about the outlook for 2019, the number of deliveries up 50% and then the margin target for Model 3 to get to 25%, does that assume that you're introducing a lower range, the short-range Model 3 at some point during the year?

Elon Musk

Well, you could call it the standard range, but it's maybe short by Tesla's standards, but it's long range by other manufacturers' standards. So - but yes, we expect to introduce the standard range Model 3 sometime - probably the middle of this year is a rough, rough guess. And we're working hard to improve our costs of production, our overhead costs, our fixed costs, just costs in general. I think this past year, while extremely difficult, has driven us to a high level of financial discipline. I think we're way smarter about how we spend money, and we're getting better with each passing week. Yes.

Emmanuel Rosner

And so to be clear, the - you expect to reach at some point this year - or you're targeting at some point this year 25% gross margins on Model 3, and that's despite introducing the lower-end - or just the standard range Model 3. Is that correct?

Elon Musk

Yes.

Emmanuel Rosner

Okay. And, I guess, my follow-up would be on the demand side. So you're talking about 50% increase this year. You said a few times that it could be higher than this. I think you just mentioned in the previous question 350,000 to 500,000, if I understood well. So what is sort of like what drives the cautious outlook that's in your letter? Because it feels like it's the - it's just basically four times the fourth quarter run rate, which would imply sort of 50% for the full year but not really a lot of growth versus what you just accomplished. So, I guess, how do we think about the total demand for 2019, especially if you introduced this - the cheaper version?

Elon Musk

Well, we need to bring the Shanghai factory online. I think that's the biggest driver for getting to 500K plus a year. Our car is just very expensive going into China. We've got import duties. We've got transport costs. We've got higher-cost labor here. And we've never been eligible for any of the EV tax credits. A lot of people sort of dependent on incentives. In fact, we are [indiscernible] EVs, we have the least access to incentives. It's pretty crazy because there's so many companies that - countries that have put price caps on the EV incentive, which affects Tesla. And in China, which is the biggest market for EVs, we've never had any subsidies or tax incentives for vehicles.

So it's - it is eligible for that. But it sounds like that's going to be reducing in China in the coming years. But, really, bottom line is, we need the Shanghai factory to achieve that 10k rate and other cars be affordable.

The demand for - the demand for Model 3 is insanely high. The inhibitor is affordability. It's just like people literally don't have the money to buy the car. It's got nothing to do with desire. They just don't have enough money in their bank account. If the car can be made more affordable, the demand is extraordinary.

Operator

Our next question comes from Pierre Ferragu with New Street Research.

Pierre Ferragu

So, Deepak, I was wondering, so as you get to 2019, we're all concerned about the potential recession, and I was wondering how you think about it and what you would tell us about what we should expect - how we should expect Tesla to react to recession in 2019. How do you manage your volume

land? How do you manage your pricing? How do you present cash? How do you manage your CapEx if things turn south in 2019? And then I have a follow-up on gross margin for Jerome.

Deepak Ahuja

Yes, it's a very broad question, which is not really just for me to answer. But I think at the highest level, the way we are trying to be prepared for any kind of contingency here is to just continue focusing on cost. And the theme of our conversations here is, how do we reduce cost all the time? And how do we run our business with a very high level of financial discipline? And Elon alluded to that and so did Jerome - Jerome, I think. That - if we do that, we believe that even in some of the scenarios of lower volumes and pricing - tight pricing, we do have a good chance and a good shot of being profitable and generate free cash flow. So that's the best way to manage the business, be frugal.

Elon Musk

Yes, I don't want to be a broken record about this, it's costs, costs, costs, because reducing our costs - by the way, while making improvements to Model 3, I want to emphasize, the product is getting better by slight degrees despite lower costs in hundreds of small ways. But you actually wouldn't notice explicitly, but they would appreciate subconsciously. And getting those costs down, variable costs and fixed costs, is what allows us to lower the price and be financially sustainable and achieve our mission of environmental sustainability. So we have to be absolute clear about this. There's no question.

Deepak Ahuja

The other aspect of this, Elon, which we've been doing extremely well, is capital efficiency. We have dramatically cut back on capital expense, and we are spending it in a very efficient manner. We talked about it in the letter on Model 3 and Gigafactory Shanghai. We talked about it for Model Y. There are just so many learnings that we are incorporating, and we just want to beat what we did with Model 3 and the kind of spending we had for the returns we got.

Elon Musk

Absolutely. I mean, we're confident that our CapEx per unit of production for Shanghai factory and for Model Y will be less than half of what we did for Model 3. Internally, we think it might be a quarter but that's probably too good to believe, but it's definitely less than half.

Operator

Our next question comes from David Tamberrino with Goldman Sachs.

David Tamberrino

First thing I want to just understand is on what you're seeing from European orders and China orders so far. There are some numbers that get thrown around, but you guys are obviously taking a look at it. How is that order profile shaping up relative to what you saw in the U.S. with the launch of the 3?

Elon Musk

I think it seems good. I mean, our share actually with Europe and China is, how do we get the cars made and on a boat as such that it reaches customers before end of quarter and we don't have a massive number of cars on the water. That's our biggest challenge. It's not demand. It's how do we get the cars there fast enough.

David Tamberrino

So like orders above, I think I've seen like 20,000 order levels for Europe and single-digit thousands for China is better than that, Elon?

Elon Musk

Yes, absolutely. The - I mean, we're not even really trying, I should point out. I guess it's - we - our factory is like, right now, only making cars for China and Europe. That's all it's doing for - with respect to Model 3. And our whole focus is, okay, how do we get those cars made, get them on a ship as fast as possible, get the ship as fast as possible to Zeebrugge in Belgium then get them over to Drammen in Norway and get those cars to customers as fast as possible. We get them to China as fast as possible.

In China, we were also - yes, we don't what's going to happen with the trade negotiations. So that's very important to get those cars especially to China as soon as possible. We hope the trade negotiations go well, but it's not clear. But we need to get them there while there's sort of a de facto - sort of a truce on the tariff war. And the demand gen is really not one of the things we're thinking about.

David Tamberrino

Okay. Then just lastly on this demand thread, customer deposit came in again over $100 million. Is it possible to give us an update? I know you don't think it's really a relevant number but I do want to know. Explain why

on the reservation count, where you were 450,000, you started delivering. And I ask this because I think we're just all trying to understand how much incremental demand you think there is based on what you see at that lower price point if, say, there's over half of those people that are still waiting for that 75k base model to come out. That would be interesting, and I think that's what you're seeing but I just want to confirm that.

Elon Musk

So Deepak, do you want to...

Deepak Ahuja

Yes, I mean, I think reservations are not relevant for us. We are really focused on orders. Now we do have a large reservations backlog still, which tells us that a lot of customers are still waiting for those cars, but I don't think it's appropriate to share the reservations number.

Elon Musk

Reservations are just like preorders. It's like here - like some video game come out and there's like a preorder number, then that's like - stops being important once you start shipping the game or product. So yes, as I said earlier, I think - my guess is demand is somewhere on the order - in a strong economy is on the order of 700,000 or 800,000 units a year for Model 3 and even in a recession is probably on the order of 0.5 million.

Operator

Our next question comes from Daniel Ives with Wedbush Securities.

Daniel Ives

So my question is around Europe. Obviously, with deliveries coming onboard in the first quarter, maybe what surprised you in terms of - your demand looks strong, but in terms of what you're seeing at the region, is it stronger than you expected in certain countries? What do you think is driving that? And maybe you can just talk about the opportunities and challenges in Europe especially from a delivery logistics perspective.

Elon Musk

Well, like I said, we're thinking about demand almost zero right now. It's really getting the product there in time and not having a ton of cars on the water and in a quarter and then for China getting cars there before there's a potential rise in tariffs. That's really - put really at front of mind that cost reduction and then improving service in North America, yes.

Daniel Ives

And just maybe a quick follow-up on - can you just talk about - when we look at the Gigafactory build-out in China and obviously how important that is, can you maybe just fast forward, let's say, 18, 24 months? I mean, how do you envision that as just a competitive advantage versus maybe some other automakers that will be trying to go in your tracks?

Elon Musk

I think it will be quite a significant advantage, a really good - it's quite fundamental to the future of Tesla, and I expect to make several trips to China this year. And I'm working very closely with the team building the factory. I literally get daily updates. So it's a super big deal and we're only just talking about Phase 1 here. Phase 1 is about 10% of what we think the Gigafactory will ultimately be. So it's a major, major, major deal. And we're getting a lot of support from the Shanghai government, which we're very appreciative of, and the national government.

Operator

Our next question comes from Toni Sacconaghi with Bernstein.

Toni Sacconaghi

You've talked repeatedly about the need to drive down costs, which, in turn, drives the elasticity of demand for cars. And I'm wondering if you can talk about how much of a price differential between the $50,000 Model 3 and the $35,000 Model 3 is structural, meaning that powertrain costs for EVs are just structurally higher than they are for internal combustion engine cars. And where do you think that difference is today and when that is no longer a factor? So is - or maybe said another way, is the bigger driver in getting to lower costs and lower - and more affordability on the Model 3, is it really around the powertrain and getting that at parity? Or is it everything else about Tesla not being as efficient as other manufacturers that is causing the higher price right now? And have I follow-up, please.

Jerome Guillen

It's both, it's both, the vehicle and both the powertrain. So I split my time half and half between the Gigafactory and here, and there is opportunities in both, yes.

Deepak Ahuja

But I think the bigger point is that, yes, there is cost reduction opportunities out, but the bigger point is it's not that our cost is higher than a gas-powered or an internal combustion engine.

Martin Viecha

I think what Toni meant is with the battery pack, as in battery pack as well as the powertrain together, are more expensive than an engine.

Elon Musk

That's true.

Toni Sacconaghi

And how big do you think that delta is today? And when it's - do you think of it as being kind of $10,000, $11,000 for that pack plus powertrain for an electric vehicle and maybe $5,000 or $6,000 for an internal combustion engine car? And is that sort of the order of magnitude? And where do you see those getting much more aligned just sort of given the lives of where you think cell and pack costs are going?

Elon Musk

Well, the biggest part to bear in mind is because of electricity, it's quite a bit less than the cost of gasoline, especially in Europe or in California or China, basically almost everywhere except, say, the middle of the United States, where the cost of gasoline is very expensive and electricity is far cheaper. The - so that factors in to the cost of ownership pretty significantly. It's on - sort of going on the order of $50 to $100 a month depending upon how much somebody drives. So that's a very important thing to consider for an electric car versus a gasoline car. The - that said, in terms of initial cost of acquisition, I think it's probably - this is just off the top of my head, not a calculated number, probably on the order of 7k but trending towards 4k or 5k. It's off the top of my head.

Toni Sacconaghi

Okay. And as you think about 2019, you talked about sort of scenarios for demand and how you plan to roll out the intermediate range and then ultimately the standard range. What is - if you do have to make a trade-off on volume or profitability during the course of the year, meaning to get the volume you need or you think you can deliver, you have to go to lower margins or vice versa, where's the trade-off? Is - are units produced most important to you? Or is delivering the 25% gross margin more important? So if you have a chance to deliver 450,000 or 500,000 cars but they'll be

more standard editions and gross margins will end the year at 20%, is that - are you willing to make that trade-off?

Elon Musk

My guess is it ends up being sort of about the 6.5 [does together] where if there's a given amount of free cash flow, you sort of decide - you decide to achieve that with a smaller production or smaller volume of cars or at a higher margin or large volume cars at a smaller margin. I think we're already towards the second. We're going to make more cars at a lower margin, but I think it's more or less a flat rate.

Operator

Our next question comes from Maynard Um with Macquarie.

Maynard Um

Can you just update us on where battery costs are now and where you anticipate they'll be by year-end? I'm just trying to gauge how much of a factor this is to lowering costs and sustaining profitability.

Elon Musk

That's a highly proprietary number. We cannot give it out, but I'd like to tell you but no. We do think we have the best costs in the world. We're - to the best of our knowledge, our costs are lower than anyone else right now and they're improving.

Maynard Um

And maybe talk about your expectations with the Panasonic-Toyota JV and how it might impact you. Was this something that you were made aware of?

Elon Musk

I spoke directly with Tsuga-san about this, the Head of Panasonic, and he assured me this will have no impact on Tesla.

Operator

Our next question comes from Dan Galves with Wolfe Research.

Dan Galves

Do you plan to offer a U.S. lease product for Model 3 in the U.S.? When can we expect it? And can you talk about what percentage of S and X have historically been leased in the U.S.?

Elon Musk

Well, we've been reluctant to introduce the leasing on Model 3 because of how - of its effect on GAAP financials. So it is worth noting that demand to date is with zero leasing. So obviously, leasing is a way to improve demand but it has - it makes our financials looks worse. So we're - we don't want to introduce that right away. I mean, we'll introduce it sometime later this year probably. What - I'm not sure the percentage of lease is for S and X right now.

Deepak Ahuja

It's around 20%, low 20s, and it stayed stable at that level for many, many quarters, which is - it seems like the natural demand because we don't do [some invention or] artificially bump up.

Elon Musk

Yes, exactly. Our leases are legit. The - it usually expects a small business. Tax write-off is important for the - for leasing. So...

Dan Galves

Okay. And then I have just, like, two quick housekeeping questions. One, is there a restructuring charge that you expect in the first quarter? How much is it? And is it included in your expectation of a small profit?

Deepak Ahuja

Yes, it is included in that. It's difficult to say exactly what that is. At this point, it's, let's say, roughly around $40 million, but that number can vary slightly.

Dan Galves

Okay. And then just the last one is...

Deepak Ahuja

Sorry, go ahead.

Dan Galves

Yes, the last one is, this change in your service parts structure to make things more distributed rather than in the parts warehouse is, would that be like a meaningful working capital drag? What's the cash impact of that?

Elon Musk

No, it's actually - we've just been very silly about where we store our parts. So it's actually going to be no change in sort of working capital or not something you would even notice in the financials. It's just being smarter about sending parts directly to service centers, in fact either directly from our factory here or from our suppliers and just ship and direct to the service center. Right now, actually, our costs will improve, I think, actually quite a lot, persistent, actually quite - they're kind of persistent. It's quite boneheaded, actually speaking self-referentially. So just being - so stopping doing the foolish things will massively improve our service costs, will massively improve customer happiness around the world, and it's just fundamentally better all around. I mean, there are some pretty - we've been just like super dumb in some of the things we've done, where - like [I went] to China last year as I always asked, "Okay, what are we doing wrong? What can we fix?" And then like our China team is great always. They're like, "Well, do you think we could have spare parts that are made in China just sent directly to China service centers? Because currently, there's a bunch of parts that are made in China then sent to a warehouse in New Jersey and then sent back to China." Literally, what was happening? It's super [dumb stuff]. So it's going to get way better. And yes, it's very queer.

Operator

Our next question comes from Ben Kallo with Baird.

Ben Kallo

I have one question and it's got four parts to it. Happy new year, Elon. So the first part is - so our Street numbers, like consensus, we've got everything wrong for six years or seven years since you went public, and there are about $6 in earnings. Talk to us about that if you can. Number two, Elon, could you talk to us about - can you talk about - I hear you cut some workforce at SpaceX and there at Tesla. I feel that you have a worry about global economy. Can you talk to us about how you feel about that with your guidance in order - in the same order? And then can we talk about, maybe sort of third thing, for JV? No one's ever going to talk about stationary storage, but we had a whole page on that with pretty good speech, and what should we be focusing on that? And what can that add to the bottom line on top of that $6 this next year?

Deepak Ahuja

I mean, we can't really, Ben, talk about consensus and what that means. I think the - maybe the better approach is we are providing certain guidance here and you and the other analysts need to reflect that in your modeling.

And that's the best indication from the company of our projections. In all fairness, that's the best way I can think of answering your question here.

Elon Musk

Yes. J.B., is there anything...

Jeffrey Straubel

I mean, I think the letter outlines the predicted growth in the battery storage business, the stationary storage business pretty clearly, and that should be included in the projections as well. So I mean, we're excited about it but I can't say much more detail.

Elon Musk

I mean, our internal projections for stationary storage are closer to 3 gigawatt hours. But some of it is kind of lumpy and may not be completed this year. We would have done more in stationary storage last year except we were so strong for vehicle production. So we had to convert a bunch of stationary storage lines, battery lines, to vehicle battery lines. Otherwise, we would have done quite a bit more in stationary storage. I expect that to grow, I mean, probably twice as fast as automotive for short - a long time.

Jeffrey Straubel

We continue to set production records basically every month. So that's growing.

Deepak Ahuja

And the profitability of the storage business and the gross margin continue to improve as we keep ramping up production and scale.

Elon Musk

It's going to be a gigantic business down the road.

Martin Viecha

And the last question was about economy, global economy.

Elon Musk

Sure. I mean, I do think that the economy moves in cycles and there's fairly a significant risk of a recession over the next 12 to 18 months, but I'm confident that Tesla will remain at least slightly profitable even with - even if there is a significant recession. And then when - and be all the stronger for it

when there's recession. And the - we have to be relentless about cost in order to make affordable cars and not go back up. That's what our headcount reduction is about, yes, yes. I think we have to - it's - we have to be super hardcore about it. It's the only way to make affordable cars. The - on the SpaceX side, the cost reduction was for a different reason unrelated to - SpaceX has really - SpaceX has two absolutely insane projects that would normally bankrupt a company, Starship and Starlink, and so SpaceX has to be incredibly spartan with expenditures until those programs reach fruition.

Martin Viecha

Okay, Great. I think that's all we have time for today. Thank you very much for your questions, and Elon would like to have some closing remarks.

Elon Musk

Yes. So let's see. The - so Deepak is - well, I'd like you to make the announcement, but Deepak is going to be retiring.

Deepak Ahuja

Again.

Elon Musk

Yes, from Tesla.

Deepak Ahuja

Yes.

Elon Musk

Deepak, I think it's now been - you first started with Tesla about 11 years ago, right?

Deepak Ahuja

When - close to that, yes.

Elon Musk

Yes, almost 11 years. Thank you for your tremendous contribution to Tesla. And he's announcing retirement but the retirement will not be immediate, but Deepak will continue to be at Tesla for a few more months and will continue to serve as a senior adviser to Tesla for probably years to come hopefully. And we thought long and hard about who the right person is to

take over from Deepak, and that's Zach. And Zach has been with Tesla now for nine years...

Martin Viecha

Nine years.

Elon Musk

Yes. So Zach [ph] you had management and technology at Wharton undergrad and then worked at Tesla and then spent a couple of years at Harvard Business School, which I actually don't think was necessary, by the way.

Martin Viecha

You told me that when I came back.

Elon Musk

Yes, exactly. So Zach's incredibly talented, has made a huge contribution to Tesla over the years, and obviously a very well-known [quantity] to the whole team and has the respect of the whole team. And Zach, I don't know if you'd like to say a few words?

Martin Viecha

Yes, I will.

Elon Musk

Okay. Or do you want, Deepak, to save you?

Martin Viecha

Deepak?

Deepak Ahuja

Sure, okay. Thank you, yes. Well, first of all, Elon, thank you very much for the opportunity for me to be here and be here again a second time. I've learned a lot from you and I've been always inspired by you, and I've been also very inspired by the team at Tesla who are incredibly brilliant, very passionate and just amazingly perseverant, the best team I could imagine. So thank you everybody for that. There is no good time to make this change. We felt strongly this was a good time. It's a new chapter, a new year. Tesla has had two great quarters of profitability, cash flow, so now a really solid foundation. And I feel really good about Zach taking over as the

CFO. He's proven himself with his many years of experience and many tough challenges that he's worked on and really excited to have Zach take on this role, and I'll be here to support him and make sure we are all successful as a company.

Martin Viecha

Yes, well, thank you, Deepak. Thank you, Elon. So my name is Zach Kirkhorn. Just a brief background on myself. So I joined Tesla just under nine years ago when it's a super small company with a lot of potential ahead of us and I was attracted to the mission and the vision of the company. Throughout that time, I've been deep in the operations of every major program of the company, from the Roadster to Model S and X, Model 3, scaling our Energy business and more things to come, which we've talked about on the call. I feel we're starting 2019 with a very strong financial foundation. We have enough cash to continue launching new programs and developing new technologies, and we're able to service upcoming debt obligations with our forecasted cash flows. My focus alongside the talented and amazingly passionate team at Tesla is to ensure we continue the terrific momentum on cost management and operational efficiency, which will enable us more - enable more access to our products around the world, which is key to achieving the mission of the company. On a personal note, Deepak, a huge thank you to you for your leadership, mentorship and support and very much looking forward to discussing our progress on future earnings calls.