

Yes. Thank you very much, guys. Congratulations on a good quarter. I think, obviously, the execution look great, but my one question would be, just can you help us walk a little bit from I think your margin is adjusted 10% axe ZEV credits. It sounds like you still have levers to put to get to the 25. Can you just go through those with us?

Deepak Ahuja

I think, Patrick, Deepak here. Our automotive gross margin excluding the ZEV Credits is closer to 13% and maybe we can walk you through later on to clarify. I know this is a confusing quarter with significant accounting numbers here, so we will just help you with that. But, we see clearly a path that gets us to 25% excluding ZEV credits given the actions that are underway and have been underway for a while and these relate to on the cost reduction aspects with our cost reduction roadmap, the efficiencies we have in our manufacturing and supply chain that are happening over the second half as well as a combination of the new options that we have put in the marketplace and the margin enhancement we get from there I am sure Elon has more to add.

Elon Musk

Right. Well, I mean, just in summary, we are about 12 points away from getting to the 25% gross margin target with our ZEV credits. And if you look at say Q1, Q2, we increased eight points. So, obviously, on average between Q3 and Q4, we need to do six points per quarter, so we need to make as quite as big an improvement as we did Q1, Q2, but obviously, so significant hill to climb and huge amount of work, but we feel pretty confident about the 25% number. And, it's important to note that we have visibility into these numbers more than ahead of time. So, the things that affect the gross margin, in order for them to, the fourth quarter really needs to be in place, we are essentially in place about a month before the fourth quarter, otherwise the parts that go into the car will not contain the [cost savings] that are necessary. So, essentially things needs to be in place next month and so that's not very far away. That's why we felt confident enough to reaffirm the 25% gross margin guidance [ZEV credits] for the fourth quarter.

Patrick Archambault - Goldman Sachs

Okay.

Deepak Ahuja

Of course major event or something, some really big unexpected thing, but as long as there's nothing really unusual that happens then that should meet that target.

Patrick Archambault - Goldman Sachs

Okay. Great. Then I guess we haven't had an update on the X and when that's likely to,

we understand that. Obviously, the variance of S or what's taking a lot of engineering resources kind of in the near-term, Deepak, maybe in terms of the X timing, is it still towards the end of next year when you are thinking about it. And, when do those engineering resources sort of come to bear on your capital budget? Thanks.

Elon Musk

I will may be do part of the answer and then allow Deepak. Yes. We are hard at work on the Model X refining the design. We expect to be in limited [volume] to deliver a small number of units at the end of next year and then volume production would recur in 2015. So, in terms of, if you are trying model it financially, I would model it more in 2015 than in 2014. Although we are on track to deliver University customers at the end of next year.

From a product standpoint, the Model X is our primary focus, obviously at this point. For the most part, our researchers are spending a lot of time personally on the Model X and trying to get the details right. I think there are some things we can do to improve the Model X over the early demonstration prototype that people have seen. I think there is room to make it better.

So we are going to push pretty hard to make it better than what people have seen. I think this is an exciting feature as that, I mean that I love that, hopefully other people like them to.

Deepak Ahuja

Yes, I think Elon spoke of a key point. A lot of the resources acquired for Model S is in our plan and have done some expenditures and that's one of the contributors (inaudible) R&D expenses as we go forward.

Operator

Our next question comes from Andrea James with Dougherty & Company. Your line is open.

Andrea James - Dougherty & Company

Thank you for taking my question. I just imagine you have several options available to you now. I mean from investing in the Model S capacity which you mentioned in your letter to finishing up the Model X and then to

engineering the next generation vehicle. I was wondering if you could just weight your priorities and tell us how are you thinking about it, both from factory investment and also from your R&D?

Elon Musk

Okay. So it difficult how I am supposed to weight those things. So in terms of our expenditures, we are still more on Model S than anything else, on every front, including R&D because, bear in mind, we have got right hand drive that's coming out in the spring. Then there is the China version and actually there's the European version that's tying in a note there. A number of nuances and there are a very few European countries that require work to, should the car operate smoothly.

There is the Japan right hand drive version. So there is just a lot of versions and especially maybe not so huge but you add them up and they amount to a fair bit of spending. In terms of executive time, I think the Model X is swiftly raising to become the main priority but it's not quite there yet but it will be soon. I am allocating an increasing portion of my time to that every week. Probably in the fourth quarter it becomes the top one, the top item. That's my guess. These are just somewhat of qualitative statements.

Deepak Ahuja

The capital expenditure for Model S will primarily kick in next year as we start to get some of the tooling place. Right now its about more of a human resource expenditure. It's design and engineering but not a lot of tooling. So it's a lot of lab work and design work but not a lot of hard drilling or anything. Yes, so that will be a fairly big chunk of that in second and third quarter and fourth quarter next year.

Andrea James - Dougherty & Company

When does the next generation of vehicle move up? Is it a timing thing? Is it a cost of the battery packing, the resources?

Elon Musk

You mean a high volume affordable cost?

Andrea James - Dougherty & Company

That's right.

Elon Musk

All right. So there is couple of, here is the thing, like as we think ahead to that vehicle, where we are allocating a little bit of time to do some of that advanced planning. It's only may be less than 5% but a sort of planning activity. But when you do the math on, saying "Okay. How many batteries do you need for, like what's the [capability], the raw materials all the elements?"

It's really quite a large number in order to ultimately [battery] that's producing 0.5 million vehicles a year. We saw it exceeding the entire laptop industry by a decent margin, so clearly new cell factories need to be built and we need to be smarter about the road shows going into Asia-Pac. I meant, I certainly see a clear path. I do not see obstacles. I see a fairly clear path to that vehicle. I have high confidence that we can create a compelling cog for around \$35,000, compelling meaning a 200 mile range.

And, of course, there are a lot of other features that people have come to expect from Model S. Fewer things would be default features, so yes. I still feel pretty good about it. There is a huge amount of work, but no miracles required.

Andrea James - Dougherty & Company

Are Tesla shareholders going to see any benefit from the Hyperloop?

Elon Musk

I don't know. I think, so out of the question, but I think I kind of shot myself if I ever mentioning Hyperloop, because obviously I have to focus on core Tesla business and SpaceX business and that's more than enough, but I did commit to publishing a design and provide quite a detailed design I think on Monday and then invite critical feedback and see if the people can find ways to improve it and then you can just be out there as kind of like a open source design that maybe you can keep improving and I don't have any plan to execute, because I must remain focused on SpaceX and Tesla. If nothing happens for a few years, with that I mean maybe it could make sense to make the halfway path with Tesla involvement, but I would say is you shouldn't be speculative.

Andrea James - Dougherty & Company

Finally just for Deepak, what were the other regulatory credits in the quarter and does your [assumptions] include those in the long-term?

Deepak Ahuja

Yes. Our gross margin for automotive does include the other regulatory credits, because we have good visibility of those. They are locked in for us over a longer term. ZEV credits are the one which are not predictable in terms of recognizing sales and revenue by quarter and given their unpredictability we have deliberately kept that aside in our own projections. In this quarter in Q2, those were up roughly \$18 million.

Andrea James - Dougherty & Company

The visibility is better than the ZEV credits, because why exactly and then I will hop off? Thank you.

Deepak Ahuja

Because we have longer term contracts with certain car makers to sell those credits.

Operator

Our next question comes from Adam Jonas with Morgan Stanley. Your line is open.

Adam Jonas - Morgan Stanley

Hi. everybody. Okay, Elon. I am not going to ask you any questions about cap raise this time. I don't think we need to go there. First question on the 40,000 unit annualized sales comment you made by late 2014 as a potential. What metric were you using when you were extrapolating that for Asia? Is that something like on a sales per store or percentage of addressable market?

Elon Musk

Actually it's just based on what we kind of see the demand as like. I mean, right now obviously we are selling in North America at about 20,000 units a year. So, Europe is a similar size market to North America. China is actually bigger and then that doesn't include the rest of Asia Pacific, South America, South Africa, Australia. So it seems like that's a pretty safe number to assume. We are probably got some potentially upside from that number.

Adam Jonas - Morgan Stanley

Okay. That's clear. Just next one. Can you elaborate a bit on the nature of the supplier bottlenecks that you mentioned? Is it related to homologation for some of the exotic European or right hand drive tech deliveries? Is it a new issue or is it a lingering legacy issue? Any update on when this could be resolved?

Elon Musk

Yes, this is an important point. We have production constraints, not demand constraint. Very often, we will shift also to marketing ideas and certain other thing but obviously I kind of spent trying to figure out how to make more comps and the things that prevent us from doing at are supply of parts, essentially. 90% of our suppliers are able to ramp-up and 5% have some difficulty and 4% have a lot of difficulty and 1% just can't and so we have got to replace those or in-source those items. You can't supply. Give people a car that's 99% complete, unfortunately and there are several thousands unique parts in the car.

So that's where we are really spending our time line, is clearing up those production bottlenecks or supply chain bottlenecks. I think we should have probably cleared most of the amount in the next six months. Maybe into Q1, Q2, we should, certainly by Q2, I think with a fair amount of production potential. Then we will see what the demand looks like at that point. But we are striving to become demand limited as opposed to production limited.

And I feel like we are actually able to attract, kind of the A team on suppliers because whereas previously we had some trouble attracting A team from suppliers because they felt we wouldn't be around long-term and we have that issue where IHS have predicted that Tesla would only ever sale 3,000 cars lifetime of the Model S. Then we sold that in, basically, the first quarter of production.

So the tricky thing has been, a lot of us, as many of our suppliers have taken IHS number or taken like historical electric vehicle numbers and maybe given us a little bit of credit for our projections but not much. So they didn't tool up for the production that we actually experienced as we were scrambling to make up for it. So that's really, they just didn't believe it. So it takes some time to tool up and do it and then some inspired, a small number, they are just not set up for volume production. So we have got to switch them out into outsourcing.

Adam Jonas - Morgan Stanley

That's clear, Elon. Thanks. This is my last question. I think many people on this call might be interested in your views on the BMW i3, That's it. Thanks. What do you think?

Elon Musk

Well, I am glad to see that BMW is bringing electric car to market. That's cool. I think there is room to improve on the i3 and I hope that they do. My comments about other manufacturers. Yes, anyway. I really do encourage

other manufacturers bringing electric cars in the market because this is a good thing and say, they need to bring it to market and then keep iterating and improving and making better and better electric cars and that's what's going to results in humanity achieving a sustainable transport future. I wish it was going faster than it is.

Operator

Our next question comes from Brian Johnson with Barclays. Your line is open.

Brian Johnson - Barclays Capital

Two questions one for Deepak probably and one for Elon on Gen 3. For Deepak, the first question I ask you to bridge on gross margin through the end of the year. Could you just maybe give us on the bridge of improvement from 1Q to 2Q, the big chunks of things that contributed to that margin increase axe REV credits?

Deepak Ahuja

Sure. I would say the biggest pieces there were stock cost reduction as we continue to get more efficient at our suppliers as well as some of the design changes we need to make the design efficient while not taking anything away from the consumer point of view. We also had improvements in labor and overhead and our freight costs and all of those in fact were partially offset by the mix we had a poor mix in Q2 since we sold the 40 kilowatt hour cars that had the 60 kilowatt-hour battery pack.

Elon Musk

Yes. Essentially saw that last.

Deepak Ahuja

Right. Yes, which had a from a average gross margin perspective a negative impact, so I think what I am sharing with you is no different than what we have shared before. It's still the same levers and part cost is our biggest lever that's helps to drive these improvements.

Elon Musk

Required parts, labor and that's what price of made of. And maybe another way to characterize it is like in the fourth quarter of last year, we were extremely down without making cars. In the first quarter, we were maybe still pretty down and we are slightly down in the second quarter. And hopefully by the fourth quarter, we will at least not be down.

Brian Johnson - Barclays Capital

I will figure out how to quantify that.

Deepak Ahuja

This is not some super. How do we get so super good? It's like how do we stop being so stupid.

Brian Johnson - Barclays Capital

Second question, Gen 3, two questions underneath, the \$35,000 price point is that before or after consumer credits and tax credits? Then second, as you kind of think of Gen 3 and making money at it, some talk I have heard that maybe it's small format batteries aren't the right way to go, but large format. Just maybe reiterate I kind of think the small format kind of where you are in those and how that gives you some comfort in getting to the price point on the Gen 3.

Deepak Ahuja

Sure. So, the \$35,000 does not assume that the \$7,500 federal tax credit is no longer available and there may be other state level tax credit so maybe other things but we are assuming that the 35, 000 is without any subsidy.

Elon Musk

It's always helpful to have [some], but we are not counting on it. Yes. So, in terms of the sales format, for us, when we talk to our key sales suppliers and we ask them to give us the, say at the sale level what is the best energy density, so brought us pure down and what is the best price in we will dollars for one hour.

Invariably, the 18-650 format is the best. Usually buy at pretty decent margin. That's a 18 millimeter by 65 millimeter cylinder with yes. That's the format that has to (Inaudible). It has advantages. I think why does it cost less? I mean I think you are able to kind of pack and why should that be done? To be able to compress and pack in quite a bit of electrode and electrolyte in that cylinder.

So, our battery is really a, like conservative batteries of like cylinders with double head, triple and that kind of thing, but you can pack more in there. It has a fairly efficient manufacturing process in almost every way, relative to the pragmatic approach. Also as you make the cell bigger, you have to say that the reject rates for the cell is going to increase.

So you think of maybe an analogy to the silicon wafer fab and say what would be cheaper? Having a whole bunch of say, six inch wafers or one 12 inch wafer? Actually it's the lower diameter wafer that is cheaper because, with silicon as the electrode area, you have to reject anything that's got a flaw. So the reject rate and it is supposed to help us make things in a limit.

So I would say, in a limit where the whole battery is one cell, the reject rate will be virtually 100% and then as you make the cells smaller and smaller, the reject rate will reduce and at (inaudible) that reject rate is very low. A very good statistical reliability. So I am sort of giving a long winded answer here.

Brian Johnson - Barclays Capital

But short hand, could we call it a server rack versus a mainframe strategy?

Elon Musk

Yes, sure.

Brian Johnson - Barclays Capital

Okay, and then in terms of how you are managing the load, are there advantages to having several thousands, I have heard numbers of 5,000 to 8000 cells versus a smaller number? Again kind of thinking about the statistics behind it?

Elon Musk

Well, I think we are at around 7,000 cell number for the 85 kilowatt hour pack. If we were to say, what's the ideal cell number and if we were to go whole new cell, like a whole new sort of cell plant, I think we might drop the cell number in half, but probably not less than that. The other thing that cells give you is that, for long-term life of the pack, if you have a large number of cells, then losing a cell actually has a very small impact on the total capacity of the pack. Whereas if you have a small number of cells then losing a cell has a big impact on the capacity of the pack. So there are some advantages for life as well and for our liability

Operator

Our next question comes from Dan Galves with Deutsche Bank. Your line is open.

Dan Galves - Deutsche Bank

Okay, thanks. Just wanted to follow up on the 40,000 units per year by late 2014 comment in the shareholder letter. Can you tell us what North American order flow is on an annualized basis right now and what type of order rate are you seeing in Europe currently and what's been the trajectory?

Elon Musk

Yes. So I wouldn't get too specific but, in terms of weekly net orders, new orders net of cancellations, it is something, it fluctuates a little bit from week to week but it's around 20,000 right now for North America. We are not trying to push it higher than that because it's kind of pointless to push volume when you don't have the production to meet it.

So I think there's potential there for, once we are where we have the service centers in more parts of the country and maybe more stores out there and more word of mouth and more Supercharger stations. This is not going to be the long-term demand in North America is greater than 20,000 units a year since we lack those things today and have that approximate demand.

Also, in Europe, we are actually not trying to push sales very hard because if you order a car in Europe you are going to get it get it in, like maybe November. So we really again need to improve our production. We need to make sure that the entry of the car into Europe is smooth, that people have a good experience with the car, that all the service centers are there, that the people are well trained and maybe these are the really important things and then like I said, if you look at sort of supply and demand, EU or greater EU area is actually higher than North America in general for that demand.

So if you say, how many premium sedans are sold, more are sold in the Greater EU areas than in North America. So, to a read up, we achieve some of that percentage in Europe and maybe it's a bit less, because our cost of it more because it's got to come from U.S. and there is increased logistics costs and some import duties and that kind of thing. So maybe that's (Inaudible) assume it is going to be as good as North America, but it is probably at least half as good as North America. And maybe it ultimately as good as North America, but I will consider that's why we say that half as good. Then China and the rest of Asia and other countries, well, if they can be half as good as North America, then we are at the 40,000 unit number and so that all seems pretty reasonable to me.

Dan Galves - Deutsche Bank

In terms of capacity to build I think your current line is set up for maybe 40,000 units to 50,000 units on two shifts. I guess two questions. When do you think you can get to that number in terms of production rate and what is

the decision making process in terms of potentially adding more capacity if you are going to fill that up with just the Model S.

Elon Musk

Right. As I said earlier, while we have the ability to produce at the 40,000 unit level all of our suppliers also have got ability, so that's the thing that's holding us back. I think, there is certainly room to grow beyond that where we have a big factory. Yes, so we will have to see how demand settles out.

As I mentioned, we want to get to being demand for traders as possible. Hopefully, we will get there next year. That's our goal, at least by the end of next year and there of course we will bring the Model X online in limited number next year and bigger number in 2015 and the potential is obviously very significant, but our promise or I think there is lot of potential but we will have to see how it turns out.

Dan Galves - Deutsche Bank

Great. One last question. You mentioned that the changes to options and pricing that went in maybe a week ago was going to be a benefit to margin in the back half. Do you have any sense of kind of how much it would've benefited margins in this quarter or do you have a projection for how much of an increase you will see from that action?

Deepak Ahuja

We are really not sure, because we only introduced them less than a week, ago like four days ago, five days ago and we don't know what the take rate is going to be, but we have got some guesses, but I think there is no need to guess, because we are in let's say a few weeks time we will have the pretty good sense for what the option mix it is in reality as opposed to just gas.

So, what we did with the options, we have unbundled a bunch of things, we added some additional options that weren't there before like parking sensors and improved interior options and a number of other things that people have been asking for is a subzero weather package, there is improved tires which come as default on the 85 and option the safety.

It's a whole logical things actually and then new wheels, the aero wheels which improve range and give us actually by far the lowest (Inaudible) any car production. There is whole bunch of cool stuff and then we like to unbundled some things like the performance package which required by whole bunch of things in addition to the 0 to 60 time.

Now you essentially can buy just the power and then decide if you want the other options. We are slightly low at the price of the technology package, so and to be clear, the base price stayed the same and the technology package cold weather package we also dropped in reference to our customers in Norway, because I think they called with the sub zero package you kind of need if you are in Norway. And so we actually dropped the cost there a fair bit.

You may have seen on headlines in the high definition back up camera. We made that standard equipment on all cars. So, essentially I think the value for money is actually better. But we did increase the price on some of the optional, the extras that you said if we sold, we will actually make more margin on some of the things out there like for example the leather seats. Those were a fairly low margin item so we increased the price to make it more of a better margin item for us.

Operator

The next question comes from Colin Rusch with Northland Capital Markets. Your line is open.

Colin Rusch - Northland Capital Markets

Can you guys talk a little bit about the introduction of new generation of batteries into the batteries pack. How much testing they need to go through and how much impact do you think that can be on the cost structure over the next several quarters?

Elon Musk

We are not planning on making a significant fundamental technology change at the cell level. We are making a number of improvements at the pack level and then there is electronics and packaging and fillets [ph] that surrounds the pack. So the cell and non-cell portion of the cost. To get the cell costs lower, we are working with our main cell supplier which is Panasonic and working with them to improve the cost of the cell and obviously the more volume there helps. We are quite optimistic about that relationship. It's going really well. They are a great partner to have, actually.

So I am not quite fully answering your question but we feel good about where things are and where they are headed on both the cell and non-cell portion of the battery pack cost.

Colin Rusch - Northland Capital Markets

Okay, perfect. Then with the purchase of the additional land around your current facility, buying the site, how much capacity will that potentially give you if you build out on all that area?

Elon Musk

Well, that piece land adjacent to the factory was originally part of the NUMMI facility. So when we brought the factory, it was actually divided in two, the central parcel and then the north parcel that was mostly just land and a south parcel that was mostly land. So when we bought the factory and the main parcel of land but there were these two satellite parcels. What we did was, we brought about half, I guess, of the south land parcel and NUMMI as a whole as a factory had about half million unit capacity. So production needs to be slightly more space efficient than to achieve the 500K number or buy some more land. So I don't think buying that land puts us above the 500K number. It just makes it easier for us to achieve the 500K number.

Operator

Our next question comes from John Lovallo with Banks of America Merrill Lynch. Your line is open.

John Lovallo - Bank of America/Merrill Lynch

First question would be on what you are expecting in terms of the ramp in R&D and SG&A in the back half of the year? Could you hear me okay?

Elon Musk

Yes. Already an issue in hearing?

Deepak Ahuja

Right, I mean I think certainly it's going to be fairly significant. I want to be careful about how much I quote in terms of percentages but I think it's more important to understand the physical since we have indicated in the shareholder letter that overall, given the continued emphasis on multiple product programs that we have, we will see an increase in R&D and on the sales and SG&A side overall we are strengthening our infrastructure globally on a variety of fronts, so I would say from a trend perspective, the percentage increase would be higher than what you have seen in last couple of quarters.

John Lovallo - Bank of America/Merrill Lynch

Okay. That's helpful. Then if we think about cash flow for a minute, I think if you look at just free cash flow was a use of about \$79 million in the quarter.

I think if you make the adjustments that you guys had talked about I think \$11 million for the DoE payments was of \$67 million increase in receivables that may not occur. Is that looks like about used per \$1 million. Now, you have CapEx ramping up in the back half of the year, so how are you thinking about just kind of free cash flow generation through the remainder of the year and into 2014?

Deepak Ahuja

As we said in the shareholder letter that we clearly intend to cash flow from operations. And you are right in pointing out that some of that will be offset by our capital expenditures and we want to be very careful about burning cash. We want to be sure we are close as possible to a free cash flow position, but that's something that we don't want to necessarily guide to how we are going to manage it, but we are going to be still judicious and spend the CapEx where we need to in order to make sure that we are growing at the right pace.

Elon Musk

We are I mean we are aspiring to make slight improvements to our cash position quarter-over-quarter I mean, that's our aspiration.

John Lovallo - Bank of America/Merrill Lynch

Okay. That's very helpful again. The final question would be, I mean just looking at kind of the typical ramp curve of a vehicle after launch, I mean, generally speaking and I mean, I don't want to put you guys in the category within the other vehicle, but generally speaking volumes tend to peak call it seven to eight quarters out. Now you guys, sorry?

Elon Musk

I don't think that's going to be the case in for the Model S.

John Lovallo - Bank of America/Merrill Lynch

Okay. That was the question. So, in North America, you would say that you have not seen any signs of slowdown in new orders.

Elon Musk

No.

Deepak Ahuja

The traditional model doesn't apply for Tesla, because that assumes that you have a network, which is already present not only in the U.S., but globally. We just don't have that presence. We are starting here essentially from scratch and slowly increasing our presence and making consumers feel comfortable about what EVs are.

Elon Musk

Exactly. I think there is pretty long way to go. It sort of like a S curve of technology adoption. You got that is the sort of really early adopters, but for the mainstream audience they need to really see a lot of cars that would work for long time to really feel like comfortable buying particularly when it's a new technology like electric cars.

Operator

Our next question comes from Craig Irwin with Wedbush. Your line is open.

Craig Irwin - Wedbush

Good evening, gentlemen. Congratulations on the solid progress.

Elon Musk

Thanks.

Craig Irwin - Wedbush

First question I wanted to ask was about the Tilburg plant capacity what sort of capacity have you put into that plant and what sort of capital investment will be needed there as far as expanding finishing capacity I mean, can you sort of sketch this out for us a little bit?

Elon Musk

Yes. I really don't think that that's going to be in anyway a limitation on our progress. It's a final assembly plant, so we are not dependent on parts from suppliers or anything. Generally when we haven't been dependent on parts, when we haven't had an external dependency, we have been able to get the job done. One state is in the hands of others that makes it a lot more difficult and I will update is not in the hands of the others in the case Tilburg plant.

Craig Irwin - Wedbush

Great. Then progress in China, obviously, Chinese market is a huge market. There is a lot of enthusiasm over there for electric cars. Can you share with

us where you stand on your order rate out of China? What you think we are likely to see over the course of next couple of quarters and if maybe you could update us on your eco plan for China?

Elon Musk

Sure. I wouldn't say this is quite the quarter to talk about China. I think we might want to talk about it probably at the next earnings call in more depth. But I do say, China, it's a huge market. It's the world's biggest market for premium sedans. If you take something like, say the Mercedes S class, they sell approximately half of all their worldwide production in China. Obviously if we were to ratio, have a similar ratio that would be a pretty amazing outcome for Tesla.

We are not counting on anything remotely like that. Quite the opposite. But it could be a positive upside surprise there. You just never know. But we have one store in Beijing that we will probably open later this year. Then I am going to visit China obviously and really try to understand the market and make sure we are doing the right things for Chinese consumers and the buyers over there, because not every market wants exactly the same thing.

So we have got to make sure that our product is properly tailored to the desires of consumers in every market in Europe, North America or China or Japan or anywhere else. So we are doing a few things, especially for the China market. For example, improving the comfort level of the rear seat because it's common for people in China to be driven rather than driving themselves.

When we first signed the model as we designed it to be the big driver's car, really. That's how do we make the driver following up with car. And obviously if people are being driven around then we need to make sure that the back seat is optimized for an executive back seat that's more comfortable than what we have right now which is like the family of back seat.

So those are the things. It's a little difficult to predict. This is not the quarter to talk about China. Maybe at the next earnings call. Certainly at the earnings call about Q4 is where we would be talking quite a bit about it at that point, I think.

Colin Rusch - Northland Capital Markets

Great, and then last one if I may. You have set a pretty interesting trajectory on battery cost over the next few years. Can you share with us philosophically whether or not you might use the reduction in battery pack costs to delay the sort of neutralize the impact of the Federal Tax Credit

ruling off for your customers? Or do you see this possibly extending out beyond the timeframe where that would have the necessary benefit?

Elon Musk

Well you see the limit, the \$2,500 Federal Tax Credit is limited to the first 200,000 cars for any manufacturer. So that, between Model S and X we think probably that's going to get exhausted in the next several years. That's how we think it probably will apply to third generation affordable car. At that point, if it is possible for us to maintain a high margin and neutralize the loss of the tax credit, I think we would probably like to do that rather than have a higher margin car.

Jeff Evanson

Jim, we are running about five minutes, over. Everyone, we want to make sure that we get to all the questions in the queue. So we have a couple more left. So if we can keep the questions brief, we will wrap this up as quickly as we can.

Operator

Our next question comes from Aditya Satghare with Lazard Capital Markets. Your line is open.

Aditya Satghare - Lazard Capital Markets

I had two questions. So firstly, just a follow up on 40,000 unit target. How many different versions of the Model S? And in how many different countries do you plan to sell into to get to that 40,000 unit target?

Elon Musk

Well in terms of actually number of countries, it's quite a large number of countries because of the year. I am not sure of the exact number of countries in the next 14 or 15, or something like that. Then of course there is no way and restriction on the (Inaudible) Canada, U.S. Canada, talking about 20 countries right there and then the Greater China, Japan the trends of our important market for us by the way going to take the Japan market very seriously.

I know that lot of car companies that don't take the Japan market really seriously, but I think we are going to do that. it was [it's] very discerning and actually I would consider it a great honor if the Japanese were to actually buy our car.

Aditya Satghare - Lazard Capital Markets

Got it. Okay. The second question was on the U.S. Market so, could you give us a little bit more color about your buyer base here and you know what kind of potential brands do you think your customers are swapping out and who do you think you are grabbing share from?

Elon Musk

We hit some pretty good numbers for that. It's a really broad mix of cars. It's not and not just a premium sedan. In fact, I think we

Deepak Ahuja

I believe we used off that in our last earnings call that we shared

Aditya Satghare - Lazard Capital Markets

..it's a the capital raise

Deepak Ahuja

Probably that's right.

Deepak Ahuja

If you go back and look at our capital raise presentation,

Elon Musk

And we haven't go ahead and just talk about some of the cars we are replacing. Yes. It's a wide range of cars. It's not like you can say or it's been probably five or something like that or it's quite short right now, it's like. (Inaudible).

Deepak Ahuja

This is from the ALG overview taking data from that bulk and they are showing sort of its various events and hybrids, so are the big ones. But it's interesting like we have got the largest one here is sort of in the order of 10% and 11%. A lot of people are buying our car instead of the Prius, but that's 10%. Obviously things like the E-Class are buying our cars there is a lead which also coming from so, it's like E-Class, Prius, lead the Highlander, BMW 5 Series, Odyssey Honda Odyssey it's like it's 4% in the Honda Odyssey very like Model S (Inaudible) is 4%. Volkswagen Jetta is 4%.

Aditya Satghare - Lazard Capital Markets

Interesting.

Elon Musk

Mix of Honda Civic is 3%, so it's really a pretty broad range just from previous segment.

Aditya Satghare - Lazard Capital Markets

Got it. Now that's helpful and congratulations on the good execution this quarter.

Deepak Ahuja

Okay. We have time for one last question please.

Operator

Our last question comes from Elaine Kwei from Jefferies. Your line is open.

Elaine Kwei - Jefferies

Hi, everyone. Thanks for squeezing me in. Just now that you are beginning to ship internationally, could you talk a little bit thinking behind the pricing strategy for Europe and Asia? Just are there any adjustments based on local incentives. Is it based on what the local market can bear and would you expect margins to vary compared to the U.S.?

Then the second part in there, the Super Charger Network has really overcome the infrastructure obstacles for long distance driving and does Tesla have any strategy for addressing any challenges for urban dwellers, especially in the international markets where that might be more common? Thanks so much.

Elon Musk

Sure. The Tesla policy is to try to make the same amount of money on a car in any given market. This is not a policy that, in fact we maybe unique in this. I am not sure if it is. I am not the [automaker] business, but we don't want to make but we don't want to make more money off of someone just because they are in another country, so I don't think that's the right thing to do.

So, for example, in China it's quite common for as manufacturers to mark-up the cars in a pretty huge way. We will not be doing that. We will also try to be extremely transparent about our pricing. So if you can take the U.S. price and you put back into your logistics and any import taxes and then there is a maybe a 3% allowable for exchange rate movements and then some incremental for any extra costs of doing business in that country that

increase our overhead. But we try to be really transparent about that and keep trying to improve those costs every time. I guess that the overarching principle here is that we don't want to rip anyone off. So you should see in the same way in every country.

Elaine Kwei - Jefferies

That's great and then is there any thoughts behind addressing the challenges for folks living in apartments or condos where you might not have a personal garage? As I could see this especially being an issue for the Gen 3 buyers especially.

Elon Musk

Yes, absolutely. It's not a huge percentage of the market that has the issue, but it is what is. Something we need to address. So for the biggest and toughest one is I guess street parking. A lot of cities and municipalities are putting in charging infrastructure on the street. So we are working with them to get more of that established.

For apartment and condos, for their garages there, we actually have loosely formed a group within our sales and service operation team that is able to work with whoever is running the condo or apartment building and tell them what they need to do to install sockets. Then I think what's going to be important long-term, is the ability to load level or limit total electricity power load in an apartment building.

So if there is a lot of cars, you don't want to exceed the total power of going to that building at any one time. So you should cap a peak power limiter that's able to communicate between the cars that are getting charged. Then there are a few companies we are working with in that regard to deal with that sort of peak power load in apartment buildings.

It really hasn't been thus far a constraint on our growth. So if it occupied a little bit of our attention as that becomes, next year perhaps, it will become constraint on our growth and then its going to be more centrally in our attention.

Elaine Kwei - Jefferies

That's great to hear on the international and infrastructure front. Thanks you so much you, Elon.

Jeff Evanson

Okay. Thank you everyone for joining us today. We look forward to seeing you over the next quarter and in fact we will be at Jefferies Industrial Growth Conference in Manhattan, next Monday and on Tuesday, also in Manhattan, we will be at JP Morgan's Auto Conference. So hope to see you all out on the road and happy driving.