TESLA MOTORS INC
Form 10-Q
May 11, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-34756

Tesla Motors, Inc.

(Exact name of registrant as specified in its charter)

Delaware	91-2197729
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3500 Deer Creek Road

Palo Alto, California	94304
(Address of principal executive offices)	(Zip Code)

(650) 681-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") during the preceding 12 months (or for such shorter period that the

registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of April 30, 2015, there were 126,403,793 shares of the registrant's Common Stock outstanding.

TESLA MOTORS, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2015

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Forward-Looking Statements

The discussions in this Quarterly Report on Form 10-Q contain forward-looking statements reflecting our current expectations that involve risks and uncertainties. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, future profitability, future delivery of automobiles, projected costs, expectations regarding demand and acceptance for our technologies, growth opportunities and trends in the market in which we operate, prospects, plans and objectives of management and the statements made below under the heading “Management Opportunities, Challenges and Risks.” The words “anticipates”, “believes”, “estimates”, “expects”, “intends”, “may”, “plans”, “projects”, “will”, “would” and similar expressions to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, the risks set forth in Part II, Item 1A, “Risk Factors” in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission. We do not assume any obligation to update any forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Tesla Motors, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	March 31, 2015 (unaudited)	December 31, 2014
Assets		
Current assets		
Cash and cash equivalents	$1,510,076	$1,905,713
Restricted cash and marketable securities	20,693	17,947
Accounts receivable	200,052	226,604
Inventory	1,054,840	953,675
Prepaid expenses and other current assets	135,756	94,718
Total current assets	2,921,417	3,198,657
Operating lease vehicles, net	912,061	766,744
Property, plant and equipment, net	2,224,191	1,829,267
Restricted cash	13,846	11,374
Other assets	48,515	43,209
Total assets	$6,120,030	$5,849,251
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$732,331	$777,946
Accrued liabilities	353,768	268,884
Deferred revenue	226,474	191,651
Capital lease obligations, current portion	9,622	9,532
Customer deposits	249,476	257,587
Convertible senior notes and other debt	620,710	601,566
Total current liabilities	2,192,381	2,107,166
Capital lease obligations, less current portion	11,265	12,267
Deferred revenue, less current portion	312,850	292,271
Convertible senior notes and other debt, less current portion	1,888,672	1,806,518
Resale value guarantee	606,221	487,879
Other long-term liabilities	228,367	173,244
Total liabilities	5,239,756	4,879,345
Commitments and contingencies (Note 9)		
Convertible senior notes (Notes 6)	54,277	58,196
Stockholders' equity:		
Preferred stock; $0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—

Common stock; $0.001 par value; 2,000,000,000 shares authorized as of March 31, 2015 and December 31, 2014, respectively; 126,362,303 and 125,687,607 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively	126	126
Additional paid-in capital	2,429,677	2,345,266
Accumulated other comprehensive loss	(15,965)	(22)
Accumulated deficit	(1,587,841)	(1,433,660)
Total stockholders' equity	825,997	911,710
Total liabilities and stockholders' equity	$6,120,030	$5,849,251

The accompanying notes are an integral part of these condensed consolidated financial statements.

Tesla Motors, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except share and per share data)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Revenues		
Automotive	$893,320	$588,871
Services and other	46,560	31,671
Total revenues	939,880	620,542
Cost of revenues		
Automotive	631,745	436,254
Services and other	48,062	29,160
Total cost of revenues	679,807	465,414
Gross profit	260,073	155,128
Operating expenses		
Research and development	167,154	81,544
Selling, general and administrative	195,365	117,551
Total operating expenses	362,519	199,095
Loss from operations	(102,446)	(43,967)
Interest income	184	141
Interest expense	(26,574)	(11,883)
Other income (expense), net	(22,305)	6,718
Loss before income taxes	(151,141)	(48,991)
Provision for income taxes	3,040	809
Net loss	$(154,181)	$(49,800)
Net loss per share of common stock, basic and diluted	$(1.22)	$(0.40)
Weighted average shares used in computing net loss per share of common stock, basic and diluted	125,946,657	123,472,782

The accompanying notes are an integral part of these condensed consolidated financial statements.

Tesla Motors, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net loss	$(154,181)	$(49,800)
Other comprehensive loss, net of tax:		
Unrealized net gain on short-term marketable securities	204	—
Foreign currency translation adjustment	(16,147)	—
Other comprehensive loss	(15,943)	—
Comprehensive loss	$(170,124)	$(49,800)

The accompanying notes are an integral part of these condensed consolidated financial statements.

Tesla Motors, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Cash Flows From Operating Activities		
Net loss	$(154,181)	$(49,800)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	77,112	44,268
Stock-based compensation	43,026	37,038
Amortization of discount on convertible debt	17,941	8,493
Inventory write-downs	5,901	1,578
Fixed asset disposal	2,753	—
Other non-cash operating activities	2,862	2,561
Foreign currency transaction (gain) loss	27,977	(1,909)
Changes in operating assets and liabilities		
Accounts receivable	2,175	(23,721)
Inventories and operating lease vehicles	(307,209)	(198,594)
Prepaid expenses and other current assets	(43,475)	(11,429)
Other assets	(6,055)	153
Accounts payable	(43,242)	78,257
Accrued liabilities	90,735	19,280
Deferred revenue	50,729	50,394
Customer deposits	(3,012)	34,981
Resale value guarantee	62,712	54,318
Other long-term liabilities	41,457	12,855
Net cash provided by (used in) operating activities	(131,794)	58,723
Cash Flows From Investing Activities		
Purchases of property and equipment excluding capital leases	(426,060)	(141,364)
(Increase) decrease in other restricted cash	(6,284)	1,295
Purchases of short-term marketable securities	—	(189,111)
Net cash used in investing activities	(432,344)	(329,180)
Cash Flows From Financing Activities		
Collateralized lease borrowing	77,961	—
Proceeds from issuance of convertible and other debt	77,661	2,000,000
Proceeds from exercise of stock options and other stock issuances	35,218	35,726
Principal payments on capital leases and other debt	(3,726)	(2,545)
Common stock and convertible other debt issuance costs	(958)	(30,302)
Proceeds from issuance of warrants	—	338,400
Purchase of convertible note hedges	—	(524,720)
Net cash provided by financing activities	186,156	1,816,559

Effect of exchange rate changes on cash and cash equivalents	(17,655)	1,917
Net increase (decrease) in cash and cash equivalents	(395,637)	1,548,019
Cash and cash equivalents at beginning of period	1,905,713	845,889
Cash and cash equivalents at end of period	$1,510,076	$2,393,908
Supplemental noncash investing activities		
Acquisition of property and equipment included in accounts payable and accrued liabilities	235,582	36,835
Estimated fair market value of facilities under build-to-suit lease	29,212	—

The accompanying notes are an integral part of these condensed consolidated financial statements.

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Overview of the Company

Tesla Motors, Inc. (Tesla, we, us or our) was incorporated in the state of Delaware on July 1, 2003. We design, develop, manufacture and sell high-performance fully electric vehicles, advanced electric vehicle powertrain components, and energy storage applications. We have wholly-owned subsidiaries in North America, Europe and Asia. The primary purpose of these subsidiaries is to market, manufacture, sell and/or service our vehicles.

2. Summary of Significant Accounting Policies

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Tesla and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and reported amounts of expenses during the reporting period, including revenue recognition, residual value of operating lease vehicles, inventory valuation, warranties, fair value of financial instruments and stock-based compensation. Actual results could differ from those estimates.

Unaudited Interim Financial Statements

The accompanying condensed consolidated balance sheet as of March 31, 2015, the condensed consolidated statements of operations and condensed consolidated statements of comprehensive loss for the three months ended March 31, 2015 and 2014 and the condensed consolidated statements of cash flows for the three months ended March 31, 2015 and 2014 and other information disclosed in the related notes are unaudited. The condensed consolidated balance sheet as of December 31, 2014 was derived from our audited consolidated financial statements at that date. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in our Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission.

The accompanying interim condensed consolidated financial statements and related disclosures have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair statement of the results of operations for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of the results to be expected for the full year or for any other future year or interim period.

Beginning in the three months ended March 31, 2015, we changed the composition of the revenue and cost of revenue lines in our statements of operations. Automotive includes revenues related to deliveries of new Model S, including vehicle options, data connectivity, and Supercharging, sales of regulatory credits to other automotive manufacturers, amortization of revenue for cars sold with resale value guarantees, Model S leasing revenue, and scrap sales. Services and other consists of sales of electric vehicle powertrain components and systems to other manufacturers, maintenance and development services, Tesla Energy, and pre-owned Tesla vehicle sales. Prior period amounts have been reclassified to conform to the current period presentation.

Beginning January 1, 2015, the functional currency of each of our foreign subsidiaries changed to the local country's currency. This change was based on the culmination of facts and circumstances that have developed as we expanded our foreign operations over the past year. The adjustment of $10.0 million attributable to the current rate translation of non-monetary assets as of the date of the change is included in accumulated other comprehensive loss on the Company's condensed consolidated balance sheet as of March 31, 2015.

During the three months ended June 30, 2014, we began separately presenting the effect of exchange rate changes on our cash and cash equivalents in our condensed consolidated statements of cash flows due to our growing operations in foreign currency environments. Prior period amounts have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued an accounting update which amends the existing accounting standards for revenue recognition. The new guidance provides a unified model to determine when and how revenue is recognized. Under the new model, revenue is recognized as goods or services are delivered in an amount that reflects the consideration we expect to collect. The guidance is effective for fiscal years beginning after December 15, 2016; early adoption is prohibited. The new standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. We have not yet selected a transition method and are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

Revenue Recognition

We recognize revenues from sales of Model S and the Tesla Roadster, including vehicle options and accessories, vehicle service and sales of regulatory credits, such as zero emission vehicle and greenhouse gas emission credits, as well as sales of electric vehicle powertrain components and systems, such as battery packs and drive units. We recognize revenue when: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and there are no uncertainties regarding customer acceptance; (iii) fees are fixed or determinable; and (iv) collection is reasonably assured.

Car sales include certain standard features and customer selected options and configurations that meet the definition of a deliverable under multiple-element accounting guidance, including internet connectivity, Supercharging access, and specified software updates for cars equipped with Autopilot hardware. These deliverables are valued on a stand-alone basis and we recognize their related revenue over our performance period which is generally the eight-year life of the car or, for software upgrades, as they are delivered. If we sell a deliverable separately, we use that pricing to determine its fair value; otherwise, we use our best estimated selling price by considering third party pricing of similar options, costs used to develop and deliver the service, and other information which may be available.

As of March 31, 2015, we had deferred $43.8 million, $29.1 million, $16.7 million, and $1.2 million related to the purchase of vehicle maintenance and service plans, access to our Supercharger network, Model S connectivity, and Autopilot software upgrades. As of December 31, 2014, we had deferred $39.7 million, $25.6 million, $14.4 million, and $1.5 million related to these same performance obligations.

Resale Value Guarantees

We offer resale value guarantees or similar buy-back terms to all customers who purchase a Model S in the US, Canada and selected European and Asian markets and finance their vehicle through one of our specified commercial banking partners. Under the program, Model S customers have the option of selling their vehicle back to us during the period of 36 to 39 months after delivery for a pre-determined resale value. Although we receive full payment for the vehicle sales price at the time of delivery, we account for transactions under the resale value guarantee program as operating leases. Accordingly, we defer revenue on the sale of the vehicle to deferred revenue and residual value guarantee and recognize revenue attributable to the lease on a straight-line basis over the guarantee period to automotive revenue. Similarly, we capitalize the cost of the leased vehicle and depreciate its value, less expected salvage value, to cost of automotive revenue over the same period.

At the end of the resale value guarantee period, which is the earlier of 39 months or the pay-off date of the initial loan, the resale value guarantee and deferred revenue balances are settled to automotive revenue and the net book value of the leased vehicle is expensed to costs of automotive revenue if our customer retains ownership of the car. In cases where a customer returns the vehicle back to us between months 36 and 39, we purchase the car in the amount of the

resale value guarantee and settle any remaining deferred revenue balance to automotive revenue.

In the fourth quarter of 2014, Tesla also began offering resale value guarantees in connection with automobile sales to certain bank leasing partners. As Tesla has guaranteed the value of these vehicles and as the vehicles are expected to be leased to end-customers, we account for them as collateralized borrowings. As of March 31, 2015 and December 31, 2014, we had $76.7 million and $19.6 million of such borrowings recorded in resale value guarantee and $17.2 million and $0 million recorded in deferred revenue liability, of which a portion will be accreted to revenue and a portion may be distributed to the bank leasing partner should we decide to repurchase the vehicles at the end of the term or should the bank sell the car to a third party and receive proceeds less than the value we have guaranteed. The maximum cash payment to re-purchase these vehicles under these arrangements at March 31, 2015, is $55.4 million. Cash received upon the sale of such cars is classified as collateralized lease borrowing within cash flows from financing activities in our Consolidated Statement of Cash Flows.

Account activity related to our resale value guarantee program consisted of the following for the periods presented (in thousands):

	Three Months Ended March 31,	
	2015	2014
Operating Lease Vehicles		
Operating lease vehicles under the resale value guarantee program—beginning of period	$684,590	$376,979
Net increase in operating lease vehicles under the resale value guarantee program	139,791	84,515
Depreciation expense recorded in cost of automotive revenues	(22,041)	(12,402)
Additional depreciation expense recorded in cost of automotive revenues as a result of early cancellation of resale value guarantee	(4,396)	(2,060)
Reclassifications to inventory resulting from return of vehicle under trade-in program	(5,233)	—
Operating lease vehicles under the resale value guarantee program—end of period	$792,711	$447,032
Deferred Revenue		
Deferred revenue related to the resale value guarantee program—beginning of period	$381,096	$230,856
Net increase in deferred revenue including Model S deliveries with resale value guarantee and reclassification of collateralized borrowing from long-term to short-term	91,694	63,070
Amortization of deferred revenue and short-term collateralized borrowing recorded in automotive revenue	(44,980)	(21,779)
Additional revenue recorded in automotive revenue as a result of early cancellation of resale value guarantee	(909)	(1,441)
Release of deferred revenue resulting from return of vehicle under trade-in program	(2,797)	—
Deferred revenue related to the resale value guarantee program—end of period	$424,104	$270,706
Resale Value Guarantee		
Resale value guarantee liability—beginning of period	$487,879	$236,298
Net increase in resale value guarantee	124,112	55,602
Reclassification from long-term to short-term collateralized borrowing	(644)	—
Additional revenue recorded in automotive revenue as a	(1,070)	(1,283)

result of early cancellation of resale value guarantee		
Release of resale value guarantee resulting from return of vehicle under trade-in program	(4,056)	—
Resale value guarantee liability—end of period	$606,221	$290,617

Model S Leasing Program

In April 2014, we began offering a leasing program in the United States and Canada for Model S. Qualifying customers are permitted to lease a Model S for 36 months, after which time they have the option of either returning the vehicle to us or purchasing it for a pre-determined residual value. We account for these leasing transactions as operating leases and accordingly, we recognize leasing revenues over the contractual term of the individual leases and record cost of automotive revenues equal to the depreciation of the leased vehicles. As of March 31, 2015 and December 31, 2014, we had deferred $14.8 million and $9.4 million of lease-related upfront payments which will be recognized on a straight-line basis over the contractual term of the individual leases. Lease revenues are recorded in automotive revenue and for the three months ended March 31, 2015, we recognized $6.6 million.

Warranties

We provide a warranty on all vehicles, production powertrain components and systems sales, and we accrue warranty reserves upon delivery to the customer. Warranty reserves include management’s best estimate of the projected costs to repair or to replace items under warranty. These estimates are based on actual claims incurred to-date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain and changes to our historical or projected experience may cause material changes to our warranty reserves in the future. The portion of the warranty provision expected to be incurred within 12 months is classified as current within accrued liabilities, while the remaining amount is classified as long-term within other long-term liabilities.

Accrued warranty activity consisted of the following for the periods presented (in thousands):

	Three Months Ended March 31,	
	2015	2014
Accrued warranty—beginning of period	$129,043	$53,182
Warranty costs incurred	(11,786)	(9,300)
Net changes in liability for pre-existing warranties, including expirations	10,762	8,120
Provision for warranty	27,282	19,930
Accrued warranty—end of period	$155,301	$71,932

Our warranty reserves do not include projected warranty costs associated with our operating lease vehicles and vehicles sold with resale value guarantee and similar buy-back terms as such actual warranty costs are expensed as incurred. For the three months ended March 31, 2015 and 2014, warranty costs incurred for our operating lease vehicles were $1.8 million and $1.2 million. Warranty expense is recorded as a component of cost of automotive revenue.

Cost of automotive revenue during the first quarter of 2015 also included a $10.7 million increase to our warranty reserve to reflect the additional preventative repairs we plan to perform on customer drive units and high-voltage battery packs when brought in for warranty related service.

Inventory Valuation

We value our inventories at the lower of cost or market. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis. We record inventory write-downs for estimated obsolescence or unmarketable inventories based upon assumptions about future demand forecasts. If our inventory on hand is in excess of our future demand forecast, the excess amounts are written off.

We also review inventory to determine whether its carrying value exceeds the net amount realizable upon the ultimate sale of the inventory. This requires us to determine the estimated selling price of our vehicles less the estimated cost to convert inventory on hand into a finished product. Should our estimates of future selling prices or production costs change, material changes to these reserves may be required. A small change in our estimates may result in a material charge to our reported financial results.

Concentration of Risk

Credit Risk

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents, restricted cash and accounts receivable. Our cash equivalents are primarily invested in money market funds with high credit quality financial institutions in the United States. At times, these deposits and securities may be in excess of insured limits. We invest cash not required for use in operations in high credit quality securities based on our investment policy. Our investment policy provides guidelines and limits regarding credit quality, investment concentration, investment type, and maturity that we believe will provide liquidity while reducing risk of loss of capital. Our investments are currently of a short-term nature and include U.S. treasury bills.

As of March 31, 2015 and December 31, 2014, our accounts receivable were derived primarily from amounts to be received from financial institutions and leasing companies offering various financing products to our customers, sales of regulatory credits, as well as the development and sales of powertrain components and systems to automotive original equipment manufacturers (OEMs). As of March 31, 2015, we have two customers who individually account for 23% and 10% of our accounts receivable.

Supply Risk

Although there may be multiple suppliers available, many of the components used in our vehicles are purchased by us from a single source. If these single source suppliers fail to satisfy our requirements on a timely basis at competitive prices, we could suffer manufacturing delays, a possible loss of revenues, or incur higher cost of sales, any of which could adversely affect our operating results.

Stock-Based Compensation

We use the fair value method of accounting for our stock options and restricted stock units (RSUs) granted to employees and our Employee Stock Purchase Plan (ESPP) to measure the cost of employee services received in exchange for the stock-based awards. The fair value of stock options and ESPP are estimated on the grant date and offering date using the Black-Scholes option-pricing

model. The fair value of RSUs is measured on the grant date based on the closing fair market value of our common stock. The resulting cost is recognized over the period during which an employee is required to provide service in exchange for the awards, usually the vesting period which is generally four years for stock options and RSUs and six months for the ESPP. Stock-based compensation expense is recognized on a straight-line basis, net of estimated forfeitures.

Net Loss per Share of Common Stock

Our basic and diluted net loss per share of common stock is calculated by dividing net loss by the weighted-average shares of common stock outstanding for the period. Potentially dilutive shares, which are based on the number of shares underlying outstanding stock options and warrants as well as our convertible senior notes, are not included when their effect is antidilutive.

The following table presents the potential weighted common shares outstanding that were excluded from the computation of diluted net loss per share of common stock for the periods presented. Anti-dilutive share counts for the twelve months ended December 31, 2014 have been updated.

	Three Months Ended March 31,		Twelve Months Ended December 31,
	2015	2014	2014
Employee share based awards	15,711,086	14,288,189	14,729,749
Convertible senior notes	2,040,822	2,015,267	2,344,998
Warrants issued May 2013	471,339	433,479	921,985

Since we expect to settle the principal amount of our outstanding convertible senior notes in cash, we use the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on diluted net income per share of common stock when the average market price of our common stock for a given period exceeds the conversion price of $124.52, $359.87 and $359.87 per share for the 2018 Notes, 2019 Notes and 2021 Notes.

Uncertain Tax Positions

As of March 31, 2015 and December 31, 2014, the aggregate balances of our gross unrecognized tax benefits were $47.8 million and $41.4 million, of which $45.2 million and $39.1 million, would not affect our effective tax rate as the tax benefits would increase a deferred tax asset which is currently offset by a full valuation allowance.

3. Balance Sheet Components

Inventory

As of March 31, 2015 and December 31, 2014, our inventory consisted of the following (in thousands):

	March 31, 2015	December 31, 2014
Raw materials	$370,553	$392,292
Work in process	63,058	56,114
Finished goods	492,645	397,318
Service parts	128,584	107,951
Total	$1,054,840	$953,675

Finished goods inventory includes vehicles in transit to fulfill customer orders, vehicles used for marketing purposes and service loaners, until they are sold to customers, new vehicles available for immediate sale at our retail and service center locations, and pre-owned Tesla vehicles. The increase in finished goods inventory was primarily due to customer orders that were in transit for delivery at quarter-end while there was a reduction in the new vehicles available for immediate sale.

Property, Plant and Equipment

As of March 31, 2015 and December 31, 2014, our property, plant and equipment, net, consisted of the following (in thousands):

	March 31, 2015	December 31, 2014
Machinery, equipment and office furniture	$819,794	$720,746
Construction in progress	763,628	572,125
Leasehold improvements	310,235	230,270
Tooling	308,082	295,906
Building and building improvements	198,024	154,362
Computer equipment and software	114,824	98,970
Land	51,990	49,478
	2,566,577	2,121,857
Less: Accumulated depreciation and amortization	(342,386)	(292,590)
Total	$2,224,191	$1,829,267

Construction in progress is comprised primarily of assets related to the manufacturing of our Model S, including building improvements at our Tesla Factory in Fremont, California, Gigafactory construction, tooling and manufacturing equipment and capitalized interest expense. Depreciation of construction in progress begins when the assets are ready for their intended use. Interest expense on outstanding debt is capitalized during the period of significant capital asset construction. Capitalized interest on construction in progress is included in property, plant and equipment, and is amortized over the life of the related assets. During the three months ended March 31, 2015 and 2014, we capitalized $8.3 million and $1.2 million of interest expense.

We are sometimes involved in construction at our leased facilities. In accordance with Accounting Standards Codification 840, Leases, for build-to-suit lease arrangements where we are involved in the construction of structural improvements prior to the commencement of the lease or take some level of construction risk, we are considered the owner of the assets during the construction period. Accordingly, upon commencement of our construction activities, we record a construction in progress asset and a corresponding financing liability. Once the construction is completed, if the lease meets certain “sale-leaseback” criteria, we will remove the asset and related financial obligation from the balance sheet and treat the building lease as an operating lease. If upon completion of construction, the project does not meet the “sale-leaseback” criteria, the leased property will be treated as a capital lease for financial reporting purposes and included in building and building improvements in the table above. As of March 31, 2015 and December 31, 2014, the table above includes $61.5 million and $52.4 million of build-to-suit assets. As of March 31, 2015 and December 31, 2014, corresponding financing obligations of $0 million and $21.0 million are recorded in accrued liabilities and $61.3 million and $31.4 million are recorded in other long-term liabilities.

Depreciation and amortization expense during the three months ended March 31, 2015 and 2014 were $52.1 million and $28.9 million. Total property and equipment assets under capital lease as of March 31, 2015 and December 31, 2014 were $34.8 million and $33.4 million. Accumulated depreciation related to assets under capital lease as of these dates were $14.7 million and $12.8 million.

We have acquired land for the site of our Gigafactory and have incurred$146.2 million of construction costs as of March 31, 2015.

Accrued Liabilities

As of March 31, 2015 and December 31, 2014, our accrued liabilities consisted of the following (in thousands):

	March 31, 2015	December 31, 2014
Taxes payable	$83,739	$71,229
Accrued purchases	146,952	68,547
Payroll and related costs	66,544	54,492
Other	56,533	74,616
Total	$353,768	$268,884

4. Fair Value of Financial Instruments

The carrying values of our financial instruments including cash equivalents, marketable securities, accounts receivable and accounts payable approximate their fair value due to their short-term nature. As a basis for determining the fair value of certain of our assets and liabilities, we established a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level III) unobservable inputs in which there is little or no market data which requires us to develop our own assumptions. This hierarchy requires us to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. Our financial assets that are measured at fair value on a recurring basis consist of cash equivalents and marketable securities.

All of our cash equivalents and current restricted cash, which are comprised primarily of money market funds, are classified within Level I of the fair value hierarchy because they are valued using quoted market prices or market prices for similar securities. Our restricted short-term marketable securities are classified within Level I of the fair value hierarchy.

As of March 31, 2015 and December 31, 2014, the fair value hierarchy for our financial assets that are carried at fair value was as follows (in thousands):

	March 31, 2015				December 31, 2014			
	Fair Value	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III
Money market funds	$874,305	$874,305	$ —	$ —	$1,275,346	$1,275,346	$ —	$ —
U.S. treasury bills	16,682	16,682	—	—	16,673	16,673	—	—
Total	$890,987	$890,987	$ —	$ —	$1,292,019	$1,292,019	$ —	$ —

Our available-for-sale marketable securities classified by security type as of March 31, 2015 and December 31, 2014 consisted of the following (in thousands):

	March 31, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury bills	$16,478	$ 204	$ —	$ 16,682	$16,695	$ —	$ (22)	$ 16,673

As of March 31, 2015, the estimated fair value of our 2018 Notes, 2019 Notes, and 2021 Notes was $1.06 billion (par value $659.8 million), $807.3 million (par value $920.0 million), and $1.17 billion (par value $1.38 billion). As of December 31, 2014 the estimated fair value of our 2018 Notes, 2019 Notes, and 2021 Notes was $1.22 billion (par value $659.8 million), $852.2 million (par value $920.0 million), and $1.25 billion (par value $1.38 billion). These fair values represent level II valuations. When determining the estimated fair value of our long-term debt, we used a commonly accepted valuation methodology and market-based risk measurements that are indirectly observable, such as credit risk. As of March 31, 2015, the $77.7 million carrying value of our Warehouse Facility liability approximates the fair value.

5. Customer Deposits

We collect deposits from customers at the time they place an order for a vehicle and, in some locations, at certain additional milestones up to the point of delivery. Customer deposit amounts and timing vary depending on the vehicle model and country of delivery. Customer deposits related to Model X currently represent fully refundable reservations. Customer deposits are included in current liabilities until refunded or until they are applied to a customer's purchase balance at time of delivery.

As of March 31, 2015 and December 31, 2014, we held customer deposits of $249.5 million and $257.6 million.

6. Convertible and Long-term Debt Obligations

0.25% and 1.25% Convertible Senior Notes and Bond Hedge and Warrant Transactions

In March 2014, we issued $800.0 million principal amount of 0.25% convertible senior notes due 2019 (2019 Notes) and $1.20 billion principal amount of 1.25% convertible senior notes due 2021 (2021 Notes) in a public offering. In April 2014, we issued an additional $120.0 million aggregate principal amount of 2019 Notes and $180.0 million aggregate principal amount of 2021 Notes, pursuant to the exercise in full of the overallotment options of the underwriters of our March 2014 public offering. Each $1,000 of principal of the 2019 Notes and 2021 Notes will initially be convertible into 2.7788 shares of our common stock, which is equivalent

to an initial conversion price of approximately $359.87 per share, subject to adjustment upon the occurrence of specified events. The total net proceeds from these offerings, after deducting transaction costs, were approximately $905.8 million from 2019 Notes and $1.36 billion from 2021 Notes. We incurred $14.2 million and $21.4 million, of debt issuance costs in connection with the 2019 Notes and the 2021 Notes, which we initially recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual terms of these notes. The interest rates are fixed at 0.25% and 1.25% per annum and are payable semi-annually in arrears on March 1 and September 1 of each year, commencing on September 1, 2014.

In connection with the offering of these notes in March 2014, we entered into convertible note hedge transactions whereby we have the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 5.6 million shares of our common stock at a price of approximately $359.87 per share. The total cost of the convertible note hedge transactions was $524.7 million. In addition, we sold warrants whereby the holders of the warrants have the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 2.2 million shares of our common stock at a price of $512.66 for the 2019 Notes and a total of approximately 3.3 million shares of our common stock at a price of $560.64 per share for 2021 Notes. We received $338.4 million in cash proceeds from the sale of these warrants. Similarly, in connection with the issuance of additional notes in April 2014, we entered into convertible note hedge transactions and paid an aggregate $78.7 million. In addition, we sold warrants to purchase (subject to adjustment for certain specified events) a total of approximately 0.3 million shares of our common stock at a strike price of $512.66 per share for the warrants relating to 2019 Notes, and a total of approximately 0.5 million shares of our common stock at a strike price of $560.64 per share for the warrants relating to 2021 Notes. We received aggregate proceeds of approximately $50.8 million from the sale of the warrants. Taken together, the purchase of the convertible note hedges and the sale of warrants are intended to offset any actual dilution from the conversion of these notes and to effectively increase the overall conversion price from $359.87 to $512.66 per share in the case of warrants relating to 2019 Notes and from $359.87 to $560.64 in the case of warrants relating to 2021 Notes. As these transactions meet certain accounting criteria, the convertible note hedges and warrants are recorded in stockholders' equity and are not accounted for as derivatives. The net cost incurred in connection with the convertible note hedge and warrant transactions was recorded as a reduction to additional paid-in capital on the condensed consolidated balance sheet.

During the first quarter of 2015, the closing price of our common stock did not meet or exceed 130% of the applicable conversion price of our 2019 Notes and 2021 Notes on at least 20 of the last 30 consecutive trading days of the quarter; furthermore, no other conditions allowing holders of the 2019 Notes and 2021 Notes to convert have been met as of March 31, 2015. Therefore, the 2019 Notes and 2021 Notes are not convertible during the second quarter of 2015 and are classified as long-term debt. Should the closing price conditions be met in the second quarter of 2015 or a future quarter, the 2019 Notes and 2021 Notes will be convertible at their holders' option during the immediately following quarters.

1.50% Convertible Senior Notes and Bond Hedge and Warrant Transactions

In May 2013, we issued $660.0 million aggregate principal amount of convertible senior notes due 2018 (2018 Notes) in a public offering. The net proceeds from the offering, after deducting transaction costs, were approximately $648.0 million. We incurred $12.0 million of debt issuance costs in connection with 2018 Notes which we initially recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual term of 2018 Notes. Each $1,000 of principal of the 2018 Notes will initially be convertible into 8.0306 shares of our common stock, which is equivalent to an initial conversion price of approximately $124.52 per share, subject to adjustment upon the occurrence of specified events. The interest under 2018 Notes is fixed at 1.50% per annum and is payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2013.

In connection with the offering of the 2018 Notes, we entered into convertible note hedge transactions whereby we have the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 5.3 million shares of our common stock at a price of approximately $124.52 per share. The cost of the convertible note hedge transactions was $177.5 million. In addition, we sold warrants whereby the holders of the warrants have the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 5.3 million shares of our common stock at a price of $184.48 per share. We received $120.3 million in cash proceeds from the sale of these warrants. Taken together, the purchase of the convertible note hedges and the sale of warrants are intended to offset any actual dilution from the conversion of the 2018 Notes and to effectively increase the overall conversion price from $124.52 to $184.48 per share. As these transactions meet certain accounting criteria, the convertible note hedges and warrants are recorded in stockholders' equity and are not accounted for as derivatives. The net cost incurred in connection with the convertible note hedge and warrant transactions was recorded as a reduction to additional paid-in capital in the condensed consolidated balance sheet.

During the first quarter of 2015, the closing price of our common stock exceeded 130% of the applicable conversion price of our 2018 Notes on at least 20 of the last 30 consecutive trading days of the quarter; therefore, holders of 2018 Notes may convert their notes during the second quarter of 2015. As such, we classified the $605.5 million carrying value of our 2018 Notes as current liabilities and classified $54.3 million, representing the difference between the aggregate principal of our 2018 Notes of $659.8 million and the carrying value of 2018 Notes, as mezzanine equity on our condensed consolidated balance sheet as of March 31, 2015. Similarly, debt issuance costs were classified as other current assets as of March 31, 2015. Should the closing price conditions be met in the second quarter of 2015 or a future quarter, 2018 Notes will be convertible at their holders' option during the immediately following quarter.

Convertible Senior Notes Carrying Value and Interest Expense

In accordance with accounting guidance on embedded conversion features, we valued and bifurcated the conversion option associated with the notes from the respective host debt instrument and initially recorded the conversion option for the 2018, 2019, and 2021 Notes in stockholders' equity. The resulting debt discounts on the 2019 Notes, 2021 Notes, and 2018 Notes are being amortized to interest expense at the effective interest rate over the contractual terms of the notes.

	March 31, 2015			December 31, 2014		
	2018 Notes	2019 Notes	2021 Notes	2018 Notes	2019 Notes	2021 Notes
	(in thousands, except years and percentages)					
Carrying value	$605,485	$768,488	$1,057,749	$601,566	$759,891	$1,046,627
Unamortized discount	54,277	151,512	322,251	58,196	160,109	333,373
Principal amount	$659,762	$920,000	$1,380,000	$659,762	$920,000	$1,380,000
Remaining amortization period (years)	2.9	3.7	5.7			
Effective interest rate on liability component	4.29 %	4.89 %	5.96 %			
Carrying amount of equity component	$82,800	$188,100	$369,400			
If converted value in excess of par value	$340,432	$—	$—			

Warehouse line of credit

In March 2015, we entered into a loan and security agreement (the "Warehouse Facility") for a secured asset based line of credit for a principal amount up to $100 million. Obligations under the Warehouse Facility are secured on a first priority basis by certain of our direct lease contracts and the related lease vehicles. We sell the lease contracts and related vehicles to a wholly owned, bankruptcy-remote, special purpose entity that transfers an ownership interest in these assets, but not the assets themselves, to third-party lenders. Borrowings under the Warehouse Facility are generally limited to up to 72% of the present value of the remaining lease payments and the residual vehicle values under eligible lease contracts. As of March 31, 2015, we have borrowed $77 million under the Warehouse Facility.

Interest is payable monthly on amounts borrowed under the Warehouse Facility at a variable rate of LIBOR plus 1.65% and on undrawn amounts at a rate of 0.5%. The Warehouse facility matures in March 2017, at which time all outstanding borrowing will become due. Prior to that date, principal payments will be due in the amount that the borrowing limit decreases below our outstanding principal balance.

Interest Expense

The following table presents the aggregate amount of interest expense recognized on the warehouse line of credit, 2018 Notes, 2019 Notes, and 2021 Notes relating to the contractual interest coupon and amortization of the debt issuance costs and debt discount.

	Three Months Ended March 31,	
	2015	2014
Contractual interest coupon	$7,307	$3,652
Amortization of debt issuance costs	1,530	736
Amortization of debt discount	23,638	8,492
Total	$32,475	$12,880

7. Equity Incentive Plans

Performance-based Stock Option Grant

In 2014, to create incentives for continued long term success beyond the Model S program and to closely align executive pay with our stockholders' interests in the achievement of significant milestones by our company, the Compensation Committee of our Board of Directors granted stock options to certain employees to purchase 1,073,000 shares of our common stock. Each such grant consists of four vesting tranches with a vesting schedule based entirely on the attainment of future performance milestones, assuming continued employment and service to us through each vesting date.

- 1/4th of the shares subject to the options are scheduled to vest upon completion of the first Model X Production Vehicle;
- 1/4th of the shares subject to the options are scheduled to vest upon achieving aggregate vehicle production of 100,000 vehicles in a trailing 12-month period;
- 1/4th of the shares subject to the options are scheduled to vest upon completion of the first Gen III Production Vehicle; and
- 1/4th of the shares subject to the options are scheduled to vest upon achievement of annualized gross margin of greater than 30.0% in any three years.

As of March 31, 2015, the following performance milestone was considered probable of achievement.

- Completion of the first Model X Production Vehicle.

For the three months ended March 31, 2015 and 2014, we recorded stock-based compensation expense of $3.7 million and $2.9 million related to this grant, respectively.

2012 CEO Grant

In August 2012, our Board of Directors granted 5,274,901 stock options to our CEO (2012 CEO Grant). The 2012 CEO Grant consists of ten vesting tranches with a vesting schedule based entirely on the attainment of both performance conditions and market conditions, assuming continued employment and service to us through each vesting date.

Each of the ten vesting tranches requires a combination of one of the ten pre-determined performance milestones and an incremental increase in our market capitalization of $4.0 billion, as compared to the initial market capitalization of $3.2 billion measured at the time of the 2012 CEO Grant.

As of March 31, 2015, the market conditions for six vesting tranches and the following performance milestone were achieved and approved by our Board of Directors:

- Successful completion of the Model X Alpha Prototype.
- Successful completion of the Model X Beta Prototype;

As of March 31, 2015, the following three performance milestones were considered probable of achievement:

- Completion of the first Model X Production Vehicle;
- Successful completion of the Model 3 Alpha Prototype; and
- Aggregate vehicle production of 100,000 vehicles.

For the three months ended March 31, 2015 and 2014, we recorded stock-based compensation expense of $1.4 million and $10.0 million related to this grant, respectively.

No cash compensation has been received by our CEO for his services to the company.

Summary Stock-Based Compensation Information

The following table summarizes our stock-based compensation expense by line item in the condensed consolidated statements of operations (in thousands):

	Three Months Ended March 31,	
	2015	2014
Cost of sales	$4,601	$3,106
Research and development	19,792	13,545
Selling, general and administrative	18,633	20,387
Total	$43,026	$37,038

8. Commitments and Contingencies

Legal Proceedings

From time to time, we are subject to various legal proceedings that arise from the normal course of business activities. In addition, from time to time, third parties may assert intellectual property infringement claims against us in the form of letters and other forms of communication. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on our results of operations, prospects, cash flows, financial position and brand.

In November 2013, a putative securities class action lawsuit was filed against Tesla in U.S. District Court, Northern District of California, alleging violations of, and seeking remedies pursuant to, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The complaint, made claims against Tesla and its CEO, Elon Musk, sought damages and attorney's fees on the basis of allegations that, among other things, Tesla and Mr. Musk made false and/or misleading representations and omissions, including with respect to the safety of Model S. This case was brought on behalf of a putative class consisting of certain persons who purchased Tesla's securities between August 19, 2013 and November 17, 2013. On September 26, 2014, the trial court, upon the motion of Tesla and Mr. Musk, dismissed the complaint with prejudice, and thereafter issued a formal written order to that effect. The plaintiffs have appealed from the trial court's order, and that appeal is pending.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the related notes that appear elsewhere in this Form 10-Q.

Overview and Quarter Highlights

We design, develop, manufacture and sell high-performance fully electric vehicles, advanced electric vehicle powertrain components and energy storage applications. We are currently producing and selling our second vehicle, the Model S sedan. Model S is a four door, five-passenger premium sedan that offers exceptional performance, functionality and attractive styling. Model S inherited many of the electric powertrain innovations we introduced with our first vehicle, the Tesla Roadster. We commenced deliveries of Model S in June 2012 and have delivered over 66,000 vehicles through March 31, 2015. In 2014 we announced the availability of our All-Wheel Drive Model S and began delivery, starting with a performance-optimized version, in December 2014. Since then we have announced a 70 kWh All-Wheel Drive Model S and discontinued the 60 kWh Model S.

We are continuing to develop our Model X crossover vehicle and intend to commence customer deliveries late in the third quarter of 2015. After the Model X, our goal is to introduce Model 3, a lower priced sedan designed for the mass market, in 2017.

Our primary source of revenue is from the sale of our vehicles. During the three months ended March 31, 2015, we recognized total revenues of $939.9 million, an increase of $319.3 million over total revenues of $620.5 million for the three months ended March 31, 2014, primarily driven by growth of Model S deliveries worldwide.

Gross margin for the three months ended March 31, 2015 was 27.7%, an increase from 25.0% for the three months ended March 31, 2014. Higher vehicle production volume, manufacturing efficiencies and vehicle cost reductions, combined with favorable product mix, contributed to higher gross margin in the first quarter of 2015, despite the strengthening of the U.S. dollar which affected our revenue from sales in foreign markets.

Research and development (R&D) expenses for the three months ended March 31, 2015 were $167.2 million, an increase from $81.5 million for the three months ended March 31, 2014. Higher R&D expenses in the first quarter of 2015 reflected our growing engineering work on Model X as well as efforts to develop the right hand drive All-Wheel Drive Model S.

We continue to increase our sales and service footprint worldwide and expand our Supercharging network. With the continued global expansion of our customer support and Supercharger infrastructure, selling, general and administrative expenses were $195.4 million for the three months ended March 31, 2015, compared to $117.6 million for the three months ended March 31, 2014.

Management Opportunities, Challenges and Risks

Orders, Production and Deliveries

During the last several months, we have broadened the appeal of Model S by introducing all-wheel drive vehicles and Model S 70D. In addition, we remain on track to introduce Model X late in the third quarter of this year. We expect that demand for our vehicles will continue to increase worldwide as more people drive and become aware of our vehicles, as we grow our customer support infrastructure, and as we continue to develop our products.

In order to meet this anticipated demand for both Model S and Model X, we are executing a plan to increase our combined Model S and Model X production capacity to over 2,000 units per week by the end of 2015. In August 2014, we began our production ramp by transitioning to our new final assembly line and upgrading our body center. We are continuing to make further investment in production capacity during 2015, including building a new paint shop, a new body shop for Model X, and additional stamping capacity. We expect our annual production will increase by over 50% each year for the next several years. In addition, scaling our deliveries entails that we increase the number of customer-configured cars in-transit. We therefore expect production to increase faster than deliveries, resulting in higher finished goods inventory.

Our recent production capacity expansion contributed to average weekly production in excess of 1,000 vehicles per week during the first quarter of 2015, considering the planned shutdown of production during the first week of the year. During 2015, we plan to achieve significant efficiencies in Model S production and begin production of Model X with the intent of achieving a significantly faster initial production ramp than we achieved with Model S. The introduction of Model X into our existing production process will add significant complexity and may affect our ability to initially meet future efficiency and delivery targets.

In addition to expanding our production, we expect to continue to lower the cost of manufacturing our vehicles and improve our gross margin. Significant cost improvements for Model S were achieved in 2014, including material cost reductions from both engineering and commercial actions, as well as manufacturing efficiencies. We expect that this trend will continue as we execute on our roadmap. We expect that such improvements will allow us to significantly improve our gross margin excluding the impact of foreign currency movements. During our product introductions in 2014, we incurred manufacturing inefficiencies which negatively impacted our gross margin. When we introduce Model X, we expect that both production inefficiencies and supply chain inefficiencies typical of a new product introduction will suppress Model X margins for at least a few quarters after its introduction. If we are not able to achieve the planned cost reductions from our various cost savings and process improvement initiatives or introduce Model X efficiently, our ability to reach our gross margin goals would be negatively affected.

We expect to deliver approximately 55,000 Model S and X vehicles worldwide in 2015, which is about 74% more deliveries than we achieved in 2014. To support this growth, we plan to continue to expand our Supercharger, stores and service infrastructure worldwide as well as to provide better service in areas with a high concentration of Model S customers. As we now offer Model S in many countries within North America, Europe and Asia, our expansion will primarily occur in geographic areas in which we already have a presence. Based on our current projections, we expect our long-term sales outside of North America will be almost half of our worldwide automotive revenue. Despite initial challenges in China, we plan to continue to invest in our infrastructure in China as we believe that the country could be one of our largest markets within a few years. However, as compared to markets in the United States and Europe, we have relatively limited experience in China and other Asian markets; thus, we may face continuing difficulties meeting our future expansion plans in Asia.

Trends in Capital Expenditures and Operating Expenses

Our capital expenditures and operating expenses have significantly increased in the past year. As we continue to invest in the long term growth of Tesla, capital spending and operating expenses will continue to increase, but at a more moderate pace than in 2014. During 2015, capital expenditures are expected to be about $1.5 billion as we expand production capacity, complete Model X development, and continue to build the Gigafactory and expand our stores and service centers, as well as continue other product development programs, including Model 3.

Our operating expenses will continue to grow in 2015, but at less than half the pace of growth in 2014. Our R&D expenses in particular will continue to increase as we complete the development, validation, and testing of Model X and accelerate design and engineering work on Model 3. Growth of sales, general and administrative expenses will be more modest as we will be particularly focused on increasing operational efficiency while we continue to expand our customer and corporate infrastructure. Over time, we expect overall operating expenses to decrease as a percentage of revenue.

As of March 31, 2015 and December 31, 2014, the net book value of our Supercharger network was $128.5 million and $107.8 million and currently includes 425 locations globally. We plan to continue investing in our Supercharger network for the foreseeable future, including in North America, Europe and Asia and expect such spending to be approximately 5% of total capital spending over the next 12 months. During 2015, this investment will grow our Supercharger network by about 50%. We allocate Supercharger related expenses to cost of automotive revenues and selling, general, and administrative expenses. These costs were immaterial for all periods presented.

Customer Financing Options

We offer loans and leases in North America, Europe and Asia primarily through various financial institutions. We offer a resale value guarantee in connection with certain loans offered by financial institutions and provide this guarantee to approximately 11,760 Model S customers. We expanded this program to selected European and Asian

markets this quarter. Model S deliveries with the resale value guarantee currently do not impact our near-term cash flows and liquidity, since we receive the full amount of cash for the vehicle sales price at delivery. However, this program requires the deferral of revenues and costs into future periods under lease accounting. Although lease accounting will continue to impact our revenues and operating results in the period cars are sold under this and similar programs, as time passes, the amortization of existing deferred revenues and costs will begin to partially offset this adverse impact. Furthermore, while we do not assume any credit risk related to the customer, we are exposed to the risk that a vehicle's resale value may be lower than our estimates and the volume of vehicles returned to us may be higher than our estimates which could adversely impact our cash flows.

We currently offer leases in the U.S. directly from Tesla Finance, our captive financing entity, as well as through a banking partner. Leasing through Tesla Finance is now available in 37 states, the District of Columbia and in 4 provinces of Canada. Through March 31, 2015, we have leased approximately 1,740 vehicles through Tesla Finance and approximately 900 vehicles through our banking partner. Leasing through both Tesla Finance and our banking partner exposes us to residual value risk and will adversely impact our near-term revenues and operating results by requiring the deferral of revenues and costs into future periods under lease accounting. In addition, for leases offered directly from Tesla Finance (but not for those offered through our bank partner), we will not receive the full amount of the cash for the vehicle price at delivery and will assume customer credit risk. We plan to continue expanding our leasing offerings.

We have set the residual values given to our customers under our resale value guarantee program at what we estimate will be the trade-in value of these vehicles at the end of the term of the option. Based on current market demand for our cars, we estimate the resale prices for our vehicles will continue to be above our resale value guarantee amounts. Should market values or customer demand decrease, these estimates may be impacted materially.

The Tesla Gigafactory

We are building the Tesla Gigafactory, a facility where we intend to work together with our suppliers to integrate battery precursor material, cell, module and battery pack production in one location. In June 2014, we broke ground on the Gigafactory outside of Reno, Nevada. Construction continued during the first quarter of 2015 with plans that the first cells will be produced in 2016.

We will prepare and provide the land, buildings and utilities for the Gigafactory, invest in production equipment for battery cell, module and pack production and be responsible for the overall management of the Gigafactory and we will engage with partners who have significant experience in battery cell production. We have partnered with Panasonic to manufacture and supply us with battery cells and we anticipate bringing on additional partners to create a fully integrated industrial complex. Although planning discussions with production and supply chain partners continue to progress, to-date we have not formalized any agreements with any other partners. Given the size and complexity of this undertaking, the cost of building and operating the Gigafactory could exceed our current expectations and the Gigafactory may take longer to bring online than we anticipate.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience, as appropriate, and on various other assumptions that we believe to be reasonable under the circumstances. Changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

For a description of our critical accounting policies and estimates, please refer to the “Critical Accounting Policies and Estimates” section of our Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission (SEC). In addition, please refer to Note 2, “Summary of Significant Accounting Policies,” to our Condensed Consolidated Financial Statements included under Part I, Item 1 of this Quarterly Report on Form 10-Q.

Results of Operations

Revenues

Automotive revenue includes revenues related to deliveries of new Model S, including internet connectivity, Supercharging access, and specified software updates for cars equipped with Autopilot hardware, as well as sales of regulatory credits to other automotive manufacturers, amortization of revenue for cars sold with resale value guarantees, and Model S leasing revenue. Services and other revenue consists of sales of electric vehicle powertrain components and systems to other manufacturers, maintenance and development services, Tesla Energy, and pre-owned Tesla vehicle sales.

Automotive revenue during the three months ended March 31, 2015, were $893.3 million, an increase from $588.9 million during the three months ended March 31, 2014. The increase was primarily driven by the ramp in Model S deliveries. For the three months ended March 31, 2015 and 2014, automotive revenue includes $53.7 million and $23.7 million from the accretion of the deferred revenues from our resale value guarantee and other similar programs, as well as Model S leasing.

Service and other revenue during the three months ended March 31, 2015 were $46.6 million, an increase from $31.7 million during the three months ended March 31, 2014 related primarily to increases in maintenance service revenue and powertrain sales.

Cost of Revenues and Gross Profit

Cost of revenues includes direct parts, material and labor costs, manufacturing overhead, including amortized tooling costs, royalty fees, shipping and logistic costs and reserves for estimated warranty expenses. Cost of revenues also includes adjustments to warranty expense and charges to write down the carrying value of our inventory when it exceeds its estimated net realizable value and to provide for obsolete and on-hand inventory in excess of forecasted demand.

Cost of automotive revenues during the three months ended March 31, 2015 were $679.8 million, an increase from $465.4 million for the three months ended March 31, 2014. The increase in cost of automotive revenues was driven primarily by increased Model S deliveries. In the three months ended March 31, 2015 and 2014, we recognized $24.9 million and $14.5 million in cost of automotive revenues related to vehicle depreciation for cars accounted for as operating leases. For cars accounted for as leases our warranty reserves do not include projected warranty costs as such actual warranty costs are expensed as incurred. For the three months ended March 31, 2015 and 2014, warranty costs incurred for our lease vehicles were $1.8 million and $1.2 million.

Cost of services and other revenue during the three months ended March 31, 2015 were $48.1 million, an increase from $29.2 million for the three months ended March 31, 2014. The increase in cost of services and other revenues was driven primarily by increased cost associated powertrain sales to Daimler and maintenance services.

Gross profit for the three months ended March 31, 2015 and 2014 were $260.1 million and $155.1 million. Gross margin for the three months ended March 31, 2015 and 2014 were 27.7% and 25.0%. The increase in gross profit from 2014 to 2015 was primarily due to manufacturing efficiencies, vehicle cost reductions, and favorable product mix, as well as higher regulatory credit sales, partially offset by increased warranty reserve estimates. Services and other gross margin was negative 3.2%, which was primarily driven by a planned price reduction for powertrain sales to Daimler.

Research and Development Expenses

Research and development (R&D) expenses consist primarily of personnel costs for our teams in engineering and research, supply chain, quality, manufacturing engineering and manufacturing test organizations, prototyping expense, contract and professional services and amortized equipment expense. Also included in R&D expenses are development services costs that we incur, if any, prior to the finalization of agreements with our development services customers as reaching a final agreement and revenue recognition is not assured. Development services costs incurred after the finalization of an agreement are recorded in cost of revenues.

R&D expenses for the three months ended March 31, 2015 were $167.2 million, an increase from $81.5 million for the three months ended March 31, 2014. The increase in R&D expenses consisted primarily of a $39.8 million increase in expensed materials primarily to support our Model X development, Autopilot, and other Model S improvements, a $22.7 million increase in employee compensation expenses, a $10.4 million increase in costs related to Model X, Autopilot, and dual motor powertrain engineering, design and testing activities, and a $5.9 million increase in stock-based compensation expense related to increased headcount and increasing values of awards granted.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses consist primarily of personnel and facilities costs related to our Tesla stores, marketing, sales, executive, finance, human resources, information technology and legal organizations, as well as litigation settlements and fees for professional and contract services.

SG&A expenses for the three months ended March 31, 2015 were $195.4 million, an increase from $117.6 million for the three months ended March 31, 2014. SG&A expenses increased primarily from higher headcount and costs to support an expanded retail, service and Supercharger footprint as well as the general growth of the business. The $77.8 million increase in our SG&A expenses consisted primarily of a $36.5 million increase in office, information technology and facilities-related costs to support the growth of our business as well as sales and marketing activities to handle our expanding market presence, a $33.3 million increase in employee compensation expenses related to higher sales and marketing headcount to support sales activities worldwide and higher general and administrative headcount to support the expansion of the business, and a $9.9 million increase in professional and outside services costs.

Interest Expense

Interest expense for the three months ended March 31, 2015 and 2014 was $26.6 million and $11.9 million. The increase in interest expense from 2014 to 2015 was due to the issuance of $920.0 million aggregate principal amount of 2019 Notes and $1.38 billion aggregate principal amount of 2021 Notes during the first half of 2014.

Other Income (Expense), Net

Other income (expense), net, consists primarily of foreign exchange gains and losses related to our foreign currency-denominated assets and liabilities. We expect our foreign exchange gains and losses will vary depending upon movements in the underlying exchange rates.

Other expense, net, during the three months ended March 31, 2015 was $22.3 million, as compared to $6.7 million other income during the three months ended March 31, 2014. The increase in our other expense, net, is primarily attributable to a $21.7 million unfavorable foreign currency exchange impact from our foreign currency-denominated assets and liabilities, primarily unsettled intercompany balances and cash held in foreign currencies.

Provision for Income Taxes

Our provision for income taxes for the three months ended March 31, 2015 and 2014 was $3.0 million and $0.8 million. The increases in the provision for income taxes were due primarily to the increase in taxable income in our international jurisdictions.

Liquidity and Capital Resources

As of March 31, 2015, we had $1.51 billion in principal sources of liquidity available from our cash and cash equivalents including $874.3 million of money market funds. Amounts held in foreign currencies had a U.S. dollar equivalent of $408 million as of March 31, 2015, and consisted primarily of Norwegian krone, Japanese yen, euro, and Chinese yuan.

Sources of cash are predominately from our deliveries of Model S, as well as customer deposits for Model S and Model X, sales of regulatory credits, and sales of powertrain components and systems. We expect that our current sources of liquidity, including cash and cash equivalents, together with our current projections of cash flow from operating activities, will provide us with adequate liquidity over the next 12 months based on our current plans. These cash flows enable us to fund our ongoing operations, research and development projects for our planned Model X, Model 3, and certain other future products; purchase tooling and manufacturing equipment required to introduce Model X and to continue to ramp up production of Model S; construct our Gigafactory; and establish and expand our stores, service centers and Supercharger network. We currently anticipate making aggregate capital expenditures of about $1.5 billion during 2015.

When market conditions are favorable, we may evaluate alternatives to pursue liquidity options to fund capital intensive initiatives. Should prevailing economic, financial, business or other factors adversely affect our ability to meet our operating cash requirements, we could be required to obtain funding though traditional or alternative sources of financing. We cannot be certain that additional funds would be available to us on favorable terms when required, or at all.

Summary of Cash Flows

	Three Months Ended March 31,	
	2015	2014
Net cash provided by (used in) operating activities	$(131,794)	$58,723
Net cash used in investing activities	(432,344)	(329,180)
Net cash provided by financing activities	186,156	1,816,559

Cash Flows from Operating Activities

Our cash flows from operating activities are significantly affected by our cash investments to support the growth of our business in areas such as manufacturing, research and development and selling, general and administrative. Our operating cash flows are also affected by our working capital needs to support growth and fluctuations in inventory, personnel related expenditures, accounts payable and other current assets and liabilities.

Our operating cash inflows include cash from sales of our Model S, customer deposits for Model S and Model X, sales of regulatory credits, cash from the provision of development services, and sales of powertrain components and systems. These cash inflows are offset by payments we make to our suppliers for production materials and parts used in our manufacturing process, employee compensation, operating leases and interest expense on our financings.

During the three months ended March 31, 2015 and 2014, cash provided by (used in) operating activities was ($131.8) million and $58.7 million. The decrease in operating cash flows in 2015 as compared to 2014 was due to an increase in finished goods inventory primarily due to cars in transit for customer orders and pre-owned vehicles, partially offset by proceeds from sales and marketing vehicles, as well as cash used for operating lease vehicles and higher operating expenses in R&D and SG&A.

Cash Flows from Investing Activities

Cash flows from investing activities primarily relate to capital expenditures to support our growth in operations, including investments in Model S manufacturing equipment and tooling and our stores, service centers and Supercharger network infrastructure. During the three months ended March 31, 2015 and 2014, cash used in investing activities was $432.3 million and $329.2 million. Cash flows from investing activities and variability between comparable periods related primarily to capital expenditures, which were $426.1 million and $141.4 million during the three months ended March 31, 2015 and 2014. Expenditures in all periods consisted primarily of purchases of capital equipment, tooling, and facilities to support our Model S and Model X manufacturing. Additionally, during the three months ended March 31, 2014 we purchased $189.1 million in marketable securities.

In 2014, we began construction of our Gigafactory facility in Nevada. Tesla’s contribution to total capital expenditures is expected to be about $2.0 billion over the next 5 years. During the three months ended March 31, 2015, we used cash of $56.3 million towards the construction of this project and expect to spend up to $300 million for the full year.

Cash Flows from Financing Activities

During the three months ended March 31, 2015 and 2014, net cash provided by financing activities was $186.2 million and $1.82 billion. Cash flows from financing activities during the three months ended March 31, 2015 consisted primarily of $76.7 million in net proceeds from our warehouse facility and $78.0 million received from vehicle sales to our bank leasing partners. Cash flows from financing activities during the three months ended March 31, 2014 consisted primarily of $1.8 billion net proceeds from the issuance of our 2019 and 2021 Notes, including the associated hedge and warrant transactions.

0.25% and 1.25% Convertible Senior Notes and Bond Hedge and Warrant Transactions

In 2014, we issued $920.0 million principal amount of 0.25% convertible senior notes due 2019 (2019 Notes) and $1.38 billion principal amount of 1.25% convertible senior notes due 2021 (2021 Notes) in a public offering. The total net proceeds from these offerings, after deducting transaction costs, were approximately $905.8 million from 2019 Notes and $1.36 billion from 2021 Notes. The interest rates are fixed at 0.25% and 1.25% per annum for the 2019 and 2021 Notes and are payable semi-annually in arrears on March 1 and September 1 of each year, commencing on September 1, 2014.

In connection with the offering of these notes in 2014, we purchased a convertible note hedges for $603.4 million and sold warrants $389.2 million. Taken together, the purchase of the convertible note hedges and the sale of warrants are intended to offset any actual dilution from the conversion of the 2019 Notes and 2021 Notes.

During the first quarter of 2015, the closing price of our common stock did not meet or exceed 130% of the applicable conversion price of our 2019 Notes and 2021 Notes on at least 20 of the last 30 consecutive trading days of the quarter; furthermore, no other conditions allowing holders of these notes to convert have been met as of March 31, 2015. Therefore, the 2019 Notes and 2021 Notes are not convertible during the second quarter of 2015 and are classified as long-term debt. Should the closing price conditions be met in the second quarter of 2015 or a future quarter, the Notes will be convertible at their holders' option during the immediately following quarter.

1.50% Convertible Senior Notes and Bond Hedge and Warrant Transactions

In May 2013, we issued $660.0 million aggregate principal amount of 1.50% convertible senior notes due 2018 (the Notes) in a public offering. The net proceeds from the offering, after deducting transaction costs, were approximately $648.0 million. The interest under the Notes is fixed at 1.50% per annum and is payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2013.

In connection with the offering of the 2018 Notes, we purchased a convertible note hedge for $177.5 million and sold warrants for $120.3 million. Taken together, the purchase of the convertible note hedges and the sale of warrants are intended to offset any actual dilution from the conversion of the 2018 Notes.

During the first quarter of 2015, the closing price of our common stock exceeded 130% of the applicable conversion price of our 2018 Notes on at least 20 of the last 30 consecutive trading days of the quarter; therefore, holders of 2018 Notes may convert their notes during the second quarter of 2015. Upon conversion of 2018 Notes, we will be obligated to pay cash for the principal amount of the converted notes and we may also have to deliver shares of our common stock in respect of such converted notes. Any conversion of the notes prior to their maturity or acceleration of the repayment of the notes could have a material adverse effect on our cash flows, business, results of operations and financial condition. Should the closing price conditions be met in the second quarter of 2015 or a future quarter, 2018 Notes will be convertible at their holders' option during the immediately following quarter. Under current market conditions, we do not expect the 2018 Notes will be converted in the short term.

For more information on the 2018 Notes, 2019 Notes, and 2021 Notes see Note 6 to our Condensed Consolidated Financial Statements included under Part 1, Item 1 of this Quarterly Report on Form 10-Q.

Contractual Obligations

We are party to contractual obligations involving commitments to make payments to third parties, including certain debt financing arrangements and leases, primarily for stores, service centers, certain manufacturing and corporate offices. These also include, as part of our normal business practices, contracts with suppliers for purchases of certain raw materials, components, and services to facilitate adequate supply of these materials and services and capacity reservation contracts.

During the three months ended March 31, 2015, we received proceeds of $77.7 million under our Warehouse Facility. The Warehouse facility matures in March 2017, at which time all outstanding borrowing will become due. Prior to that date, principal payments will be due in the amount that the borrowing limit decreases below our outstanding principal balance.

During the three months ended March 31, 2015 we made additional sales to bank leasing partners, which are accounted for as collateralized borrowing. Under these arrangements, we have guaranteed that the bank will receive a minimum residual value for each vehicle. Should the car be sold by the bank to a third party, we are obligated to pay the bank for the difference between sales proceeds and the guarantee amount. We may, at our option, elect to repurchase the vehicles by paying the full guarantee amount, which was $55.4 million March 31, 2015.

There have been no other material changes during the three months ended March 31, 2015 from the contractual obligations disclosed in Part II, Item 7, Contractual Obligations, of our Annual Report on Form 10-K for the year ended December 31, 2014.

Off-Balance Sheet Arrangements

During the periods presented, we did not have relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

Our revenues and costs denominated in foreign currencies are not completely matched. Accordingly, if the value of the U.S. dollar depreciates significantly against currencies where we have a net short exposure, our costs as measured in U.S. dollars as a percent of our revenues will correspondingly increase which may adversely impact our operating results. Conversely, as the value of the U.S. dollar appreciates significantly against currencies where revenues exceed expenses, our revenues as measured in U.S. dollars may be reduced.

As a result of the unfavorable impact from unsettled foreign currency-denominated intercompany balances and foreign currency cash holdings, related largely to our Norwegian kroner and euro balances, we recorded losses of $21.7 million on foreign exchange transactions in other income (expense), net, for the three months ended March 31, 2015.

Interest Rate Risk

We had cash and cash equivalents totaling $1.5 billion as of March 31, 2015. A significant portion of our cash and cash equivalents were invested in money market funds. Cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value as a result of changes in interest rates due to the short term nature of our cash equivalents.

As of March 31, 2015, we had $2.96 billion aggregate principal amount of convertible senior notes outstanding and capital lease obligations of $20.9 million, all of which are fixed rate instruments. Therefore, these instruments are not subject to fluctuations in interest rates.

We pay interest on our Warehouse Facility at a rate of LIBOR plus 1.65%. As such, should interest rates increase significantly it could have an adverse impact on our results of operations and cash flows.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2015. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of March 31, 2015, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting which occurred during the period covered by this Quarterly Report on Form 10-Q, which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Securities Litigation

In November 2013, a putative securities class action lawsuit was filed against Tesla in U.S. District Court, Northern District of California, alleging violations of, and seeking remedies pursuant to, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The complaint, made claims against Tesla and its CEO, Elon Musk, sought damages and attorney's fees on the basis of allegations that, among other things, Tesla and Mr. Musk made false and/or misleading representations and omissions, including with respect to the safety of Model S. This case was brought on behalf of a putative class consisting of certain persons who purchased Tesla's securities between August 19, 2013 and November 17, 2013. On September 26, 2014, the trial court, upon the motion of Tesla and Mr. Musk, dismissed the complaint with prejudice, and thereafter issued a formal written order to that effect. The plaintiffs have appealed from the trial court's order, and that appeal is pending.

Other Matters

From time to time, we are subject to various other legal proceedings that arise from the normal course of business activities. In addition, from time to time, third parties may assert intellectual property infringement claims against us in the form of letters and other forms of communication. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on our results of operations, prospects, cash flows, financial position and brand.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below together with the other information set forth in this report, which could materially affect our business, financial condition and future results. The risks described below are not the only risks facing our company. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and operating results.

Risks Related to Our Business and Industry

We may experience significant delays or other complications in the design, manufacture, launch and production ramp of Model X, as well as future vehicles such as Model 3, which could harm our brand, business, prospects, financial condition and operating results.

We may experience significant delays or other complications in bringing new vehicles to market. For example, while we expect Model X deliveries to start late in the third quarter of 2015, refinements resulting from ongoing development and extensive testing of this vehicle could result in delays in its introduction. Complications could also arise from other factors, including the expansion of our production capacity required to bring Model X to market, finalization of its supply chain, and completion of regulatory approvals. Ahead of the Model X launch, we plan to expand capacity in several areas for our current and future vehicles, including installing a state of the art, highly automated casting and machining operation for various aluminum components for our vehicles, increasing production on our new drive unit line, installing a new robotic body assembly shop for Model X production and commissioning a new paint facility. Our suppliers may not be able to provide components in a timely manner, at an acceptable price or in the necessary quantities. Finally, we will also need to do extensive testing to ensure that Model X is in compliance with applicable NHTSA safety regulations and obtain EPA and CARB certification to emission regulations prior to beginning volume production and delivery of the vehicles.

We, as well as other automobile manufacturers, have experienced delays or other complications in connection with new vehicle models. In 2012, we experienced delays in the production ramp of Model S and in 2014, we delayed the start of the production ramp for the All-Wheel Drive Dual Motor Model S. Any significant delay or other complication in the development, manufacture, launch and production ramp of Model X or our future vehicles, including complications associated with expanding our production capacity, supply chain or regulatory approvals, could materially damage our brand, business, prospects, financial condition and operating results.

Our long-term success will be dependent upon our ability to design, build and achieve market acceptance of our vehicles, including Model S and new vehicle models such as Model X and Model 3.

Our long-term success is dependent on market acceptance of Model S and future electric vehicles we introduce. In the United States, there is no guarantee that Model S will continue to be successfully accepted by the general public, especially in the long-term. As we expand in Europe and Asia, there is no guarantee that customers in these markets will embrace our vehicles and if they do not, demand for our vehicles could be lower than our expectations.

Moreover, there can be no assurance that we will be able to design future electric vehicles that will meet the expectations of our customers or that our future models, including Model X, will become commercially viable. To date, we have publicly revealed only an early prototype of the Model X and work continues on the finalization of it. To the extent that we are not able to build Model X in accordance with consumer expectations, customers may cancel their reservations, our future sales could be harmed and investors may lose confidence in us.

Also, we have announced our intent to develop Model 3 which we expect to produce at the Tesla Factory after the introduction of Model X. We intend to offer this vehicle at a lower price point and expect to produce it at higher volumes than our Model S. Importantly, we anticipate producing Model 3 for the mass market and thus we will need a high-volume supply of lithium-ion cells at reasonable prices. In addition, we have not yet finalized the design, engineering or component sourcing plans for Model 3 and there are no assurances that we will be able to bring this vehicle to market at the price point and in the volume that we currently intend. The market for vehicles in the price range we expect for Model 3 is much more competitive than for Model S and Model X, and therefore margins may be lower compared to Model S and Model X margins.

While we intend each of our production vehicles and their variants to meet a distinct segment of the automotive market, our vehicles may end up competing with each other which may delay sales and associated revenue to future periods. Also, if we fail to accurately anticipate demand for each of our vehicles, this could result in inefficient expenditures and production delays. Furthermore, to date, we have limited experience simultaneously designing, testing, manufacturing, upgrading, adapting and selling our electric vehicles as well as limited experience allocating our available resources among the design and production of multiple vehicles, such as Model S, Model X and Model 3.

We may be unable to meet our production and delivery plans for Model S and Model X, both of which could harm our business and prospects.

Since we began manufacturing and delivering Model S in 2012, we have significantly increased production and deliveries, and our plans call for an even greater increase in production and deliveries going forward. As part of this effort, we recently completed a new final assembly line and added more automation to our body shop at the Fremont factory, are installing a highly automated casting and machining operation for various aluminum components and are finishing the construction of a new high volume paint shop. Our ability to further ramp-up high volume Model S production, including for the All-Wheel Drive Dual Motor Model S, which we recently began producing for the first time, and ultimately to commence and ramp production and delivery of Model X, will depend upon a number of factors, including our ability to use these new manufacturing processes as planned while maintaining our desired quality levels, our suppliers' ability to deliver quality parts to us in a timely manner, and efficiently making design changes to ensure consistently high quality. To produce a vehicle that meets our quality standards requires us to carefully analyze each step of our production plan, improve the efficiency of our manufacturing processes and continue to train our employees. Our suppliers also must produce new products in sufficient quantities and quality to meet our demand. Certain suppliers have experienced delays in meeting our demand or have sought to renegotiate the terms of the supply arrangements, and we continue to focus on supplier capabilities and constraints. Any disruption in our production of Model S and Model X in line with our plans could materially damage our brand, business, prospects, financial condition and operating results.

In addition, for Model S we have introduced a number of new manufacturing technologies and techniques, such as aluminum spot welding systems, which have not been widely adopted in the automotive industry; and the Model S has a number of new and unique design features, such as a 17 inch display screen, retractable exterior door handles, and all-new dual motor and autopilot hardware, each of which poses unique manufacturing challenges. Similarly, Model X will have additional new manufacturing technologies and techniques, such as those associated with the falcon-wing door, which will pose different manufacturing challenges. Production and deliveries for Model S and then Model X

will continue to require significant resources and we may experience unexpected delays or difficulties that could harm our ability to maintain full manufacturing capacity or cause us to miss planned production targets, any of which could have a material adverse effect on our financial condition and operating results. Additionally, sustaining high volume production and doing so in a manner that avoids significant cost overruns, including as a result of factors beyond our control such as problems with suppliers and vendors, may be difficult.

Concurrent with the significant increase in our planned production levels, we will also need to continue to significantly increase deliveries of our vehicles. We have limited experience in delivering a high volume of vehicles, and, in particular, to locations outside of the United States. We may face difficulties meeting our delivery and growth plans in Asia and the right hand drive markets we have entered, which may impact our ability to achieve our worldwide delivery goals. If we are unable to ramp up to meet our delivery goals globally to match the production rate of our vehicles, this could result in negative publicity, damage our brand and have a material adverse effect on our business, prospects, financial condition and operating results.

Our ability to grow volume production and deliveries for our vehicles is subject to certain risks and uncertainties, including:

- that our suppliers will be able and willing to deliver components on a timely basis and in the necessary quantities, quality and at acceptable prices to produce our vehicles in volume and reach our financial targets;
- that we will be able to complete any necessary adjustments to the vehicle design or manufacturing processes of our vehicles in a timely manner that meets our production plan and allows for high quality vehicles;
- that we will be able to fully ramp production of our vehicles to keep up with demand;
- that we will be able to ramp sales of Model S throughout Asia;
- that we will be able to adequately respond in a timely manner to any problems that may arise with our vehicles;
- that we will be able to schedule and complete deliveries at our planned higher volume production levels;
- that the equipment or tooling which we have purchased or which we select, including those that are part of our higher capacity production line that recently became operational, will be able to accurately manufacture the vehicle within specified design tolerances, and will not suffer from unexpected breakdowns or damage which could negatively affect the rate needed to produce vehicles in volume;
- that we will be able to comply with environmental, workplace safety, customs and similar regulations required to operate our manufacturing facilities;
- that we will be able to maintain and improve quality controls as we transition to a higher level of in-house manufacturing process; and
- that the information technology systems that we are currently expanding and improving upon will be effective to manage higher volume production.

Finally, detailed long-term testing of quality, reliability and durability of our vehicles is ongoing and any negative results from such testing could cause production or delivery delays, cost increases, or lower quality of our vehicles.

Problems or delays in bringing the Gigafactory online and operating it in line with our expectations could negatively affect us.

To lower the cost of cell production and produce cells in volume to allow us to grow quickly, we intend to integrate the production of lithium-ion cells and finished battery packs for our vehicles at our new Gigafactory. Our Gigafactory plan, however, is at an early stage. While we recently entered into various formal agreements with Panasonic on the Gigafactory, we have very little experience in building a factory of the size and scope planned for the Gigafactory, and no experience directly in the production of lithium-ion cells. In addition, to date we have not finalized agreements with additional Gigafactory partners that will be co-located at the Gigafactory. Also, the cost of building and operating the Gigafactory could exceed our current expectations and the Gigafactory may take longer to bring online than we anticipate. If we are unable to build the Gigafactory in a timely manner to produce high volumes of quality lithium-ion cells at reasonable prices, then our ability to supply battery packs to our vehicles, including Model 3, according to our schedule and/or at a price that allows us to sell them profitably and in the quantities we estimate could be constrained. Any such problems or delays with Gigafactory could negatively affect our brand and harm our business, prospects, financial condition and operating results.

If our vehicles or vehicles that contain our powertrains fail to perform as expected, our ability to develop, market and sell our electric vehicles could be harmed.

Our vehicles or vehicles that contain our powertrains, such as the Toyota RAV4 EV or the Mercedes-Benz B-Class EV, may contain defects in design and manufacture that may cause them not to perform as expected or that may require repair. For example, our vehicles are highly dependent on software to operate. Software products are inherently complex and often contain defects and errors when first introduced, and changes to software may have unexpected effects. Model S issues experienced by customers include those related to the software for the 17 inch display screen, the panoramic roof and the 12 volt battery. Although we attempt to remedy any issues we observe in

our vehicles as effectively and as rapidly as possible, such efforts may not be timely or up to the satisfaction of our customers. Any product defects or any other failure of our vehicles to perform as expected could harm our reputation and result in adverse publicity, lost revenue, delivery delays, product recalls, product liability claims, harm to our brand and reputation, and significant warranty and other expenses, and could have a material adverse impact on our business, financial condition, operating results and prospects.

While we have performed extensive internal testing, we currently have a limited frame of reference by which to evaluate the long-term performance of our battery packs, powertrains and vehicles. Specifically, we have only a limited amount of data by which to evaluate Model S, upon which our business prospects depend, due to the fact that we only recently began production in June 2012. There can be no assurance that we will be able to detect and fix any defects in the vehicles prior to their sale to consumers.

Additionally, while Model S achieved an overall five star safety rating by NHTSA, there is no guarantee that future model years or variants or other Tesla vehicles will also attain such safety ratings, and any such rating is not a guarantee of safe product design or that any individual vehicle will be free of any defect or failure.

We are dependent on our suppliers, the majority of which are single source suppliers, and the inability of these suppliers to continue to deliver, or their refusal to deliver, necessary components of our vehicles in a timely manner at prices, quality levels, and volumes acceptable to us would have a material adverse effect on our financial condition and operating results.

Model S contains numerous purchased parts which we source globally from over 300 direct suppliers, the majority of whom are currently single source suppliers for these components. We expect that Model X will be sourced in an approximately similar manner. While we obtain components from multiple sources whenever possible, similar to other automobile manufacturers, the majority of the components used in our vehicles are purchased by us from single sources. To date, we have not qualified alternative sources for most of the single sourced components used in our vehicles and we do not maintain long-term agreements with a number of our suppliers.

While we believe that we may be able to establish alternate supply relationships and can obtain or engineer replacement components for our single source components, we may be unable to do so in the short term, or at all, at prices or costs that are favorable to us. In particular, while we believe that we will be able to secure alternate sources of supply for most of our single sourced components in a relatively short time frame, qualifying alternate suppliers or developing our own replacements for certain highly customized components of our vehicles may be time consuming, costly and may force us to make additional modifications to a vehicle’s design.

This limited supply chain exposes us to multiple potential sources of delivery failure or component shortages for our vehicles, as well as for our powertrain component sales activities. For example, earthquakes similar to the one that occurred in Japan in March 2011 or labor issues such as work stoppages or strikes at the ports on the west coast could negatively impact our supply chain. We have in the past experienced source disruptions in our supply chains, including those relating to our slower-than-anticipated ramp in our Model S production goals for 2012. We may experience additional delays in the future with respect to Model S, Model X and any other future vehicle we may produce.

In addition, because we have written agreements in place with the majority, but not all, of our suppliers, this may create uncertainty regarding a supplier’s obligations to us, including but not limited to, those regarding warranty and product liability. Changes in business conditions, wars, governmental changes and other factors beyond our control or which we do not presently anticipate, could also affect our suppliers’ ability to deliver components to us on a timely basis. Furthermore, if we experience significantly increased demand, or need to replace certain existing suppliers, there can be no assurance that additional supplies of component parts will be available when required on terms that are favorable to us, at all, or that any supplier would allocate sufficient supplies to us in order to meet our requirements or fill our orders in a timely manner. In the past, we have replaced certain suppliers because of their failure to provide components that met our quality control standards. The loss of any single or limited source supplier or the disruption in the supply of components from these suppliers could lead to delays in vehicle deliveries to our customers, which could hurt our relationships with our customers and also materially and adversely affect our financial condition and operating results.

Changes in our supply chain have resulted in the past, and may result in the future, in increased cost and delay. We have also experienced cost increases from certain of our suppliers in order to meet our quality targets and development timelines as well as due to design changes that we made, and we may experience similar cost increases in the future. Additionally, we are negotiating with existing suppliers for cost reductions, seeking new and less expensive suppliers for certain parts, and attempting to redesign certain parts to make them cheaper to produce. If we are unsuccessful in our efforts to control and reduce supplier costs, our operating results will suffer. Additionally, cost reduction efforts may interrupt or harm our normal production processes, thereby harming vehicle quality or reducing Model S production output.

Furthermore, a failure by our suppliers to provide the components in a timely manner or at the level of quality necessary to manufacture our vehicles could prevent us from fulfilling customer orders in a timely fashion which could result in negative publicity, damage our brand and have a material adverse effect on our business, prospects, financial condition and operating results.

Finally, in October 2013, we entered into an amendment to our existing supply agreement with Panasonic Corporation in order to address our anticipated short- to medium-term lithium-ion battery cell needs. While we expect that this supply agreement, as amended, will provide us with sufficient cells for the next few years, we may not be able to meet our long-term needs, including for Model 3 and other programs we may introduce, without securing additional suppliers or other sources for cells. We have recently signed an agreement with Panasonic to be our partner in the Gigafactory and be responsible for, among other things, manufacturing cells from there for use in our products. If we encounter unexpected difficulties with our current suppliers, including Panasonic, and if we are unable to fill these needs from other suppliers, we could experience production delays, which could have a material adverse effect on our financial condition and operating results.

Our future growth is dependent upon consumers' willingness to adopt electric vehicles.

Our growth is highly dependent upon the adoption by consumers of, and we are subject to an elevated risk of any reduced demand for, alternative fuel vehicles in general and electric vehicles in particular. If the market for electric vehicles in North America, Europe and Asia does not develop as we expect, or develops more slowly than we expect, our business, prospects, financial condition and operating results will be harmed. The market for alternative fuel vehicles is relatively new, rapidly evolving, characterized by rapidly changing technologies, price competition, additional competitors, evolving government regulation and industry standards, frequent new vehicle announcements and changing consumer demands and behaviors. Factors that may influence the adoption of alternative fuel vehicles, and specifically electric vehicles, include:

- perceptions about electric vehicle quality, safety (in particular with respect to lithium-ion battery packs), design, performance and cost;
- perceptions about the limited range over which electric vehicles may be driven on a single battery charge;
- the decline of an electric vehicle's range resulting from deterioration over time in the battery's ability to hold a charge;
- the availability of alternative fuel vehicles, including plug-in hybrid electric vehicles;
- improvements in the fuel economy of the internal combustion engine;
- the availability of service for electric vehicles;
- volatility in the cost of oil and gasoline;
- government regulations and economic incentives promoting fuel efficiency and alternate forms of energy as well as tax and other governmental incentives to purchase and operate electric vehicles; and
- access to charging facilities, standardization of electric vehicle charging systems and consumers' perceptions about convenience and cost to charge an electric vehicle.

Additionally, we will become subject to regulations that require us to alter the design of our vehicles, which could negatively impact consumer interest in our vehicles. For example, our electric vehicles make less noise than internal combustion vehicles. Due to concerns about quiet vehicles and vision impaired pedestrians, in January 2011, Congress passed and the President signed the Pedestrian Safety Enhancement Act of 2010. The new law requires NHTSA to establish minimum sounds for electric vehicles and hybrid electric vehicles when travelling at low speeds. NHTSA issued a notice of proposed rulemaking in 2013 and plans to finalize a rule as soon as sometime in 2015 with a potential effective date for implementation as early as 2018. This will begin a three year phase-in schedule for establishing these minimum sounds in all electric and hybrid electric vehicles. Adding this artificial noise may cause current or potential customers not to purchase our electric vehicles, which would materially and adversely affect our business, operating results, financial condition and prospects.

If we fail to manage future growth effectively as we rapidly grow our company, especially internationally, we may not be able to produce, market, sell and service our vehicles successfully.

Any failure to manage our growth effectively could materially and adversely affect our business, prospects, operating results and financial condition. We continue to expand our operations significantly in North America as well as in

Europe and Asia. Our future operating results depend to a large extent on our ability to manage this expansion and growth successfully. Risks that we face in undertaking this global expansion include:

- finding and training new personnel, especially in new markets such as Europe and Asia;
- controlling expenses and investments in anticipation of expanded operations;
- establishing or expanding sales, service and Supercharger facilities in a timely manner;

· adapting our products to meet local requirements in countries around the world; and
· implementing and enhancing manufacturing, logistics and administrative infrastructure, systems and processes.

We intend to continue to hire a significant number of additional personnel, including manufacturing personnel, design personnel, engineers and service technicians. Because our vehicles are based on a different technology platform than traditional internal combustion engines, we may not be able to hire individuals with sufficient training in electric vehicles, and we will need to expend significant time and expense training the employees we do hire. Competition for individuals with experience designing, manufacturing and servicing electric vehicles is intense, and we may not be able to attract, assimilate, train or retain additional highly qualified personnel in the future, the failure of which could seriously harm our business, prospects, operating results and financial condition.

If we are unable to adequately reduce the manufacturing costs of Model S, control manufacturing costs for Model X or otherwise control the costs associated with operating our business, our financial condition and operating results will suffer.

Our production costs for Model S were high initially due to start-up costs at the Tesla Factory, manufacturing inefficiencies including low absorption of fixed manufacturing costs, higher logistics costs due to the immaturity of our supply chain, and higher initial prices for component parts during the initial period after the launch and ramp of Model S. As we have gradually ramped production of Model S, manufacturing costs per vehicle have decreased. While we expect further cost reductions to be realized by both us and our suppliers during the next several quarters, there is no guarantee we will be able to achieve sufficient cost savings to reach our gross margin and profitability goals.

We incur significant costs related to procuring the raw materials required to manufacture our vehicles, assembling vehicles and compensating our personnel. We may also incur substantial costs or cost overruns in increasing the production capability of Model S and powertrain manufacturing facilities and the recent launch in Asia. Furthermore, if we are unable to produce Model X pursuant to our plan due to cost overruns or other unexpected costs, we may not be able to meet our gross margin targets.

Furthermore, many of the factors that impact our operating costs are beyond our control. For example, the costs of our raw materials and components, such as lithium-ion battery cells or aluminum used to produce body panels, could increase due to shortages as global demand for these products increases. Indeed, if the popularity of electric vehicles exceeds current expectations without significant expansion in battery cell production capacity and advancements in battery cell technology, shortages could occur which would result in increased material costs to us or potentially limit our ability to expand production. Additionally, we may be required to incur substantial marketing costs and expenses to promote our vehicles, including through the use of traditional media such as television, radio and print, even though our marketing expenses to date have been relatively limited as we have to date relied upon unconventional marketing efforts. If we are unable to keep our operating costs aligned with the level of revenues we generate, our operating results, business and prospects will be harmed.

We may fail to meet our publicly announced guidance or other expectations about our business, which would cause our stock price to decline.

We occasionally provide guidance regarding our expected financial and business performance, such as projections regarding the number of vehicles we hope to sell, produce or deliver in future periods and anticipated future revenues, gross margins, profitability and cash flows. Correctly identifying the key factors affecting business conditions and predicting future events is inherently an uncertain process. Our guidance is based in part on assumptions which include, but are not limited to, assumptions regarding:

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our ability to achieve anticipated production and sales volumes and projected average sales prices for Model S and Model X in North America, Europe and Asia;

- supplier and commodity-related costs; and
- planned cost reductions.

Such guidance may not always be accurate or may vary from actual results due to our inability to meet our assumptions and the impact on our financial performance that could occur as a result of the various risks and uncertainties to our business as set forth in these risk factors, or because of the way that applicable accounting rules require us to treat new product and service offerings that we may offer. We offer no assurance that such guidance will ultimately be accurate, and investors should treat any such guidance with appropriate caution. If we fail to meet our guidance or if we find it necessary to revise such guidance, even if such failure or revision is seemingly insignificant, investors and analysts may lose confidence in us and the market value of our common stock could be materially and adversely affected.

Our vehicles make use of lithium-ion battery cells, which have been observed to catch fire or vent smoke and flame, and such events have raised concerns, and future events may lead to additional concerns, about the batteries used in automotive applications.

The battery pack in our vehicles and the battery packs that we sell to Toyota and Daimler make use of lithium-ion cells. On rare occasions, lithium-ion cells can rapidly release the energy they contain by venting smoke and flames in a manner that can ignite nearby materials as well as other lithium-ion cells. Extremely rare incidents of laptop computers, cell phones and electric vehicle battery packs catching fire have focused consumer attention on the safety of these cells.

These events have raised concerns about the batteries used in automotive applications. To address these questions and concerns, a number of cell manufacturers are pursuing alternative lithium-ion battery cell chemistries to improve safety. We have designed the battery pack to passively contain any single cell's release of energy without spreading to neighboring cells. However, we have delivered only a limited number of our vehicles to customers and have limited field experience with them. We have also only delivered a limited number of battery packs to Daimler. Accordingly, there can be no assurance that a field or testing failure of our vehicles or other battery packs that we produce will not occur, which could subject us to lawsuits, product recalls, or redesign efforts, all of which would be time consuming and expensive. Also, negative public perceptions regarding the suitability of lithium-ion cells for automotive applications or any future incident involving lithium-ion cells such as a vehicle or other fire, even if such incident does not involve us, could seriously harm our business.

In addition, we store a significant number of lithium-ion cells at our manufacturing facility. Any mishandling of battery cells may cause disruption to the operation of our facilities. While we have implemented safety procedures related to the handling of the cells, there can be no assurance that a safety issue or fire related to the cells would not disrupt our operations. Such damage or injury would likely lead to adverse publicity and potentially a safety recall. Moreover, any failure of a competitor's electric vehicle, especially those that use a high volume of commodity cells similar to Tesla's vehicles, may cause indirect adverse publicity for us and our electric vehicles. Such adverse publicity would negatively affect our brand and harm our business, prospects, financial condition and operating results.

We have a history of losses and have to deliver significant cost reductions to achieve sustained, long-term profitability and long-term commercial success.

We have had net losses on a GAAP basis in each quarter since our inception, except for the first quarter of 2013. Even if we are able to continue to increase Model S production and sales and begin to produce and sell Model X and future vehicles, there can be no assurance that we will be profitable. In order to achieve profitability as well as long-term commercial success, we must continue to achieve our planned cost reductions, control our operational costs while producing quality vehicles, increase our production rate, maintain strong demand in North America, and grow demand abroad in Europe and Asia. Failure to do one or more of these things could prevent us from achieving sustained, long-term profitability.

Foreign currency movements relative to the U.S. dollar could harm our financial results.

Our revenues and costs denominated in foreign currencies are not completely matched. As we have increased Model S deliveries in markets outside of the United States, we have much higher revenues than costs denominated in other currencies such as the euro, Norwegian kroner, and Chinese yuan. The recent strengthening of the U.S. dollar therefore has reduced, and any further strengthening of the U.S. dollar would tend to further reduce, our revenues as measured in U.S. dollars. In addition, a portion of our costs and expenses have been, and we anticipate will continue to be, denominated in foreign currencies, including the Japanese yen. If we do not have fully offsetting revenues in these currencies and if the value of the U.S. dollar depreciates significantly against these currencies, our costs as

measured in U.S. dollars as a percent of our revenues will correspondingly increase and our margins will suffer. As a result, our operating results could be adversely affected.

The introduction of our resale value guarantee and leasing programs may result in lower revenues and profits and exposes us to resale risk to the extent many customers elect to return their vehicles to us and the residual values are lower than our estimates.

In 2013, we began offering resale value guarantees to many of our customers. In April and October of 2014, we started offering leasing to business customers and individual customers, respectively, including through Tesla Finance, our captive finance company. Both the resale value guarantee program and leasing offered through Tesla Finance generate lower revenues in the period the car is delivered as compared to cash purchases and both expose us to the risk that any vehicles repurchased or returned to us under the programs may be resold by us for prices less than we estimate.

Under the resale value guarantee program, Model S customers have the option of selling their vehicle back to us at a certain point in time for a pre-determined resale value. As a result of this resale value guarantee and customers having the option of selling their vehicles to us, we apply lease accounting to such purchases, which defers the recognition of the associated revenues over time instead of full recognition at vehicle delivery. Although the resale value guarantee does not impact our cash flows and liquidity at the time of vehicle delivery, a significant uptake under this program could have a significant adverse impact on our near term GAAP revenues and operating results.

Under the leasing program offered through Tesla Finance, we lease vehicles directly to customers. Customers have the option of purchasing their vehicles at the stated value in the leasing contract or returning their vehicles to us. We apply lease accounting to such purchases. Unlike the resale value guarantee program, we may receive only a very small portion of the price of the vehicle from our customers at the time of purchase, and instead will receive a stream of lease payments. To the extent we expand this program and are unable to secure appropriate financing, our cash flow and liquidity, as well as our near term GAAP revenues and operating results, could be negatively impacted. Furthermore, we are exposed to credit risk that customers may not pay their lease payments on time and according to the terms of our leasing contracts.

Under both programs, we are exposed to the risk that the vehicles' resale value may be lower than our estimates and the volume of vehicles returned to us may be higher than our estimates, which could impact our future cash flows and/or profitability. Currently, there is only a very limited secondary market for our electric vehicles on which to base our estimates, and such a secondary market may not develop in the future. Our residual value and return volume estimates could prove to be incorrect, either of which could harm our financial condition and operating results.

If we fail to effectively manage the residual, financing and credit risks for our recently launched Model S leasing program, our business may suffer.

We recently introduced a leasing program in the United States and Canada through our captive finance company, Tesla Finance. The profitability of the leasing program depends on our ability to accurately project residual values, secure adequate financing and/or business partners to fund and grow this program, and manage customer credit risk. If actual residual values of Model S vehicles are below our estimates, we may suffer lower profitability or potentially have losses. If we are unable to adequately fund our leasing program with either internal funds or external financing sources, we may be unable to grow our sales. Additionally, if we do not properly screen customers for ability to pay their leases on time, we may be exposed to excessive credit risks and associated losses. Furthermore, if our leasing business grows substantially, our business may suffer if we cannot effectively manage the greater levels of residual and credit risks resulting from growth. Finally, if we do not successfully monitor and comply with federal and state financial regulations and consumer protection laws governing lease transactions, we may become subject to enforcement actions or penalties, either of which may harm our business.

Increases in costs, disruption of supply or shortage of raw materials, in particular lithium-ion cells, could harm our business.

We may experience increases in the cost or a sustained interruption in the supply or shortage of raw materials. Any such increase or supply interruption could materially and negatively impact our business, prospects, financial condition and operating results. We use various raw materials in our business including aluminum, steel, nickel and copper. The prices for these raw materials fluctuate depending on market conditions and global demand for these materials and could adversely affect our business and operating results. For instance, we are exposed to multiple risks relating to lithium-ion cells. These risks include:

- the inability or unwillingness of current battery manufacturers to build or operate battery cell manufacturing plants to supply the numbers of lithium-ion cells required to support the growth of the electric or plug-in hybrid vehicle

industry as demand for such cells increases;
- disruption in the supply of cells due to quality issues or recalls by battery cell manufacturers;
- an increase in the cost of raw materials, such as nickel used in lithium-ion cells, or aluminum used in the body of Model S; and
- fluctuations in the value of the Japanese yen against the U.S. dollar as our battery cell purchases are currently denominated in Japanese yen.

Our business is dependent on the continued supply of battery cells for our vehicles' battery packs as well as for the battery packs we produce for other automobile manufacturers. While we believe several sources of the battery cells are available for such battery packs, we have fully qualified only one supplier for the cells used in such battery packs and have very limited flexibility in changing cell suppliers. Any disruption in the supply of battery cells from such vendors could disrupt production of our vehicles and of the battery packs we produce for other automobile manufacturers until such time as a different supplier is fully qualified. Furthermore, fluctuations or shortages in petroleum and other economic conditions may cause us to experience significant increases in freight charges and raw material costs. Substantial increases in the prices for our raw materials or prices charged to us, such as those charged by our battery cell manufacturers, would increase our operating costs, and could reduce our margins if we cannot recoup the increased costs through increased vehicle prices. There can be no assurance that we will be able to recoup increasing costs of raw materials by increasing vehicle prices. Any attempts to increase vehicle prices in response to increased raw material costs could be viewed negatively by our customers, result in cancellations of vehicle orders and reservations and could materially and adversely affect our brand, image, business, prospects and operating results.

Our success could be harmed by negative publicity regarding our company or our products.

Occasionally, third parties evaluate or publish stories regarding our vehicles. For example, in 2013 the New York Times published a negative review of the Model S and our Supercharger network on a route from Washington, D.C. to Boston. The story created a negative public perception about Model S, its capabilities and the Supercharger network. To the extent that negative comments about us or our products are believed by the public, this may cause current or potential customers not to purchase our electric vehicles, including Model S and Model X, which can materially and adversely affect our business, operating results, financial conditions and prospects.

Our distribution model is different from the predominant current distribution model for automobile manufacturers, which makes evaluating our business, operating results and future prospects difficult.

Our distribution model is not common in the automobile industry today, particularly in the United States. We plan to continue to sell our vehicles in company-owned Tesla stores and over the internet. While we believe our approach is important to the success of our technology and vehicles, this model of vehicle distribution is relatively new and unproven, especially in the United States, and subjects us to substantial risk as it requires, in the aggregate, a significant expenditure and provides for slower expansion of our distribution and sales systems than may be possible by utilizing a more traditional dealer franchise system.

We have opened Tesla stores in North America, Europe and the Asia Pacific Region, many of which have been open for only a short period of time. We have relatively limited experience distributing and selling our vehicles through our Tesla stores, especially in Asia. Our success will depend in large part on our ability to effectively develop our own sales channels and marketing strategies. Implementing our business model is subject to numerous significant challenges, including obtaining permits and approvals from local and state authorities, and we may not be successful in addressing these challenges. The concept and layout of our interactive stores, is different than what has previously been used in automotive sales. We do not know whether our store strategy will continue to be successful. We may incur additional costs in order to improve or change our retail strategy.

Other aspects of our distribution model also differ from those used by traditional automobile manufacturers. For example, we do not anticipate that we will ever carry a significant amount of vehicle inventory at our stores and customers may need to wait up to a few months from the time they place an order until the time they receive their vehicle. This type of custom manufacturing is unusual in the premium sedan market in the United States and it is unproven whether the average customer will be willing to wait this amount of time for such a vehicle. If customers do not embrace this ordering and retail experience, our business will be harmed.

We may become subject to product liability claims, which could harm our financial condition and liquidity if we are not able to successfully defend or insure against such claims.

We may become subject to product liability claims, which could harm our business, prospects, operating results and financial condition. The automobile industry experiences significant product liability claims and we face inherent risk of exposure to claims in the event our vehicles do not perform as expected or malfunction resulting in personal injury or death. Our risks in this area are particularly pronounced given the limited number of vehicles delivered to date and limited field experience of those vehicles. A successful product liability claim against us could require us to pay a substantial monetary award. Moreover, a product liability claim could generate substantial negative publicity about our vehicles and business and would have material adverse effect on our brand, business, prospects and operating results. We self-insure against the risk of product liability claims, meaning that any product liability claims will have to be paid from company funds, not by insurance. Any lawsuit seeking significant monetary damages may have a material adverse effect on our reputation, business and financial condition. We may not be able to secure additional product liability insurance coverage on commercially acceptable terms or at reasonable costs when needed, particularly if we do face liability for our products and are forced to make a claim under such a policy.

We are currently expanding and improving our information technology systems. If these implementations are not successful, our business and operations could be disrupted and our operating results could be harmed.

We are currently expanding and improving our information technology systems, including implementing new internally developed systems, to assist us in the management of our business. In particular, our volume production of Model S necessitates continued development, maintenance and improvement of our information technology systems in the U.S. and abroad, which include product data management, procurement, inventory management, production planning and execution, sales, service and logistics, dealer management, financial, tax and regulatory compliance systems. These systems support our operations and enable us to produce Model S and future vehicles like Model X in volume. The implementation, maintenance and improvement of these systems require significant management time, support and cost. Moreover, there are inherent risks associated with developing, improving and expanding our core systems as well as implementing new systems, including the disruption of our data management, procurement, manufacturing execution, finance, supply chain and sales and service processes. These risks may affect our ability to manage our data and inventory, procure parts or supplies or manufacture, sell, deliver and service vehicles, or achieve and maintain compliance with, or realize available benefits under, tax laws and other applicable regulations.

We cannot be sure that these expanded systems or their required functionality will be effectively implemented or sufficiently maintained. If we do not successfully implement, improve or maintain these systems, our operations may be disrupted, our ability to accurately and/or timely report our financial results could be impaired; and deficiencies may arise in our internal control over financial reporting, which may impact our ability to certify our financial results. If these systems or their functionality do not operate as we expect them to, we may be required to expend significant resources to make corrections or find alternative sources for performing these functions.

The automotive market is highly competitive, and we may not be successful in competing in this industry. We currently face competition from new and established competitors and expect to face competition from others in the future.

The worldwide automotive market, particularly for alternative fuel vehicles, is highly competitive today and we expect it will become even more so in the future. Other automobile manufacturers entered the electric vehicle market at the end of 2010 and we expect additional competitors to enter this market. With respect to Model S, we face competition from existing and future automobile manufacturers in the extremely competitive premium sedan market, including Audi, BMW, Lexus and Mercedes.

Many established and new automobile manufacturers have entered or have announced plans to enter the alternative fuel vehicle market. BMW, Daimler, Nissan, Fiat, Ford and Mitsubishi, among others, have electric vehicles available today. Moreover, Porsche, Lexus, Audi, Volkswagen and Volvo are also developing electric vehicles. In addition, several manufacturers, including General Motors, Toyota, Ford, and Honda, are each selling hybrid vehicles, and certain of these manufacturers have announced plug-in versions of their hybrid vehicles. For example, in December 2010, General Motors introduced the Chevrolet Volt, which is a plug-in hybrid vehicle that operates purely on electric power for a limited number of miles, at which time an internal combustion engine engages to recharge the battery pack.

Moreover, it has been reported that many of the other large OEMs, such as Daimler, Lexus and Audi, are also developing electric vehicles. Several new start-ups have also entered or announced plans to enter the market for electric vehicles. Finally, electric vehicles have already been brought to market in China and other foreign countries and we expect a number of those manufacturers to enter the United States market as well.

Most of our current and potential competitors have significantly greater financial, technical, manufacturing, marketing and other resources than we do and may be able to devote greater resources to the design, development,

manufacturing, distribution, promotion, sale and support of their products. Virtually all of our competitors have more extensive customer bases and broader customer and industry relationships than we do. In addition, almost all of these companies have longer operating histories and greater name recognition than we do.

We expect competition in our industry to intensify in the future in light of increased demand for alternative fuel vehicles, continuing globalization and consolidation in the worldwide automotive industry. There can be no assurances that we will be able to compete successfully in our markets. Increased competition could result in lower vehicle unit sales, price reductions,revenue shortfalls, loss of customers and loss of market share, which could harm our business, prospects, financial condition and operating results.

Demand in the automobile industry is volatile, which may lead to lower vehicle unit sales and adversely affect our operating results.

Volatility of demand in the automobile industry may materially and adversely affect our business, prospects, operating results and financial condition. The markets in which we currently compete and plan to compete in the future have been subject to considerable volatility in demand in recent periods. Demand for automobile sales depends to a large extent on general, economic, political and social conditions in a given market and the introduction of new vehicles and technologies. As a low volume producer, we have less financial resources than more established automobile manufacturers to withstand changes in the market and disruptions in demand. As our business grows, economic conditions and trends in other countries and regions where we currently or will sell our vehicles, such as Europe and Asia, will impact our business, prospects and operating results as well. Demand for our vehicles may also be affected by factors directly impacting automobile price or the cost of purchasing and operating automobiles, such as sales and financing incentives, prices of raw materials and parts and components, cost of fuel and governmental regulations, including tariffs, import regulation and other taxes. Volatility in demand may lead to lower vehicle unit sales and increased inventory, which may result in further downward price pressure and adversely affect our business, prospects, financial condition and operating results. These effects may have a more pronounced impact on our business given our relatively smaller scale and financial resources as compared to many incumbent automobile manufacturers.

If we are unable to establish and maintain confidence in our long-term business prospects among consumers, analysts and within our industry, then our financial condition, operating results, business prospects and stock price may suffer materially.

Our vehicles are highly technical products that require maintenance and support. If we were to cease or cut back operations, even years from now, buyers of our vehicles from years earlier might have much more difficulty in maintaining their vehicles and obtaining satisfactory support. As a result, consumers may be less likely to purchase our vehicles now if they are not convinced that our business will succeed or that our operations will continue for many years. Similarly, suppliers and other third parties will be less likely to invest time and resources in developing business relationships with us if they are not convinced that our business will succeed.

Accordingly, in order to build and maintain our business, we must maintain confidence among customers, suppliers, analysts and other parties in our liquidity and long-term business prospects. In contrast to some more established automakers, we believe that, in our case, the task of maintaining such confidence may be particularly complicated by factors such as the following:

- our limited operating history;
- unfamiliarity with or uncertainty about Model X and future Tesla vehicles;
- uncertainty about the long-term market acceptance of alternative fuel vehicles generally, or electric vehicles specifically;
- the perceived prospect that we will need ongoing infusions of external capital to fund our planned operations;
- the size of our expansion plans in comparison to our existing capital base and scope and history of operations; and
- the prospect or actual emergence of direct, sustained competitive pressure from more established automakers, which may be more likely if our initial efforts are perceived to be commercially successful.

Many of these factors are largely outside our control, and any negative perceptions about our long-term business prospects, even if exaggerated or unfounded, would likely harm our business and make it more difficult to raise additional funds when needed.

We have limited experience servicing our vehicles, especially in certain regions outside of the United States, and we are using a different service model from the one typically used in the industry. If we are unable to address the service requirements of our existing and future customers, our business will be materially and adversely affected.

We have limited experience servicing our vehicles, especially in Asia. Servicing electric vehicles is different than servicing vehicles with internal combustion engines and requires specialized skills, including high voltage training and servicing techniques. If we are unable to satisfactorily service our customers and the various service related issues that they are facing and may face in the future, our ability to generate customer loyalty, grow our business and sell additional vehicles could be impaired.

We service our vehicles through our company-owned Tesla service centers, certain of our stores, and through our mobile service technicians known as the Tesla Rangers. We will need to open new standalone service centers in locations around the world and hire and train significant numbers of new employees to staff these service centers and act as Tesla Rangers in order to successfully maintain our fleet of delivered vehicles. We may have difficulties in continuing to adequately address the service requirements of our customers to their satisfaction, or that we will have sufficient resources to meet these service requirements in a timely manner as the volume of vehicles we are able to deliver annually increases.

We do not expect to be able to open Tesla service centers in all the geographic areas in which our existing and potential customers may reside. In order to address the service needs of customers who are not in geographical proximity to our service centers, we plan to either transport those vehicles to the nearest Tesla store or service center for servicing or deploy our mobile Tesla Rangers to service the vehicles at the customer's location. These special arrangements may be expensive and we may not be able to recoup the costs of providing these services to our customers. If we do not adequately address our customers' service needs, our brand and reputation will be adversely affected, which in turn, could have a material and adverse impact on our business, financial condition, operating results and prospects.

Traditional automobile manufacturers in the United States do not provide maintenance and repair services directly. Consumers must rather service their vehicles through franchised dealerships or through third party maintenance service providers. We do not have any such arrangements with third party service providers and it is unclear when or even whether such third party service providers will be able to acquire the expertise to service our vehicles. At this point, we anticipate that we will be providing substantially all of the service for our vehicles for the foreseeable future.

In addition, the motor vehicle industry laws in many states require that service facilities be available with respect to vehicles physically sold from locations in the state. Whether these laws would also require that service facilities be available with respect to vehicles sold over the internet to consumers in a state in which we have no physical presence is uncertain. While we believe our Tesla Ranger program and our practice of transporting customers' vehicles to our nearest Tesla service center would satisfy regulators in these circumstances, without seeking formal regulatory guidance, there are no assurances that regulators will not attempt to require that we provide physical service facilities in their states. Further, certain state franchise laws which prohibit manufacturers from being licensed as a dealer or acting in the capacity of dealer also restrict manufacturers from providing vehicle service. If issues arise in connection with these laws, certain aspects of Tesla's service program would need to be restructured to comply with state law, which may harm our business.

We may not succeed in maintaining and strengthening the Tesla brand, which would materially and adversely affect customer acceptance of our vehicles and components and our business, revenues and prospects.

Our business and prospects are heavily dependent on our ability to develop, maintain and strengthen the Tesla brand. Any failure to develop, maintain and strengthen our brand may materially and adversely affect our ability to sell the Model S, Model X, Model 3 and other future planned electric vehicles, and sell our electric powertrain components. If we do not continue to establish, maintain and strengthen our brand, we may lose the opportunity to build a critical mass of customers. Promoting and positioning our brand will likely depend significantly on our ability to provide high quality electric cars and maintenance and repair services. Any problems associated with the Toyota RAV4 EV and Mercedes-Benz B-Class EV, both of which use a Tesla powertrain may also hurt the Tesla brand.

In addition, we expect that our ability to develop, maintain and strengthen the Tesla brand will also depend heavily on the success of our marketing efforts. To date, we have limited experience with marketing activities as we have relied primarily on the internet, word of mouth and attendance at industry trade shows to promote our brand. To further promote our brand, we may be required to change our marketing practices, which could result in substantially increased advertising expenses, including the need to use traditional media such as television, radio and print. The automobile industry is intensely competitive, and we may not be successful in building, maintaining and strengthening our brand. Many of our current and potential competitors, particularly automobile manufacturers headquartered in Detroit, Japan and the European Union, have greater name recognition, broader customer relationships and substantially greater marketing resources than we do. If we do not develop and maintain a strong brand, our business, prospects, financial condition and operating results will be materially and adversely impacted.

Our plan to expand our network of Tesla stores, service centers and Superchargers will require significant cash investments and management resources and may not meet our expectations with respect to additional sales of our electric vehicles. In addition, we may not be able to open stores or service centers in certain states or Superchargers in desired locations.

Our plan to expand our network of Tesla stores, service centers and Superchargers will require significant cash investments and management resources and may not meet our expectations with respect to additional sales of our vehicles. This ongoing global expansion may not have the desired effect of increasing sales and expanding our brand presence to the degree we are anticipating. Furthermore, there can be no assurances that we will be able to expand on the budget or timeline we have established. We will also need to ensure we are in compliance with any regulatory requirements applicable to the sale and service of our vehicles in those jurisdictions, which could take considerable time and expense. If we experience any delays in expanding our network of Tesla stores, service centers and Superchargers, this could lead to a decrease in sales of our vehicles and could negatively impact our business, prospects, financial condition and operating results. We have opened Tesla stores and service centers in major metropolitan areas throughout North America, Europe and Asia, and we plan to open additional stores and service centers worldwide to support our ongoing growth. We have also rapidly expanded our Supercharger network in the U.S., Europe and China. However, we may not be able to expand at a sufficient rate and our planned expansion will require significant cash investment and management resources, as well as efficiency in the execution of establishing these locations and in hiring and training the necessary employees to effectively sell and service our vehicles.

Furthermore, certain states and foreign jurisdictions may have permit requirements, franchise dealer laws or similar laws or regulations that may preclude or restrict our ability to open stores or sell vehicles out of such states and jurisdictions. Any such prohibition or restriction may lead to decreased sales in such jurisdictions, which could harm our business, prospects and operating results. See Risk Factor “We may face regulatory limitations on our ability to sell vehicles directly or over the internet which could materially and adversely affect our ability to sell our electric vehicles.” Additionally, we may face potential difficulties in finding suitable Supercharger sites in desired locations, negotiating leases or obtaining required permits for such locations.

We face risks associated with our international operations and expansion, including unfavorable regulatory, political, tax and labor conditions and establishing ourselves in new markets, all of which could harm our business.

We face various risks associated with our international operations and expansion. We currently have international operations and subsidiaries in various countries and jurisdictions in Europe and Asia that are subject to the legal, political, regulatory and social requirements and economic conditions in these jurisdictions. Additionally, as part of our growth strategy, we will continue to expand our sales, maintenance, repair and Supercharger services internationally, particularly in China. However, we have limited experience to date selling and servicing our vehicles internationally, as well as limited experience installing and operating Superchargers internationally, and international expansion requires us to make significant expenditures, including the establishment of local operating entities, hiring of local employees and establishing facilities in advance of generating any revenue. We are subject to a number of risks associated with international business activities that may increase our costs, impact our ability to sell our electric vehicles and require significant management attention. These risks include:

- conforming our vehicles to various international regulatory and safety requirements where our vehicles are sold, or homologation;
- difficulty in establishing, staffing and managing foreign operations;
- difficulties attracting customers in new jurisdictions;
- foreign government taxes, regulations and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;

- fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent as do the United States, Japan and European countries, which increases the risk of unauthorized, and uncompensated, use of our technology;
- United States and foreign government trade restrictions, customs regulations, tariffs and price or exchange controls;
- foreign labor laws, regulations and restrictions;
- preferences of foreign nations for domestically produced vehicles;
- changes in diplomatic and trade relationships;

·political instability, natural disasters, war or events of terrorism; and
·the strength of international economies.

Additionally, as we have expanded into new international markets, we have faced challenges with ensuring that our charging equipment works successfully with the charging infrastructure in such markets. For example, we have encountered such challenges in Norway and China. If customers experience problems with the way our charging equipment works with the local charging infrastructure, or we are unable to adapt our equipment to resolve such problems, then the viability and acceptance of our vehicles in such markets could be materially and adversely affected.

If we fail to successfully address these risks, our business, prospects, operating results and financial condition could be materially harmed.

The unavailability, reduction or elimination of, or uncertainty regarding, government and economic incentives in the U.S. and abroad could have a material adverse effect on our business, financial condition, operating results and prospects.

Any reduction or elimination of government and economic incentives may result in the diminished competitiveness of the alternative fuel vehicle industry generally or our electric vehicles in particular. We currently benefit from certain exemptions in the United States, such as the California state sales and use taxes. Similarly, government programs in Europe favor the purchase of electric vehicles, including through disincentives that discourage the use of gas-powered vehicles. In Norway, for example, the purchase of electric vehicles is not currently subject to import taxes, taxes on non-recurring vehicle fees, the 25% value added tax or the purchase taxes that apply to the purchase of gas-powered vehicles. If such government programs are reduced or eliminated, or the available benefits thereunder are exhausted earlier than anticipated, sales of all electric vehicles, including our Model S, could be adversely affected. In addition, customers in certain markets may delay taking delivery of their Tesla vehicles if they believe that certain electric vehicle incentives will be available at a later date, which may negatively affect our ability to achieve our planned delivery targets.

Our strategic relationships with third parties, such as Panasonic, are subject to various risks which could adversely affect our business and future prospects.

Our strategic relationships with third parties, such as Panasonic which supplies us with battery cells for use in Model S and Model X and is our partner in the Gigafactory, pose various risks to us, including potential loss of access to important technology and vehicle parts, potential loss of business and adverse publicity. In addition, these third parties may not perform as expected under our agreements with them, such as with respect to vehicle parts quality and timeliness, and we may have disagreements or disputes with these third parties. The occurrence of any of the foregoing could adversely affect our business, prospects, financial condition and operating results.

If we are unable to keep up with advances in electric vehicle technology, we may suffer a decline in our competitive position.

We may be unable to keep up with changes in electric vehicle technology and, as a result, may suffer a decline in our competitive position. Any failure to keep up with advances in electric vehicle technology would result in a decline in our competitive position which would materially and adversely affect our business, prospects, operating results and financial condition. Our research and development efforts may not be sufficient to adapt to changes in electric vehicle technology. As technologies change, we plan to upgrade or adapt our vehicles and introduce new models in order to continue to provide vehicles with the latest technology, in particular battery cell technology. However, our vehicles may not compete effectively with alternative vehicles if we are not able to source and integrate the latest technology into our vehicles.

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If we are unable to attract and/or retain key employees and hire qualified management, technical, vehicle engineering and manufacturing personnel, our ability to compete could be harmed and our stock price may decline.

The loss of the services of any of our key employees could disrupt our operations, delay the development and introduction of our vehicles and services, and negatively impact our business, prospects and operating results as well as cause our stock price to decline. In particular, we are highly dependent on the services of Elon Musk, our Chief Executive Officer, Product Architect and Chairman of our Board of Directors, and JB Straubel, our Chief Technical Officer. None of our key employees is bound by an employment agreement for any specific term. There can be no assurance that we will be able to successfully attract and retain senior leadership necessary to grow our business. Our future success depends upon our ability to attract and retain our executive officers and other key technology, sales, marketing, engineering, manufacturing and support personnel and any failure to do so could adversely impact our business, prospects, financial condition and operating results. We have in the past and may in the future experience difficulty in retaining members of our senior management team as well as technical, vehicle engineering and manufacturing personnel due to various factors, such as a very competitive labor market for talented individuals with automotive experience. In addition, we do not have “key person” life insurance policies covering any of our officers or other key employees.

Currently in Northern California, there is increasing competition for talented individuals with the specialized knowledge of electric vehicles, software engineers, manufacturing engineers and other skilled employees and this competition affects both our ability to retain key employees and hire new ones. Our continued success depends upon our continued ability to hire new employees in a timely manner and retain current employees. Additionally, we compete with many mature and prosperous companies in Northern California that have far greater financial resources than we do and thus can offer current or perspective employees more lucrative incentive packages than we can. Any difficulties in retaining current employees or recruiting new ones would have an adverse effect on our performance.

We are highly dependent on the services of Elon Musk, our Chief Executive Officer.

We are highly dependent on the services of Elon Musk, our Chief Executive Officer, Product Architect, Chairman of our Board of Directors and largest stockholder. Although Mr. Musk spends significant time with Tesla and is highly active in our management, he does not devote his full time and attention to Tesla. Mr. Musk also currently serves as Chief Executive Officer and Chief Technical Officer of Space Exploration Technologies, a developer and manufacturer of space launch vehicles, and Chairman of SolarCity, a solar equipment installation company.

We are subject to various environmental and safety laws and regulations that could impose substantial costs upon us and negatively impact our ability to operate our manufacturing facilities.

As an automobile manufacturer, we are subject to national, state, provincial and/or local environmental, health and safety laws and regulations, including laws relating to the use, handling, storage, disposal and human exposure to hazardous materials, both in the United States and abroad. Environmental, health and safety laws and regulations can be complex, and we expect that our business and operations will be affected by new, or future amendments to, such laws that may require us to change our operations, potentially resulting in a material adverse effect on our business. These laws can give rise to liability for administrative oversight costs, cleanup costs, property damage, bodily injury and associated fines and penalties. Capital and operating expenses needed to comply with environmental, health and safety laws and regulations can be significant, and violations of those laws may result in substantial fines and penalties, third party damages, suspension of production or a cessation of our operations. These expenses could have a material adverse effect on our financial condition or operating results.

Contamination at properties formerly owned or operated by us, as well as at properties we will own and operate, and properties to which hazardous substances were sent by us, may result in liability for us under environmental laws and

regulations.

We may also face unexpected delays in obtaining the necessary permits and approvals required by environmental laws in connection with our manufacturing facilities that could require significant time and financial resources and negatively impact our ability to operate these facilities, which would adversely impact our business prospects and operating results. As the owner of the Tesla Factory and surrounding land, we may be responsible under federal and state laws and regulations for the entire investigation and remediation of any environmental contamination at the Tesla Factory, whether it occurred before or after the date we purchased the property. When Tesla purchased the property, the previous owner and operator of the Tesla Factory, New United Motor Manufacturing, Inc. (NUMMI), identified environmental conditions at the Tesla Factory that could adversely affect soil and groundwater, and agreed to remediate these conditions. Although NUMMI stated that it fully documented and managed all environmental issues at the Tesla Factory, we cannot determine with certainty the truth of this statement, nor the total costs to remediate any pre-existing contamination that may eventually be found. We have reached an agreement with NUMMI under which, over a ten year period, we will pay the first $15.0 million of any costs of any governmentally-required remediation activities for contamination that existed prior to the closing of the purchase for any known or unknown environmental conditions (Remediation Activities), and NUMMI has agreed to pay the next $15.0 million for such Remediation Activities. Our agreement provides, in part, that NUMMI will pay up to the first $15.0 million on our behalf if such expenses are incurred in the first four years of our agreement, subject to our reimbursement of such costs on the fourth anniversary date of the closing.

On either the ten-year anniversary of the closing or whenever $30.0 million has been spent on Remediation Activities, whichever comes first, NUMMI’s liability to us with respect to Remediation Activities ceases, and we are responsible for any and all environmental conditions at the Fremont site. At that point in time, we have agreed to indemnify, defend, and hold harmless NUMMI from all liability, including attorney fees, or any costs or penalties it may incur arising out of or in connection with any claim relating to environmental conditions and we have released NUMMI for any known or unknown claims except for NUMMI’s obligations for representations and warranties under the agreement.

There are no assurances that NUMMI will perform its obligations under our agreement and NUMMI’s failure to perform would require us to undertake these obligations at a potentially significant cost. Such performance may also adversely affect the production capacity of, and our ability to operate, the Tesla Factory. Any Remediation Activities or other environmental conditions at the Fremont site could harm our operations and the future use and value of the Fremont site and could delay our production plans for Model S.

Our business may be adversely affected by union activities.

Although none of our employees is currently represented by a labor union, it is common throughout the automobile industry generally for many employees at automobile companies to belong to a union, which can result in higher employee costs and increased risk of work stoppages. Our employees may join or seek recognition to form a labor union, or we may be required to become a union signatory. Our automobile production facility in Fremont, California was purchased from NUMMI. Prior employees of NUMMI were union members and our future work force at this facility may be inclined to vote in favor of forming a labor union. We also own and operate another component manufacturing facility in Lathrop, California. Furthermore, we are directly or indirectly dependent upon companies with unionized work forces, such as parts suppliers and trucking and freight companies, and work stoppages or strikes organized by such unions could have a material adverse impact on our business, financial condition or operating results. If a work stoppage occurs, it could delay the manufacture and sale of our vehicles and have a material adverse effect on our business, prospects, operating results or financial condition. The mere fact that our labor force could be unionized may harm our reputation in the eyes of some investors and thereby negatively affect our stock price.

We are subject to substantial regulation, which is evolving, and unfavorable changes or failure by us to comply with these regulations could substantially harm our business and operating results.

The production and sale of motor vehicles, in general and specifically related to electric vehicles, are subject to substantial regulation under international, federal, state, and local laws. We have incurred, and expect to continue to incur, significant costs in complying with these regulations.

Regulations related to the electric vehicle industry and alternative energy are currently evolving and we face risks associated with changes to these regulations. In the United States, the following are examples of regulatory and statutory issues facing us:

- the amendment or rescission of the federal law and regulations mandating increased fuel economy in the United States, referred to as the Corporate Average Fuel Economy (CAFE) standards, could reduce new business opportunities for our powertrain sales and development activities;
- the amendment or rescission of federal greenhouse gas tailpipe emission regulations administered by EPA under the authority of the Clean Air Act could reduce new business opportunities for our powertrain sales and development activities;

- the amendment or rescission of California's zero emission vehicle (ZEV) regulations administered by the California Air Resources Board under the California Health & Safety Code could reduce new business opportunities for our powertrain sales and development activities, as well as our ability to monetize ZEV credits not only in California, but also in the eleven additional states that have adopted the California program;
- changes to the vehicle-specific Federal Motor Vehicle Safety Standards, which govern how all motor vehicles are made within the United States, could result in costly changes to how current vehicles are produced; and
- changes to regulations governing the export of our products could increase our delivery costs to outside the United States or force us to charge consumers in such jurisdictions a higher price for our vehicles.

In addition, as the automotive industry moves towards greater use of electronics in vehicle systems, NHTSA and other regulatory bodies may regulate these electronic systems more stringently, particularly as concerns about distracted driving increase. Such concerns could affect use of electronic systems in Model S, such as the 17 inch display screen, which could reduce the appeal of Model S or require adjustments to the display screen's functionality.

As we are currently delivering vehicles in Europe and Asia, we are subject to laws and regulations applicable to the import, sale and service of automobiles in those regions. For example, we are required to meet vehicle-specific safety standards that are often materially different from U.S. requirements, thus resulting in additional investment into the vehicles and systems to ensure regulatory compliance. Unlike in the U.S. where we self-certify our vehicles' compliance with standards, we must obtain advanced approval from regulatory agencies regarding the proper certification or homologation of our vehicles to enter into these markets. This process necessitates that foreign regulatory officials review and certify our vehicles prior to market entry. In addition, we must comply with regulations applicable to vehicles after they enter the market, including foreign reporting requirements and recall management systems.

To the extent U.S. or international laws change, some or all of our vehicles may not comply with any new applicable international, federal, state or local laws, which would have an adverse effect on our business. Compliance with changing regulations could be burdensome, time consuming, and expensive. To the extent compliance with new regulations is cost prohibitive, our business, prospects, financial condition and operating results will be adversely affected.

We retain certain personal information about our customers and may be subject to various privacy and consumer protection laws.

Our collection, use, retention, security and transfer of personal information of our customers is subject to federal, state, and international laws. These laws continue to be enacted and may be inconsistent from jurisdiction to jurisdiction. Complying with changing international laws may cause us to incur substantial costs, expose us to legal liability or require us to change our business practices. Our privacy policy is posted on our website, and any failure by us or our vendor or other business partners to comply with it or with federal, state or international privacy, data protection or security laws or regulations could result in regulatory or litigation-related actions against us, legal liability, fines, damages and other costs. Although we take steps to protect the security of our customers' personal information, we may be required to expend significant resources to comply with data breach requirements if third parties improperly obtain and use the personal information of our customers or we otherwise experience a data loss with respect to customers' personal information. A major breach of our network security and systems could have negative consequences for our business and future prospects, including possible fines, penalties and damages, reduced customer demand for our vehicles, and harm to our reputation and brand.

We may be compelled to undertake product recalls or take other actions, which could adversely affect our brand image and financial performance.

Any product recall in the future may result in adverse publicity, damage our brand and adversely affect our business, prospects, operating results and financial condition. We previously experienced product recalls in May 2009, October 2010 and June 2013, none of which was related to our electric powertrain. In April 2009, we determined that a condition caused by insufficient torqueing of the rear inner hub flange bolt existed in some of our Tesla Roadsters, as a result of a missed process during the manufacture of the Tesla Roadster glider. In October 2010, we initiated a product recall after the 12 volt, low voltage auxiliary cable in a single vehicle chafed against the edge of a carbon fiber panel in the vehicle causing a short, smoke and possible fire behind the right front headlamp of the vehicle. In June 2013, we initiated a recall of slightly more than one thousand Model S vehicles to inspect and repair rear seat strikers that may have been compromised during the assembly process. Rear seat strikers are used to retain the rear seat backs in an upright position. Failure of this component may have resulted in collapse of the rear seat back during a crash. Finally, in January 2014, we implemented a firmware update to address issues with certain Universal Mobile Connector NEMA 14-50 adapters, which are part of the charging units and are not part of the vehicles themselves, potentially overheating during charging. In the future, we may at various times, voluntarily or involuntarily, initiate a recall if any of our vehicles, including Model S, or our electric powertrain components prove to be defective or noncompliant with applicable federal motor vehicle safety standards. Such recalls, voluntary or involuntary, involve significant expense and diversion of management attention and other resources, and could adversely affect our brand image in our target markets, as well as our business, prospects, financial condition and results of operations.

Our current and future warranty reserves may be insufficient to cover future warranty claims which could adversely affect our financial performance.

If our warranty reserves are inadequate to cover future warranty claims on our vehicles, our business, prospects, financial condition and operating results could be materially and adversely affected. Warranty reserves include management's best estimate of the projected costs to repair or to replace items under warranty. These estimates are based on actual claims incurred to-date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain and changes to our historical or projected experience may cause material changes to our warranty reserves in the future. Subject to separate limited warranties for the supplemental restraint system and battery, we provide a four year or 50,000 mile New Vehicle Limited Warranty for the purchasers of Model S. The New Vehicle Limited Warranty for Model S also covers the drive unit for eight years and the battery for a period of eight years or 125,000 miles or unlimited miles, depending on the size of the vehicle's battery; although the battery's charging capacity is not covered under the New Vehicle Limited Warranty or any Extended Service plan.

In addition, customers have the opportunity to purchase an Extended Service plan for the period after the end of the New Vehicle Limited Warranty for Model S to cover additional services for an additional four years or 50,000 miles, provided it is purchased within a specified period of time. The New Vehicle Limited Warranty and Extended Service plans for the Tesla Roadster and Model S are subject to certain limitations, exclusions or separate warranties, including certain wear items, such as tires, brake pads, paint and general appearance, and battery performance, and is intended to cover parts and labor to repair defects in material or workmanship in the vehicle including the body, chassis, suspension, interior, electronic systems, powertrain and brake system. We have previously provided our Tesla Roadster customers with a battery replacement option to replace the battery in their vehicles at any time after the expiration of the New Vehicle Limited Warranty but before the tenth anniversary of the purchase date of their vehicles. Additionally, in 2013, as part of our ongoing efforts to improve the customer ownership experience, we expanded the battery pack warranty and also eliminated the annual service requirement that was needed to keep the New Vehicle Limited Warranty in effect. Should this change in warranty coverage lead to an increase in warranty claims, we may need to record additional warranty reserves which would negatively affect our profitability.

Our insurance strategy may not be adequate to protect us from all business risks.

We may be subject, in the ordinary course of business, to losses resulting from products liability, accidents, acts of God and other claims against us, for which we may have no insurance coverage. While we currently maintain general liability, automobile, property, workers' compensation, and directors' and officers' insurance policies, as a general matter, we do not maintain as much insurance coverage as many other companies do, and in some cases, we do not maintain any at all. Additionally, the policies that we do have may include significant deductibles, and we cannot be certain that our insurance coverage will be sufficient to cover all future claims against us. A loss that is uninsured or which exceeds policy limits may require us to pay substantial amounts, which could adversely affect our financial condition and operating results.

Our financial results may vary significantly from period-to-period due fluctuations in our operating costs and the seasonality of our business.

We expect our period-to-period operating results to vary based on our operating costs which we anticipate will increase significantly in future periods as we, among other things, design, develop and manufacture Model X and future products, increase the production capacity at our manufacturing facilities to produce vehicles at higher volumes, develop the Gigafactory, open new Tesla service centers with maintenance and repair capabilities, open new Supercharger locations, increase our sales and marketing activities, and increase our general and administrative functions to support our growing operations. As a result of these factors, we believe that quarter-to-quarter comparisons of our operating results, especially in the short-term, are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of future performance. Moreover, our operating results may not meet expectations of equity research analysts or investors. If any of this occurs, the trading price of our stock could fall substantially, either suddenly or over time.

Additionally, sales of new cars in the automobile industry typically decline over the winter season and are generally higher during the spring and summer months. We anticipate that our sales of Model S and future models may have similar seasonality, but our limited operating history makes it difficult for us to judge the exact nature or extent of the seasonality of our business. Our operating results could also suffer if we do not achieve revenue consistent with our expectations for this seasonal demand because many of our expenses are based on anticipated levels of annual revenue.

Unauthorized control or manipulation of our vehicles' systems may cause them to operate improperly or not at all, or compromise their safety and data security, which could result in loss of confidence in us and our vehicles and harm our business.

There have been reports of vehicles of other automobile manufacturers being "hacked" to grant access and operation of the vehicles to unauthorized persons and would-be thieves. Our vehicles, and in particular Model S, are technologically advanced machines requiring the interoperation of numerous complex and evolving hardware and software systems. Subject to our customers' ability to opt out pursuant to our privacy policy, Model S is designed with built-in data connectivity to accept and install periodic remote updates from us to improve or update the functionality of these systems. Although we have designed, implemented and tested security measures to prevent unauthorized access to our vehicles and their systems, if our information technology networks and communications with our vehicles were to be manipulated, damaged, disrupted or shutdown due to attacks by hackers or breaches due to errors by personnel who have access to our networks and systems, such attacks or breaches could result in unexpected control of or changes to our vehicles' functionality, user interface and performance characteristics. Hackers may also use similar means to gain access to data stored in or generated by the vehicle, such as its current geographical position, previous and stored destination address history and web browser "favorites." Any such unauthorized control of vehicles or access to or loss of information could result in legal claims or proceedings and negative publicity, which would negatively affect our brand and harm our business, prospects, financial condition and operating results.

We may need or want to raise additional funds and these funds may not be available to us when we need them. If we cannot raise additional funds when we need or want them, our operations and prospects could be negatively affected.

The design, manufacture, sale and servicing of automobiles is a capital intensive business. We expect that our principal sources of liquidity will provide us adequate liquidity based on our current plans. However, until we are consistently generating positive free cash flows, if the costs for developing and manufacturing Model X exceed our expectations or if we incur any significant unplanned expenses or embark on or accelerate new significant strategic investments, such as the Gigafactory, we may need to raise additional funds through the issuance of equity, equity-related or debt securities or through obtaining credit from government or financial institutions. We need

sufficient capital to fund our ongoing operations, continue research and development projects, including those for our planned Model X crossover and Model 3 vehicle, establish sales and service centers, build and deploy Superchargers and to make the investments in tooling and manufacturing capital required to introduce Model X. We cannot be certain that additional funds will be available to us on favorable terms when required, or at all. If we cannot raise additional funds when we need them, our financial condition, results of operations, business and prospects could be materially adversely affected.

We may face regulatory limitations on our ability to sell vehicles directly or over the internet which could materially and adversely affect our ability to sell our electric vehicles.

We sell our vehicles from our Tesla stores as well as over the internet. We may not be able to sell our vehicles through this sales model in each state in the United States as many states have laws that may be interpreted to prohibit internet sales by manufacturers to residents of the state or to impose other limitations on this sales model, including laws that prohibit manufacturers from selling vehicles directly to consumers without the use of an independent dealership or without a physical presence in the state. In certain

states in which we are not able to obtain dealer licenses, we have worked with state regulators to open galleries, which are locations where potential customers can view our vehicles but are not full retail locations.

In many states, the application of state motor vehicle laws to our specific sales model is largely untested under state motor vehicle industry laws and is being determined by a fact specific analysis of numerous factors, including whether we have a physical presence or employees in the applicable state, whether we advertise or conduct other activities in the applicable state, how the sale transaction is structured, the volume of sales into the state, and whether the state in question prohibits manufacturers from acting as dealers. As a result of the fact specific and largely untested nature of these issues, and the fact that applying these laws intended for the traditional automobile distribution model to our sales model allows for some interpretation and discretion by the regulators, the manner in which the applicable authorities are applying their state laws to our distribution model continues to be difficult to predict. Laws in some states have limited our ability to obtain dealer licenses from state motor vehicle regulators and may continue to do so.

In addition, decisions by regulators permitting us to sell vehicles may be subject to challenges as to whether such decisions comply with applicable state motor vehicle industry laws. For example, vehicle dealer associations in New York, Ohio and Massachusetts have filed lawsuits to revoke dealer licenses issued to us. These lawsuits have been dismissed, and in one recent court decision, the Supreme Court of Massachusetts held that state franchise laws like the one in Massachusetts do not restrict a manufacturer, like Tesla, that does not use franchised dealers from selling its vehicles directly to consumers. Such results have reinforced our continuing belief that state laws were not designed to prevent our distribution model. Similar lawsuits have been filed in Georgia and Missouri. Possible additional challenges in other states, if successful, could restrict or prohibit our ability to sell our vehicles to residents in such states. In some states, there have also been regulatory and legislative efforts by vehicle dealer associations to propose bills and regulations that, if enacted, would prevent us from obtaining dealer licenses in their states given our current sales model. Such events recently occurred in New Jersey, where the Motor Vehicle Commission, at the behest of the local automobile dealer lobby, passed a new regulation which purported to invalidate our sales licenses in the state, and in Michigan, where the state's automobile dealer association managed to add language into an unrelated bill that had the effect of impairing our right to sell vehicles through Tesla stores in Michigan. The law in New Jersey has subsequently been clarified to permit our operations, and we are evaluating legislative and litigation solutions to remedy the situation in Michigan. Other states, such as New York, Ohio and Pennsylvania, have passed legislation that clarifies our ability to operate, but at the same time limits the number of dealer licenses we can obtain or stores that we can operate.

We are also registered as both a motor vehicle manufacturer and dealer in Canada, Australia, and Japan, and have obtained licenses to sell vehicles in other places such as Hong Kong and China. Furthermore, while we have performed an analysis of the principal laws in the European Union relating to our distribution model and believe we comply with such laws, we have not performed a complete analysis in all foreign jurisdictions in which we may sell vehicles. Accordingly, there may be laws in jurisdictions we have not yet entered or laws we are unaware of in jurisdictions we have entered that may restrict our sales or other business practices. Even for those jurisdictions we have analyzed, the laws in this area can be complex, difficult to interpret and may change over time.

We may need to defend ourselves against patent or trademark infringement claims, which may be time-consuming and would cause us to incur substantial costs.

Companies, organizations or individuals, including our competitors, may hold or obtain patents, trademarks or other proprietary rights that would prevent, limit or interfere with our ability to make, use, develop, sell or market our vehicles or components, which could make it more difficult for us to operate our business. From time to time, we may receive communications from holders of patents or trademarks regarding their proprietary rights. Companies holding patents or other intellectual property rights may bring suits alleging infringement of such rights or otherwise assert their rights and urge us to take licenses. In addition, if we are determined to have infringed upon a third party's

intellectual property rights, we may be required to do one or more of the following:

- cease selling, incorporating or using vehicles or offering goods or services that incorporate or use the challenged intellectual property;
- pay substantial damages;
- obtain a license from the holder of the infringed intellectual property right, which license may not be available on reasonable terms or at all;
- redesign our vehicles or other goods or services; or
- establish and maintain alternative branding for our products and services.

In the event of a successful claim of infringement against us and our failure or inability to obtain a license to the infringed technology or other intellectual property right, our business, prospects, operating results and financial condition could be materially

adversely affected. In addition, any litigation or claims, whether or not valid, could result in substantial costs and diversion of resources and management attention.

We may also face claims that our use of technology licensed or otherwise obtained from a third party infringes the rights of others. In such cases, we may seek indemnification from our licensors/suppliers under our contracts with them. However, indemnification may be unavailable or insufficient to cover our costs and losses, depending on our use of the technology, whether we choose to retain control over conduct of the litigation, and other factors.

Our patent applications may not result in issued patents, which may have a material adverse effect on our ability to prevent others from interfering with our commercialization of our products.

The status of patents involves complex legal and factual questions and the breadth and effectiveness of patented claims is uncertain. We cannot be certain that we are the first creator of inventions covered by pending patent applications or the first to file patent applications on these inventions, nor can we be certain that our pending patent applications will result in issued patents or that any of our issued patents will afford sufficient protection against someone creating a knockoff of our products, or as a defense against a competitor who claims that we are infringing its patents. In addition, patent applications filed in foreign countries are subject to laws, rules and procedures that differ from those of the United States, and thus we cannot be certain that foreign patent applications related to issued U.S. patents will result in issued patents in those foreign jurisdictions. In addition, others may obtain patents that we need to license or design around, either of which would increase costs and may adversely affect our business, prospects, financial condition and operating results.

Our trademark applications in certain countries remain subject to outstanding opposition proceedings.

We currently sell and market our products and services in various countries under our Tesla marks. We have filed trademark applications for our Tesla marks and opposition proceedings to trademark applications of third parties in various countries in which we currently sell and plan to sell our products and services. Certain of our trademark applications are subject to outstanding opposition proceedings brought by owners or applicants alleging prior applications for or use of similar marks. If we cannot resolve these oppositions and thereby secure registered rights in these countries, our ability to challenge third party users of the Tesla marks will be reduced and the value of the marks representing our exclusive brand name in these countries will be diluted. In addition, there is a risk that the prior rights owners could in the future take actions to challenge our use of the Tesla marks in these countries. Such actions could have a severe impact on our position in these countries and may inhibit our ability to use the Tesla marks in these countries. If we were prevented from using the Tesla marks in any or all of these countries, we would need to expend significant additional financial and marketing resources on establishing an alternative brand identity in these markets.

Our facilities or operations could be damaged or adversely affected as a result of disasters or unpredictable events.

Our corporate headquarters in Palo Alto, Tesla Factory in Fremont and additional component manufacturing facilities in Lathrop are located in Northern California, a region known for seismic activity. If major disasters such as earthquakes, fires, floods, hurricanes, wars, terrorist attacks, computer viruses, pandemics or other events occur, or our information system or communications network breaks down or operates improperly, our headquarters and production facilities may be seriously damaged, or we may have to stop or delay production and shipment of our products. In addition, our lease for our Palo Alto facility permits the landlord to terminate the lease following a casualty event if the needed repairs are in excess of certain thresholds and we do not agree to pay for any uninsured amounts. We may incur expenses relating to such damages, which could have a material adverse impact on our business, operating results and financial condition.

Servicing our convertible senior notes requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

We incurred $660.0 million, $920.0 million and $1.38 billion, respectively, in aggregate principal amount of senior indebtedness when we issued pursuant to registered public offerings 1.50% convertible senior notes due 2018 (2018 Notes) in 2013, and 0.25% convertible senior notes due 2019 (2019 Notes) and 1.25% convertible senior notes due 2021 (2021 Notes) in 2014. Our ability to make scheduled payments of the principal when due, to make quarterly interest payments or to make payments upon conversion or to refinance the Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to satisfy our obligations under the Notes and any future indebtedness we may incur and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance the Notes or future indebtedness will depend on the capital markets and our financial condition at such time. We

may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on the Notes or future indebtedness.

Pursuant to their terms, holders may convert their Notes at their option at any time prior to the final three-month period of the scheduled term of the respective Notes only under certain circumstances. For example, holders may generally convert their Notes at their option during a quarter (and only during such quarter), commencing with the fourth quarter of 2013 in the case of the 2018 Notes and the third quarter of 2014 in the case of the 2019 Notes and the 2021 Notes, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding quarter is greater than or equal to 130% of the conversion price for such series of Notes on each applicable trading day. As a result of this conversion feature, the 2018 Notes have been convertible at their holders' option during each quarter commencing with the fourth quarter of 2013, except the first quarter of 2014. Neither this nor any other conversion feature has been met with respect to the 2019 Notes and 2021 Notes, and consequently the 2019 Notes and 2021 have not been convertible at their holders' option Upon conversion of the Notes, we will be obligated to make cash payments in respect of the principal amounts thereof, and we may also have to deliver cash and, if applicable, shares of our common stock, in respect of such Notes. Any conversion of the Notes prior to their maturity, or acceleration of the repayment of the Notes or future indebtedness after any applicable notice or grace periods could have a material adverse effect on our business, results of operations and financial condition.

In addition, holders of the Notes will have the right to require us to purchase their Notes upon the occurrence of a fundamental change at a purchase price equal to 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change purchase date. However, we may not have enough available cash or be able to obtain financing at the time we are required to make purchases of Notes surrendered therefor or Notes being converted. In addition, our ability to purchase the Notes or to pay cash upon conversions of the Notes may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to purchase Notes at a time when the purchase is required by the indenture or to pay cash payable on future conversions of the Notes as required by the indenture would constitute a default under the indenture. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and purchase the Notes or make cash payments upon conversions thereof.

We may still incur substantially more debt or take other actions, which would intensify the risks discussed above.

We and our subsidiaries are not restricted under the terms of the indenture governing the Notes, or the indenture, from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture that could have the effect of diminishing our ability to make payments on the Notes when due.

The classification of our Notes may have a material effect on our reported financial results.

As described in the Risk Factor "Servicing our convertible senior notes requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt," Notes have been historically, and may become in the future, convertible at the option of their holders prior to their scheduled terms under certain circumstances. Even if holders do not elect to convert their Notes, the Notes become convertible prior to their scheduled maturity dates, we would be required to reclassify such Notes and the related debt issuance costs as current liabilities and certain portions of our equity outside of equity to mezzanine equity, which would have an adverse impact on our reported financial results for such quarter, and could have an adverse impact on the market price of our common stock.

Risks Related to the Ownership of our Common Stock

The trading price of our common stock is likely to continue to be volatile.

Our shares of common stock began trading on the Nasdaq Global Select Market in 2010 and, therefore, the trading history for our common stock has been limited. In addition, the trading price of our common stock has been highly volatile and could continue to be subject to wide fluctuations in response to various factors, some of which are beyond our control. Our common stock has experienced an intra-day trading high of $291.42 per share and a low of $177.22 per share over the last 52 weeks.

In addition, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Broad market and industry factors may seriously affect the market price of companies' stock, including ours, regardless of actual operating performance. These fluctuations may be even more pronounced in the trading market for our stock during the period following a securities offering. In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. For example, a shareholder litigation like this was filed against us in 2013. While the trial court dismissed the plaintiffs' complaint with prejudice, this litigation

(if the trial court's order is successfully appealed) or others like it could result in substantial costs and a diversion of our management's attention and resources.

Conversion of the Notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their Notes, or may otherwise depress the price of our common stock.

The conversion of some or all of the Notes will dilute the ownership interests of existing stockholders to the extent we deliver shares upon conversion of any of the Notes. As described in the Risk Factor "Servicing our convertible senior notes requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt," Notes have been historically, and may become in the future, convertible at the option of their holders prior to their scheduled terms under certain circumstances. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the Notes may encourage short selling by market participants because the conversion of the Notes could be used to satisfy short positions, or anticipated conversion of the Notes into shares of our common stock could depress the price of our common stock.

The convertible note hedge and warrant transactions we entered into in connection with the issuance of Notes may affect the value of the Notes and our common stock.

In connection with each issuance of the Notes, we entered into convertible note hedge transactions with the hedge counterparties. The convertible note hedge transactions cover, subject to customary anti-dilution adjustments, the number of shares of our common stock that initially underlay the applicable Notes. The convertible note hedge transactions are expected to reduce the potential dilution and/or offset potential cash payments we are required to make in excess of the principal amount upon conversion of the applicable Notes. We also entered into warrant transactions with the hedge counterparties relating to the same number of shares of our common stock, subject to customary anti-dilution adjustments. However, the warrant transactions could separately have a dilutive effect on our common stock to the extent that the market price per share of our common stock exceeds the applicable strike price of the warrants on the applicable expiration dates.

In addition, the hedge counterparties or their affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the applicable Notes (and are likely to do so during any observation period related to a conversion of Notes). This activity could also cause or prevent an increase or a decrease in the market price of our common stock or the Notes.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the prices of the Notes or the shares of our common stock. In addition, we do not make any representation that the hedge counterparties have engaged or will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

Mr. Musk borrowed funds from affiliates of certain underwriters in our public offerings and/or private placements and has pledged shares of our common stock to secure these borrowings. The forced sale of these shares pursuant to a margin call could cause our stock price to decline and negatively impact our business.

Beginning in June 2011, banking institutions that are affiliated with certain underwriters of our completed public offerings of common stock and Notes made extensions of credit to Elon Musk and the Elon Musk Revocable Trust dated July 22, 2003, or the Trust, a portion of which Mr. Musk used to purchase shares of common stock in our public offering in May 2013 and private placements in June 2011 and June 2013. Interest on such loans accrues at market rates and the banking institutions received customary fees and expense reimbursements in connection with these

loans.

We are not a party to these loans, which are full recourse against Mr. Musk and the Trust and are secured by pledges of a portion of the Tesla common stock currently owned by Mr. Musk and the Trust and other shares of capital stock of unrelated entities owned by Mr. Musk and the Trust. The terms of these loans were negotiated directly between Mr. Musk and the applicable banking institutions.

If the price of our common stock declines, Mr. Musk may be forced by one or more of the banking institutions to provide additional collateral for the loans or to sell shares of Tesla common stock in order to remain within the margin limitations imposed under the terms of his loans. The loans between these banking institutions on the one hand, and Mr. Musk and the Trust on the other hand, prohibit the non-pledged shares currently owned by Mr. Musk and the Trust from being pledged to secure any other loans. These factors may limit Mr. Musk’s ability to either pledge additional shares of Tesla common stock or sell shares of Tesla common stock as a means to avoid or satisfy a margin call with respect to his pledged Tesla common stock in the event of a decline in our stock

price that is large enough to trigger a margin call. Any sales of common stock following a margin call that is not satisfied may cause the price of our common stock to decline further.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, the provisions of Delaware law, and the terms of our convertible notes could impair a takeover attempt.

Our certificate of incorporation, bylaws, Delaware law and the terms of our Notes contain provisions which could have the effect of rendering more difficult, delaying or preventing an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- creating a classified board of directors whose members serve staggered three-year terms;
- authorizing "blank check" preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- controlling the procedures for the conduct and scheduling of board and stockholder meetings; and
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock.

Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

In addition, the terms of the convertible notes require us to repurchase the convertible notes in the event of a fundamental change. A takeover of our company would trigger an option of the holders of the convertible notes to require us to repurchase the convertible notes. This may have the effect of delaying or preventing a takeover of our company that would otherwise be beneficial to our stockholders or investors in the convertible notes.

The fundamental change repurchase feature of the Notes may delay or prevent an otherwise beneficial attempt to take over our company.

The terms of the Notes require us to repurchase the Notes in the event of a fundamental change. A takeover of our company would trigger options by the respective holders of the applicable Notes to require us to repurchase such Notes. This may have the effect of delaying or preventing a takeover of our company that would otherwise be beneficial to our stockholders or investors in the Notes.

If securities or industry analysts publishing research or reports about us, our business or our market change their recommendations regarding our stock adversely or cease to publish research or reports about us, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If any of the analysts who may cover us change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
None.

ITEM 3. DEFAULT UPON SENIOR SECURITIES
None.

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

ITEM 5. OTHER INFORMATION
On May 7, 2015, Tesla Motors, Inc. (“Tesla”) entered into an Agreement for Tax Abatement and Incentives (the “Incentive Agreement”) with the State of Nevada, acting by and through the Nevada Governor’s Office of Economic Development (the “Governor’s Office”). The Incentive Agreement memorializes certain of Tesla’s previous discussions with the Governor’s Office relating to the construction and operation of the Gigafactory in Sparks, Nevada (the “Gigafactory”).

The Incentive Agreement provides for, among other things, the abatement of local sales & use taxes, real and personal property taxes, and employer excise taxes, which would otherwise be taxable for the construction and operation of the Gigafactory. The Incentive Agreement also provides for certain discounts to the base tariff energy rates for electric power consumed at the Gigafactory and the grant of certain transferable tax credits to Tesla when capital investment and job creation occur.

Each of the aforementioned tax abatements and incentives will be available for the applicable periods beginning on October 17, 2014 and ending on June 30, 2034 as specified in the Incentive Agreement, subject to capital investments by Tesla and its partners for the Gigafactory of at least $3.5 billion in the aggregate on or before June 30, 2024, and certain other conditions specified in the Incentive Agreement. If Tesla does not make the minimum capital investments, Tesla will be required to repay (with interest) to the respective taxing authorities the amounts of the tax abatements (with interest) and transferable tax credits realized by Tesla.

Tesla is also subject to compliance audit requirements throughout the applicable periods of the Incentive Agreement, which would be timely reviewed by the Governor’s Office.

The Incentive Agreement also contains customary warranty, indemnification and/or other provisions.

In connection with the Incentive Agreement, Tesla also entered into an agreement on May 8, 2015 with the county of Storey, where the Gigafactory is located, relating to the monthly reimbursement by the county of certain sales and uses taxes paid for tangible property purchased for use at the Gigafactory site.

ITEM 6. EXHIBITS
See Index to Exhibits at end of report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Tesla Motors, Inc.

Date: May 8, 2015 /s/ Deepak Ahuja
Deepak Ahuja
Chief Financial Officer
(Principal Financial Officer, Principal Accounting Officer and

Duly Authorized Officer)

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
31.1	Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Executive Officer	—	—	—	—	X
31.2	Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Financial Officer	—	—	—	—	X
32.1*	Section 1350 Certifications	—	—	—	—	X
101.INS	XBRL Instance Document	—	—	—	—	X
101.SCH	XBRL Taxonomy Extension Schema Document	—	—	—	—	X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	—	—	—	—	X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	—	—	—	—	X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	—	—	—	—	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	—	—	—	—	X

*Furnished herewith