TESLA MOTORS INC
Form 10-Q
November 12, 2010
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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 September 30, 2010

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 ¨ No x

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 ¨ 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 ¨	Accelerated filer ¨
Non-accelerated filer x (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 October 31, 2010, there were 93,270,701 shares of the registrant s Common Stock outstanding.

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TESLA MOTORS, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2010

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Tesla Motors, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

(Unaudited)

	September 30, 2010	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	$ 96,563	$ 69,627
Restricted cash	88,130	
Accounts receivable	8,062	3,488
Inventory	39,508	23,222
Prepaid expenses and other current assets	8,870	4,222
Total current assets	241,133	100,559
Operating lease vehicles, net	5,743	
Property and equipment, net	37,153	23,535
Restricted cash	57,492	3,580
Other assets	20,100	2,750
Total assets	$ 361,621	$ 130,424
Liabilities, Convertible Preferred Stock and Stockholders Equity (Deficit)		
Current liabilities		
Accounts payable	$ 26,990	$ 15,086
Accrued liabilities	10,701	14,532
Deferred development compensation		156
Deferred revenue	3,477	1,377
Capital lease obligations, current portion	291	290
Reservation payments	27,869	26,048
Total current liabilities	69,328	57,489
Common stock warrant liability	6,675	
Convertible preferred stock warrant liability		1,734
Capital lease obligations, less current portion	566	800
Deferred revenue, less current portion	2,514	1,240
Long-term debt	56,557	
Other long-term liabilities	6,058	3,459
Total liabilities	141,698	64,722

Commitments (Note 13)		
Convertible preferred stock; $0.001 par value; 221,903,982 shares authorized		
Series A convertible preferred stock; 0 and 7,213,000 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $3,556)		3,549
Series B convertible preferred stock; 0 and 17,459,456 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $12,920)		12,899
Series C convertible preferred stock; 0 and 35,242,290 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $40,000)		39,789
Series D convertible preferred stock; 0 and 18,440,449 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $45,000)		44,941
Series E convertible preferred stock; 0 and 102,776,779 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $258,175)		135,669
Series F convertible preferred stock; 0 and 27,785,263 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively (Liquidation value: $82,500)		82,378
Total convertible preferred stock		319,225
Stockholders equity (deficit)		
Common stock; $0.001 par value; 2,000,000,000 shares authorized; 93,253,398 and 7,284,200 shares issued and outstanding as of September 30, 2010 and December 31, 2009, respectively	93	7
Additional paid-in capital	583,454	7,124
Accumulated deficit	(363,624)	(260,654)
Total stockholders equity (deficit)	219,923	(253,523)
Total liabilities, convertible preferred stock and stockholders equity (deficit)	$ 361,621	$ 130,424

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

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Tesla Motors, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except share and per share data)

(Unaudited)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues				
Automotive sales	$ 23,350	$ 45,527	$ 67,906	$ 93,358
Development services	7,891		12,552	
Total revenues	31,241	45,527	80,458	93,358
Cost of revenues				
Automotive sales	19,457	37,828	56,581	85,604
Development services	2,488		4,467	
Total cost of revenues	21,945	37,828	61,048	85,604
Gross profit	9,296	7,699	19,410	7,754
Operating expenses				
Research and development (net of development compensation of $8,661 and $17,170 for the three and nine months ended September 30, 2009, respectively) (Note 2)	26,698	1,257	55,379	11,139
Selling, general and administrative	20,432	10,733	59,224	25,587
Total operating expenses	47,130	11,990	114,603	36,726
Loss from operations	(37,834)	(4,291)	(95,193)	(28,972)
Interest income	100	52	195	97
Interest expense	(298)	(18)	(992)	(2,506)
Other income (expense), net	3,180	(577)	(6,770)	(320)
Loss before income taxes	(34,852)	(4,834)	(102,760)	(31,701)
Provision for (benefit from) income taxes	83	(219)	210	(203)
Net loss	$ (34,935)	$ (4,615)	$ (102,970)	$ (31,498)
Net loss per share of common stock, basic and diluted	$ (0.38)	$ (0.66)	$ (2.86)	$ (4.51)
Shares used in computing net loss per share of common stock, basic and diluted	92,270,721	7,014,055	36,051,610	6,983,638

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

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Tesla Motors, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Nine Months Ended September 30, 2010	2009
Cash flows from operating activities		
Net loss	$ (102,970)	$ (31,498)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,733	5,005
Change in fair value of warrant liabilities	5,610	404
Gain on extinguishment of convertible notes and warrants		(1,468)
Stock-based compensation	13,313	449
Inventory write-downs	652	1,029
Interest on convertible notes		2,686
Changes in operating assets and liabilities		
Accounts receivable	(4,575)	1,934
Inventory	(16,937)	(4,032)
Prepaid expenses and other current assets	(3,109)	(2,184)
Operating lease assets	(5,932)	
Other assets	(818)	(654)
Accounts payable	7,993	3,173
Accrued liabilities	(2,131)	(79)
Deferred development compensation	(156)	(6,023)
Deferred revenue	3,374	326
Reservation payments	1,821	(23,207)
Other long-term liabilities	2,599	2,321
Net cash used in operating activities	(93,533)	(51,818)
Cash flows from investing activities		
Payments related to acquisition of Fremont manufacturing facility and related assets	(58,710)	
Purchases of property and equipment excluding capital leases	(23,055)	(5,685)
Increase in restricted cash in our dedicated Department of Energy account	(88,130)	
Increase in other restricted cash	(1,852)	(2,360)
Net cash used in investing activities	(171,747)	(8,045)
Cash flows from financing activities		
Proceeds from issuance of common stock in initial public offering	188,842	
Proceeds from issuance of common stock in private placement	50,000	
Proceeds from issuance of Series F convertible preferred stock, net of issuance costs of $122		82,378
Proceeds from issuance of Series E convertible preferred stock, net of issuance costs of $556		49,444
Principal payments on capital leases and other debt	(233)	(275)
Proceeds from long-term debt	56,557	
Proceeds from issuance of convertible notes and warrants		25,468
Proceeds from exercise of stock options	741	118

Common stock and loan facility issuance costs	(3,691)	
Net cash provided by financing activities	292,216	157,133
Net increase in cash and cash equivalents	26,936	97,270
Cash and cash equivalents at beginning of period	69,627	9,277
Cash and cash equivalents at end of period	$ 96,563	$ 106,547
Supplemental Disclosures		
Interest paid	$ 843	$ 46
Income taxes paid (refunded)	(19)	112
Supplemental noncash investing and financing activities		
Conversion of preferred stock to common stock	319,225	
Issuance of common stock upon net exercise of warrants	6,962	
Issuance of convertible preferred stock warrant	6,293	
Issuance of common stock warrants	1,700	
Conversion of notes payable to Series E convertible preferred stock		86,225
Exchange of convertible notes payable		19,073
Exchange of accrued interest for convertible notes payable		1,791

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 and advanced electric vehicle powertrain components.

Since inception, we have incurred significant losses and have used approximately $296.3 million of cash in operations through September 30, 2010. As of September 30, 2010, we had approximately $96.6 million in cash and cash equivalents. We are currently selling the Tesla Roadster automobile and are developing the Model S sedan. To the extent we do not meet our planned sales volumes or future product releases or our existing cash and cash equivalents balances are insufficient to fund our future activities, we will need to raise additional funds. We cannot be certain that additional financing, if and when needed, will be available at terms satisfactory to us, or at all. These consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

On January 20, 2010, we entered into a loan agreement with the United States Federal Financing Bank and United States Department of Energy (DOE), pursuant to the Advanced Technology Vehicles Manufacturing Incentive Program (ATVM), authorizing the commitment from the DOE to arrange loans for up to $465.0 million. See Note 7 for additional details.

In May 2010, we effected a 1-for-3 reverse stock split of our outstanding common stock, and a proportional adjustment to the existing conversion ratios for each series of preferred stock was made at the time of the effectiveness of the reverse stock split. Accordingly, all share and per share amounts for all periods presented in these condensed consolidated financial statements and notes thereto, have been adjusted retroactively, where applicable, to reflect this reverse stock split and adjustment of the preferred stock conversion ratio.

Initial Public Offering and Toyota Concurrent Private Placement

On June 28, 2010, our registration statement on Form S-1 relating to our initial public offering (IPO) was declared effective by the Securities and Exchange Commission (SEC) and our IPO closed on July 2, 2010, at which time we received cash proceeds of $188.8 million from this transaction, net of underwriting discounts and commissions. Additionally, we have incurred offering costs of $4.4 million related to the IPO (see Note 8).

Concurrent with the closing of our IPO in July 2010, we closed a private placement transaction for the sale of our common stock to Toyota Motor Corporation (Toyota) pursuant to which we received proceeds of $50.0 million from Toyota (see Note 8).

As a result of the IPO, our convertible preferred stock was automatically converted into common stock and our outstanding warrants, excluding the DOE warrant, were net exercised.

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Unadjusted Error in 2009

In June 2010, we identified an error related to the understatement in stock-based compensation expense subsequent to the issuance of the consolidated financial statements for the year ended December 31, 2009.

In the fourth quarter of 2009, we granted certain stock options for which a portion of the grant was immediately vested. We erroneously accounted for the expense on a straight-line basis over the term of the award, while expense recognition should always be at least commensurate with the number of awards vesting during the period. As a result, selling, general and administrative expenses and net loss for the year ended December 31, 2009 were understated by $2.7 million. The error did not have an effect on the valuation of the stock options. As stock-based compensation expense is a non-cash item, there was no impact on net cash used in operating activities for the year ended December 31, 2009.

To correct this error, we recorded additional stock-based compensation of $2.4 million in the three months ended June 30, 2010. We considered the impact of the error on reported operating expenses and trends in operating results and determined that the impact of the error was not material to previously reported financial information as well as those related to the three months ended June 30, 2010.

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. Actual results could differ from those estimates.

Unaudited Interim Financial Statements

The accompanying interim condensed consolidated financial statements and related disclosures are unaudited, 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.

Fair Value of Financial Instruments

The carrying values of our cash and cash equivalents, and deposits 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 only of cash equivalents. Our liabilities that are measured at fair value on a recurring basis consist of our common stock warrant liability, and previously, our convertible preferred stock warrant liability.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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. We do not have any Level II instruments, or instruments valued based on other observable inputs. Our common stock warrant liability, and previously our convertible preferred stock warrant liability, is classified within Level III of the fair value hierarchy.

As of September 30, 2010 and December 31, 2009, the fair value hierarchy for our financial assets and financial liabilities that are carried at fair value was as follows (in thousands):

	September 30, 2010				December 31, 2009			
	Fair Value	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III
Money market funds	$ 159,203	$ 159,203	$	$	$ 64,420	$ 64,420	$	$
Common stock warrant liability	6,675			6,675				
Convertible preferred stock warrant liability					1,734			1,734

The changes in the fair value of the common stock and convertible preferred stock warrant liabilities were as follows (in thousands):

	Nine Months Ended September 30,	
	2010	2009
Fair value, beginning of period	$ 1,734	$ 2,074
Issuances	6,293	
Settlements and extinguishments	(6,962)	(1,468)
Change in fair value	5,610	404
Fair value, end of period	$ 6,675	$ 1,010

The valuation of the common stock and convertible preferred stock warrants is discussed in Notes 6 and 7.

Revenue Recognition

We recognize revenues from sales of the Tesla Roadster, including vehicle options and accessories, vehicle service and sales of zero emission vehicle (ZEV) credits, and sales of electric vehicle powertrain components. 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.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Automotive Sales

Automotive sales consisted of the following for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Vehicle, options and related sales	$ 18,221	$ 45,527	$ 55,452	$ 93,358
Powertrain component and related sales	5,129		12,454	
	$ 23,350	$ 45,527	$ 67,906	$ 93,358

Automotive sales consist primarily of revenue earned from the sales of the Tesla Roadster, vehicle service, and vehicle options, accessories and destination charges as well as sales of ZEV credits. Automotive sales also consist of revenue earned from the sales of electric vehicle powertrain components, such as battery packs and battery chargers, to other automotive manufacturers. Sales or other amounts collected in advance of meeting all of the revenue recognition criteria are not recognized in the consolidated statements of operations and are instead recorded as deferred revenue on the consolidated balance sheets. Prior to February 2010, we did not provide direct financing for the purchase of the Tesla Roadster although a third-party lender has provided financing arrangements to our customers in the United States. Under these arrangements, we have been paid in full by the customer at the time of purchase.

In regards to the sale of Tesla Roadsters, revenue is generally recognized upon delivery of the vehicle. Concurrent with a purchase order for a Roadster that is manufactured to specification, customers must remit a reservation payment (see Note 4). For vehicles purchased directly from our showrooms, no deposit is required. Approximately three months prior to production of a Tesla Roadster manufactured to specification, the reservation payment becomes nonrefundable when the customer enters into a purchase agreement. In a limited number of circumstances, we may deliver a vehicle to a customer without all of the options ordered by the customer if the options do not limit the functionality of the vehicle. This may happen, for example, in an instance where the customer orders an additional hard top which is not ready at the time the vehicle is delivered. In such cases, we will continue to defer the related revenue based on the undelivered item s fair value, as evidenced by the contractual price of the option in stand-alone transactions.

While sales of vehicle options and accessories may take place separately from a vehicle sale, they are often part of one vehicle sales agreement resulting in multiple element arrangements. We are able to establish the fair value for each of the deliverables within the multiple element arrangements because we sell each of the vehicles, vehicle accessories and options separately, outside of any multiple element arrangements. As each of these items has stand alone value to the customer, revenue from sales of vehicle accessories and options are recognized when those specific items are delivered to the customer.

We record revenue for destination charges billed to our customers. Revenue from destination charges totaled $0.3 million, $0.7 million, $0.7 million and $1.7 million for the three and nine months ended September 30, 2010 and the three and nine months ended September 30, 2009, respectively. The related costs are recorded in cost of automotive sales.

In February 2010, we began offering a leasing program to qualified customers in the United States for the Tesla Roadster. Through our wholly owned subsidiary, Tesla Motors Leasing, Inc., qualifying customers are permitted to lease the Tesla Roadster 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 on a straight-line basis over the term of the individual leases and record cost of sales equal to the depreciation of the leased vehicles. As of September 30, 2010, we had deferred revenues of $0.9 million of down payments which will be recognized over the term of the individual leases. Lease revenues are recorded in automotive sales and for the three and nine months ended September 30, 2010, we recognized $0.2 million and $0.3 million, respectively.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Zero Emission Vehicle Credit Sales

California and certain other states have laws in place requiring vehicle manufacturers to ensure that a portion of the vehicles delivered for sale in that state during each model year are zero emission vehicles. These laws provide that a manufacturer of zero emission vehicles may earn credits, referred to as ZEV credits, and may sell excess credits to other manufacturers who apply such credits to comply with these regulatory requirements. As a manufacturer solely of zero emission vehicles, we have earned ZEV credits on vehicles sold in such states, and we expect to continue to earn these credits in the future. Since our only commercial vehicle is electric, we do not receive any benefit from the generation of ZEV credits, and accordingly look to sell them to other vehicle manufacturers. In order to facilitate the sale of these credits, we enter into contractual agreements with third parties requiring them to purchase our ZEV credits at pre-determined prices. We recognize revenue on the sale of these credits at the time legal title to the credits is transferred to the purchasing party by the governmental agency issuing the credits. Revenue from the sale of ZEV credits totaled $0.9 million, $2.0 million, $2.0 million and $7.6 million for the three and nine months ended September 30, 2010 and the three and nine months ended September 30, 2009, respectively.

Extended Service and Battery Replacement Plans

We provide customers with the opportunity to purchase an extended warranty for the period after the end of our initial New Vehicle Limited Warranty to extend coverage for an additional three years or 36,000 miles, whichever comes first. We refer to this program as our Extended Service Plan. Amounts collected on these sales are initially recorded in deferred revenues on the consolidated balance sheets and recognized in automotive sales over the extended warranty period. Through September 30, 2010, we have deferred $1.1 million related to the Extended Service Plan and have not yet recognized any related revenues.

Additionally, within three months of purchasing a vehicle, we provide customers with a one-time option to replace the battery packs 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. We refer to this program as our Battery Replacement Plan. Amounts collected on these sales are initially recorded in deferred revenues on the consolidated balance sheets and recognized in automotive sales as we fulfill our obligation to replace the battery packs. Through September 30, 2010, we have deferred $0.8 million related to the Battery Replacement Plan and have not yet recognized any related revenues.

Development Services Revenue

Revenue from development services arrangements consist of revenue earned from the development of electric vehicle powertrain components for other automobile manufacturers, including the design and development of battery packs and chargers to meet a customer s specifications. Beginning in the quarter ended March 31, 2010, we started entering into such contracts with the expectation that our development services would constitute a viable revenue-generating activity. Revenue is recognized as the performance requirements of each development arrangement are met and collection is reasonably assured. Where development arrangements include substantive at-risk milestones, revenue is recognized based upon the achievement of the contractually-defined milestones. Amounts collected in advance of meeting all of the revenue recognition criteria are not recognized in the consolidated statement of operations and are instead recorded as deferred revenue on the consolidated balance sheets. Costs of development services are expensed as incurred. Costs of development services incurred in periods prior to the finalization of an agreement are recorded as research and development expenses; once an agreement is finalized, these costs are recorded in cost of revenues.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Prior to 2010, compensation from the Smart fortwo development arrangement with Daimler AG (Daimler) (see Note 12), was recorded as an offset to research and development expenses. This early arrangement was motivated primarily by the opportunity to engage Daimler and at the same time, jointly progress our own research and development activities with the associated development compensation.

All amounts received under the Smart fortwo agreement were recognized as an offset to research and development expenses, as we were performing development activities on behalf of Daimler, were being compensated for the cost of these activities and could not practicably separate the efforts or costs related to these activities from our own research and development.

Freestanding Stock Warrants

We accounted for freestanding warrants to purchase shares of our convertible preferred stock as liabilities on the consolidated balance sheets at fair value upon issuance. The convertible preferred stock warrants were recorded as a liability because the underlying shares of convertible preferred stock were contingently redeemable which therefore, may have obligated us to transfer assets at some point in the future (see Note 6). The warrants were subject to re-measurement to fair value at each balance sheet date and any change in fair value was recognized in other income (expense), net, on the condensed consolidated statements of operations. For our Series C and other Series E convertible preferred stock warrants, we adjusted the liability for changes in fair value through the completion of our IPO on July 2, 2010. At that time, the convertible preferred stock warrants were net exercised and the related liability was reclassified to additional paid-in capital. For the Series E convertible preferred stock warrants issued to the DOE (see Note 7), we adjust the liability for changes in fair value until the earlier of vesting or expiration of the warrants. Upon the completion of our IPO, the DOE warrant converted into a warrant to purchase our common stock and the related liability will continue to be adjusted for changes in fair value until the earlier of vesting or expiration of the warrants. At that time, the warrant liability will be reclassified to common stock or additional paid-in capital, as applicable.

Cash and Cash Equivalents

All highly liquid investments with an original or remaining maturity of three months or less at the date of purchase are considered to be cash equivalents. We currently deposit excess cash primarily in money market funds.

Restricted Cash and Deposits

We maintain certain cash amounts restricted as to withdrawal or use. We maintained total restricted cash of approximately $145.6 million and $3.6 million as of September 30, 2010 and December 31, 2009, respectively. As of September 30, 2010, current restricted cash was comprised primarily of $88.1 million of net proceeds from the IPO and the concurrent Toyota private placement that we were required to set aside to fund a separate, dedicated account as required under our DOE loan facility (see Note 7), and noncurrent restricted cash was comprised primarily of $52.1 million of cash paid into escrow in relation to our purchase agreements with New United Motor Manufacturing, Inc. (NUMMI) (see Notes 3 and 14). Noncurrent restricted cash also includes security held by a vendor as part of the vendor s standard credit policies, security deposits related to lease agreements and equipment financing, and certain refundable reservation payments segregated in accordance with state consumer protection regulations.

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily include amounts related to sales of powertrain components and the performance of powertrain development services as of September 30, 2010 and December 31, 2009. In circumstances where we are aware of a specific customer s inability to meet its financial obligations to us, we provide an allowance against amounts receivable to reduce the net recognized receivable to the amount we reasonably believes will be collected. As of September 30, 2010 and December 31, 2009, we determined that no allowance for doubtful accounts was required. We typically do not carry accounts receivable related to our vehicle and related sales as customer payments are due prior to vehicle delivery.

Concentration of Risk

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. Our cash and 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. To date, we have not experienced any losses on our deposits of cash and cash equivalents. During the nine months ended September 30, 2010, our accounts receivable were derived primarily from sales of powertrain components and the performance of powertrain development services to Daimler (see Note 12). These accounts receivable balances represented 89% and 82% of total accounts receivable as of September 30, 2010 and December 31, 2009, respectively. We perform credit evaluations of our customers financial condition and, generally, require no collateral.

A number of components that meet our manufacturing requirements are available only from single source suppliers. For example, Lotus is the only manufacturer for certain components, such as the chassis of our Tesla Roadster. In other instances, 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.

Inventories and Inventory Valuation

Inventories are stated 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 based on reviews for excess and obsolescence determined primarily by future demand forecasts. We also adjust the carrying value of our inventories when we believe that the net realizable value is less than the carrying value. These write-downs are measured as the difference between the cost of the inventory, including estimated costs to complete, and estimated selling prices. Once inventory is written down, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Adverse Purchase Commitments

To the extent future inventory purchases under non-cancellable purchase orders are for excess or obsolete parts or the related inventory is deemed to be in excess of its net realizable value, we record a provision for adverse purchase commitments. Charges are recorded as a component of cost of sales. We did not record significant charges during the three and nine months ended September 30, 2010. During the three and nine months ended September 30, 2009, we recorded charges of $0 and $0.4 million, to cost of revenues, respectively.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Property and Equipment

Property and equipment are recognized at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

Computer equipment and software	3 years
Office furniture and equipment	3 to 7 years
Tooling	3 to 5 years

Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the term of the related lease. Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operations. Maintenance and repair expenditures are expensed as incurred, while major improvements that increase functionality of the asset are capitalized and depreciated ratably to expense over the identified useful life.

Operating Lease Vehicles

Vehicles that are leased as part of our leasing program, are classified as operating lease vehicles. Operating lease vehicles are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the term of operating leases of three years. The total cost of operating lease vehicles recorded in the condensed consolidated balance sheet as of September 30, 2010 was $5.9 million. Accumulated depreciation related to leased vehicles was $0.2 million as of September 30, 2010.

Long-lived Assets

We evaluate our long-lived assets for indicators of possible impairment when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Impairment exists if the carrying amounts of such assets exceed the estimates of future net undiscounted cash flows expected to be generated by such assets. Should impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset s estimated fair value. As of September 30, 2010, we have not recorded any impairment losses on our long-lived assets.

Research and Development Costs

Research and development costs are expensed as incurred. Research and development expenses consist primarily of payroll, benefits and stock-based compensation of those employees engaged in research, design and development activities, costs related to design tools, license expenses related to intellectual property, supplies and services, depreciation and other occupancy costs. Also included in research and development are development services costs incurred, 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.

Income Taxes

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Stock-based Compensation

Effective January 1, 2006, we adopted the fair value method of accounting for stock options granted to employees which requires the recognition of compensation expense for costs related to all share-based payments, including stock options. The fair value method requires companies to estimate the fair value of share-based payment awards on the grant date using an option pricing model. We adopted the fair value method using the prospective method which requires nonpublic entities that used the minimum value method for either pro forma or financial statement recognition purposes to apply the fair value method to option grants issued on and after the date of adoption. For options that have not yet vested but were granted prior to the adoption of the fair value method, we continue to recognize stock-based compensation expense under the intrinsic value method. In addition, we continue to amortize any stock-based compensation from options granted prior to January 1, 2006 utilizing an accelerated amortization schedule, while amortizing the stock-based compensation from options granted or modified after January 1, 2006 on a straight-line basis over the service period.

We have elected to use the with and without approach in determining the order in which tax attributes are utilized. As a result, we will only recognize a tax benefit from stock-based awards in additional paid-in capital if an incremental tax benefit is realized after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect effects of stock-based awards on other tax attributes, such as the research tax credit, through our statement of operations.

We account for equity instruments issued to non-employees based on the fair value of the awards. The fair value of the awards granted to non-employees is re-measured as the awards vest and the resulting change in fair value, if any, is recognized in the consolidated statements of operations during the period the related services are rendered.

For performance-based awards, stock-based compensation expense is recognized over the expected performance achievement period of individual performance milestones when the achievement of each individual performance milestone becomes probable.

Foreign Currency Remeasurement and Transactions

For each of our foreign subsidiaries, the functional currency is the U.S. Dollar. For these foreign subsidiaries, monetary assets and liabilities denominated in non U.S. currencies are re-measured to U.S. Dollars using current exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in non-U.S. currencies are maintained at historical U.S. Dollar exchange rates. Revenues and expenses are re-measured at average U.S. Dollar monthly rates.

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency. Transaction gains and losses are recognized in other income (expense), net in the condensed consolidated statements of operations and have not been significant for any periods presented.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Comprehensive Loss

Comprehensive loss includes all changes in equity (net assets) during a period from non-owner sources. Through September 30, 2010, there are no components of comprehensive loss which are not included in net loss; therefore, a separate statement of comprehensive loss has not been presented. We do not have any foreign currency translation adjustments as a component of other comprehensive loss through September 30, 2010, as the functional currency of all our foreign subsidiaries is the U.S. Dollar.

Warranties

We began recording warranty reserves with the commencement of Tesla Roadster sales in 2008. Initially, Tesla Roadsters were sold with a warranty of four years or 50,000 miles. More recently, Tesla Roadsters have been sold with a warranty of three years or 36,000 miles. Accrued warranty activity consisted of the following for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Accrued warranty beginning of period	$ 4,348	$ 3,026	$ 3,757	$ 858
Warranty costs incurred	(496)	(494)	(1,398)	(873)
Provision for warranty	1,342	1,698	2,835	4,245
Accrued warranty end of period	$ 5,194	$ 4,230	$ 5,194	$ 4,230

We provide a warranty on all vehicle sales, and we accrue warranty reserves at the time a vehicle is delivered to a customer. Warranty reserves include management s best estimate of the projected costs to repair or to replace any items under warranty, based on actual warranty experience as it becomes available and other known factors that may impact our evaluation of historical data. We review our reserves at least quarterly to ensure that our accruals are adequate in meeting expected future warranty obligations, and we will adjust our estimates as needed. Warranty expense is recorded as a component of cost of revenues in the consolidated statements of operations. The portion of the warranty provision which is expected to be incurred within 12 months from the balance sheet date is classified as current, while the remaining amount is classified as long-term liabilities.

Net Loss per Share of Common Stock

Our basic net loss per share of common stock is calculated by dividing the net loss by the weighted-average number of shares of common stock outstanding for the period. The weighted-average number of shares of common stock used to calculate our basic net loss per share of common stock excludes those shares subject to repurchase related to stock options that were exercised prior to vesting as these shares are not deemed to be issued for accounting purposes until they vest. The diluted net loss per share of common stock is computed by dividing the net loss using the weighted-average number of common shares, excluding common stock subject to repurchase, and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of common stock subject to repurchase and stock options to purchase common stock and warrants to purchase convertible preferred stock (using the treasury stock method) and the conversion of our convertible preferred stock and convertible notes payable (using the if-converted method).

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

The following table presents the potential common shares outstanding that were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been antidilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Convertible preferred stock		70,226,844		70,226,844
Stock options to purchase common stock	13,207,367	3,542,215	13,207,367	3,542,215
Common stock subject to repurchase	7,278	59,656	7,278	59,656
Convertible preferred stock warrants		516,506		516,506

Recent Accounting Pronouncements

In October 2009, the FASB issued an accounting standard update which requires companies to allocate revenue in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of value is not available. The guidance is effective beginning January 1, 2011 with early application permitted. We do not expect the adoption of the guidance to have a material impact on our consolidated financial statements.

In January 2010, the FASB issued updated guidance related to fair value measurements and disclosures which requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level I and Level II fair value measurements and to describe the reasons for the transfers. In addition, in the reconciliation of fair value measurements using Level III inputs, a reporting entity will be required to disclose information about purchases, sales, issuances and settlements on a gross rather than on a net basis. The updated guidance will also require fair value disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring Level II and Level III fair value measurements. The updated guidance is effective for interim or annual reporting periods beginning after December 15, 2009, except for the disclosures regarding the reconciliation of Level III fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this updated guidance did not have a material impact on our consolidated financial statements.

In April 2010, the FASB issued an accounting standard update which provides guidance on the criteria to be followed in recognizing revenue under the milestone method. The milestone method of recognition allows a vendor who is involved with the provision of deliverables to recognize the full amount of a milestone payment upon achievement, if, at the inception of the revenue arrangement, the milestone is determined to be substantive as defined in the standard. The guidance is effective on a prospective basis for milestones achieved in fiscal years and interim periods within those fiscal years, beginning on or after June 15, 2010. Early adoption is permitted. We do not expect the adoption of the guidance to have a material impact on our consolidated financial statements.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Balance Sheet Components

As of September 30, 2010 and December 31, 2009, our inventory consisted of the following components (in thousands):

	September 30, 2010	December 31, 2009
Inventory		
Raw material	$ 15,518	$ 10,001
Work in process	3,281	3,403
Finished goods	16,520	7,038
Service	4,189	2,780
	$ 39,508	$ 23,222

We write down inventory as a result of excess and obsolete inventories and when we believe that the net realizable value of inventories is less than the carrying value. During the three and nine months ended September 30, 2010 and the three and nine months ended September 30, 2009, we recorded write-downs of $0.3 million, $0.7 million, $0.3 million and $1.0 million, respectively, in cost of automotive sales.

As of September 30, 2010 and December 31, 2009, our property and equipment consisted of the following components (in thousands):

	September 30, 2010	December 31, 2009
Property and Equipment, net		
Computer equipment and software	$ 8,145	$ 5,376
Office furniture, machinery and equipment	11,181	7,935
Tooling	15,985	15,010
Leasehold improvements	12,016	5,325
Construction in progress	9,115	2,619
	56,442	36,265
Less: Accumulated depreciation and amortization	(19,289)	(12,730)
	$ 37,153	$ 23,535

Depreciation and amortization expense during the three and nine months ended September 30, 2010 and the three and nine months ended September 30, 2009, was $2.7 million, $7.3 million, $1.9 million and $5.0 million, respectively. Total property and equipment assets under capital lease at September 30, 2010 and December 31, 2009, were $0.4 million and $0.6 million, respectively. Accumulated depreciation related to assets under capital lease as of these dates were $0.1 million and $0.1 million, respectively.

As of September 30, 2010 and December 31, 2009, our other assets consisted of the following (in thousands):

	September 30, 2010	December 31, 2009
Other Assets		
Loan facility issuance costs, net	$ 7,216	$ 709
Common stock issuance costs		1,337
Deposits on property, plant and equipment purchases	11,363	
Others	1,521	704
	$ 20,100	$ 2,750

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

In May 2010, we entered into an agreement to purchase an existing automobile production facility located in Fremont, California from NUMMI, which is a joint venture between Toyota, and Motors Liquidation Company, the owner of selected assets of General Motors. In October 2010, we completed the purchase and received title to the facility and land. The aggregate purchase price was $42.0 million. The purchase totals 210 acres, or approximately 55% of the land at the site, and includes all of the manufacturing facilities located thereon.

In October 2010, we and NUMMI amended the facility purchase agreement to include the transfer to us of certain operating permits for additional consideration of $6.5 million. We completed the transfer of these permits in October 2010.

In August 2010, we entered into an additional purchase agreement with NUMMI for the purchase of certain manufacturing equipment and spare parts located at the Fremont facility above. This purchase agreement was subsequently amended to include additional manufacturing equipment and spare parts. In October 2010, we completed this purchase concurrent with the completion of the facility purchase. The aggregate purchase price for these assets was approximately $17 million.

As of September 30, 2010, prior to the completion of the facility, land and manufacturing asset purchases, we made aggregate non-refundable payments of $8.0 million to NUMMI which are recorded in other assets. Additionally, as of September 30, 2010, we made aggregate payments into escrow of $52.1 million which are recorded in noncurrent restricted cash. We intend to use the facility and manufacturing assets for the production of our planned Model S vehicle and to build our future vehicles. Amounts paid to NUMMI have been recorded in other assets.

Also included in other assets as of September 30, 2010 was a deposit paid towards the purchase of manufacturing equipment of $3.4 million.

As of September 30, 2010 and December 31, 2009, our accrued liabilities consisted of the following (in thousands):

	September 30, 2010	December 31, 2009
Accrued Liabilities		
Payroll and related costs	$ 3,989	$ 2,192
Accrued purchases	2,632	9,920
Taxes payable	2,320	452
Accrued warranty	1,760	1,445
Adverse purchase commitments		523
	$ 10,701	$ 14,532

As of September 30, 2010 and December 31, 2009, our other long-term liabilities consisted of the following (in thousands):

	September 30, 2010	December 31, 2009
Other Long-Term Liabilities		
Accrued warranty, long-term	$ 3,434	$ 2,312
Deferred rent liability	2,436	1,147
Other	188	

	$	6,058	$	3,459

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

4. Reservation Payments

Reservation payments consist of reservation and membership payments that allow potential customers to hold a reservation for the future purchase of a Tesla Roadster or Model S. These amounts are recorded as current liabilities until the vehicle is delivered. For our 2010 model year Tesla Roadsters manufactured to specification, our current purchase agreement requires the payment of an initial $9,900, 11,500 or £10,000 deposit, depending on the location of the customer. For the Model S, we require an initial refundable reservation payment of at least $5,000. For vehicles purchased directly from our showrooms, no deposit is required. Prior to the three months ended June 30, 2010, our reservation policy was to accept refundable reservation payments from all customers who wished to purchase a Tesla Roadster and require full payment of the purchase price of the vehicle at the time the customer selected their vehicle specifications. During the three months ended June 30, 2010, we changed our policy to require nonrefundable deposits for Tesla Roadsters manufactured to specification at the time a customer enters into a purchase agreement. However, we also occasionally accept refundable reservation payments for the Tesla Roadster if a customer is interested in purchasing a vehicle but not yet prepared to select the vehicle specifications. For customers who have placed a refundable reservation payment with us, the reservation payment becomes a nonrefundable deposit once the customer has selected the vehicle specifications and enters into a purchase agreement. We now require full payment of the purchase price of the vehicle only upon delivery of the vehicle to the customer. Amounts received by us as reservation payments are generally not restricted as to their use by us. Upon delivery of the vehicle, the related reservation payments are applied against the customer s total purchase price for the vehicle and recognized in automotive sales as part of the respective vehicle sale.

As of September 30, 2010 and December 31, 2009, reservation payments in the amount of $27.9 million and $26.0 million, respectively, were recorded as current liabilities on the condensed consolidated balance sheets. As of September 30, 2010, we held reservation payments for undelivered Tesla Roadsters in an aggregate amount of $2.4 million and reservation payments for Model S sedans in an aggregate amount of $25.5 million. As of December 31, 2009, we held reservation payments for undelivered Tesla Roadsters in an aggregate amount of $8.2 million and reservation payments for Model S sedans in an aggregate amount of $17.9 million. In order to convert the reservation payments into revenue, we will need to sell vehicles to these customers. All reservation payments for the Model S are fully refundable until such time that a customer enters into a purchase agreement.

5. Convertible Preferred Stock

On June 28, 2010, our registration statement on Form S-1 for our IPO was declared effective by the SEC and on July 2, 2010, we closed our IPO. As a result of the IPO, our convertible preferred stock was automatically converted into common stock

The following table summarizes information related to our convertible preferred stock prior to conversion into common stock:

	Par Value	Share Price at issuance	Authorized	Issued and Outstanding	Liquidation Preference	Proceeds, Net
		(In thousands except share and per share amounts)				
Series A	$ 0.001	$ 0.49	7,213,000	7,213,000	$ 3,556	$ 3,549*
Series B	0.001	0.74	17,459,456	17,459,456	12,920	12,899
Series C	0.001	1.14	35,893,172	35,242,290	40,000	39,789
Series D	0.001	2.44	18,440,449	18,440,449	45,000	44,941
Series E	0.001	2.51	112,897,905	102,776,779	258,175	135,669
Series F	0.001	2.97	30,000,000	27,785,263	82,500	82,378

Total	221,903,982	208,917,237	$ 442,151	$ 319,225

* Net of $3.9 million conversion of Series A convertible preferred stock to common stock.

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Each of our Series A, B, D, E and F convertible preferred stock converted on a 1:0.33 basis into common stock while the Series C convertible preferred stock converted on a 1:0.35 basis.

Dividends

No dividends on the convertible preferred stock have been declared by the Board of Directors from inception through their conversion into common stock.

6. Convertible Preferred Stock Warrants

In March 2006, we issued warrants to purchase 650,882 shares of Series C convertible preferred stock in conjunction with the conversion of previously issued convertible notes payable into Series C convertible preferred stock. The warrants had an exercise price of $1.14 per share and expired on the earlier of March 30, 2011 or an initial public offering. As a result of our IPO which closed on July 2, 2010, these warrants were net exercised for 184,359 shares of common stock. The fair value of these warrants as of July 2, 2010 in the amount of $3.6 million was recorded in equity on the condensed consolidated balance sheet. In conjunction with the settlement of our liability to issue such warrants, we recognized income of $1.1 million during the three months ended September 30, 2010, through other income (expense), net, on the condensed consolidated statement of operations as a result of the change in fair value of such warrants.

As of December 31, 2009, the fair value of warrants to purchase shares of the Series C convertible preferred stock in the amount of $1.0 million was included within the convertible preferred stock warrant liability on the condensed consolidated balance sheet. Upon the net exercise of the Series C convertible preferred stock warrants in July 2010, we recognized charges from the change in the fair value of these warrants in the amounts of $2.6 million, $0.1 million and $0.2 million during nine months ended September 30, 2010 and the three and nine months ended September 30, 2009, respectively, through other income (expense), net, on the condensed consolidated statements of operations.

In February 2008, we issued warrants with our February 2008 convertible notes payable. The warrants allowed for the purchase of shares of either Series D convertible preferred stock at a price of $2.44 per share, which amounted to warrants to purchase 8,246,914 shares of Series D convertible preferred stock, or the securities issuable in a subsequent round of financing at the per share price of such securities.

On December 24, 2008, warrants to purchase 3,439,305 of the shares of Series D convertible preferred stock were extinguished as a result of the election of certain holders of the February 2008 convertible notes to exchange their notes and warrants for December 2008 convertible notes. On the date of the exchange, we recognized a gain in the amount of $1.3 million through other income (expense), net, in connection with the extinguishment of these warrants.

During the year ended December 31, 2009, warrants to purchase an additional 3,967,152 shares of Series D convertible preferred stock were extinguished as a result of the election of certain remaining holders of the February 2008 convertible notes as part of an exchange of their notes and warrants for December 2008 convertible notes. On the date of the exchange, we recognized a gain in the amount of $1.5 million through other income (expense), net, in connection with the extinguishment of these warrants.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

In May 2009, we completed our Series E financing in which $50.0 million of proceeds was received for the purchase of 19,901,290 shares of Series E convertible preferred stock at a price of $2.51 per share. In connection with this financing, the remaining holders of the February 2008 notes and warrants converted their notes into shares of Series E convertible preferred stock and converted their warrants into warrants to purchase 866,091 shares of Series E convertible preferred stock.

As a result of our IPO which closed on July 2, 2010, these warrants which exclude the DOE warrant (see Note 7), were net exercised for 160,688 shares of common stock. The fair value of these warrants as of July 2, 2010 in the amount of $3.4 million was recorded in equity on the condensed consolidated balance sheet. Upon the settlement of our liability to issue such warrants, we recognized income of $1.3 million during the three months ended September 30, 2010, through other income (expense), net, on the condensed consolidated statement of operations as a result of the change in fair value of such warrants.

As of December 31, 2009, excluding the DOE warrant, the fair value of warrants to purchase 866,091 shares of the Series E convertible preferred stock in the amount of $0.7 million was included within the convertible preferred stock warrant liability on the condensed consolidated balance sheet. We recognized charges from the change in the fair value of these Series E warrants in the amounts of $2.7 million, $0.2 million and $0.2 million, during the nine months ended September 30, 2010, and the three and nine months ended September 30, 2009, respectively, through other income (expense), net, on the condensed consolidated statements of operations.

As of December 31, 2009, excluding the DOE warrant, there were total outstanding warrants to purchase an aggregate of 1,516,973 shares of Series C and E convertible preferred stock that had a weighted average exercise price of $1.92 per share.

7. Department of Energy Loan Facility

On January 20, 2010, we entered into a loan facility with the Federal Financing Bank (FFB), and the DOE, pursuant to the ATVM Incentive Program (the DOE Loan Facility). Under the DOE Loan Facility, the FFB has made available to us two multi-draw term loan facilities in an aggregate principal amount of up to $465.0 million. Up to an aggregate principal amount of $101.2 million will be made available under the first term loan facility to finance up to 80% of the costs eligible for funding for the powertrain engineering and the build out of a facility to design and manufacture lithium-ion battery packs, electric motors and electric components (the Powertrain Facility). Up to an aggregate principal amount of $363.9 million will be made available under the second term loan facility to finance up to 91.5% of the costs eligible for funding for the development of, and to build out the manufacturing facility for, our Model S sedan (the Model S Facility). Under the DOE Loan Facility, we are responsible for the remaining 20% of the costs eligible for funding under the ATVM Program for the projects as well as any cost overruns for each project. The costs paid by us to date for the Powertrain Facility and the Model S Facility will be applied towards our obligation to contribute 20% of the eligible project costs, and the DOE s funding of future eligible costs will be adjusted to take this into account. Our obligations for the development of, and the build-out of our manufacturing facility for, the Model S is budgeted to be an aggregate of $33 million or approximately 8.5% of the ongoing budgeted cost, plus any cost overruns for the projects. We have paid for the full 20% of the budgeted costs related to our Powertrain Facility and therefore expect to receive 100% reimbursement from the DOE Loan Facility for ongoing budgeted costs, but will continue to be responsible for cost overruns. On the closing date, we paid a facility fee to the DOE in the amount of $0.5 million. From February through September 2010, we received loans under the DOE Loan Facility for an aggregate of $56.6 million at interest rates ranging from 1.7% to 3.4%.

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Our ability to draw down funds under the DOE Loan Facility is conditioned upon several draw conditions. We are currently in compliance with these draw conditions. For the Powertrain Facility, the draw conditions include our achievement of progress milestones relating to the development of the powertrain manufacturing facility and the successful development of commercial arrangements with third parties for the supply of powertrain components. For the Model S Facility, the draw conditions include our achievement of progress milestones relating to the design and development of the Model S and the planned Model S manufacturing facility, including an environmental assessment of such facility approved by the DOE and the completion of the processes under the National Environmental Policy Act and the California Environmental Quality Act. Certain advances will be subject to additional conditions to draw-down related to the site on which the applicable project is located. We are currently progressing towards our milestones. Additionally, the DOE Loan Facility provides for the ability to update milestones should a reasonable need arise.

Advances under the DOE Loan Facility accrue interest at a per annum rate determined by the Secretary of the Treasury as of the date of the advance and will be based on the Treasury yield curve and the scheduled principal installments for such advance. Interest on advances under the DOE Loan Facility is payable quarterly in arrears. Advances under the Powertrain Facility are repayable in 28 equal quarterly installments commencing on December 15, 2012 (or for advances made after such date, in 26 equal quarterly installments commencing on June 15, 2013). All outstanding amounts under the Powertrain Facility will be due and payable on the maturity date of September 15, 2019. Advances under the Model S Facility are repayable in 40 equal quarterly installments commencing on December 15, 2012 (or for advances made after such date, in 38 equal quarterly installments commencing on June 15, 2013). All outstanding amounts under the Model S Facility will be due and payable on the maturity date of September 15, 2022. Advances under the loan facilities may be voluntarily prepaid at any time at a price determined based on interest rates at the time of prepayment for loans made from the Secretary of the Treasury to FFB for obligations with an identical payment schedule to the advance being prepaid, which could result in the advance being prepaid at a discount, at par or at a premium. The loan facilities are subject to mandatory prepayment with net cash proceeds received from certain dispositions, loss events with respect to property and other extraordinary receipts. All obligations under the DOE Loan Facility are secured by substantially all of our property.

Under the DOE Loan Facility, we have committed to pay all costs and expenses incurred to complete the projects being financed in excess of amounts funded under the loan facility. We will be required to maintain, at all times, available cash and cash equivalents of at least 105% of the amounts required to fund this excess over our financing commitment, after taking into account current cash flows and cash on hand, and reasonable projections of future generation of net cash from operations, losses and expenditures. Loans may be requested under the facilities until January 22, 2013, and we have committed to complete the projects being financed prior to such date.

The DOE Loan Facility documents contain customary covenants that include, among others, a requirement that the projects be conducted in accordance with the business plan for such project, compliance with all requirements of the ATVM Program, and limitations on our and our subsidiaries ability to incur indebtedness, incur liens, make investments or loans, enter into mergers or acquisitions, dispose of assets, pay dividends or make distributions on capital stock, pay indebtedness, pay management, advisory or similar fees to affiliates, enter into certain affiliate transactions, enter into new lines of business, and enter into certain restrictive agreements, in each case subject to customary exceptions. The DOE Loan Facility documents also contain customary financial covenants requiring us to maintain a minimum ratio of current assets to current liabilities, and (i) through December 15, 2012, a minimum cash balance, and (ii) after December 15, 2012, a maximum leverage ratio, a minimum interest coverage ratio, a minimum fixed charge coverage ratio, a limit on capital expenditures and, after March 31, 2014, a maximum ratio of total liabilities to shareholder equity. We are currently in compliance with these covenants.

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The DOE Loan Facility documents also contain customary events of default, subject in some cases to customary cure periods for certain defaults. In addition, events of default include a failure of Elon Musk, our Chief Executive Officer, Product Architect and Chairman, and certain of his affiliates, at any time prior to one year after we complete the project relating to the Model S Facility, to own at least 65% of capital stock held by Mr. Musk and such affiliates as of the date of the DOE Loan Facility.

Under the DOE Loan Facility, we are required to fund a debt service reserve account on or before December 31, 2012, in an amount equal to all principal and interest that will come due on the advances on the next two payment dates. Once we have deposited such two payments, we will not be required to further fund such debt service reserve account. We have also agreed that, in connection with the sale of our common stock in an initial public offering, at least 75% of the net offering proceeds will be received by us and, in connection with the sale of our stock in any other follow-on equity offering, at least 50% of the net offering proceeds will be received by us. Offering proceeds may not be used to pay bonuses or other compensation to officers, directors, employees or consultants in excess of the amounts contemplated by our business plan approved by the DOE.

In addition to our obligation to fund a portion of the project costs as described above, we have agreed to set aside 50% of the net proceeds from an initial public offering and any subsequent offerings of stock occurring before the completion of the projects, up to an aggregate of $100 million, to fund a separate, dedicated account under our DOE Loan Facility. This dedicated account can be used by us to fund any cost overruns for our powertrain and Model S manufacturing facility projects and will also be used as a mechanism to defer advances under the DOE Loan Facility. This will not affect our ability to draw down the full amount of the DOE loans, but will require us to use the dedicated account to fund certain project costs up front, which costs may then be reimbursed by loans under the DOE Loan Facility once the dedicated account is depleted, or as part of the final advance for the applicable project. We will be required to deposit a portion of these reimbursements into the dedicated account, in an amount equal to up to 30% of the remaining project costs for the applicable project, and these amounts may similarly be used by us to fund project costs and cost overruns and will similarly be eligible for reimbursement by the draw-down of additional loans under the DOE Loan Facility once used in full, or as part of the final advance for the applicable project. Upon the completion of our IPO and concurrent Toyota private placement in July 2010, we set aside $100.0 million to fund the dedicated account. During the three months ended September 30, 2010, we transferred $11.9 million from the dedicated account to our operating cash accounts in accordance with the provisions of the DOE Loan Facility. As of September 30, 2010, $88.1 million remained in the dedicated account. As we expect to transfer the remainder of this balance within one year, we have classified such cash as current restricted cash on the condensed consolidated balance sheet.

DOE Warrant

In connection with the closing of the DOE Loan Facility, we have also issued a warrant to the DOE to purchase up to 9,255,035 shares of our Series E convertible preferred stock at an exercise price of $2.51 per share. Upon the completion of our IPO which occurred on July 2, 2010, this preferred stock warrant became a warrant to purchase up to 3,090,111 shares of common stock at an exercise price of $7.54 per share. Beginning on December 15, 2018 and until December 14, 2022, the shares subject to purchase under the warrant will vest and become exercisable in quarterly amounts depending on the average outstanding balance of the loan during the prior quarter. The warrant may be exercised until December 15, 2023. If we prepay the DOE Loan Facility in part or in full, the total amount of shares exercisable under the warrant will be reduced.

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Notes to Condensed Consolidated Financial Statements (Continued)

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Since the number of shares ultimately issuable under the warrants will vary depending on the average outstanding balance of the loan during the contractual vesting period, and decisions to prepay would be influenced by our future stock price as well as the interest rates on our loans in relation to market interest rates, we measured the fair value of the warrant using a Monte Carlo simulation approach. The Monte Carlo approach simulates and captures the optimal decisions to be made between prepaying the DOE loan and the cancellation of the DOE warrant. For the purposes of the simulation, the optimal decision represents the scenario with the lowest economic cost to us. The total warrant value would then be calculated as the average warrant payoff across all simulated paths discounted to our valuation date.

The prepayment feature which allows us to prepay the DOE Loan Facility and consequently, affect the number of shares ultimately issuable under the DOE warrant, was determined to represent an embedded derivative. This embedded derivative is inherently valued and accounted for as part of the warrant liability on our condensed consolidated balance sheets. Changes to the fair value of the embedded derivative are reflected as part of the warrant liability re-measurement to fair value at each balance sheet reporting date.

The warrant is recorded at its estimated fair value with changes in its fair value reflected in other income (expense), net, until its expiration or vesting. The fair value of the warrant at issuance was $6.3 million, and along with the DOE Loan Facility fee of $0.5 million and other debt issuance costs of $0.9 million, represents a cost of closing the loan facility and is being amortized to interest expense over the expected term of the DOE Loan Facility of approximately 13 years. During the three and nine months ended September 30, 2010, we amortized $0.2 million and $0.4 million to interest expense, respectively.

Prior to completion of our IPO, the fair value of the DOE warrant was included within the convertible preferred stock warrant liability on the condensed consolidated balance sheet. Upon the completion of our IPO on July 2, 2010, this warrant was reclassified on our consolidated balance sheet from convertible preferred stock warrant liability to common stock warrant liability. The DOE warrant will continue to be recorded at its estimated fair value with changes in the fair value reflected in other income (expense), net, as the number of common stock ultimately issuable under the warrant is variable until its expiration or vesting. As of September 30, 2010, the fair value of the DOE warrant was $6.7 million. During the three months ended September 30, 2010, we recognized income for the change in the fair value of the DOE warrant in the amount of $0.7 million and during the nine months ended September 30, 2010, we recognized a charge for the change in the fair value of $0.4 million through other income (expense), net, in the condensed consolidated statements of operations.

8. Common Stock

As of December 31, 2009, we were authorized to issue 313,006,077 shares of capital stock with a par value of $0.001 per share. The authorized shares consisted of 100,000,000 shares of common stock and 213,006,077 shares of convertible preferred stock. In January 2010, we increased the number of authorized shares of our common stock from 100,000,000 to 106,666,667 shares and the number of authorized shares of our authorized preferred stock from 213,006,077 to 221,903,982 shares.

On June 28, 2010, our registration statement on Form S-1 for our IPO was declared effective by the SEC. As a result, the number of authorized shares of our common stock increased from 106,666,667 to 2,000,000,000 shares.

Initial Public Offering and Toyota Concurrent Private Placement

On June 28, 2010, our registration statement on Form S-1 for our IPO was declared effective by the SEC. The IPO closed on July 2, 2010, at which time we sold 11,880,600 shares of our common stock and received cash proceeds of $188.8 million from this transaction, net of underwriting discounts and commissions. Additionally, we incurred offering costs of $4.4 million related to the IPO. An additional 3,414,400 shares of common stock were sold by existing stockholders from which we did not receive any proceeds. Costs associated with the sale of common stock by existing stockholders were not incurred by us.

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Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Concurrent with the closing of our IPO, we sold 2,941,176 shares of our common stock to Toyota at a price per share equal to the IPO price, in a private placement transaction pursuant to which we received proceeds of $50.0 million.

The net proceeds from our IPO as well as the Toyota private placement, have been recorded in stockholders equity. Offering costs of $4.4 million have been reclassified from other noncurrent assets and offset against additional paid-in capital in stockholders equity.

Early Exercise of Employee Options

Stock options granted under our stock option plan on or prior to October 29, 2008 provide employee option holders the right to exercise unvested options in exchange for shares of restricted common stock. Unvested shares, in the amounts of 7,278 and 46,421 as of September 30, 2010 and December 31, 2009, respectively, were subject to a repurchase right held by us at the original issuance price in the event the optionees employment is terminated either voluntarily or involuntarily. For exercises of employee options, this repurchase right generally lapses as to 1/4th of the shares subject to the option on the first anniversary of the vesting start date and as to 1/48th of the shares monthly thereafter. Due to the administrative burden and cost, we abandoned the practice of granting options with a right to early exercise. To date, we have always exercised our right to repurchase unvested restricted shares upon the termination of an employee.

These repurchase terms are considered to be a forfeiture provision and do not result in variable accounting. The restricted shares issued upon early exercise of stock options are legally issued and outstanding. However, these restricted shares are only deemed outstanding for basic earnings per share computation purposes upon the respective repurchase rights lapsing. We treat cash received from employees for the exercise of unvested options as a refundable deposit shown as a liability in our condensed consolidated balance sheets. As of September 30, 2010 and December 31, 2009, we included cash received for early exercise of options of $9,000 and $39,000, respectively, in accrued liabilities. Amounts from accrued liabilities are transferred into common stock and additional paid-in capital as the shares vest.

Stockholder Settlement

During the three months ended March 31, 2010, three of our stockholders who are affiliated with one of our Board members asserted a claim regarding the conversion of such stockholders convertible promissory notes into shares of our Series E convertible preferred stock at the time of our Series E preferred stock financing in May 2009. In May 2010, we entered into a settlement agreement with these stockholders and pursuant to the terms of the settlement agreement, we issued warrants to such stockholders which, upon the closing of our IPO in July 2010, were automatically net exercised for an aggregate of 100,000 shares of our common stock. During the three months ended June 30, 2010, the fair value of these warrants in the amount of $1.7 million was recorded in equity on the condensed consolidated balance sheet based on a Black-Scholes valuation. In conjunction with the settlement of our liability to issue such warrants, we recognized an additional charge of $0.7 million during the three months ended June 30, 2010, through other income (expense), net, on the condensed consolidated statement of operations.

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9. Equity Incentive Plans

In July 2003, we adopted the 2003 Equity Incentive Plan. Concurrent with the effectiveness of our registration statement on Form S-1 on June 28, 2010 (see Note 8), we adopted the 2010 Equity Incentive Plan (the Plan) and all remaining common shares reserved for future grant or issuance under the 2003 Equity Incentive Plan were added to the 2010 Equity Incentive Plan. The Plan provides for the granting of stock options and stock purchase rights to employees, directors and consultants of Tesla. Options granted under the Plan may be either incentive options or nonqualified stock options. Incentive stock options may be granted only to our employees including officers and directors. Nonqualified stock options and stock purchase rights may be granted to our employees and consultants. As of September 30, 2010, there were 10,241,764 shares of common stock reserved for issuance under the Plan.

The following table summarizes option activity under the Plan:

		Outstanding Options	
	Shares Available for Grant	**Number of Options**	**Weighted Average Exercise Price**
Balance, December 31, 2009	1,014,687	11,574,034	$ 5.44
Additional options reserved	11,269,294		
Repurchased restricted stock			