TESLA MOTORS INC
Form 10-Q
May 09, 2014
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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 March 31, 2014

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, 2014, there were 124,090,160 shares of the registrant s Common Stock outstanding.

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TESLA MOTORS, INC.

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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 are intended 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.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Tesla Motors, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

(Unaudited)

	March 31, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$ 2,393,908	$ 845,889
Short-term marketable securities	189,111	
Restricted cash	1,049	3,012
Accounts receivable	72,380	49,109
Inventory	450,730	340,355
Prepaid expenses and other current assets	48,869	27,574
Total current assets	3,156,047	1,265,939
Operating lease vehicles, net	451,729	382,425
Property, plant and equipment, net	849,389	738,494
Restricted cash	7,102	6,435
Other assets	36,143	23,637
Total assets	$ 4,500,410	$ 2,416,930
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 375,778	$ 303,969
Accrued liabilities	128,674	108,252
Deferred revenue	112,740	91,882
Capital lease obligations, current portion	8,397	7,722
Customer deposits	198,006	163,153
Convertible debt	589,875	182
Total current liabilities	1,413,470	675,160
Capital lease obligations, less current portion	12,572	12,855
Deferred revenue, less current portion	210,817	181,180
Long-term debt, net, less current portion	1,519,967	586,119
Resale value guarantee	290,617	236,299

Other long-term liabilities	70,969	58,197
Total liabilities	3,518,412	1,749,810
Commitments and contingencies (Notes 6 and 10)		
1.50% convertible senior notes due 2018 (2018 Notes)	69,942	
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, 2014 and December 31, 2013, respectively; 124,040,756 and 123,090,990 shares issued and outstanding as of March 31, 2014 and December 31, 2013, respectively	124	123
Additional paid-in capital	2,101,352	1,806,617
Accumulated deficit	(1,189,420)	(1,139,620)
Total stockholders equity	912,056	667,120
Total liabilities and stockholders equity	$ 4,500,410	$ 2,416,930

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 March 31,	
	2014	**2013**
Revenues		
Automotive sales	$ 618,811	$ 555,203
Development services	1,731	6,589
Total revenues	620,542	561,792
Cost of revenues		
Automotive sales	462,471	461,818
Development services	2,943	3,654
Total cost of revenues	465,414	465,472
Gross profit	155,128	96,320
Operating expenses		
Research and development	81,544	54,859
Selling, general and administrative	117,551	47,045
Total operating expenses	199,095	101,904
Loss from operations	(43,967)	(5,584)
Interest income	141	10
Interest expense	(11,883)	(118)
Other income, net	6,718	17,091
Income (loss) before income taxes	(48,991)	11,399
Provision for income taxes	809	151
Net income (loss)	$ (49,800)	$ 11,248
Net income (loss) per share of common stock, basic	$ (0.40)	$ 0.10
Weighted average shares used in computing net income (loss) per share of common stock, basic	123,472,782	114,711,899
Net income (loss) per share of common stock, diluted	$ (0.40)	$ 0.00
	123,472,782	124,265,292

Weighted average shares used in computing net income (loss) per share of common stock, diluted		

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)

	Three Months Ended March 31,	
	2014	**2013**
Cash Flows From Operating Activities		
Net income (loss)	$ (49,800)	$ 11,248
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	44,268	17,850
Stock-based compensation	37,038	14,868
Inventory write-downs	1,578	1,532
Amortization of discount on convertible debt	8,493	
Change in fair value of Department of Energy (DOE) warrant liability		(10,692)
Other non-cash operating activities	2,562	390
Foreign currency transaction gain	(807)	
Changes in operating assets and liabilities		
Accounts receivable	(23,800)	(19,297)
Inventories and operating lease vehicles	(197,734)	18,220
Prepaid expenses and other current assets	(11,427)	(2,575)
Other assets	149	158
Accounts payable	78,533	25,661
Accrued liabilities	19,224	926
Deferred revenue	50,282	4,059
Customer deposits	35,026	(8,103)
Resale value guarantee	54,318	
Other long-term liabilities	12,738	9,834
Net cash provided by operating activities	60,640	64,079
Cash Flows From Investing Activities		
Purchase of marketable securities	(189,111)	
Purchases of property and equipment, excluding capital leases	(141,364)	(57,727)
Decrease in other restricted cash	1,295	2,560
Withdrawals out of our dedicated DOE accounts, net		(69)
Net cash used in investing activities	(329,180)	(55,236)
Cash Flows From Financing Activities		
Proceeds from issuance of convertible debt	2,000,000	
Proceeds from issuance of warrants	338,400	

Proceeds from exercise of stock options and other stock issuances	35,726	17,903
Purchase of convertible note hedges	(524,720)	
Convertible debt issuance costs	(30,302)	
Principal payments on capital leases and other debt	(2,545)	(14,219)
Net cash provided by financing activities	1,816,559	3,684
Net increase in cash and cash equivalents	1,548,019	12,527
Cash and cash equivalents at beginning of period	845,889	201,890
Cash and cash equivalents at end of period	$ 2,393,908	$ 214,417
Supplemental disclosure of noncash investing activities:		
Acquisition of property and equipment included in accounts payable and accrued liabilities	$ 36,835	$ 30,105

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

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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. 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.

Public Offerings

In March 2014, we issued $800.0 million principal amount of 0.25% convertible senior notes due March 2019 (2019 Notes) and $1.20 billion principal amount of 1.25% convertible senior notes due March 2021 (2021 Notes) in a public offering. In connection with the issuance of these 2019 Notes and 2021 Notes, we entered into convertible note hedge transactions for which we paid an aggregate $524.7 million. In addition, we sold warrants and received aggregate proceeds of approximately $338.4 million from the sale of the warrants. Taken together, we received total cash proceeds of approximately $1.78 billion, net of underwriting discounts and offering costs (see Note 6).

In May 2013, we completed a public offering of common stock and sold a total of 3,902,862 shares of our common stock for total cash proceeds of approximately $355.5 million (which includes 487,857 shares or $45.0 million sold to Elon Musk, our Chief Executive Officer (CEO)), net of underwriting discounts and offering costs. We also sold 596,272 shares of our common stock to our CEO and received total cash proceeds of $55.0 million in a private placement at the public offering price. Concurrent with these equity transactions, we also issued $660.0 million principal amount of 1.50% convertible senior notes due June 2018 (2018 Notes) in a public offering. In connection with the issuance of the 2018 Notes, we entered into convertible note hedge transactions and paid an aggregate $177.5 million. In addition, we sold warrants and received aggregate proceeds of approximately $120.3 million from the sale of the warrants. Taken together, we received total cash proceeds of approximately $590.8 million, net of underwriting discounts and offering costs. (see Note 6).

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.

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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, 2014, the condensed consolidated statements of operations for the three months ended March 31, 2014 and 2013 and the condensed consolidated statements of cash flows for the three months ended March 31, 2014 and 2013 and other information disclosed in the related notes are unaudited. The condensed consolidated balance sheet as of December 31, 2013 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, 2013 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.

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.

For Model S sales, revenue is generally recognized when all risks and rewards of ownership are transferred to our customers. In certain circumstances, we may deliver a vehicle to a customer without all of the options ordered by the customer, provided that such options do not limit the functionality of the vehicle. In such cases, we continue to defer the related revenue based on the undelivered items fair value, as evidenced by the contractual price of the option in stand-alone transactions, where available, or using the selling price hierarchy where such prices do not exist. Additionally, if a customer purchases a vehicle option that requires us to provide services in the future, we defer the related revenue based on the undelivered items fair value and recognize the associated revenue over our expected performance period. As of March 31, 2014, we had deferred $30.2 million, $13.9 million and $3.9 million related to the purchase of vehicle maintenance and service plans, access to our Supercharger network and Model S connectivity, respectively. As of December 31, 2013, we had deferred $27.6 million, $10.3 million and $0.7 million related to these same performance obligations, respectively.

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Resale Value Guarantee

In April 2013, we began offering a resale value guarantee to all customers who purchased a Model S in the United States and financed their vehicle through one of our specified commercial banking partners, and in October 2013, we introduced this program in Canada. 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 the full amount of cash for the vehicle sales price at delivery, we account for transactions under the resale value guarantee program as operating leases. Accordingly, we defer and amortize to automotive sales revenue the initial purchase consideration less resale value guarantee amount on a straight-line basis, over the contractual term of the guarantee program (i.e., the proxy operating lease term). Similarly, we capitalize and depreciate the cost of the respective operating lease vehicles less expected salvage value to cost of automotive sales over the same period. If a customer decides not to sell their vehicle back to us by the end of the resale value guarantee term, or the resale value guarantee is forfeited, any unamortized deferred revenue (including the amount of the resale value guarantee) and operating lease vehicle net book value is then recognized in automotive sales and cost of automotive sales, respectively.

The resale value guarantee amount represents management s best estimate as to the resale value of the Model S vehicle and related vehicle options during the 36 to 39 month period after delivery. Since we are depreciating our operating lease vehicles to the resale value guarantee amount, which approximates the expected salvage value of our operating lease vehicles at the end of their economic useful life (i.e. the end of their expected operating lease term), we will adjust our depreciation estimates as needed, if the expected salvage value is projected to be lower in future periods. As we accumulate more actual data related to the resale experience of Model S, we may be required to make significant changes to our estimates.

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

	Three months ended March 31, 2014
Operating lease vehicles under the resale value guarantee program beginning of period	$ 376,979
Increase in operating lease vehicles under the resale value guarantee program	84,515
Depreciation expense recorded in cost of automotive sales	(12,402)
Additional depreciation expense recorded in cost of automotive sales as a result of early cancellation of resale value guarantee	(2,060)
Operating lease vehicles under the resale value guarantee program end of period	$ 447,032
Deferred revenue beginning of period	$ 230,856
Increase in deferred revenue related to Model S deliveries with resale value guarantee	63,070
	(21,779)

Amortization of deferred revenue recorded in automotive sales		
Additional revenue recorded in automotive sales as a result of early cancellation of resale value guarantee		(1,441)
Deferred revenue end of period	$	270,706
Resale value guarantee liability beginning of period	$	236,298
Increase in resale value guarantee		55,602
Additional revenue recorded in automotive sales as a result of early cancellation of resale value guarantee		(1,283)
Resale value guarantee liability end of period	$	290,617

Marketable Securities

Marketable securities are comprised of commercial paper and are designated as available-for-sale and reported at estimated fair value, with unrealized gains and losses recorded in accumulated other comprehensive income (loss) which is included within stockholders equity. Realized gains and losses on the sale of available-for-sale marketable securities are recorded in other income, net. The cost of available-for-sale marketable securities sold is based on the specific identification method. Interest, dividends, amortization and accretion of purchase premiums and discounts on our marketable securities

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are included in other income, net. Available-for-sale marketable securities with maturities greater than three months at the date of purchase and remaining maturities of one year or less are classified as short-term marketable securities. Where temporary declines in fair value exist, we have the ability and the intent to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value.

We regularly review all of our marketable securities for other-than-temporary declines in fair value. The review includes but is not limited to (i) the consideration of the cause of the impairment, (ii) the creditworthiness of the security issuers, (iii) the length of time a security is in an unrealized loss position, and (iv) our ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

Warranties

We provide a warranty on all vehicle, production powertrain components and systems sales, and we accrue warranty reserves at the time a vehicle or production powertrain component or system is delivered to the 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. For new vehicles, warranty reserves are based on management s best estimate of projected warranty experience until adequate historical data is accumulated. Our warranty reserves do not include projected warranty costs associated with our resale value guarantee vehicles as such actual warranty costs are expensed as incurred. For the three months ended March 31, 2014, warranty costs incurred for our resale value guarantee vehicles was $1.2 million. We may have material changes as we accumulate more actual data and experience. 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 condensed 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.

We began recording warranty reserves with the commencement of Tesla Roadster sales in 2008. Initially, Tesla Roadsters were sold with a warranty of three years or 36,000 miles, which we extended to four years or 50,000 miles for the purchasers of our 2008 Tesla Roadster. Tesla Roadster customers had the opportunity to purchase an Extended Service plan for the period after the end of the New Vehicle Limited Warranty to cover additional services for an additional three years or 36,000 miles, provided they were purchased within a specified period of time.

In June 2012, we commenced deliveries of Model S. For our Model S customers, we provide a four year or 50,000 miles New Vehicle Limited Warranty, subject to separate limited warranties for the supplemental restraint system and battery. The New Vehicle Limited Warranty also covers 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. Model S customers also have the opportunity to purchase an Extended Service plan for the period after the end of the New Vehicle Limited Warranty to cover additional services for an additional four years or 50,000 miles, provided they are purchased within a specified period of time. The battery pack s charging capacity is not covered under the New Vehicle Limited Warranty or any Extended Service plan. Accrued warranty activity consisted of the following for the periods presented (in thousands):

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	Three Months Ended March 31,	
	2014	2013
Accrued warranty beginning of period	$ 53,182	$ 13,013
Warranty costs incurred	(9,300)	(3,107)
Changes in liability for pre-existing warranties, including expirations	8,120	
Provision for warranty	19,930	14,156
Accrued warranty end of period	$ 71,932	$ 24,062

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 commercial paper and U.S. treasury bills.

As of March 31, 2014 and December 31, 2013, our accounts receivable were derived primarily from amounts to be received from commercial financial institutions for approved financing arrangements between our customers and the financial institutions, sales of regulatory credits, as well as the development and sales of powertrain components and systems to automotive original equipment manufacturers (OEMs).

The following summarizes the accounts receivable from our OEM customers in excess of 10% of our total accounts receivable:

	March 31, 2014	December 31, 2013
Customer A	14%	30%
Customer B	10%	9%

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.

Net Income (Loss) per Share of Common Stock

Basic net income (loss) per common share is calculated based on the weighted-average number of shares of our common stock outstanding during the period. Diluted net income (loss) per common share is calculated based on the weighted-average number of shares of our common stock outstanding and other dilutive securities outstanding during the period. The potential dilutive shares of our common stock resulting from the assumed exercise of outstanding stock options and equivalents are determined under the treasury stock method. The following table reconciles the numerator and denominator used in the calculation of basic and diluted net income (loss) per share (in thousands, except share data);

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	Three Months Ended March 31,	
	2014	2013
Numerator		
Net income (loss) used to calculate net income (loss) per share:		
Basic	$ (49,800)	$ 11,248
Adjustment for change in fair value of warrant liability		(10,692)
Diluted	$ (49,800)	$ 556
Denominator		
Weighted-average shares, basic	123,472,782	114,711,899
Effect of dilutive securities:		
Stock options		7,057,956
DOE warrant		2,451,718
Employee stock purchase plan		43,719
Weighted-average shares, diluted	123,472,782	124,265,292

The following table presents the potential weighted common shares outstanding that were excluded from the computation of basic and diluted net income (loss) per share of common stock for the periods, related to the following securities:

	Three Months Ended March 31,	
	2014	2013
Stock options	14,066,074	14,861,523
Convertible senior notes	2,015,267	
Warrant issued in May 2013	433,479	
Restricted stock units	221,168	
Employee stock purchase plan	947	
DOE warrant		597,766

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, respectively.

Uncertain Tax Positions

As of March 31, 2014 and December 31, 2013, the aggregate balances of our gross unrecognized tax benefits were $17.4 million and $13.4 million, respectively, of which $15.7 million and $11.8 million, respectively, would not affect our effective tax rate as the tax benefits would increase a deferred tax asset which is currently offset with a full valuation allowance.

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3. Balance Sheet Components

Inventory

As of March 31, 2014 and December 31, 2013, our inventory consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Raw materials	$ 197,779	$ 184,665
Work in process	64,431	42,500
Finished goods	132,234	69,324
Service parts	56,286	43,866
Total	$ 450,730	$ 340,355

Property, Plant and Equipment

As of March 31, 2014 and December 31, 2013, our property, plant and equipment, net, consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Machinery, equipment and office furniture	$ 380,597	$ 322,394
Tooling	239,557	230,385
Leasehold improvements	117,521	94,763
Building and building improvements	75,314	67,707
Land	45,020	45,020
Computer equipment and software	50,211	42,073
Construction in progress	110,504	76,294
	1,018,724	878,636
Less: Accumulated depreciation and amortization	(169,335)	(140,142)
Total	$ 849,389	$ 738,494

Construction in progress is comprised primarily of assets related to the manufacturing of our Model X and Model S, including building improvements at our Tesla Factory in Fremont, California as well as tooling and manufacturing equipment and capitalized interest expense. Depreciation of these assets begins when they 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, 2014 and 2013, we capitalized $1.2 million and $1.5 million of interest expense, respectively.

Depreciation and amortization expense during the three months ended March 31, 2014 and 2013 were $28.9 million and $17.4 million, respectively. Total property and equipment assets under capital lease as of March 31, 2014 and December 31, 2013 were $26.0 million and $23.3 million, respectively. Accumulated depreciation related to assets under capital lease as of these dates were $6.7 million and $5.0 million, respectively.

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Other Assets

As of March 31, 2014 and December 31, 2013, our other assets consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Debt issuance costs, net	$ 19,585	$ 7,315
Emission permits	13,662	13,930
Other	2,896	2,392
Total	$ 36,143	$ 23,637

Emission permits are related to the operation of our Tesla Factory; therefore, we amortize the emission permits over the same useful life as that of the Tesla Factory. Debt issuance costs, net as of March 31, 2014, include costs associated with our 2019 Notes and 2021 Notes issued in March 2014 (see Note 6).

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Accrued Liabilities

As of March 31, 2014 and December 31, 2013, our accrued liabilities consisted of the following (in thousands):

	2014	2013
Payroll and related costs	$ 35,495	$ 26,535
Taxes payable	27,984	38,067
Accrued purchases	27,826	19,023
Accrued warranty, current portion	27,721	19,917
Accrued interest	4,393	741
Environmental liabilities, current portion	2,289	2,132
Other	2,966	1,837
Total	$ 128,674	$ 108,252

Other Long-Term Liabilities

As of March 31, 2014 and December 31, 2013, our other long-term liabilities consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Accrued warranty, less current portion	44,211	33,265
Deferred rent liability	11,239	9,886
Deferred tax liabilities	5,231	5,233
Environmental liabilities, less current portion	3,207	3,364
Asset retirement obligations	2,710	2,115
Other	4,371	4,334
Total	$ 70,969	$ 58,197

We established asset retirement obligations pursuant to lease agreements under which we are required to restore the properties to their original condition. The obligations are recorded at the inception of the lease based on estimates of the actions to be taken and related costs. Adjustments are made when necessary to reflect actual results.

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. Our liabilities that were measured at fair value on a recurring basis consisted of our common stock warrant liability, which expired in May 2013.

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 short-term marketable securities are classified within Level II of the fair value hierarchy.

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As of March 31, 2014 and December 31, 2013, the fair value hierarchy for our financial assets that are carried at fair value was as follows (in thousands):

	March 31, 2014				December 31, 2013			
	Fair Value	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III
Money market funds	$ 1,831,259	$ 1,831,259	$	$	$ 460,313	$ 460,313	$	$
Commercial paper	178,000		178,000					
U.S. treasury bills	11,111		11,111					
Total	$ 2,020,370	$ 1,831,259	$ 189,111	$	$ 460,313	$ 460,313	$	$

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

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	$ 178,000	$	$	$ 178,000
U.S. treasury bills	11,111			11,111
Total	$ 189,111	$	$	$ 189,111

The changes in the fair value of our common stock warrant liability (see Note 6) were as follows (in thousands):

	Three Months Ended March 31, 2013
Fair value, beginning of period	$ 10,692
Change in fair value	(10,692)
Fair value, end of period	$

The estimated fair value of our 2018 Notes based on a market approach was approximately $1.19 billion (par value $659.8 million) as of March 31, 2014 and $914.9 million (par value of $660.0 million) as of December 31, 2013, respectively, and represent a Level II valuation. The estimated fair value of our 2019 Notes and 2021 Notes based on a market approach was approximately $739.0 million (par value $800.0 million) and $1.09 billion (par value of $1.20 billion) as of March 31, 2014, respectively, and represents a Level II valuation. 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.

5. Customer Deposits

Customer deposits consist of payments that allow potential customers to make an advance payment for the future purchase of a Model S or Model X. These amounts are recorded as current liabilities until the vehicle is delivered. We require full payment of the purchase price of the vehicle only upon delivery of the vehicle to the customer. Amounts received by us as customer deposits are generally not restricted as to their use by us. Upon delivery of the vehicle, the related customer deposits 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 March 31, 2014 and December 31, 2013, we held customer deposits of $198.0 million and $163.2 million, respectively.

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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. The net proceeds from the offering, after deducting transaction costs, were approximately $787.6 million from the 2019 Notes and $1.18 billion from the 2021 Notes, respectively. We incurred $12.4 million and $18.7 million, respectively, 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. During the three months ended March 31, 2014, we recognized $0.2 million of interest expense related to the amortization of debt issuance costs and $1.2 million of accrued coupon interest expense.

Each $1,000 of principal of these 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. Holders of these notes may convert their Notes at their option on or after December 1, 2018 for the 2019 Notes and on or after December 1, 2020 for the 2021 Notes. Further, holders of these notes may convert their notes at their option prior to the respective dates above, only under the following circumstances: (1) during any fiscal quarter beginning after the fiscal quarter ending June 30, 2014, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the applicable notes on each applicable trading day; (2) during the five business day period following any five consecutive trading day period in which the trading price for the applicable notes is less than 98% of the average of the closing sale price of our common stock for each day during such five trading day period; or (3) if we make specified distributions to holders of our common stock or if specified corporate transactions occur. Upon conversion of the 2019 Notes, we would pay or deliver as applicable, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election. Upon conversion of the 2021 Notes, we would pay the holders in cash for the principal amount and, if applicable, shares of our common stock (subject to our right to deliver cash in lieu of all or a portion of such shares of our common stock) based on a daily conversion value. If a fundamental change occurs prior to the maturity date, holders of these notes may require us to repurchase all or a portion of their notes for cash at a repurchase price equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the applicable maturity date, we will increase the conversion rate for a holder who elects to convert their notes in connection with such a corporate event in certain circumstances.

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 of $163.6 million for the 2019 Notes and $321.2 million for the 2021 Notes in stockholders equity. The resulting debt discounts on the 2019 Notes and 2021 Notes are being amortized to interest expense at an effective interest rate of 4.89% and 5.96%, respectively, over the contractual terms of the Notes. During the three months ended March 31, 2014, we recognized $4.7 million of interest expense related to the amortization of the debt discount. As of March 31, 2014, the net carrying value of the 2019 Notes and the 2021 Notes was $638.5 million and $881.5 million, respectively.

In connection with the offering of these notes, we entered into convertible note hedge transactions whereby we have the option to purchase (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 (subject to adjustment for certain specified events) a total of approximately 2.2 million

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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 the 2021 Notes. We received $338.4 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 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 the 2019 Notes and from $359.87 to $560.64 in the case of warrants relating to the 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 in the condensed consolidated balance sheet as of March 31, 2014.

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 the 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 the 2018 Notes. The interest under the 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. During the three months ended March 31, 2014, we recognized $0.5 million of interest expense related to the amortization of debt issuance costs and $2.4 million of accrued coupon interest expense.

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. Holders of the 2018 Notes may convert their notes at their option on or after March 1, 2018. Further, holders of the 2018 Notes may convert their notes at their option prior to March 1, 2018, only under the following circumstances: (1) during any fiscal quarter beginning after the fiscal quarter ending September 30, 2013, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period following any five consecutive trading day period in which the trading price for the 2018 Notes is less than 98% of the average of the closing sale price of our common stock for each day during such five trading day period; or (3) if we make specified distributions to holders of our common stock or if specified corporate transactions occur. Upon conversion, we would pay the holders in cash for the principal amount of the 2018 Notes and, if applicable, shares of our common stock (subject to our right to deliver cash in lieu of all or a portion of such shares of our common stock) based on a daily conversion value. If a fundamental change occurs prior to the maturity date, holders of the 2018 Notes may require us to repurchase all or a portion of their notes for cash at a repurchase price equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the maturity date, we will increase the conversion rate for a holder who elects to convert their notes in connection with such a corporate event in certain circumstances.

In accordance with accounting guidance on embedded conversion features, we valued and bifurcated the conversion option associated with the 2018 Notes from the host debt instrument and initially recorded the conversion option of $82.8 million in stockholders equity. The resulting debt discount on the 2018 Notes is being amortized to interest expense at an effective interest rate of 4.29% over the contractual term of the notes. During the three months ended March 31, 2014, we recognized $3.8 million of interest expense related to the amortization of the debt discount. As of March 31, 2014, the net carrying value of the 2018 Notes was $589.9 million.

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In connection with the offering of the 2018 Notes, we entered into convertible note hedge transactions whereby we have the option to purchase (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 (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 2014, 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 the 2018 Notes may convert their notes during the second quarter of 2014. As such, we reclassified the $589.9 million carrying value of our 2018 Notes to current liabilities and reclassified $69.9 million, representing the difference between the aggregate principal of our 2018 Notes of $659.8 million and the carrying value of the 2018 Notes, from additional paid-in capital to mezzanine equity on our condensed consolidated balance sheet as of March 31, 2014. Similarly, debt issuance costs previously recorded in other assets were reclassified to other current assets as of March 31, 2014. Should the closing price conditions be met in the second quarter of 2014 or a future quarter, the 2018 Notes will be convertible at their holders option during the immediately following quarters.

Full Repayment of DOE Loan Facility and Expiration of DOE Warrant

On January 20, 2010, we entered into a loan facility with the Federal Financing Bank (FFB), and the Department of Energy (DOE), pursuant to the Advanced Technology Vehicles Manufacturing Incentive Program. We refer to the loan facility with the DOE as the DOE Loan Facility. Under the DOE Loan Facility, the FFB had made available to us two multi-draw term loan facilities in an aggregate principal amount of $465.0 million. As of August 31, 2012, we had fully drawn down the aforementioned facilities.

In connection with the closing of the DOE Loan Facility, we issued in January 2010 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 initial public offering 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.

In March 2013, we entered into an amendment with the DOE under which we agreed to repay all outstanding principal and interest payments under the DOE Loan Facility by December 15, 2017 prior to the warrant vesting start date of December 15, 2018; therefore, the DOE warrant was no longer expected to vest and its fair value was reduced to zero as of March 31, 2013. During the three months ended March 31, 2013, we recognized other income for the reduction of the fair value of the DOE warrant in the amount of $10.7 million.

In May 2013, in connection with the closing of our offerings of common stock and 2018 Notes, we paid $451.8 million to settle all outstanding loan amounts of $441.0 million under the DOE Loan Facility, including principal and interest, as well as an early repayment penalty of $10.8 million which was recorded in interest expense for the year ended December 31, 2013. Upon termination of the DOE Loan Facility, $29.3 million previously held in a dedicated debt service account was released by the DOE.

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7. Equity Incentive Plans

Performance-based Stock Option Grant

In January 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 782,500 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, 2014, the following performance milestone was considered probable of achievement.

- Completion of the first Model X Production Vehicle.

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

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, 2014, the market conditions for four vesting tranches were achieved and the following four performance milestones were considered probable of achievement:

Successful completion of the Model X Engineering Prototype (Alpha);

Successful completion of the Model X Vehicle Prototype (Beta);

Completion of the first Model X Production Vehicle; and

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Successful completion of the Gen III Engineering Prototype (Alpha).

None of the stock options granted under the 2012 CEO Grant has vested thus far as the performance milestones have not yet been achieved as of March 31, 2014. However, as the above four performance milestones were considered probable of achievement, we recorded stock-based compensation expense of $10.0 million for the three months ended March 31, 2014. We recorded no stock-based compensation expense for the three months ended March 31, 2013 as none of the performance milestones were considered probable of achievement.

Additionally, 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,	
	2014	**2013**
Cost of sales	$ 3,106	$ 1,536
Research and development	13,545	7,644
Selling, general and administrative	20,387	5,688
Total	$ 37,038	$ 14,868

8. Information about Geographic Areas

We have determined that we operate in one reporting segment which is the design, development, manufacturing and sales of electric vehicles and electric vehicle powertrain components.

The following tables set forth revenues and long-lived assets by geographic area (in thousands):

Revenues

	Three Months Ended March 31,	
	2014	**2013**
North America	$ 288,379	$ 552,496
Europe	332,108	8,851
Asia	55	445
Total	$ 620,542	$ 561,792

During the three months ended March 31, 2014 and 2013, we recognized revenues of $272.3 million and $534.5 million in the United States, respectively. During the three months ended March 31, 2014, we recognized revenues of

$211.4 million in Norway.

Long-lived Assets

	March 31, 2014	December 31, 2013
United States	$ 1,264,317	$ 1,091,487
International	36,801	29,432
Total	$ 1,301,118	$ 1,120,919

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9. Strategic Partnerships

Daimler Mercedes-Benz B-Class EV Program

During the fourth quarter of 2011, Daimler engaged us to assist with the development of a full electric powertrain for a Daimler Mercedes-Benz B-Class EV vehicle. During the fourth quarter of 2012, we entered into a development agreement to assist Daimler with the development of a full electric powertrain for a Daimler Mercedes-Benz B-Class EV vehicle. Pursuant to the development agreement, Daimler will pay us up to $33.2 million for the successful completion of certain at risk development milestones and the delivery of prototype samples. During the three months ended March 31, 2014, we delivered prototype samples and recognized $1.7 million in development services revenue. During the three months ended March 31, 2013, we completed a milestone, delivered prototype samples and recognized $6.5 million in development services revenue related to the Mercedes-Benz B-Class EV program.

Toyota RAV4 Program

In July 2011, we entered into a supply and services agreement with Toyota for the supply of a validated electric powertrain system, including a battery pack, charging system, inverter, motor, gearbox and associated software for integration into the electric vehicle version of the Toyota RAV4. Additionally, we provide Toyota with certain services related to the supply of the electric powertrain system. During the three months ended March 31, 2014 and 2013, we recognized revenue of $15.1 million and $14.4 million in automotive sales revenue, respectively. Our production activities under this program are expected to end in 2014.

10. Commitments and Contingencies

Environmental Liabilities

In May 2010, we entered into an agreement to purchase an existing automobile production facility located in Fremont, California from New United Motor Manufacturing, Inc. (NUMMI). NUMMI has previously identified environmental conditions at the Fremont site which could affect soil and groundwater, and until recently, were undertaking efforts to address these conditions. These conditions are now being addressed by us and NUMMI. Although we have been advised by NUMMI that it has documented and managed the environmental issues and we completed a reasonable level of diligence on such environmental issues at the time we purchased the facility, we cannot determine the potential costs to remediate any pre-existing contamination with any certainty. Based on management s best estimate, at the time of the facility purchase, we estimated the fair value of the environmental liabilities that we assumed to be $5.3 million. The fair value of these liabilities was determined based on an expected value analysis of the related potential costs to investigate, remediate and manage various environmental conditions that were identified as part of NUMMI s facility decommissioning activities as well as our own diligence efforts.

We 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 completion of the facility and land purchase for any known or unknown environmental conditions, 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. Through March 31 2014, remediation costs of $2.3 million had been incurred by NUMMI.

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On the ten-year anniversary of the closing or whenever $30.0 million has been spent on the 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 and we have released NUMMI for any known or unknown claims except for NUMMI s obligations for representations and warranties under the agreement. As of March 31, 2014 and December 31, 2013, we accrued a total of $5.5 million and $5.5 million related to these environmental liabilities, respectively. As we continue with our construction and operating activities, it is reasonably possible that our estimate of environmental liabilities may change materially.

Other Commitments and Contingencies

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 current complaint, which makes claims against Tesla and its CEO, Elon Musk, seeks 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 is brought on behalf of a putative class consisting of certain persons who purchased Tesla s securities between August 19, 2013 and November 17, 2013. We believe this lawsuit is without merit and intend to defend against it vigorously. As we are currently unable to predict the outcome of this lawsuit, it is not possible for us to determine whether there is a reasonable possibility that a loss has been incurred nor can we estimate the range of any potential loss.

11. Subsequent Event

In April 2014, we issued in a public offering, an additional $120.0 million aggregate principal amount of the 2019 Notes and $180.0 million aggregate principal amount of the 2021 Notes, pursuant to the exercise in full of the overallotment options of the underwriters of our March 2014 public offering. In connection with the issuance of these additional notes, 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 the 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 the 2021 Notes. We received aggregate proceeds of approximately $50.8 million from the sale of the warrants.

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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 and advanced electric vehicle powertrain components. 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. The Model S inherited many of the electric powertrain innovations we introduced with our first vehicle, the Tesla Roadster. The Tesla Roadster was launched in 2008 and was the first commercially produced and federally compliant EV in the United States. We commenced deliveries of Model S in June 2012 and delivered 22,477 vehicles in 2013. In February 2012, we revealed an early prototype of our Model X crossover vehicle. We currently expect to have production design Model X prototypes on the road by the end of 2014 and begin volume deliveries to customers in the spring of 2015.

We sell our vehicles through our own sales and service network. We are also building a network of Superchargers in the United States, Europe and Asia to allow Model S owners to have the ability to travel long distances without a limitation on range by charging their cars at a very fast rate for free.

During the three months ended March 31, 2014, we recognized total revenues of $620.5 million, an increase of $58.7 million over total revenues of $561.8 million for the three months ended March 31, 2013, primarily driven by the launch of European Model S deliveries which commenced in August 2013 and powertrain component sales to Toyota Motor Corporation (Toyota) for the Toyota RAV4 EV; partially offset by a decrease in regulatory credit sales.

Gross margin for the three months ended March 31, 2014 was 25.0%, a significant increase from 17.1% for the three months ended March 31, 2013. Higher vehicle production volume, manufacturing and supply chain efficiencies and component cost reductions contributed to the year-over-year increase in gross margin.

Research and development (R&D) expenses for the three months ended March 31, 2014 were $81.5 million, an increase from $54.9 million for the three months ended March 31, 2013. R&D expenses in the first quarter of 2013 included activities to homologate Model S for markets outside of North America as well as ongoing R&D activities related to Model S, Supercharging and other programs. Higher R&D expenses in the first quarter of 2014 reflected our accelerated engineering work on Model X and continuing efforts to adapt Model S for international markets.

During 2013, we significantly increased our sales and service footprint both in North America and Europe, as well as opened our first store in China. With the continued global expansion of our customer support infrastructure and the business in general in 2014, selling, general and administrative (SG&A) expenses were $117.6 million for the three months ended March 31, 2014, compared to $47.0 million for the three months ended March 31, 2013.

We ended the quarter with $2.58 billion in cash and cash equivalents, current restricted cash and short-term marketable securities, which was a significant increase from cash of $848.9 million held at the end of 2013.

In March 2014, we issued $800.0 million aggregate principal amount of 0.25% convertible senior notes due 2019 (2019 Notes) and $1.20 billion aggregate principal amount of 1.25% convertible senior notes due 2021 (2021 Notes). The net proceeds from the offering, after deducting transaction costs, were

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approximately $787.6 million from the 2019 Notes and $1.18 billion from the 2021 Notes. We incurred a total of $31.1 million of debt issuance costs in connection with the issuance of these notes which we recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual terms of these notes. Under the terms of these notes, 0.25% and 1.25% coupon interest per annum on the principal amount of the 2019 Notes and 2021 Notes, respectively, is 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, we entered into convertible note hedge transactions whereby we have the option to purchase (subject to adjustment for certain specified events) a total of approximately 5.6 million shares of our common stock at a price of $359.87 per share. The 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 (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 per share and a total of approximately 3.3 million shares of our common stock at a price of $560.64 per share. We received $338.4 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 these notes and to effectively increase the overall conversion price from $359.87 to $512.66 per share for the 2019 Notes and from $359.87 to $560.64 per share for the 2021 Notes.

At the end of the first quarter, the underwriters of our Notes offering notified us of their exercise in full of their overallotment options related to our 2019 Notes and 2021 Notes offerings. 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. In connection with the issuance of these Notes, we entered into convertible note hedge transactions and paid $78.7 million. In addition, we sold warrants to the note hedge counterparties, and 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 additional notes and to effectively increase their overall conversion prices. For more information on the Notes, convertible note hedge and warrant transactions, see Notes 6 and 11 to our Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q under Item 8. Financial Statements and Supplemental Data.

We expect that our current sources of liquidity together with our current projections of cash flow from operating activities will provide us adequate liquidity based on our current plans. However, if market conditions are favorable, we may evaluate alternatives to opportunistically pursue liquidity options.

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Management Opportunities, Challenges and Risks

In 2013, we made significant progress in increasing production aided by manufacturing, design and quality improvements as well as through strong efforts from our supply chain. In 2014 we expect to see an even further increase in production to about 1,000 vehicles per week by the end of the year as we expand our factory capacity and address supplier bottlenecks. Battery cell supply will continue to constrain our production during the first half of 2014, but should significantly improve in the second half of the year as our cell supplier brings new production capacity online. Based on our higher production level, we currently expect to deliver slightly over 35,000 Model S vehicles worldwide in 2014, representing a more than 55% increase over 2013.

In the first quarter of 2014, we received a significant sequential increase in global net orders for Model S. This upward trend was driven by our greater global footprint and increasing consumer awareness of Model S. Given the potential we see in Europe and Asia, we expect sales in those regions combined to comprise almost twice that of North America by the end of 2014.

Through the first half of 2013, we had delivered Model S vehicles solely to customers in North America. In August 2013, we started European deliveries of Model S. Similar to the initial launch of Model S in the United States and in Canada, we experienced an increase in our average selling price during the third quarter of 2013 due to the start of delivery of European Signature Series vehicles, and a higher mix of 85 kWh vehicles and other options in all markets.

In April 2014, we commenced deliveries in China at successful customer events in Beijing and Shanghai. Model S is priced similarly to Model S in the United States, with the addition of only unavoidable taxes, customs duties and transportation costs. While we believe that our pricing is consistent with our objective of offering transparent and fair pricing in every market, this pricing strategy is counter to prevailing auto industry practices. As such, Model S in China is priced comparable to a mid-sized premium vehicle in China instead of a large luxury vehicle.

We plan to expand in China as quickly as possible because we believe that the country could be one of our largest markets within a few years. In addition to increased deliveries into China, our expansion into the right hand drive markets, such as the United Kingdom, Hong Kong, Japan and Australia will occur starting this summer. We have not delivered Model S vehicles outside of North America and Europe in volume; thus, we may face difficulties meeting our delivery plans in Asia and right hand drive markets later this year, which may impact our ability to achieve our worldwide delivery goals.

In April 2013, we began offering a resale value guarantee to all customers who purchased a Model S in the United States and financed their vehicle through one of our specified commercial banking partners, and in October 2013, we introduced this program in Canada. 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. We account for transactions under the resale value guarantee program as operating leases and accordingly, we defer and amortize to automotive sales revenue the initial purchase consideration less resale value guarantee amount on a straight-line basis, over the contractual term of the guarantee program. Similarly, we capitalize and depreciate the cost of the respective operating lease vehicles less expected salvage value to cost of automotive sales over the same period. If a customer decides not to sell their vehicle back to us by the end of the resale value guarantee term, the amount of the resale value guarantee and operating lease vehicle net book value are then recognized in automotive sales and cost of automotive sales, respectively.

The resale value guarantee amount represents management s best estimate as to the resale value of the Model S vehicle and related vehicle options during the 36 to 39 month period after delivery. We are depreciating our operating lease vehicles to expected salvage value of our operating lease vehicles at the

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end of their economic useful life (i.e., the end of their expected operating lease term), and we will adjust our depreciation estimates as needed if the expected salvage value decreases in future periods. As we accumulate more actual data related to the resale experience of Model S, we may be required to make significant changes to our estimates.

In 2013, we provided the resale value guarantee to approximately 5,200 Model S deliveries in North America. During the first quarter of 2014, we provided the resale value guarantee to an additional 1,181 Model S deliveries. We expect the penetration rate of the resale value guarantee to remain at the current level in the near-term. Model S deliveries with the resale value guarantee currently do not impact our cash flows and liquidity, since we receive the full amount of cash for the vehicle sales price at delivery. However, this program has adversely impacted our near-term revenues and operating results by requiring the amortization of revenues and costs into future periods under lease accounting. Although lease accounting will continue to adversely impact our revenues and operating results as this and similar programs initially ramp up, 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 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 adversely impact our gross margin.

In early 2014, we announced new leasing and financing options in Germany as well as other European markets in collaboration with a number of global financial partners. In April 2014, we launched Tesla Finance in the United States to directly offer leasing to small and medium-sized businesses. Leasing through Tesla is now available in 21 states and the District of Columbia, with plans for introduction in more states and Canada this year. If customer interest in these financing options is significant, we may be directly or indirectly subject to resale value risks for the Model S. We continue to evaluate a number of other customer financing products as a way to better serve our growing customer base.

In addition to sales of Model S, we continue to recognize automotive sales from our supply of powertrain systems to Toyota for the Toyota RAV4 EV. However, Toyota is expected to end the current RAV4 EV model this year.

In 2012, we began work on a full electric powertrain under the Mercedes-Benz B-Class EV program and in 2013, we continued to provide development services and deliver prototype samples to Daimler. We have substantially completed our development services under this program and production of electric powertrains and battery packs have just commenced. Similar to our previous development services agreements, due to timing differences that may arise between the recognition of milestone revenues and the underlying costs of development services, the gross margin from our development services activities has varied from period to period and may vary in future periods.

Significant cost improvements for Model S were achieved in 2013, including part cost reductions as well as manufacturing efficiencies. We expect some of these trends to continue as we execute on our roadmap of achieving further component cost reductions and benefit from economies of scale. We therefore expect our automotive gross margin to increase to about 28% in the fourth quarter of 2014, excluding potential zero emission vehicle (ZEV) credit sales and assuming a lower option take rate as we get to a more mainstream market and a lower percentage of people take the high performance options on Model S. If we are not able to achieve the planned cost reductions from our various cost savings and process improvement initiatives, our ability to reach our gross margin goals would be negatively affected.

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We recognized $129.8 million in ZEV credit sales in 2013 which contributed to our gross margin. Although ZEV credit revenue was strong in 2013, over 90% of ZEV credit sales were recognized during the first half of 2013. During the three months ended March 31, 2014, we did not recognize any ZEV credit sales and we expect the contribution of ZEV credit revenue to remain low in the future relative to our automotive sales as we continue to grow our sales outside the United States. While we will pursue opportunities to monetize ZEV credits we earn from the sales of our vehicles, we do not plan to rely on these sales to be a contributor to gross margin. Our business model and financial plan are not predicated on such ZEV credits. Other regulatory credit sales recognized during the three months ended March 31, 2014 were $11.6 million, compared to $17.1 million for the three months ended March 31, 2013.

In February 2012, we revealed an early prototype of the Model X crossover as the first vehicle we intend to develop by leveraging the Model S platform. We have accelerated the design and engineering for Model X and the final studio release of Model X has just been completed. The tooling process has started with several suppliers and we expect production design prototypes to be ready in the fourth quarter of this year. We plan to ramp production in the spring of 2015. Our ability to launch the Model X program on time and cost efficiently is dependent upon a variety of factors, including supplier readiness, engineering completion and testing.

We plan to continue to expand our stores and service infrastructure in order to expand our geographical presence and to provide better service in areas with a high concentration of Model S customers. To help drive demand in new geographic areas, we have also begun complementing our store strategy with sales capability within service centers to more rapidly and efficiently expand our retail footprint. As of the end of 2013, we had stores, galleries and service centers in over 110 locations around the world, and plan to increase our total number of locations by more than 75% in 2014, including growing rapidly in multiple regions in China. We continue to build service infrastructure in advance of demand to ensure that after-sale services are available when and where needed, and to help create further demand.

At the end of May 2013, we announced the significant expansion of our Supercharger network as well as plans to reduce charging time at our Superchargers. Since the time of our announcement, we have been installing Superchargers at an accelerating pace and currently have a network of 100 Superchagers. We are continuing to expand our network in North America and Europe, and have recently opened three Supercharging sites in China. We plan to install another 200 Superchargers globally in 2014, including locations in Japan and Hong Kong. If we experience difficulties in finding suitable sites, negotiating leases or obtaining required permits for such locations, our planned expansion of such Superchargers could be delayed.

Operating expenses and capital expenditures are expected to significantly increase in 2014, as we plan to invest in the long-term growth of the company. In 2014, we plan to significantly expand production capacity for Model S and Model X, kick-off the construction of the Tesla Gigafactory, invest in our customer support infrastructure, complete the development of Model X and start early design work on our third generation vehicle, which we refer to as Gen III . Our R&D expenses in particular are expected to increase as design and engineering work accelerates on Model X and overall product development but decrease as a percentage of revenue over time. R&D expenses for the second quarter of 2014 are expected to grow sequentially by approximately 30% as compared to the first quarter of 2014. Our SG&A expenses will continue to grow in absolute terms as we expand our customer and corporate infrastructure globally. SG&A expenses for the second quarter of 2014 are also expected to grow sequentially by approximately 15% as compared to the first quarter of 2014. We expect capital expenditures to be approximately $650 to $850 million for 2014.

We have recently indicated our intention to build 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. While we have not finalized a site for this facility, we currently expect to start working on at least two locations in

parallel in order to minimize risk of delays arising after groundbreaking. We currently expect the facility to be built on a lot between 500 and 1,000 acres in size, with up to approximately 10 million square feet of production space with one or two levels. At full

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implementation, the Tesla Gigafactory is expected to have 6,500 dedicated Tesla and production partner employees. We currently plan to commence supplying battery packs manufactured at the Tesla Gigafactory for our vehicles, including the Gen III vehicle, and stationary storage applications, in approximately three years. The Tesla Gigafactory is on plan to begin battery cell and pack production in 2017 and is currently expected to attain full production capacity in 2020, which is anticipated to be sufficient for the production of approximately 500,000 vehicles annually as well as stationary storage applications. By the time the Gigafactory reaches full, annualized production in 2020, we expect battery pack production capacity to reach 50 GWh. Of this, we expect to build 35 GWh of cell production capacity at the Tesla Gigafactory and purchase 15 GWh of cells from other manufacturers, potentially including Panasonic.

We believe that the Tesla Gigafactory will allow us to achieve a major reduction in the cost of our battery packs of greater than 30% on a per kWh basis by the end of the first year of volume production of Gen III. The total capital expenditures associated with the Tesla Gigafactory through 2020 are expected to be $4-5 billion, of which approximately $2 billion is expected to come from Tesla.

While our plan is to attempt to produce lithium-ion cells and finished battery packs for our Gen III vehicles at a new Tesla Gigafactory, our plans for such production are at a very early stage. We have no experience in the production of lithium-ion cells, and accordingly we intend to engage partners with significant experience in cell production. Planning discussions with Panasonic and other potential production and supply chain partners continue to progress well. We recently entered into a non-binding letter of intent with Panasonic to advance work on the Tesla Gigafactory project. Although planning discussions with production and supply chain partners continue to progress well, to date we have not formalized such partnerships. In addition, the cost of building and operating the Tesla Gigafactory could exceed our current expectations and the Tesla Gigafactory may take longer to bring online than we anticipate.

During the first quarter of 2014, certain conditions with respect to the closing prices of our common stock in accordance with the terms of our 2018 convertible senior notes (2018 Notes) were met and accordingly, the 2018 Notes are convertible at the holder s option during the second quarter of 2014. Upon conversion of the 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 such closing price conditions continue to be met in future quarters, the 2018 Notes will be convertible by their holders during the immediately following quarter. Similarly, if certain conditions are met with respect to our 2019 Notes or 2021 Notes in future quarters, the 2019 Notes or 2021 Notes will be convertible by their holders during the immediately following quarter.

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, 2013, 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.

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Results of Operations

The following table sets forth our condensed consolidated statements of operations data for the periods presented (in thousands):

	Three Months Ended March 31,	
	2014	2013
Revenues		
Automotive sales	$ 618,811	$ 555,203
Development services	1,731	6,589
Total revenues	620,542	561,792
Cost of revenues		
Automotive sales	462,471	461,818
Development services	2,943	3,654
Total cost of revenues	465,414	465,472
Gross profit	155,128	96,320
Operating expenses		
Research and development	81,544	54,859
Selling, general and administrative	117,551	47,045
Total operating expenses	199,095	101,904
Loss from operations	(43,967)	(5,584)
Interest income	141	10
Interest expense	(11,883)	(118)
Other income, net	6,718	17,091
Income (loss) before income taxes	(48,991)	11,399
Provision for income taxes	809	151
Net income (loss)	$ (49,800)	$ 11,248

Revenues

Automotive Sales

Automotive sales, which include vehicle, options and related sales, and powertrain component and related sales, consisted of the following for the periods presented (in thousands):

	Three Months Ended March 31,	
	2014	2013

Vehicle, options and related sales	$ 602,522	$ 540,783
Powertrain component and related sales	16,289	14,420
Total automotive sales	$ 618,811	$ 555,203

Automotive sales during the three months ended March 31, 2014 were $618.8 million, an increase from $555.2 million during the three months ended March 31, 2013. Vehicle, options and related sales represent revenues related to deliveries of Model S, including vehicle options, accessories and destination charges, vehicle service and sales of regulatory credits to other automotive manufacturers. Powertrain component and related sales represent the sales of electric vehicle powertrain components and systems, such as battery packs and drive units, to other manufacturers.

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Vehicle, options and related sales during the three months ended March 31, 2014 were $602.5 million, an increase from $540.8 million during the three months ended March 31, 2013. The increase in vehicle, options and related sales was primarily driven by Model S deliveries which began in August 2013 in Europe. During the three months ended March 31, 2014 and 2013, we delivered 6,457 Model S vehicles and 4,901 Model S vehicles, respectively.

In April 2013, we began offering a resale value guarantee to all customers who purchased a Model S in the United States and financed their vehicle through one of our specified commercial banking partners, and in October 2013, we introduced this program in Canada. Under the program, Model S customers have the option of selling their vehicle back to us during the period of 36 to 39 months for a pre-determined resale value. We account for transactions under the resale value guarantee program as operating leases and accordingly, we defer and amortize to revenues the initial purchase consideration less resale value guarantee amount on a straight-line basis, over the contractual term of the guarantee program. If a customer decides not to sell their vehicle back to us by the end of the resale value guarantee term, the amount of the resale value guarantee is then recognized in automotive sales. During the three months ended March 31, 2014, we delivered 1,181 Model S vehicles under the resale value guarantee program. As of March 31, 2014, we had $270.7 million in deferred revenues and $290.6 million in resale value guarantee related to Model S deliveries with the resale value guarantee. During the three months ended March 31, 2014, we recognized revenue of $23.2 million in automotive sales related to this program.

Powertrain component and related sales for the periods presented were related to powertrain component sales to Toyota under the RAV4 EV supply and services agreement. Powertrain component and related sales for the three months ended March 31, 2014 was $15.1 million, a slight increase from $14.4 million during the three months ended March 31, 2013.

Development Services

Development services represent arrangements where we develop electric vehicle powertrain components and systems for other automobile manufacturers, including the design and development of battery packs, drive units and chargers to meet customers specifications.

During the fourth quarter of 2012, we entered into a development agreement with Daimler to assist with the development of a full electric powertrain for a Mercedes-Benz B-Class EV vehicle and during the three months ended March 31, 2014 and 2013, we recognized development services revenue of $1.7 million and $6.5 million, respectively. Development services revenue for the three months ended March 31, 2014 relates primarily to the delivery of prototype samples to Daimler under this program while development services revenue for the three months ended March 31, 2013 includes revenues for the achievement of a milestone and from the delivery of prototype samples to Daimler under this program.

Cost of Revenues and Gross Profit

Cost of revenues includes cost of automotive sales and costs related to our development services.

Cost of automotive sales during the three months ended March 31, 2014 was $462.5 million, relatively flat when compared to $461.8 million for the three months ended March 31, 2013 in spite of the increase in automotive sales in 2014.

Cost of automotive sales 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 automotive sales 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.

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In April 2013, we began offering a resale value guarantee to all customers who purchased a Model S in the United States and financed their vehicle and vehicle options through one of our specified commercial banking partners, and in October 2013, we introduced this program in Canada. Under the program, we capitalize the cost of Model S into operating lease vehicles and depreciate the respective operating lease vehicles less expected salvage value to cost of automotive sales on a straight-line basis, over the contractual term of the guarantee program. If a customer decides not to sell their vehicle back to us by the end of the resale value guarantee term, the remaining operating lease vehicle net book value is then recognized in automotive sales. As of March 31, 2014, we recorded $447.0 million in operating lease vehicles, net, related to Model S deliveries with the resale value guarantee. During the three months ended March 31, 2014, we recognized $14.5 million in cost of automotive sales related to operating lease vehicle depreciation under this program. Our warranty reserves do not include projected warranty costs associated with our resale value guarantee vehicles as such actual warranty costs are expensed as incurred. For the three months ended March 31, 2014, warranty costs incurred for our resale value guarantee vehicles were $1.2 million.

Gross profit during the three months ended March 31, 2014 was $155.1 million, an increase from $96.3 million during the three months ended March 31, 2013. The increase in gross profit was primarily due to higher vehicle production volume, manufacturing and supply chain efficiencies as well as component cost reductions.

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 during the three months ended March 31, 2014 were $81.5 million, an increase from $54.9 million during the three months ended March 31, 2013. R&D expenses in the first quarter of 2013 included activities to homologate Model S for markets outside of North America as well as ongoing research and development activities related to Model S, supercharging and other programs. Higher R&D expenses in the first quarter of 2014 reflected our accelerated engineering work on Model X and continuing efforts to adapt Model S for international markets. The $26.6 million increase in R&D expenses consisted primarily of a $7.3 million increase in costs related to Model X and right-hand drive Model S engineering, design and testing activities, a $6.8 million increase in stock-based compensation expense related to a larger number of outstanding equity awards due to additional headcount and generally an increasing common stock valuation applied to new grants, a $6.7 million increase in employee compensation expenses, a $4.5 million increase in expensed materials primarily to support our Model X and right-hand drive Model S, and office, information technology and facilities-related costs to support the growth of our business.

Selling, General and Administrative Expenses

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

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SG&A expenses during the three months ended March 31, 2014 were $117.6 million, an increase from $47.0 million during the three months ended March 31, 2013. 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 $70.6 million increase in our SG&A expenses consisted primarily of a $33.0 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, a $16.2 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 $14.5 million increase in stock-based compensation expense related to a larger number of outstanding equity awards due to additional headcount and generally an increasing common stock valuation applied to new grants and a $6.1 million increase in professional and outside services costs.

Interest Expense

Interest expense during the three months ended March 31, 2014 was $11.9 million, an increase from $0.1 million during the three months ended March 31, 2013. Interest expense incurred during the first quarter of 2013 related primarily to our loans under the Department of Energy loan facility (DOE Loan Facility), while interest expense for the first quarter of 2014 related primarily to our convertible senior notes due 2018, 2019 and 2021. We capitalize interest to assets under construction during the period of significant asset construction. During the three months ended March 31, 2014 and 2013, we capitalized $1.2 million and $1.5 million of interest expense to construction in progress, respectively.

In March 2014, we issued $800.0 million aggregate principal amount of 0.25% convertible senior notes due 2019 (2019 Notes) and $1.20 billion aggregate principal amount of 1.25% convertible senior notes due 2021 (2021 Notes) in a public offering. We incurred approximately $31.1 million of debt issuance costs in connection with these notes, which we initially recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual terms of the notes. The interest rates are fixed at 0.25% and 1.25% per annum for the 2019 Notes and 2021 Notes, respectively, and are payable semi-annually in arrears on March 1 and September 1 of each year, commencing on September 1, 2014. During the three months ended March 31, 2014, we recognized $0.2 million of interest expense related to the amortization of debt issuance costs and $1.2 million of accrued coupon interest expense related to these notes.

In accordance with accounting guidance on embedded conversion features, we valued and bifurcated the conversion option associated with these notes from the respective host debt instrument and initially recorded the conversion option of $163.6 million for the 2019 Notes and $321.2 million for the 2021 Notes in stockholders equity. The resulting debt discounts on the 2019 Notes and 2021 Notes are being amortized to interest expense at an effective interest rate of 4.89% and 5.96%, respectively, over the contractual terms of these notes. During the three months ended March 31, 2014, we recognized $4.7 million of interest expense related to the amortization of these debt discounts.

In May 2013, we issued $660.0 million aggregate principal amount of convertible senior notes due 2018 (2018 Notes) in a public offering. We incurred $12.0 million of debt issuance costs in connection with the issuance of the 2018 Notes which we recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual term of the 2018 Notes. Under the terms of the 2018 Notes, 1.50% coupon interest per annum on the principal amount of the notes is payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2013. During the three months ended March 31, 2014, we recognized $2.9 million of interest expense related to the amortization of debt issuance costs and accrued coupon interest.

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Similar to the 2019 and 2021 Notes, we valued and bifurcated the conversion option associated with the 2018 Notes from the host debt instrument and initially recorded the conversion option of $82.8 million in stockholders equity. The resulting debt discount on the 2018 Notes is being amortized to interest expense at an effective interest rate of 4.29% over the contractual term of the 2018 Notes. During the three months ended March 31, 2014, we recognized $3.8 million of interest expense related to the amortization of the debt discount.

Other Income, Net

Other income, net, consists primarily of the change in the fair value of our DOE common stock warrant liability and 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. Prior to the expiration of the DOE warrant in May 2013, the DOE warrant had been carried at its estimated fair value with changes in its fair value reflected in other income, net.

Other income, net, during the three months ended March 31, 2014 was $6.7 million, a decrease from $17.1 million during the three months ended March 31, 2013. In March 2013, we entered into a fourth amendment to the DOE Loan Facility which, among other things, accelerated the maturity date of our DOE loans to December 15, 2017; therefore, the DOE warrant was no longer expected to vest. We recorded the reduction in fair value of our DOE common stock warrant liability of $10.7 million in other income, net, during the three months ended March 31, 2013. Other income, net, during the three months ended March 31, 2014 and 2013 included $6.7 million and $6.4 million of favorable foreign currency exchange impact from our foreign currency-denominated assets and liabilities.

Provision for Income Taxes

Our provision for income taxes during the three months ended March 31, 2014 was $0.8 million, compared to $0.2 million during the three months ended March 31, 2013. The increase during the three months ended March 31, 2014 was due primarily to the increase in taxable income in our international jurisdictions as we continued to increase our Model S deliveries in Europe, following the commencement of European Model S deliveries in August 2013.

Liquidity and Capital Resources

Since inception and through March 31, 2014, we had accumulated net operating losses of $1.19 billion and have used $406.1 million of cash in operations. As of March 31, 2014, we had $2.58 billion in principal sources of liquidity available from our cash and cash equivalents and short-term marketable securities, including $1.83 billion of money market funds and $189.1 million in short-term marketable securities.

Other sources of cash include cash from our deliveries of 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. We expect that our current sources of liquidity, including cash and cash equivalents and short-term marketable securities, together with our current projections of cash flow from operating activities, will continue to provide us with adequate liquidity based on our current plans. These capital sources will enable us to fund our ongoing operations, continue research and development projects, including those for our planned Model X crossover and certain future products, such as our third generation vehicle, establish and expand our stores, service centers and Supercharger network and to make the investments in tooling and manufacturing capital required to introduce Model X and to continue to ramp up production of Model S as well as make investments in the Tesla Gigafactory. We may seek additional capital resources to partially fund certain long-term growth initiatives.

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As of May 1, 2014, we had 101 Supercharger stations open in North America, Europe and China. We expect to continue making investments in the Supercharger network in 2014, including in China.

If market conditions are favorable, we may evaluate alternatives to opportunistically pursue liquidity options. Also, should prevailing economic conditions and/or financial, business or other factors adversely affect the estimates of our future cash requirements, we could be required to fund our cash requirements through additional or alternative sources of financing. We cannot be certain that additional funds will be available to us on favorable terms when required, or at all.

We currently anticipate making aggregate capital expenditures of between $650 million and $850 million during the year ending December 31, 2014.

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

In March 2014, we issued $800.0 million aggregate principal amount of 0.25% convertible senior notes due 2019 (2019 Notes) and $1.20 billion aggregate principal amount of 1.25% convertible senior notes due 2021 (2021 Notes) in a public offering. The net proceeds from the offering, after deducting transaction costs, were approximately $787.6 million from the 2019 Notes and $1.18 billion from the 2021 Notes, respectively. We incurred $12.4 million and $18.7 million, respectively, of debt issuance costs in connection with these 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 for the 2019 and 2021 Notes, respectively, 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, we entered into convertible note hedge transactions whereby we have the option to purchase (subject to adjustment for certain specified events) a total of approximately 5.6 million shares of our common stock at a price of $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 (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 the 2021 Notes. We received $338.4 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 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 the 2019 Notes and from $359.87 to $560.64 in the case of warrants relating to the 2021 Notes.

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

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 (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 the issuance of the 2018 Notes which we have recorded in other assets and are amortizing to interest expense using the effective interest method over the contractual term of the 2018 Notes. The interest under the 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.

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During the first quarter of 2014, 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 the 2018 Notes may convert their notes during the second quarter of 2014. As such, we reclassified the $589.9 million carrying value of our 2018 Notes to current liabilities and reclassified $69.9 million, representing the difference between the aggregate principal of our 2018 Notes of $659.8 million and the carrying value of the notes, from additional paid-in capital to mezzanine equity on our condensed consolidated balance sheet as of March 31, 2014. Similarly, debt issuance costs previously recorded in other assets were reclassified to other current assets as of March 31, 2014. Should the closing price conditions be met in the second quarter of 2014 or a future quarter, the 2018 Notes will be convertible at their holders option during the immediately following quarters.

Furthermore, under current market conditions, we expect that almost none of the 2018 Notes will be converted in the short term.

In connection with the offering of the 2018 Notes, we entered into convertible note hedge transactions whereby we have the option to purchase (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 (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.

For more information on the 2018 Notes, 2019 Notes and 2021 Notes, see Notes 6 and 11 to our Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q under Item 1. Financial Statements.

Customer Deposits

Customer deposits consist of payments that allow potential customers to place an order for the future purchase of a Model S or Model X. These amounts are recorded as current liabilities until the vehicle is delivered. We require full payment of the purchase price of the vehicle only upon delivery of the vehicle to the customer. Amounts received by us as customer deposits are generally not restricted as to their use by us. Upon delivery of the vehicle, the related customer deposits are applied against the customer s total purchase price for the vehicle and recognized in automotive sales as part of the respective vehicle sale. Customer deposits related to Model X still represent fully refundable reservations. As of March 31, 2014, we held customer deposits of $198.0 million.

Summary of Cash Flows

	Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Net cash provided by operating activities	$ 60,640	$ 64,079
Net cash used in investing activities	(329,180)	(55,236)
Net cash provided by financing activities	1,816,559	3,684

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.

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Net cash provided by operating activities was $60.6 million during the three months ended March 31, 2014 net of adjustments for non-cash items such as depreciation and amortization of $44.3 million, $37.0 million related to stock-based compensation expense, $8.5 million related to the amortization of debt discount on our convertible senior notes and inventory write-downs of $1.6 million. Significant operating cash inflows were comprised primarily of automotive sales of $618.8 million, a $117.3 million net increase in deferred revenue, resale value guarantee and other long-term liabilities primarily associated with Model S deliveries with the resale value guarantee, a $35.0 million net increase in customer deposits and $1.7 million of development services revenue, partially offset by a $23.8 million increase in accounts receivable primarily related to receivables from our financing partners. Significant operating cash outflows for the three months ended March 31, 2014 were primarily related to $465.4 million of cost of revenues, $199.1 million of operating expenses, a $197.7 million increase in inventory and operating lease vehicles and an $11.4 million increase in prepaid expenses and other current assets, partially offset by a $97.8 million increase in accounts payable and accrued liabilities primarily due to the timing of vendor payments.

Net cash provided by operating activities was $64.1 million during the three months ended March 31, 2013 net of adjustments for non-cash items such as depreciation and amortization of $17.9 million, non-cash charges of $14.9 million related to stock-based compensation expense, and inventory write-downs of $1.5 million, partially offset by other income associated with the reduction in fair value of the DOE common stock warrant liability of $10.7 million. Significant operating cash inflows were comprised primarily of automotive sales of $555.2 million, an $18.2 million decrease in inventory and operating lease vehicles, $6.6 million of development services revenue and a $4.1 million net increase in deferred revenue associated with various vehicle service plans introduced in March 2013. Significant operating cash outflows for the three months ended March 31, 2013 were primarily related to $465.5 million of cost of revenues, $101.9 million of operating expenses, a $26.6 million decrease in accounts payable and accrued liabilities primarily due to the timing of vendor payments, an $8.1 million net decrease in customer deposits as a result of the sales of Model S and a $2.6 million increase in prepaid expenses and other current assets.

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 and our stores, service and Supercharger network infrastructure, as well as restricted cash that we were required to maintain in relation to facility lease agreements, equipment financing, certain vendor credit policies and our DOE Loan Facility.

Net cash used in investing activities was $329.2 million during the three months ended March 31, 2014 primarily related to a $189.1 million purchase of short-term marketable securities and $141.4 million in purchases of capital equipment and tooling, partially offset by a $1.3 million net decrease in restricted cash.

Net cash used in investing activities was $55.2 million during the three months ended March 31, 2013 primarily related to $57.7 million in purchases of capital equipment and tooling, partially offset by a $2.6 million net decrease in restricted cash.

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Cash Flows from Financing Activities

Net cash provided by financing activities was $1.82 billion during the three months ended March 31, 2014 and was comprised primarily of the $2.00 billion aggregate issuance of 2019 and 2021 Notes, $338.4 million from the sale of warrants in March 2014 in connection with the issuance of these notes, and $35.7 million received from the exercise of common stock options by employees and the purchase of common stock under our employee stock purchase plan, partially offset by $524.7 million related to the purchase of convertible note hedges in March 2014 in connection with the issuance of these notes, $30.3 million of issuance costs and $2.3 million related to principal payments on our capital leases.

Net cash provided by financing activities was $3.7 million during the three months ended March 31, 2013 and was comprised primarily of $17.9 million received from the exercise of common stock options by employees and the purchase of common stock under our employee stock purchase plan, partially offset by $12.7 million related to our planned quarterly repayment of loan principal under the DOE Loan Facility, and $1.5 million related to principal payments on our capital leases.

Contractual Obligations

During the first quarter of 2014, certain conditions with respect to the closing prices of our common stock in accordance with the terms of our 2018 Notes were met and therefore, holders of the 2018 Notes may convert their notes during the second quarter of 2014. As such, we reclassified the $589.9 million carrying value of our 2018 Notes to current liabilities on our condensed consolidated balance sheet as of March 31, 2014. Should such closing price conditions be met in the second quarter of 2014 or a future quarter, the 2018 Notes will be convertible by their holders during the immediately following quarter. Similarly, if certain conditions are met with respect to our 2019 and 2021 Notes in future quarters, the 2019 and 2021 Notes will be convertible by their holders during the immediately following quarter.

The following table sets forth, as of March 31, 2014, our cash obligations related to our 2018, 2019 and 2021 Notes that will affect our future liquidity (in thousands) for the following periods:

		Year Ended December 31,					
	Total	**2014**	**2015**	**2016**	**2017**	**2018**	**2019 and thereafter**
2018 Notes	$ 662,974	$ 662,974	$	$	$	$	$
2019 Notes	809,986	986	2,000	2,000	2,000	2,000	801,000
2021 Notes	1,304,897	7,397	15,000	15,000	15,000	15,000	1,237,500
Total	$ 2,777,857	$ 671,357	$ 17,000	$ 17,000	$ 17,000	$ 17,000	$ 2,038,500

There have been no other material changes from the future contractual obligations disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013.

Off-Balance Sheet Arrangements

During the periods presented, we did not have any 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.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

Our revenues and costs denominated in foreign currencies are not completely matched. We commenced deliveries of Model S in June 2012 to customers in North America and to European customers in August 2013. Through March 31, 2014, a majority of our revenues have been denominated in U.S. dollars, with a growing exposure to euro and Norwegian krona; however, a portion of our costs and expenses during the three months ended March 31, 2014 was denominated in foreign currencies, including the Japanese yen, euro and British pound. 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. We commenced Model S deliveries in China in April 2014 and plan to commence Model S deliveries in certain other countries in Asia in 2014. As we continue to launch Model S overseas, we may have greater revenues than costs denominated in other currencies, in which case a strengthening of the dollar against such currencies would tend to reduce our revenues as measured in U.S. dollars.

As a result of a favorable foreign currency exchange impact from foreign currency-denominated assets and liabilities, especially related to the Japanese yen, we recorded gains of $6.7 million on foreign exchange transactions in other income, net, for the three months ended March 31, 2014.

Interest Rate Risk

We had cash and cash equivalents and short-term marketable securities totaling $2.58 billion as of March 31, 2014. A portion of our cash and cash equivalents was invested in money market funds. Our cash and cash equivalents and short-term marketable securities 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, 2014, we had $2.66 billion aggregate principal amount of convertible senior notes outstanding and capital lease obligations of $21.0 million, all of which are fixed rate instruments. Therefore, our results of operations are not subject to fluctuations in interest rates.

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, 2014. 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, 2014, 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.

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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.

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 current complaint, which makes claims against Tesla and its CEO, Elon Musk, seeks 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 is brought on behalf of a putative class consisting of certain persons who purchased Tesla s securities between August 19, 2013 and November 17, 2013. We believe this lawsuit is without merit and intend to defend against it vigorously.

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 be unable to increase production and deliveries of Model S in line with our plans, both of which could harm our business and prospects.

We began manufacturing and delivering Model S in June 2012. We have limited experience to date in high volume manufacturing of our electric vehicles as we only recently reached volume production of Model S for the U.S. market and have just recently begun production of Model S for the European and Asian markets. Our ability to further ramp-up high volume Model S production will depend upon a number of factors, including our suppliers ability to deliver quality parts to us in a timely manner, our

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ability to use our manufacturing processes as planned for higher volume production while maintaining our desired quality levels and efficiently making design changes to ensure consistently high quality. The Model S is an all new vehicle which we are producing with new employees using new equipment and therefore our production processes are still maturing. 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 levels 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 maintaining our production level of Model S could materially damage our brand, business, prospects, financial condition and operating results.

We have limited experience in the high volume delivery of our Model S vehicles. We have gradually ramped production of Model S and we intend to continue to increase the production rate significantly over the next several quarters. Furthermore, we have only recently commenced deliveries in Europe and Asia and have not delivered Model S vehicles outside of North America and Europe in volume; thus we may face difficulties meeting our delivery and growth plans in Asia and other right hand drive markets later this year, which may impact our ability to achieve our worldwide delivery goals. If we are unable to increase the production rate and ramp up deliveries globally to match our production rate of Model S, this could result in negative publicity, damage our brand and have a material adverse effect on our 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 Model S has a number of new and unique design features, such as a 17 inch display screen, newly designed retractable exterior door handles and a panoramic roof, each of which poses unique manufacturing challenges. Model S production and deliveries will continue to require significant resources and we may experience unexpected delays or difficulties that could harm our ability to maintain full manufacturing capacity for Model S, 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.

Our ability to grow volume production and deliveries for Model S 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 Model S 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 Model S in a timely manner that meets our production plan and allows for high quality vehicles;

- that we will be able to commence and execute the launch and ramp of Model S throughout Asia pursuant to our current timeline;

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;

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that the equipment or tooling which we have purchased or which we select 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 testing of Model S, are ongoing and any negative results from such testing could cause production or delivery delays, cost increases or lower quality of our Model S vehicles.

We are dependent on our suppliers, the vast 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. 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 supply chain exposes us to multiple potential sources of delivery failure or component shortages for Model S, as well as for our powertrain component sales activities. For example, earthquakes similar to the one that occurred in Japan in March 2011 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 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 certain suppliers 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

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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 Model S 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 performance electric vehicles such as Model S 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 our third generation electric vehicle, which we refer as Gen III, and other programs we may introduce, without securing additional suppliers or other sources for cells. If we cannot secure such additional suppliers or sources, we could experience production delays, which could have a material adverse effect on our financial condition and operating results.

If we are unable to adequately reduce the manufacturing costs of Model S 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 fallen. While we expect further cost reduction efforts undertaken by both us and our suppliers will continue to reduce costs during the next several quarters, there is no guarantee that we will be able to achieve planned cost reductions from our various cost savings initiatives, and the failure to achieve such savings would negatively affect our ability to reach our gross margin and profitability goals.

We incur significant costs related to procuring the raw materials required to manufacture our high-performance electric cars, 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.

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Additionally, in the future 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. 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.

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

Our long-term success is dependent on market acceptance of the Model S sedan 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 enter into 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. For example, we have experienced greater initial success in selling Model S vehicles in Norway than in the rest of Europe.

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 the Model X crossover, will become commercially viable. To date, we have publicly revealed only an early prototype of the Model X. To the extent that we are not able to build Model X to the expectations created by the early prototype and our announced specifications, customers may cancel their reservations, our future sales could be harmed and investors may lose confidence in us.

In addition, we have also announced our intent to develop Gen III 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 our Gen III vehicle for the mass market and thus we will need a high-volume supply of lithium-ion cells at reasonable prices. While our plan is to attempt to produce lithium-ion cells and finished battery packs for our Gen III vehicles at a new Tesla Gigafactory, our plans for such production are at an early stage and we have not yet finalized a site for the construction of the Tesla Gigafactory nor completed a factory design. In addition, we have no experience in the production of lithium-ion cells, and accordingly we intend to engage partners with significant experience in cell production and to date we have not formalized such partnerships. In addition, the cost of building and operating the Tesla Gigafactory could exceed our current expectations and the Tesla Gigafactory may take longer to bring online than we anticipate. If we are unable to build the Tesla Gigafactory in a timely manner to produce high volumes of quality lithium-ion cells for Gen III at reasonable prices and thus are forced to rely on others to supply us with lithium-ion cells for Gen III, our ability to produce our Gen III vehicles at a price that allows us to sell Gen III profitably could be constrained. Finally, we have very limited experience allocating our available resources among the design and production of multiple models of vehicles, such as Model S (including any variants we may introduce such as right-hand drive), Model X and Gen III. 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

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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, historically, automobile customers have come to expect new and improved vehicle models to be introduced frequently. In order to meet these expectations, we may in the future be required to introduce on a regular basis new vehicle models as well as enhanced versions of existing vehicle models. As technologies change in the future for automobiles in general and performance electric vehicles specifically, we will be expected to upgrade or adapt our vehicles and introduce new models in order to continue to provide vehicles with the latest technology and meet customer expectations. To date, we have limited experience simultaneously designing, testing, manufacturing, upgrading, adapting and selling our electric vehicles.

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.

Other 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, especially if adverse events or accidents occur that are linked to the quality or safety of electric vehicles, such as those related to the Chevrolet Volt battery pack fires or recent incidents involving Model S;

- perceptions about vehicle safety in general, in particular safety issues that may be attributed to the use of advanced technology, including vehicle electronics and regenerative braking systems;

- negative perceptions of electric vehicles, such as that they are more expensive than non-electric vehicles and are only affordable with government subsidies;

- the limited range over which electric vehicles may be driven on a single battery charge and the effects of weather on this range;

- the decline of an electric vehicle s range resulting from deterioration over time in the battery s ability to hold a charge;

- varied calculations for driving ranges achievable by EVs, which is inherently difficult given numerous factors affecting battery range;

our capability to rapidly swap out the Model S battery pack and our plans to develop specialized public facilities to perform such swapping;

concerns about electric grid capacity and reliability, which could derail our past and present efforts to promote electric vehicles as a practical solution to vehicles which require gasoline;

concerns by potential customers that if their battery pack is not charged properly, it may become unusable and may need to be replaced;

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- 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;
- consumers desire and ability to purchase a luxury automobile or one that is perceived as exclusive;
- the environmental consciousness of consumers;
- volatility in the cost of oil and gasoline;
- consumers perceptions of the dependency of the United States on oil from unstable or hostile countries;
- 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;
- access to charging stations, standardization of electric vehicle charging systems and consumers perceptions about convenience and cost to charge an electric vehicle; and
- perceptions about and the actual cost of alternative fuel.

In addition, reports have suggested the potential for extreme temperatures to affect the range or performance of electric vehicles, and based on our own internal testing, we estimate that our vehicles may experience a material reduction in range when operated in extremely cold temperatures. To the extent customers have concerns about such reductions or third party reports which suggest reductions in range greater than our estimates gain widespread acceptance, our ability to market and sell our vehicles, particularly in colder climates, may be adversely impacted.

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 2014 with an effective date that could be implemented by September 1, 2015. 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;

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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 for our performance electric vehicles. Because our high-performance 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 performance 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.

Our limited experience with our product offerings makes evaluating our business and future prospects difficult.

We were formed in July 2003 and began delivering our first vehicle, the Tesla Roadster, in early 2008. We only began producing our second electric vehicle, Model S, in June 2012 and our production processes continue to mature, especially those production processes related to our Model S deliveries in Europe and Asia, such as for right-hand drive Model S. Model S became the primary contributor to our revenue starting in the fourth quarter of 2012. We intend in the longer term to derive substantial revenues from the sales of Model S, Model X, Gen III and future electric vehicles. Further, we have only produced an early prototype of the Model X crossover and have only recently started production of Model S for Asia. Our vehicle design and our engineering, manufacturing and component supply plans for Model S may continue to be adjusted.

In addition, our powertrain component sales, development services revenue and powertrain research and development compensation have been almost entirely generated under arrangements with Daimler AG (Daimler) and Toyota Motor Corporation (Toyota), and there is no guarantee that we will be able to enter into future agreements with these or other companies on favorable terms or manufacture and deliver powertrain components in a manner that is cost-effective to us.

Finally, it is difficult to predict our future revenues and appropriately budget for our expenses, and we have limited insight into trends that may emerge and affect our business. In the event that actual results differ from our estimates or we adjust our estimates in future periods, our operating results and financial position could be materially affected.

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 or produce 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:

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

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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 the Tesla Roadster and Model S and the battery packs that we sell to Toyota and Daimler makes use of lithium-ion cells. We also currently intend to make use of lithium-ion cells inany future vehicles we may produce. 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 Tesla Roadsters and Model S sedans to customers and have limited field experience with our vehicles, especially Model S. We have also only delivered a limited number of battery packs to Toyota and Daimler. Accordingly, there can be no assurance that a field or testing failure of our Model S or other battery packs that we produce will not occur, which could damage the vehicle or lead to personal injury or death and may subject us to lawsuits. We may have to recall our vehicles or participate in a recall of a vehicle that contains our battery packs, and redesign our battery packs, 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 the Tesla Roadster or Model S, 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.

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If our vehicles or vehicles that contain our powertrains fail to perform as expected, or if we suffer product recalls for Model S, 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 upcoming 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 use a substantial amount of software code 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 are attempting to remedy the Model S issues experienced by our customers in a rapid manner by expanding our service centers and personnel, such efforts may not be timely or up to the satisfaction of our customers.

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.

We have experienced product recalls, including in May 2009, October 2010, and June 2013, all of which were unrelated to our electric powertrain. In May 2009, we initiated a product recall after we determined that a condition caused by insufficient torquing 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, which is the partially assembled Tesla Roadster that does not contain our electric powertrain. In October 2010, we initiated a product recall for some of our Tesla Roadsters 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 a 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 the collapse of the rear seat back during a crash. Although the cost of this recall was not material, and limited to a small number of total Model S s produced, we may experience additional recalls in the future, which could adversely affect our brand in our target markets, as well as our business, prospects and results of operations.

Moreover, 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. We further announced that we will provide upgraded NEMA 14-50 adapters to our customers as an additional safeguard. If such measures do not adequately address the underlying concerns, however, or if the public perceives such steps to be an indication of safety concerns about the vehicles, our business, prospects and results of operations could be harmed.

Our electric vehicles may not perform consistent with customers expectations or consistent with other vehicles currently available. For example, our electric vehicles may not have the durability or longevity of current vehicles, and may not be as easy to repair as other vehicles currently on the market. Additionally, while Model S recently achieved an overall five star safety rating by NHTSA, such rating is not a guarantee of safe product design or that any individual vehicle will be free of any defect or failure.

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Any product defects or any other failure of our performance electric 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.

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, 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 Model S vehicles, increase our Model S production rate, maintain strong demand for Model S in North America, and grow demand for Model S abroad in Europe and Asia. Failure to do one or more of these things could prevent us from achieving sustained, long-term profitability.

The introduction of our resale value guarantee 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 of these cars are below the guaranteed value.

In 2013 we began offering a resale value guarantee to all customers who purchased a Model S in the United States and Canada and financed 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 following delivery 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. During the first quarter of 2014, we provided the resale value guarantee to an additional 1,181 Model S deliveries and we expect the penetration rate to increase with the expansion of our financing programs in additional states in the United States and in international markets. 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.

Furthermore, while we do not assume any credit risk related to the customer, 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 in particular, and electric vehicles in general, 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.

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;

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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 Model S 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 electric 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 Model S prices in response to increased raw material costs could be viewed negatively by our customers, result in cancellations of Model S 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, particularly Model S.

Occasionally, third parties evaluate or publish stories regarding our vehicles. For example, in 2013 the New York Times published a review of the Model S and our Supercharger network on a route from Washington, D.C. to Boston. Despite instructions to the contrary, the reporter did not follow all recommendations, including failing to fully recharge the vehicle at one of the two Supercharger locations along the route. As a result, the Model S failed to complete the journey under its own power and the NY Times reporter published a negative review. While there were subsequent corrections by the NY Times Public Editor regarding the reporter s failure to conform to all Tesla recommendations, as well as problems with precision and judgment, the original story still created a negative public perception about Model S, its capabilities and the Supercharger network. Such comments can and did negatively impact sales in that region. In addition, citation to the original NY Times article has continued long after its publication. To the extent that these comments 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 performance electric vehicles in company-owned Tesla stores and over the internet. This model of vehicle distribution is relatively new and unproven, especially in the

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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. For example, we will not be able to utilize long-established sales channels developed through a franchise system to increase our sales volume, which may harm our business, prospects, financial condition and operating results. Moreover, we will be competing with companies with well-established distribution channels.

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 performance 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, which are typically located in high profile retail centers, 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 Model S 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, including Model S. 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 inhibit or prevent commercialization of other future vehicle candidates which would have material adverse effect on our brand, business, prospects and operating results. We self-insure against the risk of product liability claims. 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 in the U.S. and abroad necessitates continued development, maintenance and improvement of our information technology systems, which include product data

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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 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 processes, manufacturing execution, finance, supply chain and sales and service processes that 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 fully or effectively implemented on a timely basis, if at all, or maintained. If we do not successfully implement, improve or maintain these systems, our operations may be disrupted and our operating results could be harmed. In addition, these systems or their functionality may not operate as we expect them to, and we may be required to expend significant resources to correct problems or find alternative sources for performing these functions.

We may not realize the benefits of our Supercharger network, which could harm our business, brand and operating results.

We have only recently started to deploy Tesla Superchargers in the United States, Europe and Asia. Tesla Superchargers are a network of charging stations designed to provide fast-charge capability to owners of Model S vehicles with the Supercharging option. We intend to expand the Tesla Supercharger network throughout the U.S., Canada, Europe and Asia, but we may be unable to do so due to a number of factors, including the inability to secure, or delays in securing, suitable locations and permits, problems negotiating leases with landowners or obtaining required permits for such locations, difficulties in interfacing with the infrastructures of various utility companies and greater than expected costs and difficulties of installing, maintaining and operating the network.

We may also be unable to expand the Supercharger network as fast as we intend or as the public expects, or to place the charging stations in places our customers believe to be optimal. Furthermore, even where Superchargers exist, the increasing number of Model S vehicles may oversaturate the available charging bays at such Superchargers, leading to increased wait times and dissatisfaction for customers. In addition, as we have announced that we will not be charging our customers to access this network in addition to what they have already paid for their vehicles, any significant unexpected costs that we encounter will entirely be borne by us and may harm our operating results. Although our Supercharger network is intended to address customer concerns regarding long-distance travel, this network may not result in increased reservations or sales of Model S or future vehicles. If our Supercharger network is not expanded as currently planned or as quickly as planned, we may not realize the benefits of our Supercharger network and our business and operating results could be materially affected.

If we are unable to design, develop, market and sell new electric vehicles that address additional market opportunities, our business, prospects and operating results will suffer.

We may not be able to successfully develop new electric vehicles, address new market segments or develop a significantly broader customer base. In 2012, we publicly revealed an early prototype of the Model X crossover as the first vehicle we intend to develop by leveraging the Model S platform. We have also announced our intent to develop Gen III based on a smaller platform than the Model S which we expect to produce at the Tesla Factory after the introduction of Model X. The Gen III is currently planned to be a lower cost, smaller sedan designed for the mass market. Therefore, we intend to the manufacture Gen III in significantly higher volumes than Model S and there can be no assurance we can successfully scale our business accordingly. In addition, we have not yet finalized the design, engineering or component sourcing plans for Gen III and there are no assurances that we will be able to bring this

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vehicle to market at the price point and in the volume that we currently intend, if at all. The market for vehicles in the price range we expect for Gen III is much more competitive than for Models S and X, and therefore margins are likely to be lower compared to Model S margins. Our efforts to manufacture and sell a sufficiently profitable Gen III may not be as successful, and therefore our business, prospects and operating results may suffer. Our failure to address additional market opportunities would harm our business, prospects, financial condition and operating results.

We may experience significant delays in the design, manufacture and launch of Model X which could harm our business and prospects.

We expect to have Model X prototypes with production design on the road by the end of 2014 and begin volume deliveries to customers in the spring of 2015. Any significant delay in the design, manufacture and launch of Model X could materially damage our brand, business, prospects, financial condition and operating results. Automobile manufacturers often experience delays in the design, manufacture and commercial release of new vehicle models. We experienced significant delays in launching the Tesla Roadster, which resulted in additional costs and adverse publicity for our business. In 2012, we also experienced delays in the ramp of Model S. We may experience further delays in launching Model X which may result in cost overruns and adverse publicity. We are in the design and development stages of Model X. Furthermore, we have not yet evaluated, qualified or selected all of our suppliers for the planned production of Model X. We may not be able to engage suppliers for the components in a timely manner, at an acceptable price or in the necessary quantities. 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. In addition, we have limited resources and, to the extent that such engineering and manufacturing resources are devoted to Model S or are otherwise engaged such as in development services activities, we may have difficulty designing and delivering Model X in a timely manner. If we are not able to manufacture and deliver Model X in a timely manner and consistent with our production timeline, budget and cost projections, our business, prospects, operating results and financial condition will be negatively impacted and our ability to grow our business will be harmed.

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. Mitsubishi has been selling its fully electric iMiEV in Japan since April 2010 and Nissan has been selling the fully electric Nissan Leaf since December 2010. In the past few years, Ford has introduced the fully electric Ford Focus, Renault has introduced the fully electric Renault Fluence, and Fiat has introduced the Fiat 500e, among others. Moreover, BMW intends to introduce the fully electric BMW i3 in the second quarter of 2014 and Volkswagen plans to introduce its fully electric e-Golf in 2014. 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.

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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 performance 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. Our competitors may be in a stronger position to respond quickly to new technologies and may be able to design, develop, market and sell their products more effectively. Additionally, we have not in the past, and do not currently, offer customary discounts on our vehicles like most of our competitors 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. Factors affecting competition include product quality and features, innovation and development time, pricing, reliability, safety, fuel economy, customer service and financing terms. Increased competition may lead to lower vehicle unit sales and increased inventory, which may result in a further downward price pressure and adversely affect our business, financial condition, operating results and prospects. Our ability to successfully compete in our industry will be fundamental to our future success in existing and new markets and our market share. There can be no assurances that we will be able to compete successfully in our markets. If our competitors introduce new cars or services that compete with or surpass the quality, price or performance of our cars or services, we may be unable to satisfy existing customers or attract new customers at the prices and levels that would allow us to generate attractive rates of return on our investment. Increased competition could result in price reductions and 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 highly 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. For example, according to automotive industry sources, sales of passenger vehicles in North America during the fourth quarter of 2008 were over 30% lower than those during the same period in the prior year. 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 new automobile manufacturer and 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 electric vehicles, such as Europe and Asia, will impact our business, prospects and operating results as well. Demand for our electric 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.

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

Our operating results may vary significantly from period-to-period due to many factors, including seasonal factors that may have an effect on the demand for our electric vehicles. Demand for new cars in the automobile industry typically declines over the winter season, while sales are generally higher during the spring and summer months. Sales of the Tesla Roadster fluctuated on a seasonal basis with increased sales during the spring and summer months in our second and third fiscal quarters relative to our fourth and first fiscal quarters. We note that, in general, automotive sales tend to decline over the winter season and we anticipate that our sales of Model S and future models may have similar seasonality. However, our limited operating history makes it difficult for us to judge the exact nature or extent of the seasonality of our business. Also, any unusually severe weather conditions in some markets may impact demand for our vehicles. 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.

In addition, 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 Tesla 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 common stock could fall substantially, either suddenly or over time.

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. If we are required to curtail our expansion plans in the future as we have done in the past, this may result in negative perceptions regarding our long-term business prospects and may lead to cancellations of Model S or Model X orders and reservations.

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;

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unfamiliarity with or uncertainty about Model X;

uncertainty about the long-term marketplace 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 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.

If we are unable to successfully address the service requirements of our existing and future customers and meet customer expectations regarding service, our business and prospects will be materially and adversely affected. We have limited experience servicing our vehicles, especially in Europe and 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 Model S vehicles could be impaired.

We service our performance electric vehicles through our company-owned Tesla service centers, certain of our stores, and through our mobile service technicians known as the Tesla Rangers. However, certain service centers have been open for short periods, such as those outside of the United States, and to date we have only limited experience servicing our performance vehicles at these locations. 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 performance electric vehicles. We only implemented our Tesla Rangers program in October 2009 and have limited experience in deploying them to service our customers vehicles. There can be no assurance that these service arrangements or our limited experience servicing our vehicles will 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. In addition, a number of potential

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customers may choose not to purchase our vehicles because of the lack of a more widespread service network. 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. As our vehicles are placed in more locations, we may encounter negative reactions from our consumers who are frustrated that they cannot use local service stations to the same extent as they have with their conventional automobiles and this frustration may result in negative publicity and reduced sales, thereby harming our business and prospects.

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 shipping customers vehicles to our nearest Tesla store for service 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, Gen III 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, and we have very limited experience in these areas. Any problems associated with the Toyota RAV4 EV that uses a Tesla powertrain, the Mercedes-Benz B-Class EV that will use a Tesla powertrain or the Model X may 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.

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If our vehicle owners customize our vehicles or change the charging infrastructure with aftermarket products, the vehicle may not operate properly, which could harm our business.

Automobile enthusiasts may seek to hack our vehicles to modify its performance which could compromise vehicle safety systems. Also, we are aware of customers who have customized their vehicles with after-market parts that may compromise driver safety. For example, some customers have installed seats that elevate the driver such that airbag and other safety systems could be compromised. Other customers have changed wheels and tires, while others have installed large speaker systems that may impact the electrical systems of the vehicle. We have not tested, nor do we endorse, such changes or products. In addition, customer use of improper external cabling or unsafe charging outlets can expose our customers to injury from high voltage electricity. Such unauthorized modifications could reduce the safety of our vehicles and any injuries resulting from such modifications could result in adverse publicity which would negatively affect our brand and harm our business, prospects, financial condition and operating results.

Our deposits for Model S and reservations for Model X may be refundable to customers, and significant cancellations could harm our financial condition and business prospects.

As of March 31, 2014, we had $198.0 million in customer deposits, primarily for Model S and Model X. Model S deposits are generally subject to cancellation by the customer and fully refundable up until two weeks after placing the order. Model X reservations are fully refundable until such time when customers begin to configure their vehicles for delivery. We have experienced order cancellations for our vehicles and have had to refund the related deposits, and cancellations may continue.

Given the lead times that we have historically experienced between customer reservation and delivery on the Tesla Roadster and on Model S and that we expect to experience on Model X, there is risk that customers who have placed orders or made reservations for our vehicles may cancel such orders or reservations and not ultimately take delivery on vehicles due to potential changes in customer preferences, competitive developments and other factors.

Additionally, if we encounter delays in our ramp in Asia, or further delays in the introduction of Model X, a significant number of our customers could similarly cancel their orders or reservations and demand refunds of their deposits. As a result, no assurance can be made that orders and reservations will not be cancelled and will ultimately result in the final purchase, delivery, and sale of the vehicle.

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 electric 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

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metropolitan areas throughout North America, Europe and Asia, and we plan to open additional stores and service centers worldwide to support our ongoing worldwide Model S rollout. We have also rapidly expanded our Supercharger network in the U.S. and Europe. 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;

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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. These types of issues could also arise as we enter into other new markets, such as 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.

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. A portion of our costs and expenses have been and we anticipate will continue to be denominated in foreign currencies, including the Japanese yen, the euro, the Chinese yuan and the British pound. 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 (especially against the Japanese yen), 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. As we dramatically increase Model S deliveries overseas during 2014 and beyond, as well as begin delivering powertrain units to Daimler, we may have greater revenues than costs denominated in other currencies, in which case a strengthening of the dollar would tend to reduce our revenues as measured in U.S. dollars.

Developments in alternative technologies or improvements in the internal combustion engine may materially adversely affect the demand for our electric vehicles.

Significant developments in alternative technologies, such as advanced diesel, ethanol, fuel cells or compressed natural gas, or improvements in the fuel economy of the internal combustion engine, may materially and adversely affect our business and prospects in ways we do not currently anticipate. Any failure by us to develop new or enhanced technologies or processes, or to react to changes in existing technologies, could materially delay our development and introduction of new and enhanced electric vehicles, which could result in the loss of competitiveness of our vehicles, decreased revenue and a loss of market share to competitors.

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The unavailability, reduction or elimination of 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, elimination of government and economic incentives because of policy changes, the reduced need for such incentives due to the customer base of our electric vehicles, fiscal tightening or other reasons may result in the diminished competitiveness of the alternative fuel vehicle industry generally or our electric vehicles in particular. This could materially and adversely affect our growth as well as our business, prospects, financial condition and operating results, as our growth depends, in part, on the availability and amounts of government incentives. For example, we currently benefit from certain exemptions in the United States, such as from California state sales and use taxes. Also, government programs have been enacted in Europe favoring the purchase of electric vehicles, including 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, or the 25% value added tax or other purchase taxes that apply to the purchase of gas-powered vehicles. In the event that such government programs are reduced or eliminated, or the available benefits thereunder are exhausted earlier than anticipated, sales of electric vehicles, including our Model S, could be adversely affected.

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

Our strategic relationships third parties, such as Daimler, Toyota and Panasonic, pose various risks to us, including potential loss of access to important technology and vehicle parts , potential loss of business and adverse publicity to our brand image if there are defects or other problems discovered with the electric powertrain components that Daimler and Toyota have incorporated into their vehicles. In addition, these third parties may not perform as expected under our agreements with them, 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.

Any failure to execute on the Daimler B-Class EV program could hurt our reputation as well as our profitability on this program.

We are working with Daimler to develop a full electric powertrain for a Daimler Mercedes-Benz B-Class EV vehicle. We have substantially completed our development services under this B-Class program and commenced production of electric powertrains and battery packs for Daimler. The supply agreement for these products contemplates customary obligations of us such as timely deliveries, warranty and product defect obligations. If we fail to meet these obligations, or if we exceed our current cost projections for producing these products, our profitability on this program will suffer and this could have a negative impact on our operating results.

The operation of our vehicles is different from internal combustion engine vehicles and our customers may experience difficulty operating them properly, including difficulty transitioning between different methods of braking.

We have designed our vehicles to minimize inconvenience and inadvertent driver damage to the powertrain. In certain instances, these protections may cause the vehicle to behave in ways that are unfamiliar to drivers of internal combustion vehicles. For example, we employ regenerative braking to recharge the battery pack in most modes of vehicle operation. Our customers may become accustomed to using this regenerative braking instead of the wheel brakes to slow the vehicle. However, when the vehicle is at maximum charge, the regenerative braking is not needed and is not employed by the vehicle. Accordingly, our customers may have difficulty shifting between different methods of braking. In addition, we use safety mechanisms to limit motor torque when the powertrain system reaches elevated temperatures. In such instances, the vehicle s acceleration and speed will decrease. Finally, if the driver

permits the battery pack to substantially deplete its charge, the vehicle will progressively limit motor torque and speed to preserve the charge that remains. The vehicle will lose speed and ultimately coast to a stop. Despite several warnings about an imminent loss of charge, the ultimate loss of speed may be unexpected. There can be no assurance that our customers will operate the vehicles properly, especially in these situations. Any accidents resulting from such failure to operate our vehicles properly could harm our brand and reputation, result in adverse publicity and product liability claims, and have a material adverse effect on our business, prospects, financial condition and operating results. In addition, if consumers dislike these features, they may choose not to buy additional cars from us, which could also harm our business and prospects.

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

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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. For example, we do not currently manufacture battery cells, which makes us dependent upon other suppliers of battery cell technology for our battery packs.

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 and our operations, both in the United States and abroad, 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. Environmental and health and safety laws and regulations can be complex, and we expect that our

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business and operations will be affected by future amendments to such laws or other new environmental and health and safety laws which 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 fines and penalties. Capital and operating expenses needed to comply with environmental, health and safety laws and regulations can be significant, and violations may result in substantial fines and penalties, third party damages, suspension of production or a cessation of our operations.

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, including, but not limited to the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), which can impose liability for the full amount of remediation-related costs without regard to fault, for the investigation and cleanup of contaminated soil and ground water, for building contamination and impacts to human health and for damages to natural resources. The costs of complying with environmental laws and regulations and any claims concerning noncompliance, or liability with respect to contamination in the future, could have a material adverse effect on our financial condition or operating results. We may 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.

New United Motor Manufacturing, Inc. (NUMMI) has previously identified environmental conditions at the Tesla Factory which could affect soil and groundwater, and has undertaken efforts to address these conditions. Although we have been advised by NUMMI that it has documented and managed the environmental issues at the Fremont site, we cannot currently determine with certainty the total potential costs to remediate pre-existing contamination, and we may be exposed to material liability as a result of the existence of any environmental contamination at the Fremont site.

As the owner of the Fremont site, we may be responsible under federal and state laws and regulations for the entire investigation and remediation of any environmental contamination at the Fremont site, whether it occurred before or after the date we purchased the property. 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 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. As of March 31, 2014, we have accrued $5.5 million related to these environmental liabilities.

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 and risk to our ability to increase the production capacity of, and operate, our 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.

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Our business may be adversely affected by union activities.

Although none of our employees are 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 are also 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 performance electric 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. Consequently, the unionization of our labor force could negatively impact the company s health.

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.

Our performance electric vehicles, the sale of motor vehicles in general and the electronic components used in our vehicles are subject to substantial regulation under international, federal, state, and local laws. We have incurred, and expect to incur in the future, 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, such as in the United States:

- the imposition of a carbon tax or the introduction of a cap-and-trade system on electric utilities could increase the cost of electricity;
- increasingly stringent Clean Air Act emission regulations affecting power plants used to generate electricity could increase the cost of electricity;
- changes to the regulations governing the assembly and transportation of lithium-ion battery packs, such as the UN Recommendations of the Safe Transport of Dangerous Goods Model Regulations or regulations adopted by the U.S. Pipeline and Hazardous Materials Safety Administration (PHMSA) could increase the cost of lithium-ion battery packs or restrict their transport;
- 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;

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the amendment or rescission of California s zero emission vehicle 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;

increased sensitivity by regulators to the needs of established automobile manufacturers with large employment bases, high fixed costs and business models based on the internal combustion engine could lead them to pass regulations that could reduce the compliance costs of such established manufacturers or mitigate the effects of government efforts to promote alternative fuel vehicles; and

changes to regulations governing the export of our products could increase our costs incurred to deliver products outside the United States or force us to charge a higher price for our vehicles in such jurisdictions.

In addition, as the automotive industry moves towards greater use of electronics for vehicle systems, NHTSA and other regulatory bodies may in the future increase regulation for these electronic systems as concerns about distracted driving increase. Such concerns could affect electronic systems in Model S, including those used with the 17 inch display screen in Model S, 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 also become subject to additional laws and regulations applicable to the import, sale and service of automobiles in those regions, with which we have little or no experience complying.

To the extent the laws change, some or all of our vehicles may not comply with 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.

We use our vehicles electronic systems to log information about each vehicle s condition, performance and use in order to aid us in providing customer service, including vehicle diagnostics, repair and maintenance, as well as to help us collect data regarding our customers charge time, battery usage, mileage and efficiency habits and to improve our vehicles. We also collect information about our customers through our website, at our stores and facilities, and via telephone. Our customers may object to the processing of this data, which may negatively impact our ability to provide effective customer service and develop new vehicles and products. Collection and use of our customers personal information in conducting our business may be subject to federal and/or state laws and regulations in the United States and foreign jurisdictions including, in particular, various jurisdictions in Europe, and such laws and regulations may restrict our processing of such personal information and hinder our ability to attract new customers or market to existing customers. We may incur significant expenses to comply with privacy, consumer protection and security standards and protocols imposed by law, regulation, industry standards or contractual obligations. 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 serious negative consequences for our businesses and future prospects, including possible fines, penalties and damages, reduced customer demand for our vehicles, and harm to

our reputation and brand.

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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 torquing 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. For example, in November 2013 NHTSA initiated a preliminary evaluation with respect to two recent incidents in which Model S vehicles collided with road debris at highway speeds. Although we believe that NHTSA should close the preliminary evaluation without a finding of defect, it is possible that NHTSA could find that there is a defect and order Model S to be recalled. 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. We provide a three year or 36,000 mile New Vehicle Limited Warranty with every Tesla Roadster, which we extended to four years or 50,000 miles for the purchasers of our 2008 Tesla Roadster. In addition, customers have the opportunity to purchase Extended Service plans for the period after the end of the New Vehicle Limited Warranty for the Tesla Roadster to cover additional services for up to an additional three years or 36,000 miles, provided they are purchased within a specified period of time. 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 covers 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

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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.

We record and adjust warranty reserves based on changes in estimated costs and actual warranty costs. For new vehicles in particular, we record warranty reserves based on management s best estimate of projected warranty experience until adequate historical data is accumulated over a period of time, generally a few quarters. As we have limited operating experience with Model S, and therefore little experience with warranty claims for this vehicle, reserves that we recorded for Model S may be insufficient to cover all future warranty claims. 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.

Since we began initiating sales of our vehicles, we have continued to refine our warranty reserves based on our actual warranty claim experience and we may be required to undertake further changes in the future. As of March 31, 2014, we had warranty reserves of $72.0 million, and such reserve amount will increase significantly in the future as our product offerings and sales grow. We could in the future become subject to a significant and unexpected warranty expense. There can be no assurances that our currently existing or future warranty reserves will be sufficient to cover all claims due to potential higher average warranty expenses over the product life cycle or that our limited experience with warranty claims will adequately address the needs of our customers to their satisfaction.

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, our information technology networks and communications with our vehicles may be vulnerable to interception, manipulation, damage, disruptions or shutdowns due to attacks by hackers or breaches due to errors by personnel who have access to our networks and systems. Any such attacks or breaches could result in unexpected 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.

The range and power of our electric vehicles on a single charge declines over time, and this may negatively influence potential customers decisions whether to purchase our vehicles.

The range and power of our electric vehicles on a single charge declines principally as a function of usage, time and charging patterns as well as other factors. How a customer uses their Tesla vehicle, the frequency of recharging the battery pack at a low state of charge and the means of charging can result in additional deterioration of the battery

pack s ability to hold a charge over the long term. For example, we

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currently expect that our battery pack for the Tesla Roadster will retain approximately 70% of its ability to hold its initial charge after approximately 100,000 miles or seven years, which will result in a decrease to the vehicle s initial range and power. Deterioration of the Model S battery pack is expected to be less than the Roadster, however, such battery pack deterioration and the related decrease in range and power over time as well as any perceived deterioration or fluctuation in range may negatively influence potential customer decisions whether to purchase our vehicles, which may harm our ability to market and sell our vehicles.

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 Tesla 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. This capital will be necessary to fund our ongoing operations, continue research and development projects, including those for our planned Model X crossover and Gen III 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.

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 for small and medium sized businesses in the United States. The profitability of the leasing program depends on our ability to accurately project residual values, secure adequate financing 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, while our leasing program is currently limited in scope and financed with our own funds, 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 regulations governing lease transactions, we may become subject to enforcement actions or penalties, either of which may harm our business.

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. It is possible that a state regulator could later determine that the activities at our gallery constitute unlicensed sales of motor vehicles.

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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, in October 2012, vehicle dealer associations in New York and Massachusetts filed lawsuits to revoke the dealer license issued to Tesla Motors New York in New York and to limit the business activity of Tesla Motors MA, Inc. in Massachusetts. These lawsuits have been dismissed, reinforcing our continuing belief that state laws were not designed to prevent our distribution model. A similar litigation was recently filed in the state of Ohio. 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 legislative efforts by vehicle dealer associations to propose bills that, if enacted, would prevent us from obtaining dealer licenses in their states given our current sales model.

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.

Regulatory limitations on our ability to sell vehicles could materially and adversely affect our ability to sell our electric vehicles.

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 inquiries 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 seek 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;

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- 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; or
- redesign our vehicles or other goods or 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 business will be adversely affected if we are unable to protect our intellectual property rights from unauthorized use or infringement by third parties.

Any failure to adequately protect our proprietary rights could result in weakening or loss of such rights, which may allow our competitors to offer similar or identical products or use identical or confusingly similar branding, potentially resulting in the loss of some of our competitive advantage, a decrease in our revenue and an attribution of potentially lower quality products to us, which would adversely affect our business, prospects, financial condition and operating results. Our success depends, at least in part, on our ability to protect our core technology and intellectual property. To accomplish this, we rely on a combination of patents, patent applications, trade secrets, including know-how, employee and third party nondisclosure agreements, copyright protection, trademarks, intellectual property licenses and other contractual rights to establish and protect our proprietary rights in our technology. We have also received from third parties patent licenses related to manufacturing our vehicles.

The protection provided by the patent laws is and will be important to our future opportunities. However, such patents and agreements and various other measures we take to protect our intellectual property from use by others may not be effective for various reasons, including the following:

- our pending patent applications may not result in the issuance of patents;
- our patents, if issued, may not be broad enough to protect our commercial endeavors;
- the patents we have been granted may be challenged, invalidated or circumvented because of the pre-existence of similar patented or unpatented technology or for other reasons;

the costs associated with obtaining and enforcing patents, confidentiality and invention agreements or other intellectual property rights may make aggressive enforcement impracticable;

current and future competitors may independently develop similar technology, duplicate our vehicles or design new vehicles in a way that circumvents our intellectual property; and

our in-licensed patents may be invalidated or the holders of these patents may seek to terminate or modify our license arrangements.

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Existing trademark and trade secret laws and confidentiality agreements afford only limited protection. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States, and policing the unauthorized use of our intellectual property is difficult. Unauthorized use or infringement of our trademarks in countries which have a first-to-file system could affect our ability to successfully grow our business internationally.

Our patent applications may not result in issued patents, which may have a material adverse effect on our ability to prevent others from commercially exploiting products similar to ours.

The status of patents involves complex legal and factual questions and the breadth 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 a competitor with similar technology. 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. Furthermore, even if these patent applications do result in issued patents, some foreign countries provide significantly less effective patent enforcement than in the United States. In addition, patents issued to us may be infringed upon or designed around by others and 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 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 and Tesla Factory in Fremont 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.

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If our suppliers fail to use ethical business practices and comply with applicable laws and regulations, our brand image could be harmed due to negative publicity.

Our core values, which include developing the highest quality electric vehicles while operating with integrity, are an important component of our brand image, which makes our reputation particularly sensitive to allegations of unethical business practices. We do not control our independent suppliers or their business practices. Accordingly, we cannot guarantee their compliance with ethical business practices, such as environmental responsibility, fair wage practices, appropriate sourcing of raw materials, and compliance with child labor laws, among others. A lack of demonstrated compliance could lead us to seek alternative suppliers, which could increase our costs and result in delayed delivery of our products, product shortages or other disruptions of our operations.

Violation of labor or other laws by our suppliers or the divergence of an independent supplier s labor or other practices from those generally accepted as ethical in the United States or other markets in which we do business could also attract negative publicity for us and our brand. This could diminish the value of our brand image and reduce demand for our performance electric vehicles if, as a result of such violation, we were to attract negative publicity. If we, or other manufacturers in our industry, encounter similar problems in the future, it could harm our brand image, business, prospects, financial condition and operating results.

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 in aggregate principal amount of senior indebtedness in May 2013 when we issued pursuant to registered public offerings 1.50% convertible senior notes due 2018 (2018 Notes). In March and April 2014, we incurred an additional $920.0 million and $1.38 billion, respectively, in aggregate principal amount of senior indebtedness by issuing pursuant to registered public offerings 0.25% convertible senior notes due 2019 (2019 Notes) and 1.25% convertible senior notes due 2021 (2021 Notes and together with the 2018 Notes and 2019 Notes, collectively, the Notes). Our ability to make scheduled payments of the principal of, to pay interest on, 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) 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. This condition was met in the first quarter of 2014 for the 2018 Notes, and consequently the 2018 Notes are convertible by their holders during the second quarter of 2014. This conversion feature will apply to the 2019 Notes and 2021 Notes for any quarter commencing with the third quarter of 2014 if the sales price condition for the applicable series of the 2019 and the 2021 Notes is met in the immediately preceding quarter. Upon conversion of the Notes, we will be

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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. Even if holders do not elect to convert their Notes, if the Notes become convertible we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material adverse impact on our reported financial results.

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 may be able to incur substantial additional debt in the future. We 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.

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) 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 trading day. This condition was met for the 2018 Notes in the first quarter of 2014, and consequently the 2018 Notes are convertible by their holders during the second quarter of 2014. This conversion feature will apply to the 2019 Notes and the 2021 Notes for any quarter commencing with the third quarter of 2014 if the sales price condition for the applicable series of Notes is met in the immediately preceding quarter. If 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.

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Risks Related to the Ownership of our Common Stock

Concentration of ownership among our existing executive officers, directors and their affiliates may prevent new investors from influencing significant corporate decisions.

As of March 31, 2014, our executive officers, directors and their affiliates beneficially owned, in the aggregate, approximately 28.0% of our outstanding shares of common stock. In particular, Elon Musk, our Chief Executive Officer, Product Architect and Chairman of our Board of Directors, beneficially owned approximately 26.8% of our outstanding shares of common stock as of March 31, 2014. As a result, these stockholders will be able to exercise a significant level of control over all matters requiring stockholder approval, including the election of directors, amendment of our certificate of incorporation and approval of significant corporate transactions. This control could have the effect of delaying or preventing a change of control of our company or changes in management and will make the approval of certain transactions difficult or impossible without the support of these stockholders.

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 on June 29, 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 $265.00 per share and a low of $69.25 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 has recently been instituted against us. While we do not believe that it has merit, this litigation or others like it could result in substantial costs and a diversion of our management s attention and resources.

A substantial portion of our total outstanding shares are held by a small number of insiders and investors and may be sold in the near future. The large number of shares eligible for public sale or subject to rights requiring us to register them for public sale could depress the market price of our common stock.

The market price of our common stock could decline as a result of sales of a large number of shares of our common stock in the market in the future, and the perception that these sales could occur may also depress the market price of our common stock. Stockholders owning a substantial portion of our total outstanding shares are entitled, under contracts providing for registration rights, to require us to register shares of our common stock owned by them for public sale in the United States, subject to the restrictions of Rule 144. In addition, we have registered shares previously issued or reserved for future issuance under our equity compensation plans and agreements, a portion of which are related to outstanding option awards. Subject to the satisfaction of applicable exercise periods and, in certain cases, lock-up agreements, the shares of common stock issued upon exercise of outstanding options will be available for immediate resale in the United States in the open market. Sales of our common stock as restrictions end or pursuant to registration rights may make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. These sales also could cause our stock price to fall and make it more difficult to sell shares of our common stock.

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*

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have sufficient cash flow from our business to pay our substantial debt, the Notes due 2018 are convertible by their holders during the second quarter of 2014. Moreover, these Notes, and commencing with the third quarter of 2014, the Notes due 2019 and Notes due 2021, may become convertible in future periods if a condition to conversion for the Notes is met. 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 in 2011 and 2013 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, Goldman Sachs Bank USA, an affiliate of Goldman, Sachs & Co., has made extensions of credit in the aggregate amount of $275 million 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 the loan accrues at market rates. Goldman Sachs Bank USA received customary fees and expense reimbursements in connection with these loans. As a regulated entity, Goldman Sachs Bank USA makes decisions regarding making and managing its loans independent of Goldman, Sachs & Co. Mr. Musk and Goldman have a long-standing relationship of almost a decade. In addition, Morgan Stanley Smith Barney LLC, an affiliate of Morgan Stanley & Co. LLC, has made a loan to Mr. Musk in the aggregate amount of $25 million. Interest on this loan accrues at market rates. Morgan Stanley Smith Barney LLC received customary fees and expense reimbursements in connection with this loan.

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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 Goldman Sachs Bank USA and Morgan Stanley Smith Barney LLC.

If the price of our common stock declines, Mr. Musk may be forced by Goldman Sachs Bank USA and/or Morgan Stanley Smith Barney LLC 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 Goldman Sachs Bank USA and Morgan Stanley Smith Barney LLC 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.

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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 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at end of report.

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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 9, 2014

/s/ Deepak Ahuja
Deepak Ahuja
Chief Financial Officer
(Principal Financial Officer, Principal Accounting Officer and

Duly Authorized Officer)

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INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
4.1	Second Supplemental Indenture, dated as of March 5, 2014, by and between Tesla Motors, Inc. and U.S. Bank National Association.	8-K	001-34756	4.2	March 5, 2014	
4.2	Form of 0.25% Convertible Senior Note Due March 1, 2019 (included in Exhibit 4.1).	8-K	001-34756	4.2	March 5, 2014	
4.3	Third Supplemental Indenture, dated as of March 5, 2014, by and between Tesla Motors, Inc. and U.S. Bank National Association.	8-K	001-34756	4.4	March 5, 2014	
4.4	Form of 1.25% Convertible Senior Note Due March 1, 2021 (included in Exhibit 4.3).	8-K	001-34756	4.4	March 5, 2014	
10.1	Indemnification Agreement, dated as of February 27, 2014, by and between Tesla Motors, Inc. and J.P. Morgan Securities LLC.	8-K	001-34756	10.1	March 5, 2014	
10.2	Form of Call Option Confirmation relating to 0.25% Convertible Senior Notes Due March 1, 2019.	8-K	001-34756	10.2	March 5, 2014	
10.3	Form of Call Option Confirmation relating to 1.25% Convertible Senior Notes Due March 1, 2021.	8-K	001-34756	10.3	March 5, 2014	
10.4	Form of Warrant Confirmation relating to 0.25% Convertible Senior Notes Due March 1, 2019.	8-K	001-34756	10.4	March 5, 2014	
10.5	Form of Warrant Confirmation relating to 1.25% Convertible Senior Notes Due March 1, 2021.	8-K	001-34756	10.5	March 5, 2014	
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					

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