

Tesla, Inc.
Form 10-Q
November 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-34756

Tesla, Inc.

(Exact name of registrant as specified in its charter)

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

3500 Deer Creek Road

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

(650) 681-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Edgar Filing: Tesla, Inc. - Form 10-Q

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 27, 2017, there were 168,067,395 shares of the registrant’s common stock outstanding.

TESLA, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2017

INDEX

	Page
PART I.	<u>FINANCIAL INFORMATION</u>
Item 1.	<u>Financial Statements</u> <u>(Unaudited)</u> 4
	<u>Consolidated Balance Sheets</u> 4
	<u>Consolidated Statements of</u> <u>Operations</u> 5
	<u>Consolidated Statements of</u> <u>Comprehensive Income (Loss)</u> 6
	<u>Consolidated Statements of</u> <u>Cash Flows</u> 7
	<u>Notes to Consolidated Financial</u> <u>Statements</u> 8
Item 2.	<u>Management’s Discussion and</u> <u>Analysis of Financial Condition</u> <u>and Results of Operations</u> 31
Item 3.	<u>Quantitative and Qualitative</u> <u>Disclosures About Market Risk</u> 40
Item 4.	<u>Controls and Procedures</u> 41
PART II.	<u>OTHER INFORMATION</u>
Item 1.	<u>Legal Proceedings</u> 42
Item 1A.	<u>Risk Factors</u> 43
	<u>Unregistered Sales of Equity</u> <u>Securities and Use of Proceeds</u> 58
Item 2.	<u>Defaults Upon Senior Securities</u> 58
Item 3.	<u>Mine Safety Disclosures</u> 58
Item 4.	<u>Other Information</u> 58
Item 5.	<u>Exhibits</u> 58
Item 6.	
	<u>SIGNATURES</u> 61

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, projected costs, profitability, expected cost reductions, capital adequacy, expectations regarding demand and acceptance for our technologies, growth opportunities and trends in the market in which we operate, prospects and plans and objectives of management. The words “anticipates”, “believes”, “could”, “estimates”, “expects”, “intends”, “may”, “might”, “plans”, “pro” “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 these forward-looking statements, and you should not place undue reliance on these forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause our actual results or events to differ materially from the plans, intentions or expectations disclosed in these forward-looking statements, including, without limitation, the risks set forth in Part II, Item 1A, “Risk Factors” in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission. We do not assume any obligation to update any forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Tesla, Inc.

Consolidated Balance Sheets

(in thousands, except for par values)

(unaudited)

	September 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 3,530,030	\$ 3,393,216
Restricted cash	138,181	105,519
Accounts receivable, net	607,734	499,142
Inventory	2,471,382	2,067,454
Prepaid expenses and other current assets	321,406	194,465
Total current assets	7,068,733	6,259,796
Operating lease vehicles, net	3,834,234	3,134,080
Solar energy systems, leased and to be leased, net	6,287,965	5,919,880
Property, plant and equipment, net	9,394,397	5,982,957
Intangible assets, net	372,238	376,145
Goodwill	45,236	—
MyPower customer notes receivable, net of current portion	463,878	506,302
Restricted cash, net of current portion	408,544	268,165
Other assets	231,849	216,751
Total assets	\$ 28,107,074	\$ 22,664,076
Liabilities		
Current liabilities		
Accounts payable	\$ 2,385,778	\$ 1,860,341
Accrued liabilities and other	1,477,784	1,210,028
Deferred revenue	951,734	763,126
Resale value guarantees	543,336	179,504
Customer deposits	686,084	663,859
Current portion of long-term debt and capital leases	324,224	984,211
Current portion of solar bonds and promissory notes issued to related parties	100,000	165,936
Total current liabilities	6,468,940	5,827,005
Long-term debt and capital leases, net of current portion	9,581,616	5,860,049
Solar bonds issued to related parties, net of current portion	100	99,164
Convertible senior notes issued to related parties	2,481	10,287
Deferred revenue, net of current portion	1,082,870	851,790
Resale value guarantees, net of current portion	2,410,220	2,210,423

Edgar Filing: Tesla, Inc. - Form 10-Q

Other long-term liabilities	2,382,830	1,891,449
Total liabilities	21,929,057	16,750,167
Commitments and contingencies (Note 14)		
Redeemable noncontrolling interests in subsidiaries	402,943	367,039
Convertible senior notes (Note 11)	357	8,784
Equity		
Stockholders' equity		
Preferred stock; \$0.001 par value; 100,000 shares authorized; no shares		
issued and outstanding	—	—
Common stock; \$0.001 par value; 2,000,000 shares authorized; 168,017 and 161,561		
shares issued and outstanding as of September 30, 2017 and December 31, 2016,		
respectively	168	161
Additional paid-in capital	8,989,022	7,773,727
Accumulated other comprehensive gain (loss)	21,250	(23,740)
Accumulated deficit	(4,298,960)	(2,997,237)
Total stockholders' equity	4,711,480	4,752,911
Noncontrolling interests in subsidiaries	1,063,237	785,175
Total liabilities and equity	\$ 28,107,074	\$ 22,664,076

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

Tesla, Inc.

Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Revenues				
Automotive sales	\$2,076,731	\$1,917,442	\$6,125,643	\$3,849,558
Automotive leasing	286,158	231,285	813,462	507,085
Total automotive revenues	2,362,889	2,148,727	6,939,105	4,356,643
Energy generation and storage	317,505	23,334	818,229	50,009
Services and other	304,281	126,375	713,168	308,849
Total revenues	2,984,675	2,298,436	8,470,502	4,715,501
Cost of revenues				
Automotive sales	1,755,622	1,355,102	4,724,849	2,895,483
Automotive leasing	175,224	161,959	516,683	310,176
Total automotive cost of revenues	1,930,846	1,517,061	5,241,532	3,205,659
Energy generation and storage	237,288	24,281	592,823	50,553
Services and other	367,401	120,359	852,446	295,310
Total cost of revenues	2,535,535	1,661,701	6,686,801	3,551,522
Gross profit	449,140	636,735	1,783,701	1,163,979
Operating expenses				
Research and development	331,622	214,302	1,023,436	588,448
Selling, general and administrative	652,998	336,811	1,794,210	976,173
Total operating expenses	984,620	551,113	2,817,646	1,564,621
(Loss) income from operations	(535,480)	85,622	(1,033,945)	(400,642)
Interest income	5,531	2,858	13,406	6,351
Interest expense	(117,109)	(46,713)	(324,896)	(133,706)
Other expense, net	(24,390)	(11,756)	(83,696)	(9,952)
(Loss) income before income taxes	(671,448)	30,011	(1,429,131)	(537,949)
(Benefit) provision for income taxes	(285)	8,133	40,640	15,628
Net (loss) income	(671,163)	21,878	(1,469,771)	(553,577)
Net loss attributable to noncontrolling interests and				
redeemable noncontrolling interests in subsidiaries	(51,787)	—	(183,721)	—
Net (loss) income attributable to common stockholders	\$(619,376)	\$21,878	\$(1,286,050)	\$(553,577)
Net (loss) income per share of common stock attributable to				
common stockholders, basic and diluted				
Basic	\$(3.70)	\$0.15	\$(7.80)	\$(3.94)
Diluted	\$(3.70)	\$0.14	\$(7.80)	\$(3.94)
Weighted average shares used in computing net income (loss)				

Edgar Filing: Tesla, Inc. - Form 10-Q

per share of common stock, basic and diluted

Basic	167,294	148,991	164,897	140,581
Diluted	167,294	156,935	164,897	140,581

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

Tesla, Inc.

Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net (loss) income attributable to common stockholders	\$(619,376)	\$21,878	\$(1,286,050)	\$(553,577)
Unrealized gain (loss) on derivatives:				
Change in net unrealized gain	—	3,349	—	48,359
Less: Reclassification adjustment for net gains into				
net loss	—	(14,246)	(5,570)	(15,523)
Net unrealized (loss) gain on derivatives	—	(10,897)	(5,570)	32,836
Foreign currency translation adjustment	10,289	2,014	50,560	(3,970)
Other comprehensive income (loss)	10,289	(8,883)	44,990	28,866
Comprehensive (loss) income	\$(609,087)	\$12,995	\$(1,241,060)	\$(524,711)

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

Tesla, Inc.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2017	2016
Cash Flows From Operating Activities		
Net loss	\$(1,469,771)	\$(553,577)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,166,397	620,160
Stock-based compensation	332,412	246,512
Amortization of debt discounts and issuance costs	60,613	69,861
Inventory write-downs	98,347	50,289
Loss on disposal of fixed assets	59,640	12,181
Foreign currency transaction loss	35,933	10,422
Loss on the acquisition of SolarCity	29,796	—
Non-cash interest and other operating activities	109,729	15,798
Changes in operating assets and liabilities, net of effect of business combinations		
Accounts receivable	(105,643)	(110,510)
Inventories	(418,970)	(345,331)
Operating lease vehicles	(1,083,140)	(1,452,883)
Prepaid expenses and other current assets	(123,832)	34,636
MyPower customer notes receivable and other assets	17,628	(2,586)
Accounts payable and accrued liabilities	170,326	697,528
Deferred revenue	329,007	256,187
Customer deposits	3,815	409,139
Resale value guarantee	141,044	322,244
Other long-term liabilities	76,124	44,310
Net cash (used in) provided by operating activities	(570,545)	324,380
Cash Flows From Investing Activities		
Purchases of property and equipment excluding capital leases, net of sales	(2,628,126)	(759,190)
Maturities of short-term marketable securities	—	16,667
Purchase of solar energy systems, leased and to be leased	(547,085)	—
Increase in restricted cash	(172,733)	(79,156)
Business combination, net of cash acquired	(109,147)	—
Net cash used in investing activities	(3,457,091)	(821,679)
Cash Flows From Financing Activities		
Proceeds from issuance of common stock in public offering	400,175	1,701,734
Proceeds from issuance of convertible and other debt	5,401,158	1,685,279
Repayments of convertible and other debt	(2,442,942)	(1,678,475)
Repayments of borrowings under solar bonds issued to related parties	(165,000)	—
Collateralized lease borrowings	416,427	557,669

Edgar Filing: Tesla, Inc. - Form 10-Q

Proceeds from exercise of stock options and other stock issuances	239,328	153,461
Principal payments on capital leases	(69,496)	(30,447)
Common stock and debt issuance costs	(50,530)	(18,072)
Purchase of convertible note hedges	(204,102)	—
Proceeds from settlement of convertible note hedges	269,456	—
Proceeds from issuance of warrants	52,883	—
Payments for settlement of warrants	(219,538)	—
Proceeds from investment by noncontrolling interests in subsidiaries	691,918	—
Distributions paid to noncontrolling interests in subsidiaries	(190,715)	—
Net cash provided by financing activities	4,129,022	2,371,149
Effect of exchange rate changes on cash and cash equivalents	35,428	13,499
Net increase in cash and cash equivalents	136,814	1,887,349
Cash and cash equivalents, beginning of period	3,393,216	1,196,908
Cash and cash equivalents, end of period	\$3,530,030	\$3,084,257
Supplemental noncash investing and financing activities		
Acquisition of property and equipment included in liabilities	\$963,664	\$459,472
Estimated fair value of facilities under build-to-suit leases	\$278,741	\$236,538

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

Tesla, Inc.

Notes to Consolidated Financial Statements

(unaudited)

Note 1 – Overview

Tesla, Inc. (“Tesla”, the “Company”, “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 design, manufacture, install and sell solar energy generation and energy storage products. Our Chief Executive Officer, as the chief operating decision maker (“CODM”), organizes the Company, manages resource allocations and measures performance among two operating segments: (i) automotive and (ii) energy generation and storage.

Note 2 – Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

The consolidated balance sheet as of September 30, 2017, the consolidated statements of operations and the consolidated statements of comprehensive loss for the three and nine months ended September 30, 2017 and 2016 and the consolidated statements of cash flows for the nine months ended September 30, 2017 and 2016, as well as other information disclosed in the accompanying notes, are unaudited. The consolidated balance sheet as of December 31, 2016 was derived from the audited consolidated financial statements as of that date. The interim consolidated financial statements and the accompanying notes should be read in conjunction with the annual consolidated financial statements and the accompanying notes contained in our Annual Report on Form 10-K for the year ended December 31, 2016.

The interim consolidated financial statements and the accompanying notes 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 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 years or interim periods.

Reclassifications

Certain prior period balances have been reclassified to conform to the current period presentation in the consolidated financial statements and the accompanying notes. Such reclassifications had no effect on previously reported results of operations. Starting in the fourth quarter of 2016, we have reclassified the revenue and cost of revenue of our energy storage products from ‘services and other’ into ‘energy generation and storage’ for all periods presented in order to align with our reportable segments.

Resale Value Guarantees and Other Financing Programs

Vehicle sales to customers with a resale value guarantee

Prior to June 30, 2016, we offered resale value guarantees or similar buy-back terms to all customers who purchase vehicles and who financed their vehicles through one of our specified commercial banking partners. Since June 30,

2016, this program is available only in certain international markets. Under this program, customers have the option of selling their vehicle back to us during the guarantee period for a determined resale value. Guarantee periods generally range from 36 to 39 months. Although we receive full payment for the vehicle sales price at the time of delivery, we are required to account for these transactions as operating leases. The amount of sale proceeds equal to the resale value guarantee is deferred until the guarantee expires or is exercised. The remaining sale proceeds are deferred and recognized on a straight-line basis over the stated guarantee period to automotive leasing revenue. The guarantee period expires at the earlier of the end of the guarantee period or the pay-off of the initial loan. We capitalize the cost of these vehicles on the consolidated balance sheets as operating lease vehicles, net, and depreciate their value, less salvage value, to cost of automotive leasing revenue over the same period.

In cases where a customer retains ownership of a vehicle at the end of the guarantee period, the resale value guarantee liability and any remaining deferred revenue balances related to the vehicle are settled to automotive leasing revenue and the net book value of the leased vehicle is expensed to costs of automotive leasing revenue. If a customer returns the vehicle to us during the guarantee period, we purchase the vehicle from the customer in an amount equal to the resale value guarantee and settle any remaining deferred balances to automotive leasing revenue, and we reclassify the net book value of the vehicle on our balance sheet to used vehicle inventory. As of September 30, 2017 and December 31, 2016, \$279.9 million and \$179.5 million, respectively, of the guarantees were exercisable by customers within a 12-month period from each such date.

Vehicle sales to leasing partners with a resale value guarantee

We also offer resale value guarantees in connection with automobile sales to certain leasing partners. As we have guaranteed the value of these vehicles and as the vehicles are leased to end-customers, we account for these transactions as interest bearing collateralized borrowings as required under ASC 840, Leases. Under this program, cash is received for the full price of the vehicle and is recorded within resale value guarantees for the long-term portion and deferred revenue for the current portion. We accrete the deferred revenue amount to automotive leasing revenue on a straight-line basis over the guarantee period and accrue interest expense based on our borrowing rate. We capitalize vehicles under this program to operating lease vehicles, net, on the consolidated balance sheets, and we record depreciation from these vehicles to cost of automotive leasing revenues during the period the vehicle is under a lease arrangement. Cash received for these vehicles, net of revenue recognized during the period, is classified as collateralized lease borrowings within cash flows from financing activities in the consolidated statements of cash flows.

At the end of the lease term, we settle our liability in cash by either purchasing the vehicle from the leasing partner for the resale value guarantee amount or paying a shortfall to the guarantee amount the leasing partner may realize on the sale of the vehicle. Any remaining balances within deferred revenue and resale value guarantee will be settled to automotive leasing revenue. In cases where the leasing partner retains ownership of the vehicle after the end of our guarantee period, we expense the net value of the leased vehicle to costs of automotive leasing revenue. The maximum amount we could be required to pay under this program, should we decide to repurchase all vehicles, was \$1.18 billion and \$855.9 million as of September 30, 2017 and December 31, 2016, respectively, including \$263.5 million within a 12-month period from September 30, 2017.

As of September 30, 2017 and December 31, 2016, we had \$1.57 billion and \$1.18 billion, respectively, of such borrowings recorded in resale value guarantees and \$341.0 million and \$289.1 million, respectively, recorded in deferred revenue liability. As of September 30, 2017 and December 31, 2016, we had a total of \$46.5 million and \$57.0 million, respectively, in account receivables from our leasing partners.

On a quarterly basis, we assess the estimated market values of vehicles under our resale value guarantee program to determine if we have sustained a loss on any of these contracts. As we accumulate more data related to the resale values of our vehicles or as market conditions change, there may be material changes to their estimated values.

Edgar Filing: Tesla, Inc. - Form 10-Q

Activity related to our resale value guarantee and similar programs consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Operating Lease Vehicles				
Operating lease vehicles—				
beginning of period	\$2,835,674	\$2,126,581	\$2,462,061	\$1,556,529
Net increase in operating lease vehicles	237,853	375,287	904,767	1,085,551
Depreciation expense recorded in cost				
of automotive leasing revenues	(96,995)	(71,454)	(269,012)	(179,087)
Additional depreciation expense recorded in				
cost of automotive leasing revenues as				
a result of early cancellation of resale				
value guarantee	(2,416)	(5,509)	(14,631)	(11,166)
Additional depreciation expense recorded in				
cost of automotive leasing revenues				
as a result of expiration	(32,489)	(55,009)	(105,378)	(55,009)
Increases to inventory from vehicles				
returned under our trade-in program				
and exercises of resale value guarantee	(14,700)	(18,718)	(50,880)	(45,640)
Operating lease vehicles—end of period	\$2,926,927	\$2,351,178	\$2,926,927	\$2,351,178
Deferred Revenue				
Deferred revenue—beginning of period	\$1,006,600	\$851,684	\$916,652	\$679,132
Net increase in deferred revenue from new				
vehicle deliveries and reclassification of				
collateralized borrowing from long-term				
to short-term	155,133	188,113	559,996	574,226
Amortization of deferred revenue and	(171,763)	(125,411)	(474,949)	(330,093)
short-term collateralized borrowing				
recorded in automotive leasing				

revenue				
Additional revenue recorded in automotive				
leasing revenue as a result of early				
cancellation of resale value guarantee	(394)	(1,521)	(2,746)	(4,333)
Recognition of deferred revenue resulting				
from return of vehicle under trade-in				
program, expiration, and exercises of				
resale value guarantee	(3,118)	(3,456)	(12,495)	(9,523)
Deferred revenue—end of period	\$986,458	\$909,409	\$986,458	\$909,409
Resale Value Guarantee				
Resale value guarantee liability—beginning				
of period	\$2,835,849	\$2,007,347	\$2,389,927	\$1,430,573
Increase in resale value guarantee	240,134	361,434	922,342	1,013,369
Reclassification from long-term to				
short-term collateralized borrowing	(74,252)	(33,129)	(189,733)	(79,171)
Additional revenue recorded in automotive				
leasing revenue as a result of early				
cancellation of resale value guarantee	(1,322)	(4,291)	(9,570)	(10,110)
Release of resale value guarantee resulting				
from return of vehicle under trade-in				
program and exercises	(14,372)	(15,516)	(54,205)	(38,816)
Release of resale value guarantee resulting				
from expiration of resale value guarantee	(32,481)	(55,722)	(105,205)	(55,722)
Resale value guarantee liability—end of				
period	\$2,953,556	\$2,260,123	\$2,953,556	\$2,260,123

Income Taxes

There are transactions that occur during the ordinary course of business for which the ultimate tax determination is uncertain. As of September 30, 2017 and December 31, 2016, the aggregate balances of our gross unrecognized tax benefits were \$300.0 million and \$203.9 million, respectively, of which \$292.9 million and \$198.3 million, respectively, would not give rise to changes in our effective tax rate since these tax benefits would increase a deferred tax asset that is currently fully offset by a valuation allowance.

Net Loss per Share of Common Stock Attributable to Common Stockholders

Basic net income (loss) per share of common stock attributable to common stockholders is calculated by dividing net income (loss) attributable to common stockholders by the weighted-average shares of common stock outstanding for the period. Potentially dilutive shares, which are based on the weighted-average shares of common stock underlying outstanding stock-based awards, warrants and convertible senior notes using the treasury stock method or the if-converted method, as applicable, are included when calculating diluted net income (loss) per share of common stock attributable to common stockholders when their effect is dilutive. Since we expect to settle in cash the principal outstanding under the 0.25% Convertible Senior Notes due in 2019, the 1.25% Convertible Senior Notes due in 2021 and the 2.375% Convertible Senior Notes due in 2022, we use the treasury stock method when calculating their potential dilutive effect, if any. The following table presents the potentially dilutive shares that were excluded from the computation of diluted net income (loss) per share of common stock attributable to common stockholders, because their effect was anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Stock-based awards	8,855,128	5,666,686	10,177,154	16,527,336
Convertible senior notes	1,908,572	—	2,559,810	1,959,492
Warrants	414,996	—	658,345	629,782

Concentration of Risk

Credit Risk

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents, restricted cash, accounts receivable and interest rate swaps. Our cash balances are primarily invested in money market funds or on deposit at high credit quality financial institutions in the United States. At times, these deposits may be in excess of insured limits. As of September 30, 2017, no customer represented 10% or more of our total accounts receivable balance. As of December 31, 2016, one customer represented 10% or more of our total accounts receivable balance. The risk of concentration for our interest rate swaps is mitigated by transacting with several highly rated multinational banks. We maintain reserves for any amounts that we consider uncollectible.

Supply Risk

We are dependent on our suppliers, the majority of which are single source suppliers, and the inability of these suppliers to deliver necessary components of our products in a timely manner at prices, quality levels and volumes acceptable to us, or our inability to efficiently manage these components from these suppliers, could have a material adverse effect on our business, prospects, financial condition and operating results.

Warranties

We provide a manufacturer’s warranty on all new and certified used vehicles, production powertrain components and systems and energy products we sell. In addition, we also provide a warranty on the installation and components of the solar energy systems we sell for periods typically between 10 to 30 years. We accrue a warranty reserve for the products sold by us, which includes our best estimate of the projected costs to repair or replace items under warranty. These estimates are based on actual claims incurred to date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain given our relatively short history of sales, and changes to our historical or projected warranty experience may cause material changes to the warranty reserve in the future. The warranty reserve does not include projected warranty costs associated with our vehicles subject to lease accounting and our solar energy systems under lease contracts or power purchase agreements, as the costs to repair these warranty claims are expensed as incurred. The portion of the warranty reserve expected to be incurred within the next 12 months is included within accrued liabilities and other while the remaining balance is included within other long-term liabilities on our consolidated balance sheets. Warranty expense is recorded as a component of cost of revenues. Accrued warranty activity consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Accrued warranty—beginning of period	\$343,279	\$216,459	\$266,655	\$180,754
Warranty costs incurred	(39,481)	(16,571)	(87,881)	(56,734)
Net changes in liability for pre-existing warranties,				
including expirations and foreign exchange impact	4,768	(19,523)	7,239	(12,889)
Provision for warranty	60,156	46,454	182,709	115,688
Accrued warranty—end of period	\$368,722	\$226,819	\$368,722	\$226,819

For the three and nine months ended September 30, 2017, warranty costs incurred for vehicles accounted for as operating leases or collateralized debt arrangements were \$10.8 million and \$24.3 million, respectively, and for the three and nine months ended September 30, 2016, such costs were \$7.2 million and \$12.3 million, respectively.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, to replace the existing revenue recognition criteria for contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, Deferral of the Effective Date, to defer the effective date of ASU No. 2014-09 to interim and annual periods beginning after December 15, 2017, with early adoption permitted. Subsequently, the FASB issued ASU No. 2016-08, Principal versus Agent Considerations, ASU No. 2016-10, Identifying Performance Obligations and Licensing, ASU No. 2016-11, Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting, ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, and ASU No. 2016-20, Technical Corrections and Improvements, to clarify and amend the guidance in ASU No. 2014-09. We currently expect to adopt the ASUs on January 1, 2018 on a modified retrospective basis through a cumulative adjustment to equity. The adoption of the ASUs might accelerate the revenue recognition of certain vehicle sales to customers or leasing partners with a resale value guarantee, which may qualify to be accounted for as sales with a right of return as opposed to the current accounting as operating leases or collateralized lease borrowings. Our interpretation is subject to change as a result of future changes in market conditions, incentives or program offerings. Upon adoption of the ASUs, we currently estimate an increase to equity in the range of \$550.0 million to

\$750.0 million, including the impact of adjusting deferred revenue for investment tax credit balances. We are continuing to assess the impact of adopting the ASUs on the consolidated financial statements, and we are continuing to adjust our accounting processes accordingly.

In February 2016, the FASB issued ASU No. 2016-02, Leases, to require lessees to recognize all leases, with certain exceptions, on the balance sheet, while recognition on the statement of operations will remain similar to current lease accounting. The ASU also eliminates real estate-specific provisions and modifies certain aspects of lessor accounting. The ASU is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. We currently expect to adopt the ASU on January 1, 2019. We will be required to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with certain practical expedients available. We intend to elect the available practical expedients upon adoption. Upon adoption, we expect the consolidated balance sheet to include a right of use asset and liability related to substantially all of our lease arrangements. We are continuing to assess the impact of adopting the ASU on our financial position, results of operations and related disclosures and have not yet concluded whether the effect will be material.

In March 2016, the FASB issued ASU No. 2016-06, Contingent Put and Call Options in Debt Instruments, to clarify when a contingent put or call option to accelerate the repayment of debt is an embedded derivative. The ASU is effective for interim and

annual periods beginning after December 15, 2016, with early adoption permitted. Adoption of the ASU is modified retrospective. We adopted the ASU on January 1, 2017, but the ASU did not have an impact on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, to simplify the accounting for the income tax effects from share-based compensation, the accounting for forfeitures and the accounting for statutory income tax withholding, among others. In particular, the ASU requires all income tax effects from share-based compensation to be recognized in the consolidated statement of operations when the awards vest or are settled, the ASU permits accounting for forfeitures as they occur, and the ASU permits a higher level of statutory income tax withholding without triggering liability accounting. Adoption of the ASU is modified retrospective, retrospective and prospective, depending on the specific provision being adopted. We adopted the ASU on January 1, 2017. Our gross U.S. deferred tax assets increased by \$909.1 million as a result of our adoption, which was fully offset by a corresponding increase to our valuation allowance. In addition, we now account for forfeitures as they occur.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, to reduce the diversity in practice with respect to the classification of certain cash receipts and cash payments on the statement of cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is retrospective. We plan to adopt the ASU on January 1, 2018, which will impact the classifications within the consolidated statements of cash flows.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, to require the recognition of the income tax effects from an intra-entity transfer of an asset other than inventory. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is modified retrospective. We early adopted the ASU on January 1, 2017. Our adoption did not have a material impact on the consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash, which requires entities to present the aggregate changes in cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, the statement of cash flows will be required to present restricted cash and restricted cash equivalents as a part of the beginning and ending balances of cash and cash equivalents. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is retrospective. We plan to adopt the ASU on January 1, 2018, which will impact the classifications within the consolidated statements of cash flows.

In January 2017, the FASB issued ASU No. 2017-01, Clarifying the Definition of a Business, to clarify the definition of a business with the objective of assisting entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is prospective. We plan to adopt the ASU on January 1, 2018.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, to simplify the test for goodwill impairment by removing Step 2. An entity will, therefore, perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the fair value, not to exceed the total amount of goodwill allocated to the reporting unit. An entity still has the option to perform a qualitative assessment to determine if the quantitative impairment test is necessary. The ASU is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Adoption of the ASU is prospective. We have not yet selected an adoption date, and the ASU will

have a currently undetermined impact on the consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Scope of Modification Accounting, to provide guidance on which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is prospective. We plan to adopt the ASU on January 1, 2018.

In August 2017, the FASB issued ASU No. 2017-12, Targeted Improvements to Accounting for Hedging Activities, to simplify the application of current hedge accounting guidance. The ASU expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The ASU is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. Adoption of the ASU is generally modified retrospective. We are currently obtaining an understanding of the ASU and plan to adopt the ASU on January 1, 2019.

Note 3 – Business Combinations

Grohmann Acquisition

On January 3, 2017, we completed our acquisition of Grohmann Engineering GmbH (now Tesla Grohmann Automation GmbH or “Grohmann”), a company that specializes in the design, development and sale of automated manufacturing systems, for \$109.5 million in cash. We acquired Grohmann to improve the speed and efficiency of our manufacturing processes.

At the time of acquisition, we entered into an incentive compensation arrangement for up to a maximum of \$25.8 million of payments contingent upon continued service with us for 36 months after the acquisition date. Such payments would have been accounted for as compensation expense in the periods earned. However, during the three months ended March 31, 2017, we terminated the incentive compensation arrangement and accelerated the payments thereunder. As a result, we recorded the entire \$25.8 million as compensation expense during the three months ended March 31, 2017, which was included in selling, general and administrative expense in our consolidated statements of operations.

Fair Value of Assets Acquired and Liabilities Assumed

We accounted for the Grohmann acquisition using the purchase method of accounting for business combinations under ASC 805, Business Combinations. The total purchase price is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date.

As we finalize our estimate of the fair values of the identifiable intangible assets acquired and deferred taxes, additional purchase price adjustments may be recorded during the measurement period (a period not to exceed 12 months), which may have a material impact on our results of operations and financial position. Fair value estimates are based on a complex series of judgments about future events and uncertainties and rely heavily on estimates and assumptions. The judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives and the expected future cash flows and related discount rates, can materially impact our results of operations. Significant inputs used included the amount of cash flows, the expected period of the cash flows and the discount rates. There were no changes to the fair values of the assets acquired and the liabilities assumed during the six months ended September 30, 2017.

The preliminary allocation of the purchase price is based on management’s estimate of the acquisition date fair values of the assets acquired and the liabilities assumed, as follows (in thousands):

Assets acquired:	
Cash and cash equivalents	\$334
Accounts receivable	42,947
Inventory	10,031
Property, plant and equipment	44,030
Intangible assets	21,723
Prepaid expenses and other assets, current and non-current	1,998
Total assets acquired	121,063
Liabilities assumed:	
Accounts payable	(19,975)
Accrued liabilities	(12,403)

Edgar Filing: Tesla, Inc. - Form 10-Q

Debt and capital leases, current and non-current	(9,220)
Other long-term liabilities	(10,049)
Total liabilities assumed	(51,647)
Net assets acquired	69,416
Goodwill	40,065
Total purchase price	\$ 109,481

Goodwill represented the excess of the purchase price over the fair value of the net assets acquired and was primarily attributable to the expected synergies from potential monetization opportunities and from integrating Grohmann's technology into our automotive business as well as the acquired talent. Goodwill is not deductible for U.S. income tax purposes and is not amortized. Rather, we assess goodwill for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that it might be impaired, by comparing its carrying value to the reporting unit's fair value.

Identifiable Intangible Assets Acquired

Our preliminary assessment of the fair values of the identified intangible assets and their respective useful lives are as follows (in thousands, except for useful lives):

	September 30, 2017	
	Fair Value	Useful Life (in years)
Developed technology	\$ 12,528	10
Software	3,341	3
Customer relations	3,236	6
Trade name	1,775	7
Other	843	2
Total intangible assets	\$ 21,723	

Grohmann's results of operations since the acquisition date have been included within the automotive segment in our consolidated statements of operations. Actual and pro forma results of operations have not been separately presented because they were not material to our consolidated financial statements.

SolarCity Acquisition

On November 21, 2016, we completed our acquisition of SolarCity for a total purchase price of \$2.1 billion in stock. We are currently finalizing our estimates of the fair values of the solar energy systems, leased and to be leased, identifiable intangible assets, deferred revenue, deferred taxes and noncontrolling interests assumed. Fair value adjustments recorded during the measurement period (a period not to exceed 12 months) may have a material impact on our consolidated financial statements. During the three months ended March 31, 2017, we recorded an \$11.6 million measurement period adjustment to the acquisition date fair values of certain assets as previously reported in our Form 10-K for the year ended December 31, 2016. Additionally, during the three months ended September 30, 2017, we recorded an \$18.2 million measurement period adjustment to the acquisition date fair values of certain liabilities as previously reported in our Form 10-K for the year ended December 31, 2016. The measurement period adjustments were recorded as losses to other income (expense), net, in our consolidated statement of operations, to effectively reduce the gain on acquisition initially recognized during the period ended December 31, 2016.

Note 4 – Goodwill and Intangible Assets

Goodwill increased to \$45.2 million from December 31, 2016 to September 30, 2017 due to our acquisition of Grohmann and the impact of foreign currency translation adjustments.

Information regarding our acquired intangible assets was as follows (in thousands):

Edgar Filing: Tesla, Inc. - Form 10-Q

	September 30, 2017			December 31, 2016			
	Gross Carrying Amount	Accumulated Amortization	Other	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Finite-lived intangible assets:							
Developed technology	\$ 125,889	\$ (14,766)	\$ 1,880	\$ 113,003	\$ 113,361	\$ (1,740)	\$ 111,621
Trade name	45,275	(7,707)	233	37,801	43,500	(967)	42,533
Favorable contracts and leases, net	112,817	(6,695)	—	106,122	112,817	(864)	111,953
Other	34,099	(6,624)	1,005	28,480	26,679	(3,473)	23,206
Total finite-lived intangible assets	318,080	(35,792)	3,118	285,406	296,357	(7,044)	289,313
Indefinite-lived intangible assets:							
IPR&D	86,832	—	—	86,832	86,832	—	86,832
Total indefinite-lived intangible assets	86,832	—	—	86,832	86,832	—	86,832
Total intangible assets	\$ 404,912	\$ (35,792)	\$ 3,118	\$ 372,238	\$ 383,189	\$ (7,044)	\$ 376,145

The in-process research and development (“IPR&D”), which we acquired from SolarCity, is accounted for as an indefinite-lived asset until the completion or abandonment of the associated research and development efforts. If the research and development efforts are successfully completed and commercial feasibility is reached, the IPR&D would be amortized over its then estimated useful life. If the research and development efforts are not completed or are abandoned, the IPR&D might be impaired. The fair value of the IPR&D was estimated using the replacement cost method under the cost approach, based on the historical acquisition costs and expenses of the technology adjusted for estimated developer’s profit, opportunity cost and obsolescence factor. We expect to complete the research

and development efforts by the end of 2017, but there can be no assurance that the commercial feasibility will be achieved. The nature of the research and development efforts consists principally of planning, designing and testing the technology for viability in manufacturing. If commercial feasibility is not achieved, we would likely look to other alternative technologies.

Total future amortization expense for intangible assets was estimated as follows (in thousands):

	September 30, 2017
Three months ending December 31, 2017	\$ 9,583
2018	37,910
2019	37,805
2020	35,954
2021	34,987
Thereafter	129,167
Total	\$ 285,406

Note 5 – Fair Value of Financial Instruments

ASC 820, Fair Value Measurements, states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. The three-tiered fair value hierarchy, which prioritizes which inputs should be used in measuring fair value, is comprised of: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than quoted prices in active markets that are observable either directly or indirectly and (Level III) unobservable inputs for which there is little or no market data. The fair value hierarchy requires the use of observable market data when available in determining fair value. Our assets and liabilities that were measured at fair value on a recurring basis were as follows (in thousands):

	September 30, 2017				December 31, 2016			
	Fair Value	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III
Money market funds	\$2,743,467	\$2,743,467	\$—	\$—	\$—	\$2,226,322	\$2,226,322	\$—
Interest rate swaps	(5,386)	—	(5,386)	—	1,490	—	1,490	—
Total	\$2,738,081	\$2,743,467	\$(5,386)	\$—	\$—	\$2,227,812	\$2,226,322	\$1,490

All of our cash equivalents were classified within Level I of the fair value hierarchy because they were valued using quoted prices in active markets. Our interest rate swaps were classified within Level II of the fair value hierarchy because they were valued using alternative pricing sources or models that utilized market observable inputs, including current and forward interest rates. During the nine months ended September 30, 2017, there were no transfers between the levels of the fair value hierarchy.

Interest Rate Swaps

We enter into fixed-for-floating interest rate swap agreements to swap variable interest payments on certain debt for fixed interest payments, as required by certain of our lenders. We do not designate our interest rate swaps as hedging

instruments. Accordingly, our interest rate swaps are recorded at fair value on the consolidated balance sheets within other assets or other long-term liabilities, with any changes in their fair values recognized as other income (expense), net, in the consolidated statements of operations and with any cash flows recognized as investing activities in the consolidated statements of cash flows. Our interest rate swaps outstanding were as follows as of September 30, 2017 (in thousands):

	Aggregate Notional Amount	Gross Asset at Fair Value	Gross Liability at Fair Value	Gross Gains		Gross Losses	
				Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2017
Interest rate swaps	\$ 659,309	\$ 5,611	\$ 10,997	\$ 440	\$ 2,989	\$ 1,641	\$ 12,836

Disclosure of Fair Values

Our financial instruments that are not re-measured at fair value include accounts receivable, MyPower customer notes receivable, rebates receivable, accounts payable, accrued liabilities, customer deposits, convertible senior notes, the 5.30% Senior Notes due in 2025, the participation interest, solar asset-backed notes, solar loan-backed notes, Solar Bonds and long-term debt. The carrying values of these financial instruments other than the convertible senior notes, the 5.30% Senior Notes due in 2025, the participation interest, the solar asset-backed notes and the solar loan-backed notes approximate their fair values.

We estimate the fair value of the convertible senior notes and the 5.30% Senior Notes due in 2025 using commonly accepted valuation methodologies and market-based risk measurements that are indirectly observable, such as credit risk (Level II). In addition, we estimate the fair value of the participation interest, the solar asset-backed notes and the solar loan-backed notes based on rates currently offered for instruments with similar maturities and terms (Level III). The following table presents the estimated fair values and the carrying values (in thousands):

	September 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible senior notes	\$3,695,516	\$4,686,863	\$2,957,288	\$3,205,641
Senior notes	\$1,774,742	\$1,759,500	\$—	\$—
Participation interest	\$17,313	\$16,813	\$16,713	\$15,025
Solar asset-backed notes	\$422,730	\$423,779	\$442,764	\$428,551
Solar loan-backed notes	\$236,726	\$250,124	\$137,024	\$132,129

Note 6 – Inventory

Our inventory consisted of the following (in thousands):

	September 30,	December
	2017	31, 2016
Raw materials	\$ 612,225	\$680,339
Work in process	277,155	233,746
Finished goods	1,418,385	1,016,731
Service parts	163,617	136,638
Total	\$ 2,471,382	\$2,067,454

Finished goods inventory included vehicles in transit to fulfill customer orders, new vehicles available for immediate sale at our retail and service center locations, used Tesla vehicles and energy storage products.

For solar energy systems, leased and to be leased, we commence transferring component parts from inventory to construction in progress, a component of solar energy systems, leased and to be leased, once a lease contract with a customer has been executed and installation has been initiated. Additional costs incurred on the leased systems, including labor and overhead, are recorded within construction in progress.

We write-down inventory for any excess or obsolete inventories or when we believe that the net realizable value of inventories is less than the carrying value. During the three and nine months ended September 30, 2017, we recorded write-downs of \$26.2 million and \$93.0 million, respectively, in cost of revenues. During the three and nine months ended September 30, 2016, we recorded write-downs of \$14.9 million and \$38.3 million, respectively, in cost of revenues.

Note 7 – Solar Energy Systems, Leased and To Be Leased, Net

Solar energy systems, leased and to be leased, net, consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Solar energy systems leased to customers	\$ 5,878,322	\$5,052,976
Initial direct costs related to customer solar energy		
system lease acquisition costs	65,283	12,774
	5,943,605	5,065,750
Less: accumulated depreciation and amortization	(168,571)	(20,157)
	5,775,034	5,045,593
Solar energy systems under construction	241,928	460,913
Solar energy systems to be leased to customers	271,003	413,374
Solar energy systems, leased and to be leased – net (1)	\$ 6,287,965	\$5,919,880

(1) Included in solar energy systems, leased and to be leased, as of September 30, 2017 and December 31, 2016 was \$36.0 million and \$36.0 million, respectively, related to capital leased assets with an accumulated depreciation and amortization of \$1.5 million and \$0.2 million, respectively.

Note 8 – Property, Plant and Equipment

Our property, plant and equipment, net, consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Machinery, equipment, vehicles and office furniture	\$ 3,671,297	\$2,154,367
Tooling	1,112,484	794,793
Leasehold improvements	716,015	505,295
Land and buildings	1,557,697	1,079,452
Computer equipment, hardware and software	360,533	275,655
Construction in progress	3,488,046	2,147,332
Other	23,886	23,548
	10,929,958	6,980,442
Less: Accumulated depreciation and amortization	(1,535,561)	(997,485)
Total	\$ 9,394,397	\$5,982,957

Construction in progress is primarily comprised of tooling and equipment related to the manufacturing of our vehicles and a portion of Gigafactory 1 construction. In addition, construction in progress also included certain build-to-suit lease costs incurred at our Buffalo manufacturing facility, referred to as Gigafactory 2. Completed assets are transferred to their respective asset classes, and depreciation begins when an asset is ready for its intended use. Interest on outstanding debt is capitalized during periods of significant capital asset construction and amortized over the useful lives of the related assets. During the three and nine months ended September 30, 2017, we capitalized \$37.3 million and \$96.0 million, respectively, of interest. During the three and nine months ended September 30, 2016, we capitalized \$11.4 million and \$30.4 million, respectively, of interest.

As of September 30, 2017 and December 31, 2016, the table above included \$1.59 billion and \$1.32 billion, respectively, of build-to-suit lease assets. As of September 30, 2017 and December 31, 2016, the corresponding financing liabilities of \$17.5 million and \$3.8 million, respectively, were recorded in accrued liabilities and \$1.62 billion and \$1.32 billion, respectively, were recorded in other long-term liabilities.

Depreciation and amortization expense during the three and nine months ended September 30, 2017 was \$197.5 million and \$534.2 million, respectively. Depreciation and amortization expense during the three and nine months ended September 30, 2016 was \$126.8 million and \$337.9 million. Gross property and equipment under capital leases as of September 30, 2017 and December 31, 2016 was \$612.3 million and \$112.6 million, respectively. Accumulated depreciation on property and equipment under capital leases as of these dates was \$88.3 million and \$40.2 million, respectively.

We had cumulatively capitalized costs of \$2.85 billion and \$1.04 billion, respectively, for Gigafactory 1 as of September 30, 2017 and December 31, 2016.

Note 9 – Other Long-Term Liabilities

Other long-term liabilities consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Accrued warranty reserve, net of current portion	\$ 238,949	\$ 149,858
Build-to-suit lease liability, net of current portion	1,621,593	1,323,293
Deferred rent expense	43,133	36,966
Financing obligation, net of current portion	72,278	84,360
Liability for receipts from an investor	59,421	76,828
Other noncurrent liabilities	347,456	220,144
Total long-term liabilities	\$ 2,382,830	\$ 1,891,449

The liability for receipts from an investor represents the amounts received from the investor under a lease pass-through fund arrangement for the monetization of investment tax credits (“ITCs”) for solar energy systems not yet placed in service. This balance is reclassified to deferred revenue when the solar energy systems are placed in service.

Note 10 – Customer Deposits

Customer deposits primarily consisted of cash payments from customers at the time they place an order or reservation for a vehicle or an energy product and any additional payments up to the point of delivery or the completion of installation, including the

fair values of any customer trade-in vehicles that are applicable toward a new vehicle purchase. Customer deposit amounts and timing vary depending on the vehicle model, the energy product and the country of delivery. Customer deposits are fully refundable in the case of a vehicle up to the point the vehicle is placed into the production cycle, and, in the case of solar or energy storage products, prior to the entry into a purchase agreement or in certain cases for a limited time thereafter, in accordance with applicable laws. Customer deposits are included in current liabilities until refunded or until they are applied towards the customer's purchase balance. As of September 30, 2017 and December 31, 2016, we held \$686.1 million and \$663.9 million, respectively, in customer deposits.

Note 11 – Convertible and Long-Term Debt Obligations

The following is a summary of our debt as of September 30, 2017 (in thousands):

	Unpaid Principal Balance	Net Carrying Value		Unused Committed Amount	Contractual Interest Rate	Maturity Date
		Current	Long-Term			
Recourse debt:						
1.50% Convertible Senior Notes due in 2018	\$17,512	\$17,155	\$—	\$—	1.50	% June 2018
("2018 Notes")						
0.25% Convertible Senior Notes due in 2019	920,000	—	858,449	—	0.25	% March 2019
("2019 Notes")						
1.25% Convertible Senior Notes due in 2021	1,380,000	—	1,172,195	—	1.25	% March 2021
("2021 Notes")						
2.375% Convertible Senior Notes due in 2022	977,500	—	834,834	—	2.375	% March 2022
("2022 Notes")						
5.30% Senior Notes due in 2025	1,800,000	—	1,774,742	—	5.30	% August 2025
("2025 Notes")						
Credit Agreement	1,269,000	—	1,269,000	535,095	1% plus LIBOR	June 2020
Vehicle and Other Loans	15,367	12,863	2,504	—	1.8%-7.6%	October 2017- September 2019
2.75% Convertible Senior Notes due in 2018	230,000	—	221,166	—	2.75	% November 2018
1.625% Convertible Senior Notes due in 2019	566,000	—	506,535	—	1.625	% November 2019
	103,000	—	85,182	—	0.0	% December 2020

Edgar Filing: Tesla, Inc. - Form 10-Q

Zero-coupon Convertible Senior Notes due in 2020						
Related Party Promissory Notes due in February 2018	100,000	100,000	—	—	6.5	% February 2018
Solar Bonds	32,016	6,424	25,135	—	2.6%-5.8%	March 2018- January 2031
Total recourse debt	7,410,395	136,442	6,749,742	535,095		
Non-recourse debt:						
Warehouse Agreements	556,992	154,191	402,801	43,008	2.7	% September 2019
Canada Credit Facility	55,072	21,357	33,715	—	3.6%-4.5%	December 2020
Term Loan due in December 2018	154,573	3,943	150,306	21,299	4.7	% December 2018
Term Loan due in January 2021	178,820	5,745	171,938	—	4.8	% January 2021
Revolving Aggregation Credit Facility	420,265	—	417,681	179,735	4.1%-4.8%	December 2019
Solar Renewable Energy Credit Loan Facility	45,389	17,025	28,509	—	7.0	% July 2021
Cash Equity Debt	488,000	12,397	459,987	—	5.3%-5.8%	July 2033- January 2035
Solar Asset-backed Notes	438,417	16,403	406,327	—	4.0%-5.6%	November 2038- September 2046
Solar Loan-backed Notes	244,498	8,003	228,723	—	4.8%-7.5%	September 2048- September 2049
Total non-recourse debt	2,582,026	239,064	2,299,987	244,042		
Total debt	\$9,992,421	\$375,506	\$9,049,729	\$779,137		

Edgar Filing: Tesla, Inc. - Form 10-Q

The following is a summary of our debt as of December 31, 2016 (in thousands):

	Unpaid Principal Balance	Net Carrying Value		Unused Committed Amount	Contractual Interest Rate	Maturity Date
		Current	Long-Term			
Recourse debt:						
2018 Notes	\$205,013	\$196,229	\$—	\$—	1.50 %	June 2018
2019 Notes	920,000	—	827,620	—	0.25 %	March 2019
2021 Notes	1,380,000	—	1,132,029	—	1.25 %	March 2021
Credit Agreement	969,000	—	969,000	181,000	1% plus LIBOR	June 2020
Secured Revolving Credit Facility	364,000	366,247	—	24,305	4.0%-6.0%	January 2017- December 2017
Vehicle and Other Loans	23,771	17,235	6,536	—	2.9%-7.6%	March 2017- June 2019
2.75% Convertible Senior Notes due in 2018	230,000	—	212,223	—	2.75%	November 2018
1.625% Convertible Senior Notes due in 2019	566,000	—	483,820	—	1.625%	November 2019
Zero-coupon Convertible Senior Notes due in 2020	113,000	—	89,418	—	0.0%	December 2020
Solar Bonds	332,060	181,582	148,948	#	1.1%-6.5%	January 2017- January 2031
Total recourse debt	5,102,844	761,293	3,869,594	205,305		
Non-recourse debt:						
Warehouse Agreement	390,000	73,708	316,292	210,000	Various	September 2018
Canada Credit Facility	67,342	18,489	48,853	—	3.6%- 4.5%	December 2020
Term Loan due in December 2017	75,467	75,715	—	52,173	4.2%	December 2017
Term Loan due in January 2021	183,388	5,860	176,169	—	4.5%	January 2021
MyPower Revolving Credit Facility	133,762	133,827	—	56,238	4.1%-6.6%	January 2017
Revolving Aggregation Credit Facility	424,757	—	427,944	335,243	4.0%-4.8%	December 2018
Solar Renewable Energy Credit Term Loan	38,124	12,491	26,262	—	6.6%-9.9%	April 2017- July 2021
Cash Equity Debt	496,654	13,642	466,741	—	5.3%-5.8%	July 2033- January 2035
Solar Asset-backed Notes	458,836	16,113	426,651	—	4.0%-7.5%	November 2038- September 2046

Edgar Filing: Tesla, Inc. - Form 10-Q

Solar Loan-backed Notes	140,586	3,514	133,510	—	4.8%-6.9%	September 2048
Total non-recourse debt	2,408,916	353,359	2,022,422	653,654		
Total debt	\$7,511,760	\$1,114,652	\$5,892,016	\$ 858,959		

#Out of the \$350.0 million authorized to be issued, \$17.9 million remained available to be issued.

Recourse debt refers to debt that is recourse to our general assets. Non-recourse debt refers to debt that is recourse to only specified assets of our subsidiaries. The differences between the unpaid principal balances and the net carrying values are due to convertible senior note conversion features, debt discounts and deferred financing costs. As of September 30, 2017, we were in compliance with all financial debt covenants. The following descriptions summarize the significant debt activity in the nine months ended September 30, 2017.

2018 Notes

In June 2017, \$144.8 million in aggregate principal amount of the 2018 Notes were exchanged for 1,163,442 shares of our common stock (see Note 12, Common Stock). As a result, we recognized a loss on debt extinguishment of \$1.1 million.

In the third quarter of 2017, \$42.7 million in aggregate principal amount of the 2018 Notes were exchanged or converted for 250,198 shares of our common stock (see Note 12, Common Stock) and \$32.7 million in cash. As a result, we recognized a loss on debt extinguishment of \$0.3 million.

2022 Notes, Bond Hedges and Warrant Transactions

In March 2017, we issued \$977.5 million in aggregate principal amount of 2.375% convertible senior notes due in March 2022 in a public offering. The net proceeds from the issuance, after deducting transaction costs, were \$965.9 million.

Each \$1,000 of principal of the 2022 Notes is initially convertible into 3.0534 shares of our common stock, which is equivalent to an initial conversion price of approximately \$327.50 per share, subject to adjustment upon the occurrence of specified events. Holders of the 2022 Notes may convert, at their option, on or after December 15, 2021. Further, holders of the 2022 Notes may convert such 2022 Notes, at their option, prior to December 15, 2021, only under the following circumstances: (1) during any quarter beginning after June 30, 2017, if the closing price of our common stock for at least 20 trading days (whether or not consecutive) during the last 30 consecutive trading days immediately preceding the quarter is greater than or equal to 130% of the conversion price; (2) during the five-business day period following any five-consecutive trading day period in which the trading price of the 2022 Notes is less than 98% of the average of the closing price of our common stock for each day during such five-consecutive trading day period; or (3) if we make specified distributions to holders of our common stock or if specified corporate transactions occur. Upon a

conversion, we would pay cash for the principal amount and, if applicable, deliver 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 2022 Notes may require us to repurchase all or a portion of their 2022 Notes for cash at a repurchase price equal to 100% of the principal amount plus any accrued and unpaid interest. In addition, if specific corporate events occur prior to the maturity date, we would increase the conversion rate for a holder who elects to convert their 2022 Notes in connection with such an event in certain circumstances. As of September 30, 2017, none of the conditions permitting the holders of the 2022 Notes to early convert had been met. Therefore, the 2022 Notes are classified as long-term debt.

In accordance with GAAP relating to embedded conversion features, we initially valued and bifurcated the conversion feature associated with the 2022 Notes. We recorded to stockholders' equity \$145.6 million for the conversion feature. The resulting debt discount is being amortized to interest expense at an effective interest rate of 6.00%.

In connection with the offering of the 2022 Notes, we entered into convertible note hedge transactions whereby we had the option to purchase initially (subject to adjustment for certain specified events) a total of 3.0 million shares of our common stock at a price of \$327.50 per share. The cost of the convertible note hedge transactions was \$204.1 million. In addition, we sold warrants whereby the holders of the warrants had the option to purchase initially (subject to certain specified events) a total of 3.0 million shares of our common stock at a price of \$655.00 per share. We received \$52.9 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 reduce potential dilution from the conversion of the 2022 Notes and to effectively increase the overall conversion price from \$327.50 to \$655.00 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 on our consolidated balance sheet.

2025 Notes

In August 2017, we issued \$1,800.0 million in aggregate principal amount of unsecured 5.30% senior notes due in August 2025 pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended (the "Securities Act"). The net proceeds from the issuance, after deducting transaction costs, were \$1,774.2 million.

Secured Revolving Credit Facility

In August 2017, the secured revolving credit facility was terminated, and the aggregate outstanding principal amount of \$324.0 million was fully repaid.

Zero-coupon Convertible Senior Notes due in 2020

On April 26, 2017, our Chief Executive Officer converted all of his zero-coupon convertible senior notes due in 2020, which had an aggregate principal amount of \$10.0 million (see Note 12, Common Stock). As a result, we recognized a loss on debt extinguishment of \$2.2 million.

Related Party Promissory Notes due in February 2018

On April 11, 2017, our Chief Executive Officer, SolarCity's former Chief Executive Officer and SolarCity's former Chief Technology Officer exchanged their \$100.0 million (collectively) in aggregate principal amount of 6.50% Solar Bonds due in February 2018 for promissory notes in the same amounts and with substantially the same terms.

Solar Bonds

Solar Bonds are senior unsecured obligations that are structurally subordinate to the indebtedness and other liabilities of our subsidiaries. Solar Bonds were issued under multiple series between October 2014 and August 2016 with various terms and interest rates. In April 2017, we fully extinguished certain series of Solar Bonds by prepaying \$20.9 million of principal and interest. See Note 16, Related Party Transactions, for Solar Bonds issued to related parties.

Warehouse Agreements

On August 31, 2016, our subsidiaries entered into a Warehouse Agreement with a bank for loans secured by the future cash flows arising from certain leases and the related leased vehicles. On August 17, 2017, the Warehouse Agreement was amended to modify the interest rates and extend the availability period and the maturity date, by appending another Warehouse Agreement with substantially the same terms and that shares the same committed amount. Amounts drawn under the Warehouse Agreements generally bear interest at (i) LIBOR plus a fixed margin or (ii) the commercial paper rate. The Warehouse Agreements are non-recourse to our other assets.

Pursuant to the Warehouse Agreements, an undivided beneficial interest in the future cash flows arising from certain leases and the related leased vehicles has been sold for legal purposes but continues to be reported in the consolidated financial statements. The interest in the future cash flows arising from these leases and the related vehicles is not available to pay the claims of our creditors other than pursuant to obligations to the lenders under the Warehouse Agreements. We retain the right to receive the excess cash flows not needed to pay obligations under the Warehouse Agreements.

On October 18, 2017, the total committed amount under the Warehouse Agreements was increased from \$600.0 million to \$1.1 billion.

Term Loan due in December 2018

On March 31, 2016, a subsidiary of SolarCity entered into an agreement for a term loan. The term loan bears interest at an annual rate of the lender's cost of funds plus 3.25%. The fee for undrawn commitments is 0.85% per annum. On March 31, 2017, the agreement was amended to extend the availability period and the maturity date. The term loan is secured by substantially all of the assets of the subsidiary and is non-recourse to our other assets.

MyPower Revolving Credit Facility

In January 2017, the MyPower revolving credit facility matured, and the aggregate outstanding principal amount of \$133.8 million was fully repaid.

Revolving Aggregation Credit Facility

On May 4, 2015, a subsidiary of SolarCity entered into an agreement with a syndicate of banks for a revolving aggregation credit facility. On March 23, 2016 and June 23, 2017, the agreement was amended to modify the interest rates and extend the availability period and the maturity date. The revolving aggregation credit facility bears interest at an annual rate of 2.75% plus (i) for commercial paper loans, the commercial paper rate and (ii) for LIBOR loans, at our option, three-month LIBOR or daily LIBOR. The revolving aggregation credit facility is secured by certain assets of certain subsidiaries of SolarCity and is non-recourse to our other assets.

Solar Renewable Energy Credit Loan Facilities

On March 31, 2016, a subsidiary of SolarCity entered into an agreement for a term loan. The term loan bore interest at an annual rate of one-month LIBOR plus 9.00% or, at our option, 8.00% plus the highest of (i) the Federal Funds Rate plus 0.50%, (ii) the prime rate or (iii) one-month LIBOR plus 1.00%. The term loan was secured by substantially all of the assets of the subsidiary, including its rights under forward contracts to sell solar renewable energy credits, and was non-recourse to our other assets. On March 1, 2017, we fully repaid the principal outstanding under the term loan.

On July 14, 2016, the same subsidiary entered into an agreement for another loan facility. The loan facility bears interest at an annual rate of one-month LIBOR plus 5.75% or, at our option, 4.75% plus the highest of (i) the Federal Funds Rate plus 0.50%, (ii) the prime rate or (iii) one-month LIBOR plus 1.00%. The loan facility is secured by substantially all of the assets of the subsidiary, including its rights under forward contracts to sell solar renewable energy credits, and is non-recourse to our other assets.

Solar Loan-backed Notes, Series 2017-A

On January 27, 2017, we pooled and transferred certain MyPower customer notes receivable into a special purpose entity ("SPE") and issued \$123.0 million in aggregate principal amount of Solar Loan-backed Notes, Series 2017-A,

Class A; \$8.8 million in aggregate principal amount of Solar Loan-backed Notes, Series 2017-A, Class B; and \$13.2 million in aggregate principal amount of Solar Loan-backed Notes, Series 2017-A, Class C; backed by these notes receivable to investors. The SPE is wholly owned by us and is consolidated in our financial statements. Accordingly, we did not recognize a gain or loss on the transfer of these notes receivable. The Solar Loan-backed Notes were issued at a discount of 1.87% for Class A, 1.86% for Class B and 8.13% for Class C. The payments received by the SPE from these notes receivable are used to service the semi-annual principal and interest payments on the Solar Loan-backed Notes and satisfy the SPE's expenses, and any remaining cash is distributed to one of our wholly owned subsidiaries. The SPE's assets and cash flows are not available to our other creditors, and the creditors of the SPE, including the Solar Loan-backed Note holders, have no recourse to our other assets.

Interest Expense

The following table presents the interest expense related to the contractual interest coupon, the amortization of debt issuance costs and the amortization of debt discounts on convertible senior notes with cash conversion features, which includes the 2018 Notes, the 2019 Notes, the 2021 Notes and the 2022 Notes (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Contractual interest coupon	\$ 10,899	\$ 6,615	\$ 28,306	\$ 23,330
Amortization of debt issuance costs	1,759	4,952	5,274	8,835
Amortization of debt discounts	29,888	24,660	83,852	75,493
Total	\$ 42,546	\$ 36,227	\$ 117,432	\$ 107,658

Note 12 – Common Stock

In March 2017, we completed a public offering of our common stock and issued a total of 1,536,259 shares for total cash proceeds of \$399.6 million (including 95,420 shares purchased by our Chief Executive Officer for \$25.0 million), net of underwriting discounts and offering costs.

In April 2017, our Chief Executive Officer exercised his right under the indenture to convert all of his zero-coupon convertible senior notes due in 2020, which had an aggregate principal amount of \$10.0 million. As a result, on April 26, 2017, we issued 33,333 shares of our common stock to our Chief Executive Officer in accordance with the specified conversion rate, and we recorded an increase to additional paid-in capital of \$10.3 million (see Note 11, Convertible and Long-Term Debt Obligations).

In June 2017, we issued 1,163,442 shares of our common stock pursuant to exchange agreements entered into with holders of \$144.8 million in aggregate principal amount of the 2018 Notes (see Note 11, Convertible and Long-Term Debt Obligations). As a result, we recorded an increase to additional paid-in capital of \$141.8 million. In addition, we amended and settled early the associated portions of the bond hedges and warrants entered into in connection with the 2018 Notes, resulting in a net cash inflow of \$43.6 million, which was recorded as an increase to additional paid-in capital.

In the third quarter of 2017, we issued 250,198 shares of our common stock and paid \$32.7 million in cash pursuant to conversions by or exchange agreements entered into with holders of \$42.7 million in aggregate principal amount of the 2018 Notes (see Note 11, Convertible and Long-Term Debt Obligations). As a result, we recorded an increase to additional paid-in capital of \$9.3 million. In addition, we settled portions of the bond hedges and warrants entered into in connection with the 2018 Notes, resulting in a net cash inflow of \$6.3 million (which was recorded as an increase to additional paid-in capital), the issuance of 17,433 shares of our common stock and the receipt of 169,890 shares of our common stock.

Note 13 – Equity Incentive Plans

In 2010, we adopted the 2010 Equity Incentive Plan (the “2010 Plan”). The 2010 Plan provides for the granting of stock options, RSUs and stock purchase rights to our employees, directors and consultants. Options granted under the 2010 Plan may be either incentive options or nonqualified stock options. Incentive stock options may be granted only to our employees, including officers. Nonqualified stock options and stock purchase rights may be granted to our employees, including directors, and consultants. Generally, our stock option and RSU awards vest over up to four years and are exercisable over a maximum period of ten years from their grant dates. Vesting typically terminates when the employment or consulting relationship ends.

As of September 30, 2017, there were 15,014,437 shares underlying outstanding equity awards.

2014 Performance-Based Stock Option Awards

In 2014, to create incentives for continued long-term success beyond the Model S program and to closely align executive pay with our stockholders’ interests in the achievement of significant milestones by us, the Compensation Committee of our Board of Directors granted stock option awards to certain employees (excluding our Chief Executive Officer) to purchase an aggregate of 1,073,000 shares of our common stock. Each award consisted of four vesting tranches with a vesting schedule based entirely on the attainment of performance milestones, assuming continued employment and service through each vesting date:

- 1/4th of each award vested upon completion of the first Model X production vehicle;
- 1/4th of each award is scheduled to vest upon achieving aggregate production of 100,000 vehicles in a trailing 12-month period;
- 1/4th of each award is scheduled to vest upon completion of the first Model 3 production vehicle; and

1/4th of each award is scheduled to vest upon achieving an annualized gross margin of greater than 30.0% for any three-year period.

As of September 30, 2017, the following performance milestones had been achieved:

- Completion of the first Model X production vehicle;
- Aggregate production of 100,000 vehicles in a trailing 12-month period; and
- Completion of the first Model 3 production vehicle.

We begin recognizing stock-based compensation expense as each performance milestone becomes probable of achievement. As of September 30, 2017, we had unrecognized stock-based compensation expense of \$17.1 million for the performance milestone that was considered not probable of achievement. For the three and nine months ended September 30, 2017, we recorded stock-based compensation expense of \$0.5 million and \$6.8 million, respectively, related to these awards. For the three and nine months ended September 30, 2016, we recorded stock-based compensation expense of \$11.6 million and \$22.8 million, respectively, related to these awards.

2012 Chief Executive Officer Awards

In August 2012, our Board of Directors granted 5,274,901 stock option awards to our Chief Executive Officer (the “2012 CEO Grant”). The 2012 CEO Grant consists of 10 vesting tranches with a vesting schedule based entirely on the attainment of both performance conditions and market conditions, assuming continued employment and service through each vesting date. Each vesting tranche requires a combination of a pre-determined performance milestone and an incremental increase in our market capitalization of \$4.0 billion, as compared to our initial market capitalization of \$3.2 billion at the time of grant. As of September 30, 2017, the market capitalization conditions for all of the vesting tranches and the following eight performance milestones had been achieved:

- Successful completion of the Model X alpha prototype;
- Successful completion of the Model X beta prototype;
- Completion of the first Model X production vehicle;
- Aggregate production of 100,000 vehicles;
- Successful completion of the Model 3 alpha prototype,
- Successful completion of the Model 3 beta prototype;
- Aggregate production of 200,000 vehicles; and
- Completion of the first Model 3 production vehicle.

As of September 30, 2017, the following performance milestone was considered probable of achievement:

- Aggregate production of 300,000 vehicles.

We begin recognizing stock-based compensation expense as each milestone becomes probable of achievement. As of September 30, 2017, we had \$1.0 million of total unrecognized stock-based compensation expense for the performance milestone that was considered probable of achievement, which will be recognized over a weighted-average period of 0.3 years. As of September 30, 2017, we had unrecognized stock-based compensation expense of \$5.7 million for the performance milestone that was considered not probable of achievement. For the three and nine months ended September 30, 2017, we recorded stock-based compensation expense of \$1.2 million and \$4.3 million, respectively, related to the 2012 CEO Grant. For the three and nine months ended September 30, 2016, we recorded stock-based compensation expense of \$4.6 million and \$14.9 million, respectively, related to the 2012 CEO Grant.

Our Chief Executive Officer earns a base salary that reflects the currently applicable minimum wage requirements under California law, and he is subject to income taxes based on such base salary. However, he has never accepted and currently does not accept his salary.

Summary Stock-Based Compensation Information

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Cost of sales	\$ 10,166	\$ 8,939	\$ 27,663	\$ 21,837
Research and development	51,066	40,220	158,052	113,328
Selling, general and administrative	51,421	40,384	146,697	111,347
Total	\$ 112,653	\$ 89,543	\$ 332,412	\$ 246,512

We realized no income tax benefits from stock option exercises in each of the periods presented due to recurring losses and valuation allowances. As of September 30, 2017, we had \$1.1 billion of total unrecognized stock-based compensation expense related to non-performance awards, which will be recognized over a weighted-average period of 2.9 years.

Note 14 – Commitments and Contingencies

Non-Cancellable Leases

We have entered into various non-cancellable leases for certain of our offices, manufacturing and warehouse facilities, retail and service locations, equipment, vehicles, solar energy systems and Supercharger sites, throughout the world.

Build-to-Suit Lease Arrangement in Buffalo, New York

As discussed in Note 8, Property, Plant and Equipment, we have a build-to-suit lease arrangement with the Research Foundation for the State University of New York (the “Foundation”) where the Foundation will construct a solar cell and panel manufacturing facility, referred to as Gigafactory 2, with our participation in the design and construction, install certain utilities and other improvements and acquire certain manufacturing equipment designated by us to be used in the manufacturing facility. The Foundation will cover (i) construction costs related to the manufacturing facility in an amount up to \$350.0 million, (ii) the acquisition and commissioning of the manufacturing equipment in an amount up to \$274.7 million and (iii) \$125.3 million for additional specified scope costs, in cases (i) and (ii) only, subject to the maximum funding allocation from the State of New York, and we will be responsible for any construction and equipment costs in excess of such amounts. The Foundation will own the manufacturing facility and the manufacturing equipment purchased by the Foundation. Following completion of the manufacturing facility, we will lease the manufacturing facility and the manufacturing equipment owned by the Foundation for an initial period of 10 years, with an option to renew, for \$2 per year plus utilities.

Under the terms of the build-to-suit lease arrangement, we are required to achieve specific operational milestones during the initial term of the lease, which include employing a certain number of employees at the manufacturing facility, within western New York and within the State of New York within specified periods following the completion of the manufacturing facility. We are also required to spend or incur approximately \$5.0 billion in combined capital, operational expenses and other costs in the State of New York over the 10 years following the achievement of full production. On an annual basis during the initial lease term, as measured on each anniversary of

the commissioning of the manufacturing facility, if we fail to meet these specified investment and job creation requirements, then we would be obligated to pay a \$41.2 million “program payment” to the Foundation for each year that we fail to meet these requirements. Furthermore, if the arrangement is terminated due to a material breach by us, then additional amounts might be payable by us.

The non-cash investing and financing activities related to the arrangement during the three and nine months ended September 30, 2017 amounted to \$1.9 million and \$83.5 million, respectively.

Legal Proceedings

Securities Litigation

On March 28, 2014, a purported stockholder class action was filed in the United States District Court for the Northern District of California against SolarCity and two of its officers. The complaint alleges violations of federal securities laws, and seeks unspecified compensatory damages and other relief on behalf of a purported class of purchasers of SolarCity’s securities from March 6, 2013 to March 18, 2014. After a series of amendments to the original complaint, the District Court dismissed the amended complaint and entered a judgment in our favor on August 9, 2016. The plaintiffs have filed a notice of appeal. The District Court has set a hearing on plaintiffs’ notice of appeal from the dismissal for December 4, 2017. We believe that the claims are without merit and

intend to defend against this lawsuit and appeal vigorously. We are unable to estimate the possible loss or range of loss, if any, associated with this lawsuit.

On August 15, 2016, a purported stockholder class action lawsuit was filed in the United States District Court for the Northern District of California against SolarCity, two of its officers and a former officer. On March 20, 2017, the purported stockholder class filed a consolidated complaint that includes the original matter in the same court against SolarCity, one of its officers and three former officers. As consolidated, the complaint alleges that SolarCity made projections of future sales and installations that it failed to achieve and that these projections were fraudulent when made. The lawsuit claimed violations of federal securities laws and sought unspecified compensatory damages and other relief on behalf of a purported class of purchasers of SolarCity's securities from May 6, 2015 to May 9, 2016. On July 25, 2017, the court took SolarCity's fully-briefed motion to dismiss under submission. On August 11, 2017, the District Court granted the motion to dismiss with leave to amend. On September 11, 2017, after the lead plaintiff determined he would not amend, the District Court dismissed the action with prejudice and entered a judgment in favor of SolarCity and the individual defendants.

On October 10, 2017, a purported stockholder class action was filed in the United States District Court for the Northern District of California against Tesla, two of its current officers and a former officer. The complaint alleges violations of federal securities laws and seeks unspecified compensatory damages and other relief on behalf of a purported class of purchasers of Tesla securities from May 4, 2016 to October 6, 2017. The lawsuit claims that Tesla supposedly made materially false and misleading statements regarding its preparedness to produce Model 3 vehicles. We believe that the claims are without merit and intend to defend against this lawsuit vigorously. We are unable to estimate the possible loss or range of loss, if any, associated with this lawsuit.

Litigation Relating to the SolarCity Acquisition

Between September 1, 2016 and October 5, 2016, seven lawsuits were filed in the Court of Chancery of the State of Delaware by purported stockholders of Tesla challenging our acquisition of SolarCity. Following consolidation, the lawsuit names as defendants the members of Tesla's board of directors and alleges, among other things, that board members breached their fiduciary duties in connection with the acquisition. The complaint asserts both derivative claims and direct claims on behalf of a purported class and seeks, among other relief, unspecified monetary damages, attorneys' fees, and costs. On January 27, 2017, the defendants filed a motion to dismiss the operative complaint. Rather than respond to the defendants' motion, the plaintiffs filed an amended complaint. On March 17, 2017, the defendants filed a motion to dismiss the amended complaint; that motion is pending. These same plaintiffs filed a parallel action in the United States District Court for the District of Delaware on April 21, 2017, adding claims for violations of the federal securities laws.

On February 6, 2017, a purported stockholder made a demand to inspect Tesla's books and records, purportedly to investigate potential breaches of fiduciary duty in connection with the SolarCity acquisition. On April 17, 2017, the purported stockholder filed a petition for a writ of mandate in California Superior Court, seeking to compel Tesla to provide the documents requested in the demand. Tesla filed a demurrer to the writ petition or, in the alternative, a motion to stay the action, which remain pending.

On March 24, 2017, another lawsuit was filed in the United States District Court for the District of Delaware by a purported Tesla stockholder challenging the SolarCity acquisition. The complaint alleges, among other things, that Tesla's board of directors breached their fiduciary duties in connection with the acquisition and alleges violations of the federal securities laws.

We believe that claims challenging the SolarCity acquisition are without merit. We are unable to estimate the possible loss or range of loss, if any, associated with these claims.

Proceedings Relating to United States Treasury

In July 2012, SolarCity, along with other companies in the solar energy industry, received a subpoena from the United States Treasury Department's Office of the Inspector General to deliver certain documents in SolarCity's possession that relate to SolarCity's applications for United States Treasury grants. In February 2013, two financing funds affiliated with SolarCity filed a lawsuit in the United States Court of Federal Claims against the United States government, seeking to recover \$14.0 million that the United States Treasury was obligated to pay, but failed to pay, under Section 1603 of the American Recovery and Reinvestment Act of 2009. In February 2016, the United States government filed a motion seeking leave to assert a counterclaim against the two plaintiff funds on the grounds that the United States government, in fact, paid them more, not less, than they were entitled to as a matter of law. In September 2017, SolarCity and the United States government reached a global settlement of both the investigation and SolarCity's lawsuit. In that settlement, SolarCity admitted no wrongdoing and agreed to return approximately 5% of the United States Treasury cash grants it had received between 2009 and 2013, amounting to \$29.5 million. The investigation is now closed and SolarCity's lawsuit has been dismissed.

Other Matters

From time to time, we have received requests for information from regulators and governmental authorities, such as the National Highway Traffic Safety Administration, the National Transportation Safety Board and the Securities and Exchange Commission. We are also subject to various other legal proceedings and claims that arise from the normal course of business activities. 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.

Indemnifications and Guaranteed Returns

We are contractually obligated to compensate certain fund investors for any losses that they may suffer in certain limited circumstances resulting from reductions in U.S. Treasury grants or ITCs. Generally, such obligations would arise as a result of reductions to the value of the underlying solar energy systems as assessed by the U.S. Treasury Department for purposes of claiming U.S. Treasury grants or as assessed by the IRS for purposes of claiming ITCs or U.S. Treasury grants. For each balance sheet date, we assess and recognize, when applicable, a distribution payable for the potential exposure from this obligation based on all the information available at that time, including any guidelines issued by the U.S. Treasury Department on solar energy system valuations for purposes of claiming U.S. Treasury grants and any audits undertaken by the IRS. We believe that any payments to the fund investors in excess of the amount already recognized by us for this obligation are not probable based on the facts known at the filing date.

The maximum potential future payments that we could have to make under this obligation would depend on the difference between the fair values of the solar energy systems sold or transferred to the funds as determined by us and the values that the U.S. Treasury Department would determine as fair value for the systems for purposes of claiming U.S. Treasury grants or the values the IRS would determine as the fair value for the systems for purposes of claiming ITCs or U.S. Treasury grants. We claim U.S. Treasury grants based on guidelines provided by the U.S. Treasury department and the statutory regulations from the IRS. We use fair values determined with the assistance of independent third-party appraisals commissioned by us as the basis for determining the ITCs that are passed-through to and claimed by the fund investors. Since we cannot determine future revisions to U.S. Treasury Department guidelines governing solar energy system values or how the IRS will evaluate system values used in claiming ITCs or U.S. Treasury grants, we are unable to reliably estimate the maximum potential future payments that it could have to make under this obligation as of each balance sheet date.

We are eligible to receive certain state and local incentives that are associated with renewable energy generation. The amount of incentives that can be claimed is based on the projected or actual solar energy system size and/or the amount of solar energy produced. We also currently participate in one state's incentive program that is based on either the fair market value or the tax basis of solar energy systems placed in service. State and local incentives received are allocated between us and fund investors in accordance with the contractual provisions of each fund. We are not contractually obligated to indemnify any fund investor for any losses they may incur due to a shortfall in the amount of state or local incentives actually received.

We are contractually obligated to make payments to one fund investor if the fund investor does not achieve a specified minimum internal rate of return. The fund investor has already received a significant portion of the projected economic benefits from U.S. Treasury grant distributions and tax depreciation benefits. The contractual provisions of the fund state that the fund has an indefinite term unless the members agree to dissolve the fund. Based on our current financial projections regarding the amounts and timing of future distributions to the fund investor, we do not expect to make any payments as a result of this guarantee and have not accrued any liabilities for this guarantee. The amounts of any potential future payments under this guarantee are dependent on the amounts and timing of future distributions to the fund investor, future tax benefits that accrue to the fund investor, our purchase of the fund investor's interest in the fund and future distributions to the fund investor upon the liquidation of the fund. Due to the uncertainties surrounding

estimating the amounts and timing of these factors, we are unable to estimate the maximum potential payments under this guarantee. To date, the fund investor has achieved the specified minimum internal rate of return.

Our lease pass-through financing funds have a one-time lease payment reset mechanism that occurs after the installation of all solar energy systems in a fund. As a result of this mechanism, we may be required to refund master lease prepayments previously received from investors. Any refunds of master lease prepayments would reduce the lease pass-through financing obligation.

Letters of Credit

As of September 30, 2017, we had \$129.9 million of unused letters of credit outstanding.

Note 15 – VIE Arrangements

We have entered into various arrangements with investors to facilitate the funding and monetization of our solar energy systems and vehicles. In particular, our wholly owned subsidiaries and fund investors have formed and contributed cash and assets into various financing funds and entered into related agreements. We have determined that the funds are VIEs and we are the primary beneficiary of these VIEs by reference to the power and benefits criterion under ASC 810, Consolidation. We have considered the provisions within the agreements, which grant us the power to manage and make decisions that affect the operation of these VIEs, including

determining the solar energy systems or vehicles and the associated customer contracts to be sold or contributed to these VIEs, redeploying solar energy systems or vehicles and managing customer receivables. We consider that the rights granted to the fund investors under the agreements are more protective in nature rather than participating.

As the primary beneficiary of these VIEs, we consolidate in the financial statements the financial position, results of operations and cash flows of these VIEs, and all intercompany balances and transactions between us and these VIEs are eliminated in the consolidated financial statements. Cash distributions of income and other receipts by a fund, net of agreed upon expenses, estimated expenses, tax benefits and detriments of income and loss and tax credits, are allocated to the fund investor and our subsidiary as specified in the agreements.

Generally, our subsidiary has the option to acquire the fund investor's interest in the fund for an amount based on the market value of the fund or the formula specified in the agreements.

Upon the sale or liquidation of a fund, distributions would occur in the order and priority specified in the agreements.

Pursuant to management services, maintenance and warranty arrangements, we have been contracted to provide services to the funds, such as operations and maintenance support, accounting, lease servicing and performance reporting. In some instances, we have guaranteed payments to the fund investors as specified in the agreements. A fund's creditors have no recourse to our general credit or to that of other funds. None of the assets of the funds had been pledged as collateral for their obligations.

The aggregate carrying values of the VIEs' assets and liabilities, after elimination of any intercompany transactions and balances, in the consolidated balance sheets were as follows (in thousands):

	September 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	\$ 71,973	\$ 44,091
Restricted cash	33,343	20,916
Accounts receivable, net	36,248	16,023
Rebates receivable	5,060	6,646
Prepaid expenses and other current assets	3,620	7,532
Total current assets	150,244	95,208
Operating lease vehicles, net	143,613	—
Solar energy systems, leased and to be leased, net	5,098,398	4,618,443
Other assets	52,866	35,826
Total assets	\$ 5,445,121	\$ 4,749,477
Liabilities		
Accounts payable	\$ 31	\$ 20
Distributions payable to noncontrolling interests		
and redeemable noncontrolling interests	32,245	24,085
Accrued and other current liabilities	14,472	8,157
Customer deposits	4,274	1,169
Current portion of deferred revenue	51,768	17,114
Current portion of long-term debt	22,288	89,356
Total current liabilities	125,078	139,901
Deferred revenue, net of current portion	280,044	178,783

Edgar Filing: Tesla, Inc. - Form 10-Q

Long-term debt, net of current portion	650,211	466,741
Other liabilities and deferred costs	60,740	82,917
Total liabilities	\$ 1,116,073	\$ 868,342

Note 16 – Related Party Transactions

Related party balances were comprised of the following (in thousands):

	September 30, 2017	December 31, 2016
Solar Bonds issued to related parties	\$ 100	\$ 265,100
Convertible senior notes due to related parties	\$ 3,000	\$ 13,000
Promissory notes due to related parties	\$ 100,000	\$ —
Due to related parties (primarily accrued interest, included in accrued and other current liabilities)	\$ 1,133	\$ 5,136

The related party transactions were primarily issuances, maturities and exchanges of debt held by Space Exploration Technologies Corporation (“SpaceX”), our Chief Executive Officer, SolarCity’s former Chief Executive Officer, SolarCity’s former Chief Technology Officer and an entity affiliated with our Chief Executive Officer. SpaceX is considered a related party because our Chief Executive Officer is the Chief Executive Officer, Chief Technology Officer, Chairman and a significant stockholder of SpaceX.

On March 21, 2017, \$90.0 million in aggregate principal amount of 4.40% Solar Bonds held by SpaceX matured and were fully repaid by us. On June 10, 2017, \$75.0 million in aggregate principal amount of 4.40% Solar Bonds held by SpaceX matured and were fully repaid by us.

On April 11, 2017, our Chief Executive Officer, SolarCity’s former Chief Executive Officer and SolarCity’s former Chief Technology Officer exchanged their \$100.0 million (collectively) in aggregate principal amount of 6.50% Solar Bonds due in February 2018 for promissory notes in the same amounts and with substantially the same terms.

On April 18, 2017, our Chief Executive Officer converted all of his zero-coupon convertible senior notes due in 2020, which had an aggregate principal amount of \$10.0 million (see Note 12, Common Stock).

Note 17 – Segment Reporting and Information about Geographic Areas

We have two operating and reportable segments: (i) automotive and (ii) energy generation and storage. The automotive segment includes the design, development, manufacturing and sales of electric vehicles. Additionally, the automotive segment is also comprised of services and other, which includes after-sales vehicle services, used vehicle sales, powertrain sales and services by Grohmann. The energy generation and storage segment includes the design, manufacture, installation and sale or lease of stationary energy storage products and solar energy systems, or sale of electricity generated by our solar energy systems to customers. Our CODM does not evaluate operating segments using asset and liability information. The following table presents revenues and gross margins by reportable segment (in thousands):

Three Months Ended September 30,	Nine Months Ended September 30,
-------------------------------------	------------------------------------

Edgar Filing: Tesla, Inc. - Form 10-Q

	2017	2016	2017	2016
Automotive segment				
Revenues	\$2,667,170	\$2,275,102	\$7,652,273	\$4,665,492
Gross profit	\$368,923	\$637,682	\$1,558,295	\$1,164,523
Energy generation and storage segment				
Revenues	\$317,505	\$23,334	\$818,229	\$50,009
Gross profit	\$80,217	\$(947)) \$225,406	\$(544)

The following table presents revenues by geographic area based on where our products are shipped (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
United States	\$1,582,143	\$1,432,456	\$4,380,393	\$2,891,419
China	563,561	314,941	1,531,082	567,357
Norway	225,461	135,200	482,965	236,009
Other	613,510	415,839	2,076,062	1,020,716
Total	\$2,984,675	\$2,298,436	\$8,470,502	\$4,715,501

The following table presents long-lived assets by geographic area (in thousands):

	September 30, 2017	December 31, 2016
United States	\$ 14,935,394	\$ 11,399,545
International	746,968	503,294
Total	\$ 15,682,362	\$ 11,902,839

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 the consolidated financial statements and the accompanying notes included elsewhere in this Quarterly Report on Form 10-Q.

Overview

Our mission is to accelerate the world's transition to sustainable energy. We design, develop, manufacture, lease and sell high-performance fully electric vehicles, solar energy generation systems and energy storage products. We also offer maintenance, installation, operation and other services related to our products.

Automotive

Our production vehicle fleet includes our Model S premium sedan and our Model X sport utility vehicle, which are our highest-performance and most capable vehicles, and our Model 3, a lower priced sedan designed for the mass market. We continue to enhance our vehicle offerings with enhanced Autopilot options, Internet connectivity and free over-the-air software updates to provide additional safety, convenience and performance features. We are also actively working on future vehicles, such as a 100%-electric semi-truck.

Energy Generation and Storage

We lease and sell solar energy systems and sell renewable energy and energy products to our customers. We have partnered with Panasonic to provide capital and operational support to manufacture photovoltaic ("PV") cells, and thus enable high volume integrated tile and PV cell production, at our Gigafactory 2 in Buffalo, New York. We also plan to produce Solar Roof tiles at Gigafactory 2. Our energy storage products, which we manufacture at Gigafactory 1, consist of Powerwall for residential applications and Powerpack for commercial, industrial and utility-scale applications.

Management Opportunities, Challenges and Risks

Automotive Demand, Production and Deliveries

We drive demand for our vehicles by continually improving our vehicles through over-the-air software updates, expanding our retail, service and charging infrastructure, and by periodically developing and introducing new vehicle variants and models. The worldwide automotive market for alternative fuel vehicles is highly competitive and we expect it to become even more so, as many companies have announced plans to expand, and in some cases fully transition to, production of electric or environmentally friendly vehicles. We welcome the acceleration of the world's transition to sustainable transport. Nonetheless, we believe that the unique features of our vehicles, our constant innovation, our growing brand, the increased affordability introduced with Model 3, and our future vehicles, will continue to generate incremental demand for our vehicles by making our vehicles accessible to larger and previously untapped consumer and commercial markets. For example, in the third quarter of 2017, we achieved all-time quarterly records for both net orders and deliveries of Model S and X.

The initial phase of manufacturing any new vehicle is always challenging, and the Model 3 production ramp is no exception, particularly given our focus on highly automated manufacturing processes that we expect will ultimately result in higher volumes at significantly lower costs. Model 3 production in the third quarter of 2017 was less than anticipated due to production bottlenecks relating to a handful of manufacturing subsystems at our Fremont Factory and Gigafactory 1 taking longer to bring online than expected. The battery module assembly line at Gigafactory 1 has

been the primary production constraint to date, as the complex design of the module and its automated manufacturing process involves a four zone process of which we had to take over key elements of two zones from manufacturing systems suppliers and significantly redesign them. We have redirected our best engineering talent to Gigafactory 1 to fine-tune the automated processes and related robotic programming, and we believe that throughput will increase substantially in upcoming weeks and ultimately be capable of production rates significantly greater than those for which they were originally intended.

We have designed Model 3 to facilitate volume production, and we believe there are no fundamental problems with our supply chain or any of our production processes. While we continue to make significant progress each week in resolving Model 3 bottlenecks, it is difficult to predict exactly how long it will take for all bottlenecks to be resolved or when new issues may arise. Based on our current progress, we expect to achieve a production rate of 5,000 Model 3 vehicles per week by the end of the first quarter of 2018, although the precise progress of the ramp is difficult to predict given that our production growth rate is similar to a stepped exponential, so there may be significant rate increases from one week to the next. In order to optimize the incremental improvement of our automation processes and the efficiency of our capital expenditures, we will implement the capacity to further ramp production to 10,000 units per week only after we have achieved a 5,000 units per week run rate. For Model S and Model X, we have made significant and sustained progress in the production processes, and we produced 25,076 of these vehicles in the third quarter of 2017.

We are also making strides in other aspects of our vehicle production, deliveries and customer infrastructure. For example, we expect to continue to lower the cost of manufacturing our vehicles over the next several quarters due to economies of scale, material cost reductions and more efficient manufacturing. We have achieved cost improvements through material cost reductions from both engineering and commercial actions and increased manufacturing efficiencies including better inventory control. This is also evident through increased product reliability including vehicle, battery and drive units. Likewise, while we have experienced in the past and may experience in the future infrastructure constraints and customer experience issues relating to vehicle deliveries, we are trying to address such concerns by opening additional delivery centers to scale the volume of vehicles we are able to deliver. Generally, as sales of Tesla vehicles ramp, we continue to open new Tesla retail, locations, service centers and delivery hubs around the world, we continue to expand our mobile repair services, and we plan to significantly increase the number of Superchargers and Destination Charging connectors globally.

Energy Generation and Storage Demand, Production and Deployment

We are continuing to reduce customer acquisition costs of our energy generation products, including by cutting advertising spend and increasingly selling these products in Tesla stores with dedicated energy product sales personnel, and we continue to leverage well-performing channel partnerships. Moreover, we are deemphasizing absolute growth for our solar products, and we are instead analyzing our portfolio of residential and commercial solar projects to prioritize cash and profitability. Solar Roof installations will initially ramp slowly in the fourth quarter of 2017 as we move the production process from Fremont to Gigafactory 2. As we fine tune and standardize the production and installation process, we expect to ramp Solar Roof production considerably in 2018.

We believe that demand for our energy products will continue to increase with new product offerings and product integration. Demand for our Powerwall and Powerpack products presently exceeds capacity. We are ramping up production for these products at our Gigafactory 1 over the next several quarters.

Trends in Cash Flow, Capital Expenditures and Operating Expenses

We plan to continue to invest heavily in capital expenditures to ramp installed production capacity and further increase vehicle production capacity in our Fremont Facility, including for Model 3, facilities and manufacturing equipment at Gigafactory 1 as well as new retail locations, service centers, delivery hubs and Supercharger locations. Capital expenditures for our automotive segment were \$1.1 billion in the third quarter of 2017, and we expect to invest approximately \$1.0 billion in capital expenditures for our automotive segment in the fourth quarter of 2017.

We expect operating expenses to grow in 2017 as compared to 2016, driven by engineering, design, testing and production expenses related to Model 3, supplier contracts and higher sales and service costs associated with expanding our worldwide geographic presence. In addition, we expect operating expenses to increase as a result of the increased selling, general and administrative expenses incurred by our energy generation and storage segment. We expect selling, general and administrative expenses to continue to increase in absolute amounts while declining significantly as a percentage of revenue due to the significant increase in revenue primarily driven by the ramp in Model 3 sales and as we focus on increasing operational efficiency while continuing to expand our customer and corporate infrastructure.

Automotive Financing Options

We offer loans and leases for our vehicles in certain markets in North America, Europe and Asia primarily through various financial institutions. We offered resale value guarantees or similar buy-back terms to all direct customers who purchase vehicles and who financed their vehicle through one of our specified commercial banking partners. Subsequent to June 30, 2016, this program is available only in certain international markets. Resale value guarantees

available for exercise within the 12 months following September 30, 2017 totaled \$279.9 million in value.

Vehicle deliveries with the resale value guarantee do not impact our near-term cash flows and liquidity, since we receive the full amount of cash for the vehicle sales price at delivery. However, this program requires the deferral of revenues and costs into future periods as they are considered leases for accounting purposes. While we do not assume any credit risk related to the customer, if a customer exercises the option to return the vehicle to us, we are exposed to liquidity risk that the resale value of vehicles under these programs may be lower than our guarantee, or the volume of vehicles returned to us may be higher than our estimates or we may be unable to resell the used cars in a timely manner, all of which could adversely impact our cash flows. Based on current market demand for our cars, we estimate the resale prices for our vehicles will continue to be above our resale value guarantee amounts. Should market values of our vehicles or customer demand decrease, these estimates may be impacted materially.

We currently offer vehicle leases in the U.S. directly from Tesla Finance, our captive financing entity, as well as through leasing partners. Leasing through Tesla Finance is available in 39 states and the District of Columbia. We also offer financing arrangements through our entities in Canada, Germany and the United Kingdom. Leasing through our captive financing entities and our leasing partners exposes us to residual value risk and adversely impacts our near-term operating results by requiring the deferral of revenues and costs into future periods under lease accounting. In addition, for leases offered directly from our captive financing entities (but not for those offered through our leasing partners), we only receive a limited portion of cash for the vehicle price at delivery and will

assume customer credit risk. We plan to continue expanding our financing offerings, including our lease financing options and the financial sources to support them, and to support the overall financing needs of our customers. To the extent that we are unable to arrange such options for our customers on terms that are attractive, our sales, financial results and cash flows could be negatively impacted.

Energy Generation and Storage Financing Options

We offer Solar Loans, whereby a third-party lender provides financing directly to a qualified customer to enable the customer to purchase and own a solar energy system designed, installed and serviced by us. We enter into a standard solar energy system sale agreement with the customer. Separately, the customer enters into a loan agreement with a third-party lender, who finances the full purchase price. We are not a party to the loan agreement between the customer and the third-party lender, and the third-party lender has no recourse against us with respect to the loan.

Gigafactory 1

We are developing Gigafactory 1 as a facility where we work together with our suppliers to integrate production of battery material, cells, modules, battery packs and drive units in one location for vehicles and energy storage products. We broke ground on Gigafactory 1 in June 2014, began assembling our energy storage products in the first portion of the facility in the fourth quarter of 2015 and began production of lithium-ion battery cells for our energy storage products in the first quarter of 2017. At Gigafactory 1, we are now producing drive units, as well as our proprietary form factor cells, which are then assembled into battery packs, for Model 3 and for our energy storage products. We also continue to invest in construction of the building at Gigafactory 1 and in production equipment for battery, module and pack production.

Panasonic has partnered with us on Gigafactory 1 with investments in the production equipment that it uses to manufacture and supply us with battery cells. Under our arrangement with Panasonic, we plan to purchase the full output from their production equipment at negotiated prices. As these terms convey to us the right to use, as defined in ASC 840, Leases, their production equipment, we consider them to be leased assets when production commences. This results in us recording the value of their production equipment within property, plant and equipment, net, on our consolidated balance sheets with a corresponding liability recorded to financing obligations. For all suppliers and partners for which we plan to purchase the full output from their production equipment located at Gigafactory 1, we will apply similar accounting. During the three and nine months ended September 30, 2017, we recorded \$148.5 million and \$415.0 million, respectively, on our consolidated balance sheet.

While we currently believe that our progress at Gigafactory 1 will allow us to reach our production targets, our ultimate ability to do so will require us to resolve the types of challenges that are typical of a production ramp. For example, we have experienced bottlenecks in the assembly of battery modules at Gigafactory 1, which has negatively affected our production of Model 3. While we continue to make progress to resolve such issues at Gigafactory 1, given the size and complexity of this undertaking, it is possible that future events could result in the cost of building and operating Gigafactory 1 exceeding our current expectations and Gigafactory 1 taking longer to expand than we currently anticipate.

Gigafactory 2

We have an agreement with the Research Foundation for the State University of New York (“Foundation”) for the construction of a factory capable of producing 1.0 gigawatts of solar cells annually in Buffalo, New York, referred to as Gigafactory 2. In December 2016, we entered into an agreement with Panasonic under which it will manufacture custom photovoltaic (“PV”) cells and modules for us, primarily at Gigafactory 2, and we will purchase certain quantities of PV cells and modules from Panasonic during the 10-year term.

The terms of our agreement with the Foundation require us to comply with a number of covenants, and any failure to comply with these covenants could obligate us to pay significant amounts to the Foundation and result in termination of the agreement. Although we remain on track with our progress at Gigafactory 2, our expectations as to the cost of building the facility, acquiring manufacturing equipment and supporting our manufacturing operations may prove incorrect, which could subject us to significant expenses to achieve the desired benefits.

Other Manufacturing

In addition, we continue to expand production capacity at our Fremont Factory and are exploring additional production capacity in Asia and Europe.

Critical Accounting Policies and Estimates

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of the consolidated financial statements requires us to make estimates and assumptions that

affect the reported amounts of assets, liabilities, revenues, costs and expenses and the 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 us. We evaluate our estimates and assumptions on an on-going basis. To the extent that there are material differences between our estimates and actual results, the future financial statement presentation, financial condition, results of operations and cash flows would be affected.

For a description of our critical accounting policies and estimates, refer to Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Results of Operations

Revenues

(Dollars in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Change		2017	2016	Change	
			\$	%			\$	%
Automotive sales	\$2,076,731	\$1,917,442	\$159,289	8 %	\$6,125,643	\$3,849,558	\$2,276,085	59 %
Automotive leasing	286,158	231,285	54,873	24 %	813,462	507,085	306,377	60 %
Total automotive revenues	2,362,889	2,148,727	214,162	10 %	6,939,105	4,356,643	2,582,462	59 %
Services and other	304,281	126,375	177,906	141 %	713,168	308,849	404,319	131 %
Total automotive & services and other segment revenue	2,667,170	2,275,102	392,068	17 %	7,652,273	4,665,492	2,986,781	64 %
Energy generation and storage segment revenue	317,505	23,334	294,171	1261 %	818,229	50,009	768,220	1536 %
Total revenues	\$2,984,675	\$2,298,436	\$686,239	30 %	\$8,470,502	\$4,715,501	\$3,755,001	80 %

Automotive sales revenue includes revenue related to the sale of new Model S, Model X, and Model 3 vehicles, including internet connectivity, Supercharger access, specified software updates for vehicles equipped with Autopilot hardware and sales of regulatory credits to other automotive manufacturers. Automotive sales revenue increased by \$159.3 million, or 8%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This was primarily due to a 23% increase in deliveries to 20,608 vehicles resulting from increased sales of Model X and S, at average selling prices that remained relatively consistent as compared to the prior period, as well as the roll-out of Model 3 in the third quarter of 2017. The increase from new deliveries was offset by a decrease of \$147.6 million in sales of regulatory credits.

Automotive sales revenue increased by \$2.3 billion, or 59%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This was primarily due to a 68% increase in deliveries to

56,931 vehicles resulting from increased sales of Model X and S, at average selling prices that remained relatively consistent as compared to the prior period, as well as the roll-out of Model 3 in the third quarter of 2017. The increase from new deliveries was offset by a decrease of \$99.5 million in sales of regulatory credits as well as additional deferrals of Autopilot 2.0 revenue in the current period.

Automotive leasing revenue is comprised of revenue from Model S and Model X vehicles accounted for as operating leases, including the amortization of revenue for vehicles sold with resale value guarantees. Automotive leasing revenue increased by \$54.9 million, or 24%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. The increase was primarily due to a 41% increase in vehicles under leasing programs and programs with a resale value guarantee as of September 30, 2017 as compared to September 30, 2016, offset by a decrease of \$26.8 million of automotive leasing revenue upon early payoff and expiration of resale value guarantees in the three months ended September 30, 2017 as compared to the prior period.

Automotive leasing revenue increased by \$306.4 million, or 60%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. The increase was primarily due to a 41% increase in vehicles under leasing programs and programs with a resale value guarantee in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. In addition, during the nine months ended September 30, 2017, we recognized an increase of \$52.8 million of automotive leasing revenue upon early payoff and expiration of resale value guarantees in the nine months ended September 30, 2017 as compared to the prior period.

Services and other revenue include sales of used vehicles, maintenance services for the fleet of Tesla vehicles and sales of electric vehicle powertrain components and systems to other manufacturers. Service and other revenue increased by \$177.9 million, or

141%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This was primarily due to an increase in used vehicle sales as an organic result of increased automotive sales as well as from the expansion of our trade-in program.

Services and other revenue increased by \$404.3 million, or 131%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This was primarily due to an increase in used vehicle sales as an organic result of increased automotive sales as well as from the expansion of our trade-in program. Additionally, there were increases of \$43.7 million from the inclusion of engineering service revenue from Grohmann, which we acquired on January 3, 2017, and \$34.7 million in maintenance services revenue as our fleet continues to grow.

Energy Generation and Storage Segment

Energy generation and storage revenue includes sales of solar energy systems and energy storage products, leasing revenue from solar energy systems under operating leases and power purchase agreements and sales of solar energy system incentives. Energy generation and storage revenue increased by \$294.2 million, or 1261%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Energy generation and storage revenue increased by \$768.2 million, or 1536%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. These increases were primarily due to the inclusion of revenue from SolarCity, which we acquired on November 21, 2016, of \$273.0 million and \$752.8 million for the three and nine months ended September 30, 2017, respectively, as well as increases in sales of our energy storage products.

Cost of Revenues and Gross Margin

(Dollars in thousands)	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	\$	%	2017	2016	\$	%
Cost of revenues								
Automotive sales	\$1,755,622	\$1,355,102	\$400,520	30 %	\$4,724,849	\$2,895,483	\$1,829,366	63 %
Automotive leasing	175,224	161,959	13,265	8 %	516,683	310,176	206,507	67 %
Total automotive								
cost of revenues	1,930,846	1,517,061	413,785	27 %	5,241,532	3,205,659	2,035,873	64 %
Services and other	367,401	120,359	247,042	205 %	852,446	295,310	557,136	189 %
Total automotive & services and other	2,298,247	1,637,420	660,827	40 %	6,093,978	3,500,969	2,593,009	74 %
segment cost of								

Edgar Filing: Tesla, Inc. - Form 10-Q

revenue									
Energy generation and storage segment	237,288	24,281	213,007	877%	592,823	50,553	542,270	1073%	
Total cost of revenues	\$2,535,535	\$1,661,701	\$873,834	53%	\$6,686,801	\$3,551,522	\$3,135,279	88%	
Gross profit total automotive	\$432,043	\$631,666			\$1,697,573	\$1,150,984			
Gross margin total automotive	18.3%	29.4%			24.5%	26.4%			
Gross profit total automotive & services and other segment	\$368,923	\$637,682			\$1,558,295	\$1,164,523			
Gross margin total automotive & services and other segment	13.8%	28.0%			20.4%	25.0%			
Gross profit energy generation and storage segment	\$80,217	\$(947)			\$225,406	\$(544)			
Gross margin energy generation and storage segment	25.3%	-4.1%			27.5%	-1.1%			
Total gross profit	\$449,140	\$636,735			\$1,783,701	\$1,163,979			
Total gross margin	15.0%	27.7%			21.1%	24.7%			

35

Automotive & Services and Other Segment

Cost of automotive sales revenue includes direct parts, material and labor costs, manufacturing overhead, including depreciation costs of tooling and machinery, shipping and logistic costs, vehicle connectivity costs, allocations of electricity and infrastructure costs related to our Supercharger network and reserves for estimated warranty expenses. Cost of automotive sales revenue 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 or excess inventory. Cost of automotive sales revenue increased by \$400.5 million, or 30%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Cost of automotive sales revenue increased by \$1.8 billion, or 63%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. These increases were primarily due to increases in vehicle deliveries of 23% and 68% in the three and nine months ended September 30, 2017, respectively, as compared to the same periods in the prior year as a result of increased sales of Model S and Model X, and the rollout of Model 3 in the third quarter of 2017. The increase is offset by lower costs of production of Model X as we are gaining manufacturing efficiencies through lower material costs and labor hours.

Cost of automotive leasing revenue primarily includes the amortization of operating lease vehicles over the lease term as well as warranty expenses recognized as incurred. Cost of automotive leasing revenue increased by \$13.3 million, or 8%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. The increase was primarily due to a 41% increase in vehicles under leasing programs and programs with a resale value guarantee as of September 30, 2017 as compared to September 30, 2016, offset by a decrease of \$26.8 million of cost of automotive leasing revenue upon expiration of resale value guarantees in the three months ended September 30, 2017 as compared to the prior period.

Cost of automotive leasing revenue increased by \$206.5 million, or 67%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. The increase was primarily due to a 41% increase in vehicles under leasing programs and programs with a resale value guarantee in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. In addition, during the nine months ended September 30, 2017, we recognized an increase of \$52.8 million of cost of automotive leasing revenue upon early payoff and expiration of resale value guarantees in the nine months ended September 30, 2017 as compared to the prior period.

Cost of services and other revenue includes costs associated with providing maintenance services to the fleet of Tesla vehicles, costs to acquire and sell used vehicles, direct parts, material and labor costs and manufacturing overhead associated with sales of electric vehicle powertrain components and systems to other manufacturers. Cost of services and other revenue increased by \$247.0 million, or 205%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This was primarily due to the increase in costs of used vehicle sales as a result of the increase in volume, \$69.4 million increase in costs to provide maintenance service as our fleet continues to grow, and an increase of \$10.0 million due to the inclusion of Grohmann's cost of engineering services. These increases were offset by a \$24.7 million decrease in cost of powertrain sales to Daimler as we discontinued the program at the end of the second quarter of 2017.

Cost of services and other revenue increased by \$557.1 million, or 189%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This was primarily due to the increase in costs of used vehicle sales as a result of the increase in volume, \$182.3 million increase in costs to provide maintenance service as our fleet continues to grow, and an increase of \$32.6 million due to the inclusion of Grohmann's cost of engineering services. These increases were offset by a \$10.1 million decrease in cost of powertrain sales to Daimler as we discontinued the program at the end of the second quarter of 2017.

Gross margin for total automotive decreased from 29.4% to 18.3% in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This decrease was primarily due to the higher cost structure associated with the roll-out of Model 3 in the third quarter of 2017 and lower sales of regulatory credits in the current period. We anticipate the costs per unit of Model 3 to decrease significantly once production is fully ramped-up. The decrease of current period early payoffs and expirations of resale value guarantees, as compared to the same period in the prior year, partially offset the overall decrease since they have a dilutive effect on gross margin.

Gross margin for total automotive decreased from 26.4% to 24.5% in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. The roll-out of Model 3 in the third quarter of 2017, lower sales of regulatory credits and higher current period early payoffs and expirations of resale value guarantees, as compared to the same period in the prior year, contributed to the lower gross margin. Lower material and manufacturing costs for Model S and Model X, as we further improved our vehicle production processes, and the recognition of Autopilot 2.0 revenue in the current period partially offset the overall decrease.

Gross margin for total automotive & services and other segment decreased from 28.0% to 13.8% in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Gross margin for total automotive & services and other segment decreased from 25.0% to 20.4% in the nine months ended September 30, 2017 as compared to the nine months ended

September 30, 2016. These decreases are driven by the factors impacting gross margin for total automotive, as explained above, as well as higher costs of maintenance service.

Energy Generation and Storage Segment

Cost of energy generation and storage revenue includes direct material and labor costs, overhead of solar energy systems and energy storage products, depreciation expense and maintenance costs associated with leased solar energy systems. Cost of energy generation and storage revenue increased by \$213.0 million, or 877%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Cost of energy generation and storage revenue increased by \$542.3 million, or 1073%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. These increases were primarily due to the inclusion of energy generation and storage costs from SolarCity of \$178.1 million and \$497.5 million in the three and nine months ended September 30, 2017, respectively, as well as increases in sales of energy storage products as a result of growing popularity of our Powerpack and Powerwall offerings.

Gross margin for energy generation and storage increased from -4.1% to 25.3% in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Gross margin for energy generation and storage increased from -1.1% to 27.5% in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. These increases were primarily due to the inclusion of revenue and costs from SolarCity and improved gross margin of energy storage sales.

Research and Development Expense

(Dollars in thousands)	Three Months Ended				Nine Months Ended			
	September 30,		Change		September 30,		Change	
	2017	2016	\$	%	2017	2016	\$	%
Research and development	\$331,622	\$214,302	\$117,320	55%	\$1,023,436	\$588,448	\$434,988	74%
As a percentage of revenues	11.1	% 9.3	%		12.1	% 12.5	%	

Research and development expense consists 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. Research and development expense increased by \$117.3 million, or 55%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This increase was primarily due to a \$69.0 million increase in employee and labor-rated expenses from increased headcount as a result of our acquisitions as well as headcount growth from the expansion of our automotive and energy storage businesses. Additionally, there were increases in facilities expenses, depreciation expenses, professional and outside service expenses and expensed materials to support Solar Roof development as well as the development of future products.

Research and development expense increased by \$435.0 million, or 74%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This increase was primarily due to a \$216.5 million increase in employee and labor-rated expenses from increased headcount as a result of our acquisitions as well as headcount growth from the expansion of our automotive and energy storage businesses. Additionally, there were increases of \$74.4 million in facilities and depreciation expenses and \$67.0 million in expensed materials to support Model 3 and Solar Roof development as well as the development of future products.

Selling, General and Administrative Expense

(Dollars in thousands)	Three Months Ended				Nine Months Ended			
	September 30,		Change		September 30,		Change	
	2017	2016	\$	%	2017	2016	\$	%
Selling, general and administrative	\$652,998	\$336,811	\$316,187	94%	\$1,794,210	\$976,173	\$818,037	84%
As a percentage of revenues	21.9	% 14.7	%		21.2	% 20.7	%	

Selling, general and administrative expense consists primarily of personnel and facilities costs related to our stores, marketing, sales, executive, finance, human resources, information technology and legal organizations, as well as litigation settlements and fees for professional and contract services. Selling, general and administrative expense increased by \$316.2 million, or 94%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This increase was primarily due to a \$148.1 million increase in employee and labor-rated expenses from increased headcount as a result of our acquisitions as well as headcount growth from the expansion of our automotive and energy storage businesses. Additionally, the increase was due to a \$87.7 million increase in office, information technology and facilities-related expenses to support the growth of our business as well as sales and marketing activities to handle our expanding market presence and a \$53.0 million increase in professional and outside service expenses to support the growth of our business.

Selling, general and administrative expense increased by \$818.0 million, or 84%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This increase was primarily due to a \$437.0 million increase in employee and labor-rated expenses from increased headcount as a result of our acquisitions as well as headcount growth from the expansion of our automotive and energy storage businesses. Additionally, the increase was due to a \$210.3 million increase in office, information technology and facilities-related expenses to support the growth of our business as well as sales and marketing activities to handle our expanding market presence and a \$108.0 million increase in professional and outside service expenses to support the growth of our business.

Interest Expense

(Dollars in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Change \$	%	2017	2016	Change \$	%
Interest expense	\$ (117,109)	\$ (46,713)	\$ (70,396)	151 %	\$ (324,896)	\$ (133,706)	\$ (191,190)	143 %
As a percentage of revenues	3.9	% 2.0	%		3.8	% 2.8	%	

Interest expense increased by \$70.4 million, or 151%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. Interest expense increased by \$191.2 million, or 143%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. These increases were primarily due to the inclusion of interest expenses from SolarCity of \$48.7 million and \$156.5 million for the three and nine months ended September 30, 2017, respectively. In addition, our average outstanding indebtedness has increased in the three and nine months September 30, 2017 as compared to the same period in the prior year.

Other Income (Expense), Net

(Dollars in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017	2016	Change \$	%	2017	2016	Change \$	%
Other expense, net	\$ (24,390)	\$ (11,756)	\$ (12,634)	107 %	\$ (83,696)	\$ (9,952)	\$ (73,744)	741 %
As a percentage of revenues	-0.8	% -0.5	%		-1.0	% -0.2	%	

Other income (expense), net, consists primarily of foreign exchange gains and losses related to our foreign currency denominated assets and liabilities as well as gains and losses from our interest rate swaps. Other income (expense), net, decreased by \$12.6 million, or 107%, in the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. This decrease was primarily due to fluctuations in foreign currency exchange rates. Additionally, we recognized an \$18.2 million loss in the current period for measurement period adjustments to the acquisition date fair values of certain liabilities as previously reported in our Form 10-K for the year ended December 31, 2016. However, there was a partially offsetting increase of \$7.0 million from the losses recognized upon conversions of the 2018 Notes in the three months ended September 30, 2016.

Other income (expense), net, decreased by \$73.7 million, or 741%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This decrease was primarily due to fluctuations in foreign currency exchange rates. Additionally, we recognized a \$29.8 million loss in the current year for measurement period adjustments to the acquisition date fair values of certain assets and liabilities as previously reported in our Form 10-K for the year ended December 31, 2016 and a \$9.7 million loss related to our interest rate swaps in the current year.

Provision for Income Taxes

(Dollars in thousands)	Three Months Ended				Nine Months Ended			
	September 30,		Change		September 30,		Change	
	2017	2016	\$	%	2017	2016	\$	%
(Benefit) provision for income taxes	\$ (285)	\$ 8,133	\$(8,418)	-104%	\$40,640	\$15,628	\$25,012	160%
Effective tax rate	0.0 %	27.1 %			-2.8 %	-2.9 %		

Our (benefit) provision for income taxes decreased by \$8.4 million, or 104%, from an expense of \$8.1 million in the three months ended September 30, 2016 to a benefit of \$0.3 million in the three months ended September 30, 2017.

This decrease was primarily due to reduced profits in taxable jurisdictions in the current period.

Our provision for income taxes increased by \$25.0 million, or 160%, in the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. This increase was primarily due to the significant increase in taxable income in our international jurisdictions as a result of increased vehicle deliveries in the current year as compared to the prior year.

Net Income (Loss) Attributable to Noncontrolling Interests and Redeemable Noncontrolling Interests

Our net income (loss) attributable to noncontrolling interests and redeemable noncontrolling interests was related to financing fund arrangements.

Liquidity and Capital Resources

As of September 30, 2017, we had \$3.53 billion of cash and cash equivalents. Balances held in foreign currencies had a U.S. dollar equivalent of \$535.4 million and consisted primarily of Chinese yuan, euros and Norwegian kroner. Our sources of cash are predominately from our deliveries of vehicles, proceeds from debt facilities, proceeds from financing funds and sales and installations of our energy storage products and solar energy systems.

Our sources of liquidity and cash flows enable us to fund on-going operations, research and development projects, investments in tooling and manufacturing equipment for the production ramp of our Model 3 vehicle, the continued construction of Gigafactory 1 and the continued expansion of our retail stores, service centers, mobile repair services and Supercharger network. We are growing our vehicle manufacturing capacity primarily to fulfill Model 3 production at 5,000 vehicles per week and in a later phase to 10,000 vehicles per week. We expect to invest approximately \$1.0 billion in capital expenditures during the fourth quarter of 2017. We continually evaluate our capital expenditure needs and may raise additional capital to fund the rapid growth of our business in the coming years.

We have an agreement to spend or incur approximately \$5.0 billion in combined capital, operational expenses, costs of goods sold and other costs in the State of New York during the 10-year period following full production at Gigafactory 2. We anticipate meeting these obligations through our operations at Gigafactory 2 and other operations within the State of New York, and we do not believe that we face a significant risk of default.

We expect that our current sources of liquidity together with our projection of cash flows from operating activities will provide us with adequate liquidity over at least the next 12 months. A large portion of our future expenditures is to fund our growth and we can adjust our capital and operating expenditures by operating segments, including future expansion of our product offerings, stores, service centers, delivery centers and the Supercharger network. We may need or want to raise additional funds in the future, and these funds may not be available to us when we need or want them, or at all. If we cannot raise additional funds when we need or want them, our operations and prospects could be negatively affected.

In addition, we had \$1.4 billion of unused committed amounts under our credit facilities and financing funds, some of which are subject to satisfying specified conditions prior to draw-down as discussed in Note 11, Convertible and Long-Term Debt Obligations, and Note 15, VIE Arrangements. For details regarding our indebtedness, refer to Note 11, Convertible and Long-Term Debt Obligations, to the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Summary of Cash Flows

Edgar Filing: Tesla, Inc. - Form 10-Q

(Dollars in thousands)	Nine Months Ended	
	September 30,	
	2017	2016
Net cash (used in) provided by operating activities	\$(570,545)	\$324,380
Net cash used in investing activities	\$(3,457,091)	\$(821,679)
Net cash provided by financing activities	\$4,129,022	\$2,371,149

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 research and development and selling, general and administrative. Our operating cash inflows include cash from vehicle sales and lease payments directly from our customers, customer deposits for vehicles, sales of regulatory credits and energy generation and storage products. These cash inflows are offset by payments we make to our suppliers for production materials and parts used in our manufacturing process, employee compensation, operating lease payments and interest expenses on our financings.

Net cash from operating activities during the nine months ended September 30, 2017 decreased by \$894.9 million as compared to the nine months ended September 30, 2016, due to an increase in working capital of \$846.4 million and an increase in net loss adjusted for non-cash items by \$48.6 million. The change in net cash from operating activities was primarily a result of the growth of our business. In addition, we received significantly more customer deposits in the nine months ended September 30, 2016, when we

began taking reservations for Model 3, and we had larger increases to our accounts payable and accrued liabilities balances in the same period.

Cash Flows from Investing Activities

Net cash used in investing activities was \$3.5 billion and \$821.7 million during the nine months ended September 30, 2017 and 2016, respectively. Cash flows from investing activities and the variability across each period related primarily to capital expenditures, which were \$3.2 billion and \$759.2 million for the nine months ended September 30, 2017 and 2016, respectively. The increase in capital expenditures was primarily due to payments for Model 3 production equipment and the design, acquisition and installation of solar energy systems under operating leases with our customers, in the nine months ended September 30, 2017. We also paid \$109.1 million, net of cash acquired, for the acquisition of Grohmann in the nine months ended September 30, 2017.

In 2014, we began construction of our Gigafactory 1 facility in Nevada. During the nine months ended September 30, 2017, we used cash of \$1.2 billion towards Gigafactory 1 construction.

Cash Flows from Financing Activities

During the nine months ended September 30, 2017, net cash provided by financing activities was \$4.1 billion, which consisted primarily of \$966.4 million from the issuance of convertible senior notes, \$1.8 billion from the issuance of senior notes and \$400.2 million from a public offering of our common stock, net of underwriter fees. However, we paid \$151.2 million for the purchase of bond hedges, net of the amount we received from the sale of warrants. Furthermore, we received proceeds from vehicle sales to our bank leasing partners of \$416.4 million and net proceeds from investments by fund investors of \$501.2 million.

During the nine months ended September 30, 2016, net cash provided by financing activities was \$2.4 billion, which consisted primarily of \$1.7 billion of net proceeds from our May 2016 public offering of 7,915,004 shares of common stock, \$1.7 billion of proceeds from our issuances of debt, which included \$1.3 billion of borrowings under our Credit Agreement and \$300 million of borrowings under our Warehouse Agreement, and \$557.7 million of proceeds from vehicle sales to our bank leasing partners. These increases were partially offset by our repayments of borrowings under our Credit Agreement of \$1.1 billion and the settlement of \$435.5 million for certain conversions of our 2018 Notes.

Contractual Obligations

Contractual obligations did not materially change during the nine months ended September 30, 2017 except for debt activity, as discussed in more detail in Note 11, Convertible and Long-Term Debt Obligations.

Off-Balance Sheet Arrangements

The consolidated financial statements include all assets, liabilities and results of operations of the financing fund arrangements that we have entered into. We have not entered into any other transactions that have generated relationships with unconsolidated entities, financial partnerships or special purpose entities. Accordingly, we do not have any off-balance sheet arrangements.

Recent Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, to the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

We transact business globally in multiple currencies. Our foreign operations expose us to the risk of fluctuations in foreign currency exchange rates against the functional currencies of our foreign subsidiaries and against the U.S. dollar. Upon consolidation, as foreign currency exchange rates vary, revenues and expenses may be significantly impacted, and we may record significant gains or losses on the re-measurement of our monetary assets and liabilities, including intercompany balances. As of September 30, 2017, our largest foreign currency exposures were from the euro and the Hong Kong dollar. In the nine months ended September 30, 2017, we recognized a net foreign currency exchange loss of \$35.9 million in other income (expense), net.

We considered the historical trends in foreign currency exchange rates and determined that it is reasonably possible that adverse changes in foreign exchange rates of 10% for all currencies could be experienced in the near-term. These reasonably possible adverse changes were applied to our total monetary assets and liabilities denominated in currencies other than our functional currencies as of September 30, 2017 to compute the adverse impact these changes would have had on our income before income taxes. These changes would have resulted in an adverse impact on our income before income taxes of \$408.6 million.

Interest Rate Risk

We are exposed to interest rate risk for our borrowings that bear interest at floating rates. Pursuant to our risk management policies, in certain cases, we utilize derivative instruments to manage some of our exposures to fluctuations in interest rates on certain floating-rate debt. We do not enter into any derivative instruments for trading or speculative purposes. A hypothetical 10% change in our interest rates would have increased our interest expense for the nine months ended September 30, 2017 by \$6.0 million.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that our management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of September 30 2017, our disclosure controls and procedures were designed at a reasonable assurance level and were effective to provide reasonable assurance that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting, as identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) of the Exchange Act, that occurred during the three months ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Securities Litigation

On March 28, 2014, a purported stockholder class action was filed in the United States District Court for the Northern District of California against SolarCity and two of its officers. The complaint alleges violations of federal securities laws, and seeks unspecified compensatory damages and other relief on behalf of a purported class of purchasers of SolarCity's securities from March 6, 2013 to March 18, 2014. After a series of amendments to the original complaint, the District Court dismissed the amended complaint and entered a judgment in our favor on August 9, 2016. The plaintiffs have filed a notice of appeal. The Court has set a hearing on plaintiffs' notice of appeal from the dismissal for December 4, 2017. We believe that the claims are without merit and intend to defend against this lawsuit and appeal vigorously. We are unable to estimate the possible loss or range of loss, if any, associated with this lawsuit.

On August 15, 2016, a purported stockholder class action lawsuit was filed in the United States District Court for the Northern District of California against SolarCity, two of its officers and a former officer. On March 20, 2017, the purported stockholder class filed a consolidated complaint that includes the original matter in the same court against SolarCity, one of its officers and three former officers. As consolidated, the complaint alleges that SolarCity made projections of future sales and installations that it failed to achieve and that these projections were fraudulent when made. The suit claimed violations of federal securities laws and sought unspecified compensatory damages and other relief on behalf of a purported class of purchasers of SolarCity's securities from May 6, 2015 to May 9, 2016. On July 25, 2017, the court took SolarCity's fully-briefed motion to dismiss under submission. On August 11, 2017, the court granted the motion to dismiss with leave to amend. On September 11, 2017, after lead plaintiff determined he would not amend, the Court dismissed the action with prejudice and entered judgment in favor of SolarCity and the individual defendants.

On October 10, 2017, a purported stockholder class action was filed in the United States District Court for the Northern District of California against Tesla, two of its current officers and a former officer. The complaint alleges violations of federal securities laws, and seeks unspecified compensatory damages and other relief on behalf of a purported class of purchasers of Tesla securities from May 4, 2016 to October 6, 2017. The lawsuit claims that Tesla supposedly made materially false and misleading statements regarding the Company's preparedness to produce Model 3 vehicles. We believe that the claims are without merit and intend to defend against this lawsuit vigorously. We are unable to estimate the possible loss or range of loss, if any, associated with this lawsuit.

Litigation Relating to the SolarCity Acquisition

Between September 1, 2016 and October 5, 2016, seven lawsuits were filed in the Court of Chancery of the State of Delaware by purported stockholders of Tesla challenging our acquisition of SolarCity. Following consolidation, the lawsuit names as defendants the members of Tesla's board of directors and alleges, among other things, that board members breached their fiduciary duties in connection with the acquisition. The complaint asserts both derivative claims and direct claims on behalf of a purported class and seeks, among other relief, unspecified monetary damages, attorneys' fees, and costs. On January 27, 2017, the defendants filed a motion to dismiss the operative complaint. Rather than respond to the defendants' motion, the plaintiffs filed an amended complaint. On March 17, 2017, the defendants filed a motion to dismiss the amended complaint; that motion is pending. These same plaintiffs filed a parallel action in the United States District Court for the District of Delaware on April 21, 2017, adding claims for violations of the federal securities laws.

On February 6, 2017, a purported stockholder made a demand to inspect Tesla's books and records, purportedly to investigate potential breaches of fiduciary duty in connection with the SolarCity acquisition. On April 17, 2017, the purported stockholder filed a petition for a writ of mandate in California Superior Court, seeking to compel Tesla to provide the documents requested in the demand. Tesla filed a demurrer to the writ petition or, in the alternative, a motion to stay the action, which remain pending.

On March 24, 2017, another lawsuit was filed in the United States District Court for the District of Delaware by a purported Tesla stockholder challenging the SolarCity acquisition. The complaint alleges, among other things, that Tesla's board of directors breached their fiduciary duties in connection with the acquisition and alleges violations of the federal securities laws.

We believe that claims challenging the SolarCity acquisition are without merit. We are unable to estimate the possible loss or range of loss, if any, associated with these claims.

Proceedings Relating to United States Treasury

In July 2012, SolarCity, along with other companies in the solar energy industry, received a subpoena from the U.S. Treasury Department's Office of the Inspector General to deliver certain documents in SolarCity's possession that relate to SolarCity's applications for U.S. Treasury grants. In February 2013, two financing funds affiliated with SolarCity filed a lawsuit in the United

States Court of Federal Claims against the United States government, seeking to recover \$14.0 million that the United States Treasury was obligated to pay, but failed to pay, under Section 1603 of the American Recovery and Reinvestment Act of 2009. In February 2016, the U.S. government filed a motion seeking leave to assert a counterclaim against the two plaintiff funds on the grounds that the U.S. government, in fact, paid them more, not less, than they were entitled to as a matter of law. In September 2017, SolarCity and the United States government reached a global settlement of both the investigation and Company's lawsuit. In that settlement, SolarCity admitted no wrongdoing and agreed to return approximately 5% of the cash grants it had received between 2009 and 2013, amounting to \$29.5 million. The investigation is now closed and the Company's lawsuit has been dismissed.

Other Matters

From time to time, we have received requests for information from regulators and governmental authorities, such as the National Highway Traffic Safety Administration, the National Transportation Safety Board and the Securities and Exchange Commission. We are also subject to various other legal proceedings and claims that arise from the normal course of business activities. 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 have experienced in the past, and may experience in the future, significant delays or other complications in the design, manufacture, launch and production ramp of new vehicles and other products such as Model 3, our energy storage products and the Solar Roof, which could harm our brand, business, prospects, financial condition and operating results.

We have experienced in the past launch, manufacturing and production ramp delays or other complications in connection with new vehicle models such as Model S, Model X and Model 3, and new vehicle features such as the all-wheel drive dual motor drivetrain on Model S and the second version of autopilot hardware. For example, at times since the launch of Model X, we encountered unanticipated challenges, such as certain supply chain constraints, that forced us to decrease the production of these vehicles from our initial expectations. Similarly, in the third quarter of 2017, we experienced certain production bottlenecks in the production of Model 3 due to a small number of manufacturing subsystems, including the battery module assembly line at Gigafactory 1, taking longer to bring online than expected. While we continue to make progress resolving such early bottlenecks, it is difficult to predict exactly how long it will take for all bottlenecks to be cleared or when further issues may arise. If such issues arise or recur with respect to Model 3 or any of our other production vehicles, we may experience further delays. In addition, because our vehicle models share certain production facilities with other models, the volume or efficiency of production with respect to one model may impact the production of other models.

We may also experience similar future delays or other complications in bringing to market and ramping production of new vehicles, such as ramping Model 3 on production manufacturing lines, and other products such as our announced Tesla Semi truck and our energy storage products and the Solar Roof. Any significant additional delay or other complication in the production of our current products or the development, manufacture, launch and production ramp of our future products, including complications associated with expanding our production capacity, supply chain or

regulatory approvals, could materially damage our brand, business, prospects, financial condition and operating results.

We may experience delays in realizing our projected timelines and cost and volume targets for the production and ramp of our Model 3 vehicle, which could harm our business, prospects, financial condition and operating results.

Our future business depends in large part on our ability to execute on our plans to manufacture, market and sell the Model 3 vehicle, which we are offering at a lower price point and which we intend to produce at significantly higher volumes than our present production capabilities for the Model S or Model X vehicles. We commenced production and initial customer deliveries of Model 3 in July 2017 and have announced our current expectation to achieve a production rate of 5,000 Model 3 vehicles per week by late in the first quarter of 2018.

We have no experience to date in manufacturing vehicles at the high volumes that we anticipate for Model 3, and to be successful, we will need to complete the implementation and ramp of efficient, automated and low-cost manufacturing capabilities, processes and supply chains necessary to support such volumes. Moreover, our Model 3 production plan has required and will require significant investments of cash and management resources.

Our production plan for Model 3 is based on many key assumptions, including:

- that we will be able to complete ramping the installed manufacturing capacity for high volume production of Model 3 at the Tesla Factory without exceeding our projected costs and on our projected timeline;
- that we will be able to continue to expand Gigafactory 1 in a timely manner to produce high volumes of quality lithium-ion cells to be integrated into finished battery packs and drive unit components for Model 3, all at costs that allow us to sell Model 3 at our target gross margins;
 - that the equipment and processes which we have selected for Model 3 production will be able to accurately manufacture high volumes of Model 3 vehicles within specified design tolerances and with high quality;
- that we will be able to maintain suppliers for the necessary components on terms and conditions that are acceptable to us and that we will be able to obtain components on a timely basis and in the necessary quantities to support high volume production; and
- that we will be able to attract, recruit, hire, train and retain skilled employees, including employees on the production line, to operate our planned high volume production facilities to support Model 3, including at the Tesla Factory and Gigafactory 1.

If one or more of the foregoing assumptions turns out to be incorrect, our ability to meet our Model 3 projections on time and at volumes and prices that are profitable, the number of current and future Model 3 reservations, as well as our business, prospects, operating results and financial condition, may be materially and adversely impacted.

We may be unable to meet our growing vehicle production and delivery plans, both of which could harm our business and prospects.

Our plans call for significant increases in vehicle production and deliveries to high volumes in a short amount of time. Our ability to achieve these plans will depend upon a number of factors, including our ability to utilize installed manufacturing capacity, achieve the planned production yield and further increase capacity as planned while maintaining our desired quality levels and optimize design and production changes, and our suppliers' ability to support our needs. In addition, we have used and may use in the future a number of new manufacturing technologies, techniques and processes for our vehicles, which we must successfully introduce and scale for high volume production. For example, we have introduced highly automated production lines, aluminum spot welding systems and high-speed blow forming of certain difficult to stamp vehicle parts. We have also introduced unique design features in our vehicles with different manufacturing challenges, such as large display screens, dual motor drivetrain, autopilot hardware and falcon-wing doors. We have limited experience developing, manufacturing, selling and servicing, and allocating our available resources among, multiple products simultaneously. If we are unable to realize our plans, our brand, business, prospects, financial condition and operating results could be materially damaged.

Concurrent with the significant planned increase in our vehicle production levels, we will also need to continue to significantly increase deliveries of our vehicles. Although we have a plan for delivering a significantly increased volumes of vehicles, we have limited experience in delivering a high volume of vehicles, and no experience in delivering vehicles at the significantly higher volumes we anticipate for Model 3, and we may face difficulties meeting our delivery and growth plans into both existing markets as well as new markets into which we expand. If we are unable to ramp up to meet our delivery goals globally, this could have a material adverse effect on our business, prospects, financial condition and operating results.

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

Our products contain numerous purchased parts which we source globally from hundreds of direct suppliers, the majority of whom are currently single source suppliers despite efforts to qualify and obtain components from multiple sources whenever feasible. Any significant unanticipated demand would require us to procure additional components in a short amount of time, and in the past we have also replaced certain suppliers because of their failure to provide components that met our quality control standards. While we believe that we will be able to secure additional or alternate sources of supply for most of our components in a relatively short time frame, there is no assurance that we will be able to do so or develop our own replacements for certain highly customized components of our products. Moreover, we have signed long-term agreements with Panasonic to be our manufacturing partner and supplier for lithium-ion cells at Gigafactory 1 in Nevada and PV cells and panels at Gigafactory 2 in Buffalo, New York. If we encounter

unexpected difficulties with key suppliers such as Panasonic, and if we are unable to fill these needs from other suppliers, we could experience production delays and potential loss of access to important technology and parts for producing, servicing and supporting our products.

This limited, and in many cases single source, supply chain exposes us to multiple potential sources of delivery failure or component shortages for the production of our products, such as those which we experienced in 2012 and 2016 in connection with our slower-than-planned Model S and Model X ramps. Furthermore, unexpected changes in business conditions, materials pricing, labor issues, wars, governmental changes, natural disasters such as the March 2011 earthquakes in Japan and other factors beyond our and our suppliers' control, could also affect our suppliers' ability to deliver components to us on a timely basis. The loss of any single or limited source supplier or the disruption in the supply of components from these suppliers could lead to product design changes and delays in product deliveries to our customers, which could hurt our relationships with our customers and result in negative publicity, damage to our brand and a material and adverse effect on our business, prospects, financial condition and operating results.

Changes in our supply chain have also resulted in the past, and may result in the future, in increased cost. 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. Certain suppliers have sought to renegotiate the terms of the supply arrangements. 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 less expensive to produce. If we are unsuccessful in our efforts to control and reduce supplier costs, our operating results will suffer.

We expect the foregoing discussion to apply generally to Model 3. However, because we plan to produce Model 3 at significantly higher volumes than Model S or Model X, the negative impact of any delays or other constraints with respect to our suppliers for Model 3 could be substantially greater than any such issues experienced with respect to our products to date. As some of our suppliers for Model S and Model X do not have the resources, equipment or capability to provide components for the Model 3 in line with our requirements, we have engaged a significant number of new suppliers, and such suppliers will also have to ramp to achieve our needs in a short period of time. There is no assurance that these suppliers will ultimately be able to meet our cost, quality and volume needs, or do so in a timely manner. Furthermore, as the scale of our vehicle production increases, we will need to accurately forecast, purchase, warehouse and transport to our manufacturing facilities components at much higher volumes than we have experience with. If we are unable to accurately match the timing and quantities of component purchases to our actual needs, or successfully implement automation, inventory management and other systems to accommodate the increased complexity in our supply chain, we may incur unexpected production disruption, storage, transportation and write-off costs, which could have a material adverse effect on our financial condition and operating results.

Our future growth and success is dependent upon consumers' willingness to adopt electric vehicles and specifically our vehicles, especially in the mass market demographic which we are targeting with Model 3.

Our growth is highly dependent upon the adoption by consumers of alternative fuel vehicles in general and electric vehicles in particular. Although we have successfully grown demand for Model S and Model X, have seen very strong initial demand for Model 3, and we believe that we will be able to continue to grow demand separately for each of these and future vehicles, there is no guarantee of such future demand or that our vehicles will not compete with one another in the market. Moreover, the mass market demographic which we are targeting with Model 3 is larger, but more competitive, than for Model S and Model X, and additional electric vehicles are coming on to the market.

If the market for electric vehicles in general and Tesla vehicles in particular does not develop as we expect, or develops more slowly than we expect, or if demand for our vehicles decreases in key and other markets, our business, prospects, financial condition and operating results could be harmed. The market for alternative fuel vehicles is

relatively new, rapidly evolving, and could be affected by numerous external factors, such as:

- perceptions about electric vehicle features, quality, safety, performance and cost;
- perceptions about the limited range over which electric vehicles may be driven on a single battery charge;
- competition, including from other types of alternative fuel vehicles, plug-in hybrid electric vehicles, and high fuel-economy internal combustion engine vehicles;
- volatility in the cost of oil and gasoline;
- government regulations and economic incentives; and
- access to charging facilities.

45

Future problems or delays in expanding Gigafactory 1 or ramping operations there could negatively affect the production and profitability of our products, such as Model 3.

To lower the cost of cell production and produce cells in high volume, we are integrating the production of lithium-ion cells and finished battery packs for the Model 3 and energy storage products at Gigafactory 1. While Gigafactory 1 began producing lithium-ion cells for energy storage products in January 2017 and has since begun producing lithium-ion cells for Model 3, we have no other direct experience in the production of lithium-ion cells. Given the size and complexity of this undertaking, it is possible that future events could result in the cost of expanding and operating Gigafactory 1 exceeding our current expectations and Gigafactory 1 taking longer to ramp production and expand than we currently anticipate. In order to reach our planned volume and gross margin for Model 3, we must have significant cell production from Gigafactory 1, which, among other things, requires Panasonic to successfully ramp its all-new cell production lines to significant volumes over a short period of time. Although Panasonic has a long track record of producing high-quality cells at significant volume at its factories in Japan, it has never before started and ramped cell production at a factory in the U.S. like at Gigafactory 1. We are now in the early stages of production and have experienced the types of challenges that typically come with a production ramp. We expect that we will continue to experience challenges as we move through the ramp, and we will continue to fine-tune our manufacturing lines to address them. While we currently believe that we will reach our production targets, if we are unable to resolve ramping challenges and expand Gigafactory 1 production in a timely manner and at reasonable prices, and if we or Panasonic are unable to attract, hire and retain a substantial number of highly skilled personnel, our ability to supply battery packs to our vehicles, especially Model 3, and other products could be negatively impacted. Any such problems or delays with Gigafactory 1 could negatively affect our brand and harm our business, prospects, financial condition and operating results.

If our vehicles or other products that we sell or install fail to perform as expected, our ability to develop, market and sell our products and services could be harmed.

If our vehicles or our energy products were to contain defects in design and manufacture that cause them not to perform as expected or that require repair, our ability to develop, market and sell our products and services could be harmed. For example, the operation of our vehicles is highly dependent on software, which is inherently complex and could conceivably contain defects and errors or be subject to external attacks. Issues experienced by customers have included those related to the software for the 17 inch display screen, the panoramic roof and the 12 volt battery in the Model S and the seats and doors in the Model X. Although we attempt to remedy any issues we observe in our products as effectively and rapidly as possible, such efforts may not be timely, may hamper production or may not be up to the satisfaction of our customers. While we have performed extensive internal testing on the products we manufacture, we currently have a limited frame of reference by which to evaluate detailed long-term quality, reliability, durability and performance characteristics of our battery packs, powertrains, vehicles and energy storage products. There can be no assurance that we will be able to detect and fix any defects in our products prior to their sale to or installation for consumers.

Any product defects or any other failure of our products to perform as expected could harm our reputation and result in delivery delays, product recalls, product liability claims, significant warranty and other expenses, and could have a material adverse impact on our business, financial condition, operating results and prospects. Our Model 3 vehicles have not yet been evaluated by NHTSA for a star rating under the New Car Assessment Program, and while based on our internal testing we expect to obtain comparable ratings to those achieved by Model S and Model X, there is no assurance this will occur.

If we fail to scale our business operations and otherwise manage future growth effectively as we rapidly grow our company, including internationally, we may not be able to produce, market, sell and service our products 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, including internationally, including by a planned transition to high volume vehicle production with the ramp of Model 3 and the worldwide sales, delivery and servicing of a significantly higher number of vehicles than our current vehicle fleet in the coming years. Furthermore, we are developing and growing our energy storage product and solar business worldwide, including in countries where we have limited or no previous operating experience in connection with our vehicle business. Our future operating results depend to a large extent on our ability to manage our expansion and growth successfully. We may not be successful in undertaking this global expansion if we are unable to control expenses and avoid cost overruns and other unexpected operating costs; establish sufficient worldwide automobile sales, delivery, service and Supercharger facilities in a timely manner; adapt our products and conduct our operations to meet local requirements; implement the required infrastructure, systems and processes; and find and hire a significant number of additional manufacturing, engineering, service, electrical installation, construction and administrative personnel.

If we are unable to achieve our targeted manufacturing costs for our vehicles, including Model 3, our financial condition and operating results will suffer.

While we have experienced and expect in the future to realize cost reductions by both us and our suppliers, there is no guarantee we will be able to achieve sufficient cost savings to reach our gross margin and profitability goals. We incur significant costs related

to procuring the materials required to manufacture our vehicles, assembling vehicles and compensating our personnel. We may also incur substantial costs or cost overruns in utilizing and increasing the production capability of our vehicle manufacturing facilities, such as for Model 3. Furthermore, if we are unable to achieve production cost targets on our vehicles pursuant to our plans, we may not be able to meet our gross margin and other financial targets. Furthermore, many of the factors that impact our manufacturing costs are beyond our control, such as potential increases in the costs of our materials and components, such as lithium, nickel and other components of our battery cells or aluminum used to produce body panels. If we are unable to continue to control and reduce our manufacturing costs, our operating results, business and prospects will be harmed.

We are significantly dependent upon revenue generated from the sale of a limited fleet of electric vehicles, which currently includes Model S, Model X and Model 3.

We currently generate a significant percentage of our revenues from the sale of two products: Model S and Model X vehicles. Model 3, for which we are planning significantly higher volumes than Model S or Model X, has required and will require significant investment in connection with its ongoing ramp, and there is no guarantee that it will be commercially successful. Historically, automobile customers have come to expect a variety of vehicles offered in a manufacturer's fleet and 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. To the extent our product variety and cycles do not meet consumer expectations, or cannot be produced on our projected timelines and cost and volume targets our future sales may be adversely affected. This could have a material adverse effect on our business, prospects, financial condition and operating results.

Our vehicles and energy storage products 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 packs that we produce make use of lithium-ion cells. On rare occasions, lithium-ion cells can rapidly release the energy they contain by venting smoke and flames in a manner that can ignite nearby materials as well as other lithium-ion cells. While we have designed the battery pack to passively contain any single cell's release of energy without spreading to neighboring cells, there can be no assurance that a field or testing failure of our vehicles or other battery packs that we produce will not occur, which could subject us to lawsuits, product recalls, or redesign efforts, all of which would be time consuming and expensive. Also, negative public perceptions regarding the suitability of lithium-ion cells for automotive applications or any future incident involving lithium-ion cells such as a vehicle or other fire, even if such incident does not involve our vehicles or energy storage products, could seriously harm our business.

In addition, we store a significant number of lithium-ion cells at our facilities and plan to produce high volumes of cells and battery modules and packs at Gigafactory 1. 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 could lead to adverse publicity and potentially a safety recall. Moreover, any failure of a competitor's electric vehicle or energy storage product may cause indirect adverse publicity for us and our products. Such adverse publicity could negatively affect our brand and harm our business, prospects, financial condition and operating results.

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

We may experience increases in the cost or a sustained interruption in the supply or shortage of materials. Any such increase, supply interruption or shortage could materially and negatively impact our business, prospects, financial condition and operating results. We use various materials in our business including aluminum, steel, lithium, cobalt, nickel and copper, as well as lithium-ion cells from suppliers. The prices for these materials fluctuate, and their available supply may be unstable, depending on market conditions and global demand for these materials, including as a result of increased production of electric vehicles and energy storage products by our competitors, 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:

- an increase in the cost, or decrease in the available supply, of materials used in the cells;
- disruption in the supply of cells due to quality issues or recalls by battery cell manufacturers or any issues that may arise with respect to cells manufactured at our own facilities; and
 - fluctuations in the value of the Japanese yen against the U.S. dollar as our battery cell purchases for Model S and Model X and some raw materials for cells used in Model 3 and energy storage products are currently denominated in Japanese yen.

Our business is dependent on the continued supply of battery cells for the battery packs used in our vehicles and energy storage products. While we believe several sources of the battery cells are available for such battery packs, and expect to eventually rely substantially on battery cells manufactured at our own facilities, we have to date fully qualified only a very limited number of suppliers for the cells used in such battery packs and have very limited flexibility in changing cell suppliers. In particular, we have

fully qualified only one supplier for the cells used in battery packs for our current production vehicles. Any disruption in the supply of battery cells from such suppliers could disrupt production of our vehicles and of the battery packs we produce for energy products 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 material costs. Substantial increases in the prices for our materials or prices charged to us, such as those charged by battery cell suppliers, would increase our operating costs, and could reduce our margins if we cannot recoup the increased costs through increased vehicle prices. Any attempts to increase vehicle prices in response to increased material costs could result in cancellations of vehicle orders and reservations and therefore materially and adversely affect our brand, image, business, prospects and operating results.

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.

Although we design our vehicles to be the safest vehicles on the road, product liability claims could harm our business, prospects, operating results and financial condition. The automobile industry in particular experiences significant product liability claims and we face inherent risk of exposure to claims in the event our vehicles do not perform as expected. On extremely rare occasions, our cars have been involved and we expect in the future will be involved in crashes resulting in death or personal injury, and such crashes where Autopilot is engaged are the subject of significant public attention. We have experienced and we expect to continue to face claims related to misuse or failures of new technologies that we are pioneering, including Autopilot in our vehicles. Finally, as our solar energy systems and energy storage products generate and store electricity, they have the potential to cause injury to people or property. A successful product liability claim against us could require us to pay a substantial monetary award. Our risks in this area are particularly pronounced given the limited number of vehicles and energy storage products delivered to date and limited field experience of our products. Moreover, a product liability claim could generate substantial negative publicity about our products and business and could have material adverse effect on our brand, business, prospects and operating results. In most jurisdictions, we generally self-insure against the risk of product liability claims for vehicle exposure, meaning that any product liability claims will likely have to be paid from company funds, not by insurance.

The markets in which we operate are highly competitive, and we may not be successful in competing in these industries. We currently face competition from new and established domestic and international competitors and expect to face competition from others in the future, including competition from companies with new technology.

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. There is no assurance that our vehicles will be successful in the respective markets in which they compete. Many established and new automobile manufacturers such as Audi, BMW, Daimler, General Motors, Toyota and Volvo, as well as other companies, have entered or are reported to have plans to enter the alternative fuel vehicle market, including hybrid, plug-in hybrid and fully electric vehicles. In some cases, such competitors have announced an intention to produce electric vehicles exclusively at some point in the future. Most of our current and potential competitors have significantly greater financial, technical, manufacturing, marketing, vehicle sales networks 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. Increased competition could result in lower vehicle unit sales, price reductions, revenue shortfalls, loss of customers and loss of market share, which could harm our business, prospects, financial condition and operating results. In addition, our Model 3 vehicle faces competition from existing and future automobile manufacturers in the extremely competitive entry-level premium sedan market, including Audi, BMW, Lexus and Mercedes.

The solar and energy storage industries are highly competitive. We face competition from other manufacturers, developers and installers of solar and energy storage systems, as well as from large utilities. Decreases in the retail

prices of electricity from utilities or other renewable energy sources could make our products less attractive to customers and lead to an increased rate of customer defaults under our existing long-term leases and power purchase agreements. Moreover, solar panel and lithium-ion battery prices have declined and are continuing to decline. As we increase our battery and solar panel manufacturing capabilities, including at Gigafactory 1 and Gigafactory 2, future price declines may harm our ability to produce energy storage systems and solar panels at competitive prices.

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

Consumers may be less likely to purchase our products now if they are not convinced that our business will succeed or that our service and support and other operations will continue for many years. Similarly, suppliers and other third parties will be less likely to invest time and resources in developing business relationships with us if they are not convinced that our business will succeed. Accordingly, in order to build and maintain our business, we must maintain confidence among customers, suppliers, analysts and other parties in our liquidity and long-term business prospects. Maintaining such confidence may be particularly complicated by certain

factors, such as our limited operating history, unfamiliarity with our products, competition and uncertainty regarding the future of electric vehicles or our other products and services and our quarterly production and sales performance compared with market expectations. 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 if needed.

Our plan to expand our network of Tesla stores, galleries, delivery centers, service centers and Superchargers will require significant cash investments and management resources and may not meet expectations with respect to additional sales or installations of our products or availability of Superchargers.

Our plans to expand our network of Tesla stores, galleries, delivery centers, service centers, mobile service offerings and Superchargers will require significant cash investments and management resources and may not meet our expectations with respect to additional sales or installations of our products. This ongoing global expansion, which includes planned entry into markets in which we have limited or no experience selling, delivering, installing and/or servicing our products, and which may pose legal, regulatory, cultural and political challenges that we have not previously encountered, may not have the desired effect of increasing sales and installations and expanding our brand presence to the degree we are anticipating. Furthermore, the increasing number of Model S and Model X vehicles, as well as the significant increase in our vehicle fleet size that we expect from Model 3, will require us to continue to increase the number of our Supercharger stations significantly. If we fail to do so, our customers could become dissatisfied, which could adversely affect sales of our vehicles. We will also need to ensure we are in compliance with any regulatory requirements applicable to the sale, installation and service of our products, the sale of electricity generated through our solar energy systems, and operation of Superchargers in those jurisdictions, which could take considerable time and expense. If we experience any delays or cannot meet customer expectations in expanding our network of Tesla stores, galleries, service centers, mobile service offerings and Superchargers, this could lead to a decrease in sales or installations of our products and could negatively impact our business, prospects, financial condition and operating results.

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

We currently have international operations and subsidiaries in various countries and jurisdictions that are subject to legal, political, and regulatory requirements and social and economic conditions that may be very different from those affecting us domestically. Additionally, as part of our growth strategy, we will continue to expand our sales, delivery, service and Supercharger locations internationally. 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 products and require significant management attention. These risks include conforming our products to various international regulatory and safety requirements as well as charging and other electric infrastructures, difficulty in establishing, staffing and managing foreign operations, challenges in attracting customers, foreign government taxes, regulations and permit requirements, our ability to enforce our contractual rights; trade restrictions, customs regulations, tariffs and price or exchange controls, and preferences of foreign nations for domestically manufactured products.

If we fail to effectively grow and manage the residual, financing and credit risks related to our vehicle financing programs, our business may suffer.

We offer vehicle financing arrangements for Model S and Model X through our local subsidiaries in the United States, Canada, Germany and the UK, including leasing directly through certain of those subsidiaries. The profitability of the leasing program depends on our ability to accurately project residual values, secure adequate financing and/or business partners to fund and grow this program, and screen for and manage customer credit risk. We expect the need for leasing and other financing options will continue to be important to Model S and Model X deliveries and for Model 3 in the long term. If we are unable to adequately fund our leasing program with internal funds, or partners or other external financing sources, and compelling alternative financing programs are not available for our customers, we may be unable to grow our sales. Furthermore, if our leasing business grows substantially, our business may suffer if we cannot effectively manage the greater levels of residual and credit risks resulting from growth. Finally, if we do not successfully monitor and comply with applicable national, state and/or local financial regulations and consumer protection laws governing lease transactions, we may become subject to enforcement actions or penalties, either of which may harm our business.

The unavailability, reduction or elimination of, or unfavorable determinations with respect to, government and economic incentives in the United States and abroad supporting the development and adoption of electric vehicles or solar energy could have some impact on demand for our products and services.

We currently benefit from certain government and economic incentives supporting the development and adoption of electric vehicles. In the United States and abroad, such incentives include, among other things, tax credits or rebates that encourage the

purchase of electric vehicles. In Norway, for example, the purchase of electric vehicles is not currently subject to import taxes, taxes on non-recurring vehicle fees, the 25% value added tax or the purchase taxes that apply to the purchase of gas-powered vehicles. Notably, the quantum of incentive programs promoting electric vehicles is a tiny fraction of the amount of subsidies that are provided to gas-powered vehicles through the oil and gas industries. Nevertheless, even the limited benefits from such programs could be reduced, eliminated or exhausted. For example, in April 2017 and January 2016, respectively, previously available incentives in Hong Kong and Denmark that favored the purchase of electric vehicles expired, negatively impacting sales. Moreover, under current regulations, a \$7,500 federal tax credit available in the United States for the purchase of qualified electric vehicles with at least 17 kWh of battery capacity, such as our vehicles, will begin to phase out with respect to any vehicles delivered in the second calendar quarter following the quarter in which we deliver our 200,000th qualifying vehicle in the United States. In addition, California implemented regulations phasing out a \$2,500 cash rebate on qualified electric vehicles for high-income consumers, which became effective in March 2016. In certain circumstances, there is pressure from the oil and gas lobby or related special interests to bring about such developments, which could have some negative impact on demand for our vehicles.

In addition, certain governmental rebates, tax credits and other financial incentives that are currently available with respect to our solar and energy storage product businesses allow us to lower our installation costs and cost of capital and encourage customers to buy our products and investors to invest in our solar financing funds. However, these incentives may expire on a particular date, end when the allocated funding is exhausted or be reduced or terminated as renewable energy adoption rates increase, often without warning. For example, the federal government currently offers a 30% investment tax credit (“ITC”) for the installation of solar power facilities and energy storage systems that are charged from a co-sited solar power facility. The ITC is currently scheduled to decline to 10%, and expire altogether for residential systems, by January 2022. Likewise, in jurisdictions where net energy metering is currently available, our customers receive bill credits from utilities for energy that their solar energy systems generate and export to the grid in excess of the electric load they use. Several jurisdictions have reduced or eliminated the benefit available under net energy metering, or have proposed to do so. Such reductions in or termination of governmental incentives could adversely impact our results by making our products less competitive for potential customers, increasing our cost of capital and adversely impacting our ability to attract investment partners and to form new financing funds for our solar and energy storage assets.

Moreover, we and our fund investors claim the ITC in amounts based on the fair market value of our solar and energy storage systems. Although we obtain independent appraisals to support the claimed fair market values, the relevant governmental authorities have audited such values and in certain cases have determined that they should be lower, and they may do so in the future. Such determinations may result in adverse tax consequences and/or our obligation to make indemnification or other payments, or contribute additional assets, to our funds or fund investors.

If we are unable to integrate SolarCity successfully into our business, we may not realize the anticipated benefits of our acquisition of SolarCity.

We have devoted to date, and continue to devote, substantial attention and resources to integrating into our company the business and operations of SolarCity, which we acquired in November 2016. We have no prior experience integrating a business of the size and scale of SolarCity. If the integration process takes longer than expected or is more costly than expected, we may fail to realize some or all of the anticipated benefits of the acquisition.

Potential difficulties we may encounter in the integration process include the following:

- the inability to successfully combine our business with that of SolarCity in a manner that permits the combined company to achieve the synergies we expect from the acquisition, which would result in the anticipated benefits of the acquisition not being realized partly or wholly in the time frame currently anticipated or at all;

- complexities associated with managing the combined businesses;
- integrating personnel from the two companies;
- creation of uniform standards, controls, procedures, policies and information systems; and
- potential unknown liabilities and unforeseen increased expenses, delays or regulatory conditions associated with the acquisition.

Any failure by us to realize the expected benefits of our substantial investments and commitments with respect to the manufacture of PV cells, including if we are unable to comply with the terms of our agreement with the Research Foundation for the State University of New York relating to our Gigafactory 2, could result in negative consequences for our business.

As part of our acquisition of SolarCity, we acquired certain PV cell manufacturing and technology assets, and a build-to-suit lease arrangement with the Research Foundation for the State University of New York (the “Foundation”). This agreement with the Foundation provides for the construction of Gigafactory 2 in Buffalo, New York, which at full capacity we expect will be capable of

producing 1 gigawatt of PV cells annually, including for our Solar Roof. Under this agreement, we are obligated to, among other things, employ specified minimum numbers of personnel in the State of New York during the 10-year period following the arrival of manufacturing equipment, the receipt of certain permits and other specified items at Gigafactory 2, and spend or incur approximately \$5.0 billion in combined capital, operational expenses, costs of goods sold and other costs in the State of New York during the 10-year period following the achievement of full production output at Gigafactory 2. If we fail in any year over the course of the term of the agreement to meet these obligations, we would be obligated to pay a “program payment” of \$41.2 million to the Foundation in such year. Any inability on our part to comply with the requirements of this agreement may result in the payment of significant amounts to the Foundation, the termination of our lease at Gigafactory 2, and/or the need to secure an alternative supply of PV cells for products such as our Solar Roof. Moreover, if we are unable to utilize the other manufacturing and technology assets that were acquired in the SolarCity acquisition in accordance with our expectations, we may have to recognize accounting charges pertaining to the write-off of such assets. Any of the foregoing events could have a material adverse effect on our business, prospects, financial condition and operating results.

We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial results.

Our revenues and costs denominated in foreign currencies are not completely matched. As we have increased vehicle deliveries in markets outside of the United States, we have much higher revenues than costs denominated in other currencies such as the euro, Chinese yuan, Norwegian krone, pound sterling and Canadian dollar. Any strengthening of the U.S. dollar would tend to reduce our revenues as measured in U.S. dollars, as we have historically experienced. In addition, a portion of our costs and expenses have been, and we anticipate will continue to be, denominated in foreign currencies, including the Japanese yen. If we do not have fully offsetting revenues in these currencies and if the value of the U.S. dollar depreciates significantly against these currencies, our costs as measured in U.S. dollars as a percent of our revenues will correspondingly increase and our margins will suffer. Moreover, while we undertake limited hedging activities intended to offset the impact of currency translation exposure, it is impossible to predict or eliminate such impact. As a result, our operating results could be adversely affected.

If we are unable to attract and/or retain key employees and hire qualified personnel, our ability to compete could be harmed.

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. In particular, we are highly dependent on the services of Elon Musk, our Chief Executive Officer, and Jeffrey B. Straubel, our Chief Technical Officer.

None of our key employees is bound by an employment agreement for any specific term and we may not 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 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.

Key talent may leave Tesla due to various factors, such as a very competitive labor market for talented individuals with automotive or technology experience. In California and other regions where we have operations, there is increasing competition for individuals with skillsets needed for our business, including specialized knowledge of electric vehicles, software engineering, manufacturing engineering, and other skills such as electrical and building construction expertise. 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, especially to support our expansion plans and ramp to high-volume manufacture of vehicles, and retain current employees. Additionally, we compete with both mature and prosperous companies that have far greater financial resources than we do and

start-ups and emerging companies that promise short-term growth opportunities. Difficulties in retaining current employees or recruiting new ones could 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, 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 is involved in other emerging technology ventures.

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 a manufacturing company, including with respect to facilities such as the Tesla Factory, Gigafactory 1 and Gigafactory 2, we are subject to complex environmental, health and safety laws and regulations at numerous jurisdictional levels in the United States and abroad, including laws relating to the use, handling, storage, disposal and human exposure to hazardous materials. The costs of compliance, including remediating contamination if any is found on our properties and any changes to our operations mandated by

new or amended laws, may be significant. We may also face unexpected delays in obtaining permits and approvals required by such laws in connection with our manufacturing facilities, which would hinder our operation of these facilities. Such costs and delays may adversely impact our business prospects and operating results. Furthermore, any violations of these laws may result in substantial fines and penalties, remediation costs, third party damages, or a suspension or cessation of our operations.

Our business may be adversely affected by any disruptions caused by union activities.

It is common for employees at companies with significant manufacturing operations such as us to belong to a union, which can result in higher employee costs and increased risk of work stoppages. Moreover, regulations in some jurisdictions outside of the United States mandate employee participation in industrial collective bargaining agreements and work councils with certain consultation rights with respect to the relevant companies' operations. Although we work diligently to provide the best possible work environment for our employees, they may still decide to join or seek recognition to form a labor union, or we may be required to become a union signatory. The United Automobile Workers has publicly announced a desire to organize the Fremont Factory, and has been engaged in a campaign against the company. Furthermore, we are directly or indirectly dependent upon companies with unionized work forces, such as parts suppliers and trucking and freight companies, and work stoppages or strikes organized by such unions could have a material adverse impact on our business, financial condition or operating results. If a work stoppage occurs, it could delay the manufacture and sale of our products and have a material adverse effect on our business, prospects, operating results or financial condition.

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

Motor vehicles are subject to substantial regulation under international, federal, state, and local laws. We incur significant costs in complying with these regulations, and may be required to incur additional costs to comply with any changes to such regulations. We are subject to laws and regulations applicable to the manufacture, import, sale and service of automobiles internationally. For example, in countries outside of the United States, we are required to meet vehicle-specific safety standards that are often materially different from requirements in the United States, thus resulting in additional investment into the vehicles and systems to ensure regulatory compliance in those countries. This process may include official review and certification of our vehicles by foreign regulatory agencies prior to market entry, as well as compliance with foreign reporting and recall management systems requirements.

Additionally, our vehicles are equipped with a suite of driver-assistance features called Autopilot, which help assist drivers with certain tedious and potentially dangerous aspects of road travel, but require drivers to remain engaged. Autopilot is a recently-introduced feature with which domestic and foreign regulators have limited experience. Any changes in law or regulatory enforcement could impact whether and how our customers are able to use our vehicles equipped with Autopilot, and which, depending on the severity, could adversely affect our business.

Moreover, as a manufacturer and installer of solar panels and energy storage systems and a supplier of electricity generated and stored by the solar energy and energy storage systems we install for customers, we are impacted by federal, state and local regulations and policies concerning electricity pricing, the interconnection of electricity generation and storage equipment with the electric grid, and the sale of electricity generated by third-party owned systems. For example, existing or proposed regulations and policies would permit utilities to limit the amount of electricity generated by our customers with their solar energy systems, charge fees and penalties to our customers relating to the purchase of energy other than from the grid, adjust electricity rate designs such that the price of our solar products may not be competitive with that of electricity from the grid, restrict us and our customers from transacting under our power purchase agreements or qualifying for government incentives and benefits that apply to solar power, and limit or eliminate net energy metering. If such regulations and policies remain in effect or are

adopted in other jurisdictions, or if other regulations and policies that adversely impact the interconnection of our solar and energy storage systems to the grid are introduced, modified or eliminated, they could deter potential customers from purchasing our solar and energy storage products, threaten the economics of our existing contracts and cause us to cease solar and energy storage system sales and operations in the relevant jurisdictions, which could harm our business, prospects, financial condition and results of operations.

We are subject to various privacy and consumer protection laws.

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

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

Any product recall, including for solar or charging equipment, in the future may result in adverse publicity, damage our brand and adversely affect our business, prospects, operating results and financial condition. For example, certain limited vehicle recalls that we initiated in the past two years have resulted from a component that could prevent the parking brake from releasing once engaged, a concern with the firmware in the restraints control module in certain right-hand-drive vehicles, industry-wide issues with airbags from a particular supplier, a front seat belt issue in a single field vehicle, and internal tests that revealed potential unintended movements in the Model X second row and third row seats during a collision. None of our past recalls have been related to our electric powertrain. Furthermore, testing of our vehicles by government regulators or industry groups may require us to initiate vehicle recalls or may result in negative public perceptions about the safety of our vehicles. In the future, we may at various times, voluntarily or involuntarily, initiate a recall if any of our products or our electric vehicle powertrain components that we have provided to other vehicle OEMs, including any systems or parts sourced from our suppliers, prove to be defective or noncompliant with applicable laws and regulations, such as federal motor vehicle safety standards. Such recalls, whether voluntary or involuntary or caused by systems or components engineered or manufactured by us or our suppliers, could involve significant expense and could adversely affect our brand image in our target markets, as well as our business, prospects, financial condition and results of operations.

Our resale value guarantee and leasing programs for our vehicles expose us to the risk that the resale values of vehicles returned to us are lower than our estimates and may result in lower revenues, gross margin, profitability and liquidity.

We have provided resale value guarantees to many of our customers, under which such customers may sell their vehicles back to us at certain points in time at pre-determined resale values. If the resale values of any vehicles resold or returned to us pursuant to these programs are materially lower than our estimates, our profitability and/or liquidity could be negatively impacted.

We apply lease accounting on sales of vehicles with a resale value guarantee and on leases made directly by us or by our leasing partners. Under lease accounting, we recognize the associated revenues and costs of the vehicle sale over time rather than fully upfront at vehicle delivery. As a result, these programs generate lower revenues in the period the car is delivered and higher gross margins during the period of the resale value guarantee as compared to purchases in which the resale value guarantee does not apply. A higher than anticipated prevalence of these programs could therefore have an adverse impact on our near term revenues and operating results. Moreover, unlike the sale of a vehicle with a resale value guarantee or programs with leasing partners which do not impact our cash flows and liquidity at the time of vehicle delivery, under a lease held directly by us, we may receive only a very small portion of the total vehicle purchase price at the time of lease, followed by a stream of payments over the term of the lease. To the extent we expand our leasing program without securing external financing or business partners to support such expansion, our cash flow and liquidity could also be negatively impacted.

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

Subject to separate limited warranties for the supplemental restraint system, battery and drive unit, we provide four year or 50,000 mile limited warranties for the purchasers of new Model S and Model X vehicles and pre-owned Model S vehicles certified and sold by us. The limited warranty for the battery and drive unit covers the drive unit for eight years, as well as the battery for a period of eight years (or for certain older vehicles, 125,000 miles if reached sooner than eight years), although the battery's charging capacity is not covered under any of our warranties or Extended Service plans. In addition, customers of new Model S and Model X vehicles have the opportunity to

purchase an Extended Service plan for the period after the end of the limited warranty for their new vehicles to cover additional services for up to an additional four years or 50,000 miles, provided it is purchased within a specified period of time.

For energy storage products, we provide limited warranties against defects and to guarantee minimum energy retention levels. For example, we guarantee that each Powerwall 2 product will maintain at least 70-80% of its stated energy capacity after 10 years, and that each Powerpack 2 product will retain specified minimum energy capacities in each of its first 10 to 15 years of use. For our Solar Roof, we offer a warranty on the glass tiles for the lifetime of a customer's home and a separate warranty for the energy generation capability of the solar tiles. We also offer extended warranties, availability guarantees and capacity guarantees for periods of up to 20 years at an additional cost at the time of purchase, as well as workmanship warranties to customers who elect to have us install their systems.

Finally, customers who buy energy from us under solar energy system leases or power purchase agreements are covered by warranties equal to the length of the agreement term, which is typically 20 years. Systems purchased for cash are covered by a warranty of up to 10 years, with extended warranties available at additional cost. In addition, we pass through to our customers the inverter and panel manufacturers' warranties, which generally range from 5 to 25 years, subjecting us to the risk that the manufacturers may later cease operations or fail to honor their underlying warranties. Finally, we provide a performance guarantee

with our leased solar energy systems that compensates a customer on an annual basis if their system does not meet the electricity production guarantees set forth in their lease.

If our warranty reserves are inadequate to cover future warranty claims on our products, our business, prospects, financial condition and operating results could be materially and adversely affected. Warranty reserves include management's best estimate of the projected costs to repair or to replace items under warranty. These estimates are based on actual claims incurred to-date and an estimate of the nature, frequency and costs of future claims. Such estimates are inherently uncertain and changes to our historical or projected experience, especially with respect to products such as Model 3 and Solar Roof that are new and/or that we expect to produce at significantly greater volumes than our past products, may cause material changes to our warranty reserves in the future.

We are continuously expanding and improving our information technology systems and use security measures designed to protect our systems against breaches and cyber-attacks. If these efforts are not successful, our business and operations could be disrupted and our operating results and reputation could be harmed.

We are continuously 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 multiple vehicles necessitates continued development, maintenance and improvement of our information technology systems in the United States and abroad, which include product data management, procurement, inventory management, production planning and execution, sales, service and logistics, dealer management, financial, tax and regulatory compliance systems. The implementation, maintenance and improvement of these systems require significant management time, support and cost. Moreover, there are inherent risks associated with developing, improving and expanding our core systems as well as implementing new systems, including the disruption of our data management, procurement, manufacturing execution, finance, supply chain and sales and service processes. These risks may affect our ability to manage our data and inventory, procure parts or supplies or manufacture, sell, deliver and service vehicles, or achieve and maintain compliance with, or realize available benefits under, tax laws and other applicable regulations. We also maintain information technology measures designed to protect us against system security risks, data breaches and cyber-attacks.

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

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

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

Our financial results may vary significantly from period-to-period due to fluctuations in our operating costs.

We expect our period-to-period financial 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 current and future products, increase the production capacity at our manufacturing facilities to produce vehicles at higher volumes, including ramping up the production of Model S, Model X and Model 3, expand Gigafactory 1, open new Tesla stores and service centers with maintenance and repair capabilities, open new Supercharger locations, develop Gigafactory 2, 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 financial 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 financial results may not meet expectations of equity research analysts or investors. If any of this occurs, the trading price of our stock could fall substantially, either suddenly or over time.

Any unauthorized control or manipulation of our vehicles' systems could result in loss of confidence in us and our vehicles and harm our business.

Our vehicles contain complex information technology systems. For example, our vehicles are designed with built-in data connectivity to accept and install periodic remote updates from us to improve or update the functionality of our vehicles. We have designed, implemented and tested security measures intended to prevent unauthorized access to our information technology networks, our vehicles and their systems. However, hackers have reportedly attempted, and may attempt in the future, to gain unauthorized

access to modify, alter and use such networks, vehicles and systems to gain control of, or to change, our vehicles' functionality, user interface and performance characteristics, or to gain access to data stored in or generated by the vehicle. We encourage reporting of potential vulnerabilities in the security of our vehicles via our security vulnerability reporting policy, and we aim to remedy any reported and verified vulnerabilities. Accordingly, we have received reports of potential vulnerabilities in the past and have attempted to remedy them. However, there can be no assurance that vulnerabilities will not be identified in the future, or that our remediation efforts are or will be successful.

Any unauthorized access to or control of our vehicles or their systems or any loss of data could result in legal claims or proceedings. In addition, regardless of their veracity, reports of unauthorized access to our vehicles, their systems or data, as well as other factors that may result in the perception that our vehicles, their systems or data are capable of being "hacked," could negatively affect our brand and harm our business, prospects, financial condition and operating results. We have been the subject of such reports in the past.

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

As of September 30, 2017, we and our subsidiaries had outstanding \$10.0 billion in aggregate principal amount of indebtedness (see Note 11, Convertible and Long-Term Debt Obligations, to the consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q). Our substantial consolidated indebtedness may increase our vulnerability to any generally adverse economic and industry conditions. We and our subsidiaries may, subject to the limitations in the terms of our existing and future indebtedness, incur additional debt, secure existing or future debt or recapitalize our debt.

Pursuant to their terms, holders of the 2018 Notes, 2019 Notes, 2021 Notes and 2022 Notes (collectively, the "Tesla Convertible Notes") may convert their respective Tesla Convertible Notes at their option prior to the scheduled maturities of the respective Tesla Convertible Notes under certain circumstances. The 2018 Notes have been convertible at their holders' option during each quarter commencing with the fourth quarter of 2013, except the first quarter of 2014. Upon conversion of the applicable Tesla Convertible Notes, we will be obligated to deliver cash and/or shares in respect of the principal amounts thereof and the conversion value in excess of such principal amounts on such Tesla Convertible Notes. For example, in June 2017 and September 2017, pursuant to separate privately negotiated agreements, we exchanged \$144.8 million and \$10.0 million, respectively, in aggregate principal amount of the 2018 Notes for 1.2 million shares and 0.1 million shares, respectively, of our common stock. Moreover, the 2.75% convertible senior notes due 2018, 1.625% convertible senior notes due 2019 and zero coupon convertible senior notes due 2020 issued by SolarCity Corporation (the "SolarCity Convertible Notes") are convertible into shares of our common stock at conversion prices ranging from \$300.00 to \$759.36 per share. Finally, holders of the Tesla Convertible Notes and the SolarCity Convertible Notes will have the right to require us to repurchase 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.

Our ability to make scheduled payments of the principal and interest on our indebtedness when due or to make payments upon conversion or repurchase demands with respect to our convertible notes, or to refinance our indebtedness as we may need or desire, 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 our existing indebtedness, 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 existing or future indebtedness will depend on the capital markets and our financial

condition at such time. In addition, our ability to make payments may be limited by law, by regulatory authority or by agreements governing our future indebtedness. We may not be able to engage in any of these activities or engage in these activities on desirable terms or at all, which could result in a default on our existing or future indebtedness and have a material adverse effect on our business, results of operations and financial condition.

Our debt agreements contain covenant restrictions that may limit our ability to operate our business.

The terms of certain of our credit facilities, including our senior secured asset based revolving credit agreement, contain, and any of our other future debt agreements may contain, covenant restrictions that limit our ability to operate our business, including restrictions on our ability to, among other things, incur additional debt or issue guarantees, create liens, repurchase stock or make other restricted payments, and make certain voluntary prepayments of specified debt. In addition, under certain circumstances we are required to comply with a fixed charge coverage ratio. As a result of these covenants, our ability to respond to changes in business and economic conditions and engage in beneficial transactions, including to obtain additional financing as needed, may be restricted. Furthermore, our failure to comply with our debt covenants could result in a default under our debt agreements, which could permit the holders to accelerate our obligation to repay the debt. If any of our debt is accelerated, we may not have sufficient funds available to repay it.

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, installation and/or servicing of automobiles, energy storage products and solar products is a capital intensive business. Until we are consistently generating positive free cash flows, we may need or want to raise additional funds through the issuance of equity, equity-related or debt securities or through obtaining credit from financial institutions to fund, together with our principal sources of liquidity, the costs of developing and manufacturing our current or future vehicles, energy storage products and/or solar products, to pay any significant unplanned or accelerated expenses or for new significant strategic investments, or to refinance our significant consolidated indebtedness, even if not required to do so by the terms of such indebtedness. We need sufficient capital to fund our ongoing operations, ramp vehicle production, continue research and development projects, establish sales, delivery and service centers, build and deploy Superchargers, expand Gigafactory 1, develop Gigafactory 2 and to make the investments in tooling and manufacturing capital required to introduce new vehicles, energy storage products and solar products. 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 and adversely affected.

Additionally, we use capital from third-party fund investors to reduce the cost of capital of our solar energy system installations, improve our margins, offset future reductions in government incentives and maintain the price competitiveness of our solar energy systems. The availability of this tax-advantaged financing depends upon many factors, including the confidence of the investors in the solar energy industry and the quality and mix of our customer contracts, any regulatory changes impacting the economics of our existing customer contracts, changes in legal and tax advantages or risks or government incentives associated with these financings, and our ability to compete with other renewable energy companies for the limited number of potential fund investors. Moreover, interest rates are at historically low levels. If the rate of return required by investors rises as a result of a rise in interest rates, it will reduce the present value of the customer payment streams underlying, and therefore the total value of, our financing structures, increasing our cost of capital. If we are unable to establish new financing funds on favorable terms for third-party ownership arrangements to enable our customers' access to our solar energy systems with little or no upfront cost, we may be unable to finance installation of our customers' systems, or our cost of capital could increase and our liquidity may be negatively impacted, any of which would have an adverse effect on our business, financial condition and results of operations.

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

We sell our vehicles directly to consumers. We may not be able to sell our vehicles through this sales model in each state in the United States as some states have laws that may be interpreted to impose limitations on this direct-to-consumer sales model. In certain states in which we are not able to obtain dealer licenses, we have opened galleries, which are not full retail locations.

The application of these state laws to our operations 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 by dealer associations and others as to whether such decisions comply with applicable state motor vehicle industry laws. We have prevailed in many of these lawsuits and such results have reinforced our continuing belief that state laws were not designed to prevent our distribution model. In some states, there have also been regulatory and legislative efforts by vehicle dealer associations to propose bills and regulations that, if enacted, would prevent us from obtaining dealer licenses in their states given our current sales model. A few states have passed legislation that clarifies our ability to operate, but at the

same time limits the number of dealer licenses we can obtain or stores that we can operate. We have also filed a lawsuit in federal court in Michigan challenging the constitutionality of the state's prohibition on direct sales as applied to our business.

Internationally, 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. Continued regulatory limitations and other obstacles interfering with our ability to sell vehicles directly to consumers could have a negative and material impact our business, prospects, financial condition and results of operations.

We may need to defend ourselves against intellectual property infringement claims, which may be time-consuming and could cause us to incur substantial costs.

Others, including our competitors, may hold or obtain patents, copyrights, trademarks or other proprietary rights that could prevent, limit or interfere with our ability to make, use, develop, sell or market our products and services, which could make it more difficult for us to operate our business. From time to time, the holders of such intellectual property rights may assert their rights and

urge us to take licenses, and/or may bring suits alleging infringement or misappropriation of such rights. We may consider the entering into licensing agreements with respect to such rights, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur, and such licenses could significantly increase our operating expenses. In addition, if we are determined to have infringed upon a third party's intellectual property rights, we may be required to cease making, selling or incorporating certain components or intellectual property into the goods and services we offer, to pay substantial damages and/or license royalties, to redesign our products and services, and/or to establish and maintain alternative branding for our products and services. In the event that we were required to take one or more such actions, 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, negative publicity and diversion of resources and management attention.

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

Our corporate headquarters, the Tesla Factory and Gigafactory 1 are located in seismically active regions in Northern California and Nevada. If major disasters such as earthquakes 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. We may incur expenses relating to such damages, which could have a material adverse impact on our business, operating results and financial condition.

Risks Related to the Ownership of Our Common Stock

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

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 \$389.61 per share and a low of \$178.19 per share over the last 52 weeks. 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. In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. For example, a shareholder litigation like this was filed against us in 2013. While the plaintiffs' complaint was dismissed with prejudice, any future shareholder litigation could result in substantial costs and a diversion of our management's attention and resources.

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

We occasionally provide guidance regarding our expected financial and business performance, such as projections regarding sales and production, as well as anticipated future revenues, gross margins, profitability and cash flows. Correctly identifying key factors affecting business conditions and predicting future events is inherently an uncertain process and our guidance may not ultimately be accurate. Our guidance is based on certain assumptions such as those relating to anticipated production and sales volumes and average sales prices, supplier and commodity costs, and planned cost reductions. If our guidance is not accurate or varies from actual results due to our inability to meet our assumptions or the impact on our financial performance that could occur as a result of various risks and uncertainties, the market value of our common stock could decline significantly.

Transactions relating to our convertible notes may dilute the ownership interest of existing stockholders, or may otherwise depress the price of our common stock.

The conversion of some or all of the Tesla Convertible Notes or the SolarCity Convertible Notes would dilute the ownership interests of existing stockholders to the extent we deliver shares upon conversion of any of such notes. Our 2018 Notes and the SolarCity Convertible Notes have been historically, and the other Tesla Convertible Notes may become in the future, convertible at the option of their holders prior to their scheduled terms under certain circumstances. If holders elect to convert their convertible notes, we could be required to deliver to them a significant number of shares of our common stock. 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 convertible notes may encourage short selling by market participants because the conversion of such notes could be used to satisfy short positions, or anticipated conversion of such notes into shares of our common stock could depress the price of our common stock.

Moreover, in connection with each issuance of the Tesla Convertible Notes, we entered into convertible note hedge transactions, which 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 Tesla Convertible Notes. We also entered into warrant transactions with the hedge counterparties, which 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 enter into various transactions with respect to their hedge positions, which could also cause or prevent an increase or a decrease in the market price of our common stock or the convertible notes.

Elon Musk has pledged shares of our common stock to secure certain bank borrowings. If Mr. Musk were forced to sell these shares pursuant to a margin call that he could not avoid or satisfy, such sales could cause our stock price to decline.

Certain banking institutions have made extensions of credit to Elon Musk, our Chief Executive Officer, a portion of which was used to purchase shares of common stock in certain of our public offerings and private placements at the same prices offered to third party participants in such offerings and placements. We are not a party to these loans, which are partially secured by pledges of a portion of the Tesla common stock currently owned by Mr. Musk. If the price of our common stock were to decline substantially and Mr. Musk were unable to avoid or satisfy a margin call with respect to his pledged shares, Mr. Musk may be forced by one or more of the banking institutions to sell shares of Tesla common stock in order to remain within the margin limitations imposed under the terms of his loans. Any such sales could cause the price of our common stock to decline further.

Anti-takeover provisions contained in our governing documents, applicable laws and our convertible notes could impair a takeover attempt.

Our certificate of incorporation and bylaws afford certain rights and powers to our board of directors that could contribute to the delay or prevention of an acquisition that it deems undesirable. We are also subject to Section 203 of the Delaware General Corporation Law and other provisions of Delaware law that limit the ability of stockholders in certain situations to effect certain business combinations. In addition, the terms of our convertible notes require us to repurchase such notes in the event of a fundamental change, including a takeover of our company. Any of the foregoing provisions and terms 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.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On September 11, 2017, we issued 80,306 shares of our common stock to a holder of our 2018 Notes in exchange for \$10.0 million in aggregate principal amount of 2018 Notes, pursuant to privately negotiated agreement. Such issuance was conducted pursuant to an exemption from registration provided by Rule 3(a)(9) of the Securities Act. We relied on this exemption from registration based in part on the representations made by the holder of 2018 Notes in the transaction.

In connection with the offering of the 2018 Notes in 2013, we sold certain warrants to Morgan Stanley & Co. LLC (“Morgan Stanley”). On September 12, 2017, we agreed with Morgan Stanley to partially terminate such warrants and, in connection with such partial termination, we issued 17,433 shares of our common stock to Morgan Stanley. Such issuance was conducted as a private placement pursuant to an exemption from registration provided by Rule 4(a)(2) of the Securities Act and were offered only to persons believed to be either (i) “accredited investors” within the meaning of Rule 501 of Regulation D promulgated under the Securities Act or (ii) “qualified institutional buyers” within the meaning of Rule 144A promulgated under the Securities Act. We relied on this exemption from registration based in part on the representations made by Morgan Stanley.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at the end of this Quarterly Report on Form 10-Q for the information required by this Item.

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed
		Form	File No.	Exhibit	Filing Date	Herewith
4.1	<u>Indenture, dated as of August 18, 2017, by and among the Registrant, SolarCity Corporation, and U.S. Bank National Association, as trustee.</u>	8-K	001-34756	4.1	August 23, 2017	
4.2	<u>Form of 5.30% Senior Note due August 15, 2025.</u>	8-K	001-34756	4.2	August 23, 2017	
10.1	<u>Purchase Agreement, dated as of August 11, 2017, by and among the Registrant, SolarCity Corporation and Goldman Sachs & Co. LLC and Morgan Stanley & Co. LLC as representatives of the several initial purchasers named therein.</u>	8-K	001-34756	10.1	August 23, 2017	
10.2	<u>Seventh Amendment to the ABL Credit Agreement, dated as of August 11, 2017, by and among the Registrant, Tesla Motors Netherlands B.V., Deutsche Bank AG New York Branch, as administrative agent and collateral agent, and the other agents party thereto.</u>	8-K	001-34756	10.2	August 23, 2017	
10.3†	<u>Amended and Restated Loan and Security Agreement, dated as of August 17, 2017, by and among Tesla 2014 Warehouse SPV LLC, Tesla Finance LLC, the Lenders and Group Agents from time to time party thereto, and Deutsche Bank AG, New York Branch, as Administrative Agent.</u>	—	—	—	—	X
10.4†	<u>Loan and Security Agreement, dated as of August 17, 2017, by and among LML Warehouse SPV, LLC, Tesla Finance LLC, the Lenders and Group Agents from time to time party thereto, and Deutsche Bank AG, New York Branch, as Administrative Agent.</u>	—	—	—	—	X
10.5†	<u>Required Group Agent Action No. 38, dated as of August 22, 2017, by and among by and among Megalodon Solar, LLC, as borrower, Bank of America, N.A., as collateral agent and administrative agent, and the group agents party thereto.</u>	—	—	—	—	X
10.6†	<u>Required Group Agent Action No. 39, dated as of September 29, 2017, effective as of October 1, 2017, by</u>	—	—	—	—	X

and among by and among Megalodon Solar, LLC, as borrower, Bank of America, N.A., as collateral agent and administrative agent, and the group agents party thereto.

10.7**	<u>Incentive Compensation Plan for July 1, 2017-December 31, 2017, for Jon McNeill.</u>	—	—	—	—	X
31.1	<u>Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Executive Officer</u>	—	—	—	—	X
31.2	<u>Rule 13a-14(a) / 15(d)-14(a) Certification of Principal Financial Officer</u>	—	—	—	—	X
32.1*	<u>Section 1350 Certifications</u>	—	—	—	—	X
101.INS	XBRL Instance Document	—	—	—	—	X
101.SCH	XBRL Taxonomy Extension Schema Document	—	—	—	—	X

Edgar Filing: Tesla, Inc. - Form 10-Q

Exhibit		Incorporated by Reference				Filed
Number	Exhibit Description	Form	File No.	Exhibit	Filing Date	Herewith
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.

**Indicates a management contract or compensatory plan or arrangement.

€Confidential treatment has been requested for portions of this exhibit.

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, Inc.

Date: November 2, 2017 /s/ Deepak Ahuja
Deepak Ahuja
Chief Financial Officer
(Principal Financial Officer and
Duly Authorized Officer)