TESLA MOTORS INC
Form 10-Q
November 12, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

Commission File Number: 001-34756

Tesla Motors, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**91-2197729**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
3500 Deer Creek Road Palo Alto, California	**94304**
(Address of principal executive offices)	**(Zip Code)**

(650) 681-5000

(Registrant s telephone number, including area code)

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

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

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

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

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

As of October 31, 2010, there were 93,270,701 shares of the registrant s Common Stock outstanding.

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TESLA MOTORS, INC.

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

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Tesla Motors, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

(Unaudited)

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

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

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

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Tesla Motors, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except share and per share data)

(Unaudited)

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

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

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Tesla Motors, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

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

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

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

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Overview of the Company

Tesla Motors, Inc. (Tesla , we, us or our) was incorporated in the state of Delaware on July 1, 2003. We design, develop, manufacture and sell high-performance fully electric vehicles and advanced electric vehicle powertrain components.

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

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

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

Initial Public Offering and Toyota Concurrent Private Placement

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

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

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Unadjusted Error in 2009

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

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

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

2. Summary of Significant Accounting Policies

Basis of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and reported amounts of expenses during the reporting period. Actual results could differ from those estimates.

Unaudited Interim Financial Statements

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

Fair Value of Financial Instruments

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

All of our cash equivalents and current restricted cash, which are comprised primarily of money market funds, are classified within Level I of the fair value hierarchy because they are valued using quoted market prices or market prices for similar securities. We do not have any Level II instruments, or instruments valued based on other observable inputs. Our common stock warrant liability, and previously our convertible preferred stock warrant liability, is classified within Level III of the fair value hierarchy.

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

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

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

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

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

Revenue Recognition

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Automotive Sales

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

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

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

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

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

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

In February 2010, we began offering a leasing program to qualified customers in the United States for the Tesla Roadster. Through our wholly owned subsidiary, Tesla Motors Leasing, Inc., qualifying customers are permitted to lease the Tesla Roadster for 36 months, after which time they have the option of either returning the vehicle to us or purchasing it for a pre-determined residual value. We account for these leasing transactions as operating leases and accordingly, we recognize leasing revenues on a straight-line basis over the term of the individual leases and record cost of sales equal to the depreciation of the leased vehicles. As of September 30, 2010, we had deferred revenues of $0.9 million of down payments which will be recognized over the term of the individual leases. Lease revenues are recorded in automotive sales and for the three and nine months ended September 30, 2010, we recognized $0.2 million and $0.3 million, respectively.

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Zero Emission Vehicle Credit Sales

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

Extended Service and Battery Replacement Plans

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

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

Development Services Revenue

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

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

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

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

Freestanding Stock Warrants

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

Cash and Cash Equivalents

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

Restricted Cash and Deposits

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Accounts Receivable and Allowance for Doubtful Accounts

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

Concentration of Risk

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. Our cash and cash equivalents are primarily invested in money market funds with high credit quality financial institutions in the United States. At times, these deposits and securities may be in excess of insured limits. To date, we have not experienced any losses on our deposits of cash and cash equivalents. During the nine months ended September 30, 2010, our accounts receivable were derived primarily from sales of powertrain components and the performance of powertrain development services to Daimler (see Note 12). These accounts receivable balances represented 89% and 82% of total accounts receivable as of September 30, 2010 and December 31, 2009, respectively. We perform credit evaluations of our customers financial condition and, generally, require no collateral.

A number of components that meet our manufacturing requirements are available only from single source suppliers. For example, Lotus is the only manufacturer for certain components, such as the chassis of our Tesla Roadster. In other instances, although there may be multiple suppliers available, many of the components used in our vehicles are purchased by us from a single source. If these single source suppliers fail to satisfy our requirements on a timely basis at competitive prices, we could suffer manufacturing delays, a possible loss of revenues, or incur higher cost of sales, any of which could adversely affect our operating results.

Inventories and Inventory Valuation

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

Adverse Purchase Commitments

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Property and Equipment

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

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

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

Operating Lease Vehicles

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

Long-lived Assets

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

Research and Development Costs

Research and development costs are expensed as incurred. Research and development expenses consist primarily of payroll, benefits and stock-based compensation of those employees engaged in research, design and development activities, costs related to design tools, license expenses related to intellectual property, supplies and services, depreciation and other occupancy costs. Also included in research and development are development services costs incurred, if any, prior to the finalization of agreements with our development services customers as reaching a final agreement and revenue recognition is not assured. Development services costs incurred after the finalization of an agreement are recorded in cost of revenues.

Income Taxes

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

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Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Stock-based Compensation

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

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

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

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

Foreign Currency Remeasurement and Transactions

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

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

Tesla Motors, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

Comprehensive Loss

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

Warranties

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

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