Q4 2015 Tesla Motors IncEarnings Call - Final

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Presentation

OPERATOR: Good day, ladies and gentlemen. Thank you for your patience. You have joined Tesla Motors, Incorporated, fourth-quarter 2015 financial results Q&A conference call.

(Operator Instructions)

I would now like to turn the call over to your host, Mr. Jeffrey Evanson. Sir, you may begin.

JEFFERY EVANSON, VP OF GLOBAL IR, TESLA MOTORS, INC.: Thank you, Latiffe, and good afternoon, everyone. Welcome to Tesla's fourth-quarter and full-year 2015 Q&A webcast. I'm joined today by Elon Musk, Tesla Chairman and CEO; JB Straubel, our CTO; CFO Jason Wheeler; and John McNeil, President of Global Sales, Service, and Delivery.

Our Q4 results are announced in the update letter at the same link as this webcast. As usual, this letter includes GAAP and non-GAAP financial information, and reconciliations between the two.

During our call, we will discuss our business outlook and make forward-looking statements. These are based on our predictions and expectations as of today. Actual events or results could differ materially due to a number of risks and uncertainties, including those mentioned in our most recent Form 10-Q filed with the SEC.

We're going to start today's call with some comments by Elon and then Jason. Then we'll go into the Q&A session. I would ask everyone that during the Q&A session you try to constrain yourselves to one question and one follow-up so we can give everyone fair time on the call.

With that, I will turn it over to you, Elon.

ELON MUSK, CHAIRMAN & CEO, TESLA MOTORS, INC.: Thank you. I think the newsletter largely speaks for itself, but I'll add some commentary on some of the lead points. Obviously we had a huge increase in Model S deliveries year on year in Q4 last year, going up 76%. We had a huge change in our core operational cash flow, which you can really see in the chart. It's really quite dramatic. That's why I think it's interesting to look at in chart form. It goes from negative to significantly positive in Q4 last year.

Then we made modest improvements in Model S gross margin, gained to about 25% excluding one-time items. I feel pretty good about where we're tracking to probably get close to 30% by late Q4 of this year.

Then something I am presently quite excited about is that we expect to be positive cash flow starting next month, and then continuing on into Q2 and beyond. There's one caveat there. That's including the asset back line. The S back line, that's funding for cars that are en route to customers. Particularly as our sales to international markets increases, there is more finished goods inventory on its way to customers. Inclusive of the asset back line, which really I think is most accurately regarded as a slight decrease in the gross margin of the car by about roughly 0.1%, or thereabouts. Apart from that, we were positive cash flow.

Then we are expecting to be profitable for 2016 on a non-GAAP basis. I personally think that that is the correct way to think, to look at it, because of the way GAAP treats lease accounting. Nonetheless, despite the lease accounting stuff, we anticipate it being profitable by GAAP's numbers in Q4 of this year.

We're really looking forward to the unveiling of the Model 3 at the end of next month. I think this is going to be really well received, and then getting into production and delivery at the end of next year.

Touching on a few things better in the bulk of the newsletter, I think the chart on vehicle demand is really interesting. To the degree this represents a microcosm of how Tesla vehicles will be received in other vehicle segments, it augurs extremely well for the future.

The Model S was the best selling premium sedan in the United States last year of any kind. Our sales actually increased by 51%, whereas everybody else was -- sales declined. The overall market segment declined by about 1%. I think this is -- it's really rare to see situations like this. I think this is despite us being really quite under-penetrated in the northeast. I think there's a lot of room for growth in the northeast particularly of the US, and in international markets in general.

Essentially, getting to 25% market share of all premium sedans in the US is, I think, a great achievement of the Tesla team. I think it's also great for the world, because it means -- that's 25,000 fewer gas guzzlers that are on the road. I would like to thank all the customers that went out and bought that car, because I think they're making a difference for the environment, and of course they're helping pay for the future development of the Model 3, which is the more affordable mass-market car. That's where we put all of the revenue we received from the Model S and X. It's always a point to bear that in mind, that S and X power pay for the Model 3.

One additional note is that Tesla does not advertise. We don't pay for any endorsements. We do not discount our cars for anyone, including me. I pay full retail price. Whereas those actions are -- all of our competitors take those actions. That's, I think, quite interesting. We also have far fewer sales outlets than our competitors.

Essentially, there's a lot of degrees of freedom that we are not exercising that we could in theory exercise. I think -- if you look at the text, it's worth noting that this is not just uniquely true in the United States. In Switzerland, we out-sold -- the Model S out-sold the Mercedes S class, the BMW 7 Series, Porsche Panamera, and the AUDI 8 combined; and also out-sold the Mercedes E class. In Germany, we out-sold the Porsche Panamera.

I think these are pretty good situations, even in places that have no incentives. Obviously, incentives are certainly helpful. They're a catalyst for sales. Tesla's always appreciated incentives, and I think they make a difference in accelerating the advent of electric vehicles. But sometimes incentives are characterized as, it's all about incentives or not at all about incentives. It's really important to appreciate that incentives are an accelerant. That's the reality of them.

Jason, do you want to add anything?

JASON WHEELER, CFO, TESLA MOTORS, INC.: Absolutely, thanks Elon. First of all, I look forward to working with everybody. I'm super-excited to be here, as excited I was on the first day I walked through the door.

Three quick things I want to touch on real quick. Number one, gross margin. Lots of moving parts this quarter. Let me walk you guys through it a little bit. We had over $67 million in Model X ramp-up costs and non-recurring items in the quarter, as Elon mentioned. Correcting for these items, automotive, gross margin, excluding XEV credits would have been 25%.

First thing, the major component here is labor and overhead and depreciation related to the Model X launch. The way for you all to think about this is towards the end of Q3 and into Q4, we had to bring the work force into the factory to build these wonderful vehicles. Also, soon as starter production starts, the clock starts hitting on depreciation, as well. That's what's going on there. We also had some asset impairments, one with our old paint shop. We've now got a state-of-the-art paint shop in place, which is going to give us the capacity that we need all the way through Model 3.

ELON MUSK: That's 10,000 cars a week, too.

JASON WHEELER: Yes, 10,000 cars a week. This is a good story. These are assets that we had purchased -- go all the way back to the Nummi days. We got every bit of life out of those assets as we possibly could.

The other big piece here is we had an E&O write-off, excess and obsolescence. This is a result of better production control and inventory management systems that we put in place. The place is moving really fast and we took some time. Elon talked about this in Q2 on the earnings call during the shut down, putting better systems in place to track this. We're moving to a place where we're tracking E&O on a real-time basis, and bringing those facts to the table when we're making decisions. We shouldn't be in this position again.

Next thing I wanted to talk about real quickly was cash flow. Elon covered this. I think the chart on the face of the shareholder letter really gets there. We were within striking distance of positive operating cash flows (inaudible). When you add back the leasing proceeds that we get, $209 million, it's a great step-change in the right direction to getting us to net cash flow positive.

Also, CapEx we guided at $500 million last quarter on the call, and we closed out at $411 million for the quarter. That all resulted in the ending cash balance being at $1.2 billion, which I think showcases our strong improvement in cash management and discipline in the Company.

Finally, really quickly talk about capital structure. We closed the warehouse line that we previously had before and opened the ABL, as Elon mentioned. Think of this as a shift to lower-cost financing. We've got a better deal on this line. I think it's a better way to think about that.

Intended uses, one, we'll continue to monetize our direct leases as we did with the warehouse line; but it also creates an option for us to finance our ramp in FGI as the Model X hits full production scale.

I'll close by saying my mandate from Elon is clear. Cash is king. There's some real steps that we're taking as a Company to get ourselves to net cash flow positive for the year.

ELON MUSK: And profitability.

JASON WHEELER: And profitability. One more is capital efficiency in CapEx. CapEx in 2016, as we said in the past, will be less than it was in 2015. We started to see some of this in Q4. It will continue. We're also getting to a point where we have operating leverage in the business. We'll continue to aggressively manage our growth and expenses.

Finally, and I walk around and I'm on this every day. It's the relentless focus on automotive unit cost reductions. That's my mandate. Again, I'm happy to be here. Elon, if you've got nothing else, we go to Q&A.

ELON MUSK: Yes, actually, one other point that's interesting to note, Tesla is approximately doubling its cumulative sales every year. This is -- I'm not sure if this has happened in the car industry for maybe a century. We started the beginning of last year with 50,000 cars one the road, then we ended with 100,000. This year we're maybe 60% to 80%. We're at the high end of the range. Again, potentially double the size of the fleet. I think that is pretty exciting and unusual.

Thank you. Let's go to Q&A.

JEFFERY EVANSON: All right, Latiffe. Let's take the first question, please.

Questions and Answers

OPERATOR: Yes sir. Our first question comes from the line of Brian Johnson of Barclays.

BRIAN JOHNSON, ANALYST, BARCLAYS CAPITAL: Welcome, Jason. I want to ask a couple questions revolving around the cash flow. I'm sure people will go into some of the X ramp and delivery numbers. First, you produced about 14,000. You delivered 17,000 vehicles. That would imply 3,443 reduction in finished goods, at least S inventory, which could generate $250 million, yet your inventory is roughly flat quarter over quarter. What, before we get the K and the Q, are the puts and takes there?

JASON WHEELER: I think you touched on it. We managed to do a really nice job selling inventory cars at the end of the year.

BRIAN JOHNSON: But on the balance sheet the inventory number in cash and inventory stayed about the same?

JASON WHEELER: There' a couple things going on in there. One is the finished goods, but also -- doing a nice job on the finished goods inventory, but also the ramp-up of the parts that we need to get full production with Model X.

BRIAN JOHNSON: Okay, so, it's the work in process on the X. Second, can you refresh, can you update us, given the change from the revolver to the ABL? What is currently drawn on the ABL? What's the available borrowing base? How much of that is, as you think about next year, going to be used to support increased on-balance sheet leasing versus increases in finished goods inventory? What's your remaining -- if the banks were to come -- borrowing base left would be left unpledged?

JASON WHEELER: Where we closed Q4 at, $135 million, fully drawn on it. In terms of the borrowing base, there's a lot of detailed numbers behind that. The most important thing to point out here is the increase to $1 billion that we did with our banking partners. Then there's some restrictions there, and we don't want to max that out, so we're going to monitor it carefully and make sure we do the things to do. We don't want to live on this drug.

ELON MUSK: Yes, we have a collection of lenders. It's hypothetically, if one lender were to decide not to split the ABL, then it's distributed. So it's not -- there's not a single [panacea]. And we found that the appetite with lenders is very strong for the ABL because it's a finished product that's going to a known customer. There's no channel to stuff because there is no channel. It's just [off] in transit to customers, primarily overseas.

JASON WHEELER: Yes, it grows with the inventory balance against cars that have orders placed against them.

BRIAN JOHNSON: It sounds like you could draw it, even if inventory, finished goods of inventory was flat, could you still draw on it, or does it have to track to a direct increase in finished goods inventory?

JASON WHEELER: Yes.

ELON MUSK: Yes, it does track to your finished goods inventory. Basically it's a finished goods loan.

BRIAN JOHNSON: Okay, thanks.

JASON WHEELER: No problem. Thanks for the question.

OPERATOR: Thank you. Our next question comes from the line of Colin Rusch of Oppenheimer. Your line is open.

COLIN RUSCH, ANALYST, OPPENHEIMER & COMPANY: Thanks so much. You're coming in the next couple quarters to the end of some of the initial leases on the Model S's. Can you talk a little bit about your preparations for that, and your expectations as we move throughout this year on what will happen with those cars, and how many of them are actually going to get returned?

ELON MUSK: Sure. Jon, do you want to talk about that?

JON MCNEIL, PRESIDENT OF GLOBAL SALES, SERVICE, AND DELIVERY, TESLA MOTORS, INC.: Sure. We actually started on that early, and launched a campaign in the second half of 2015 to reach out to folks who had cars coming off lease. One of the attractive things to those folks who are coming off lease is to have a car that's equipped with Autopilot. Autopilot is certainly one of the core stories of what's going on here at Tesla. It's really exciting.

We're finding that folks are willing to upgrade their Tesla as part of this campaign. We've got a total program where we're really providing a smooth transition period for these cars. In addition to that, we're finding there is a very healthy after market for these cars. The trade-in values in the market are significantly above our residual reserves on the cars, which is giving us some flexibility in terms of our financing partners offering very attractive monthly payments and loan terms, because the cars are holding -- Teslas are holding value at a much higher rate than we thought.

I think the short answer is we're out ahead of it, and we're getting really good reception and conversion from customers. We're excited about the next generation of Tesla, which is an Autopilot-equipped car.

COLIN RUSCH: Okay, great. Then the follow-up. There's some pretty significant legislation updating the Toxic Substances Control Act that passed through Congress in December. As you guys look at a lot of the details in terms of ramping the Gigafactory, can you talk a little bit about what you're seeing as the impact so far with the updated substances, and how they might be treated as we go forward here?

JB STRAUBEL, CTO, TESLA MOTORS, INC.: This is JB. I can jump in there. We haven't seen any immediate impacts from those results or changes. The materials we're using at the Gigafactory are not particularly toxic substances.

ELON MUSK: The Gigafactory has zero toxic output.

JB STRAUBEL: In terms of large industrial factories, it's an incredibly clean one. There's really no air emissions, and the raw materials are largely base metals and things like that.

COLIN RUSCH: Okay, great. I'll follow up off line. Thanks, guys.

OPERATOR: Thank you. Our next question is from Adam Jonas from Morgan Stanley. Your question, please.

ADAM JONAS, ANALYST, MORGAN STANLEY: Hi, everybody. Two quick ones. First, can you confirm reports that Jim Keller, a legend in the microprocessor world, has joined the Company to head some hardware engineering at Tesla Autopilot? If that's correct, does that signal that Tesla might be moving to design some of their own silicone?

ELON MUSK: Well, I think it's public knowledge that Jim Keller has joined. We have a lot of talented people that join Tesla all the time. Jim is indicative of that. Some people will get a bit more press than others, but I think the talent that's joining Tesla is really incredible. With regard to the latter part of your question, we just -- no comment.

ADAM JONAS: Okay. Then a follow-up. On test drives, outside of Company-sponsored events, surprised we haven't seen any full comprehensive independent test drives from the major magazines. Is there anything preventing -- I think people on the call can understand if there would be of the earlier-produced units that maybe you wouldn't want released quite yet, but is there anything preventing the magazines from gaining access to the early vehicles, the Model Xs, and conducting a full road test of the vehicle? If there is, when can we expect some of the first reviews, do you think?

ELON MUSK: We provided cars to the media, largely because we -- to the degree that we could suppress demand for the X, we did. We took basically every action we could to suppress demand for the X, because production wasn't -- we needed to get production up. There was no point in amplifying demand if production cannot meet that demand. We did our best to really suppress demand, or certainly not encourage demand.

That will obviously change in the balance of this year as we get cars to stores, because there have been no Model Xs at stores. No Model Xs available for test drives. In the coming months, I think probably next month, you will start to see some reviews in magazines and what not. The feedback from customers we've gotten has been very positive.

ADAM JONAS: Thanks, Elon.

OPERATOR: Thank you. Our next question comes from Emmanuel Rosner of CLSA. Your line is open.

EMMANUEL ROSNER, ANALYST, CLSA: Hi, good afternoon. I wanted to ask you first, can you give us a little more color on what exactly happened with the Q4 launch? In the letter, it implied that it took maybe longer than expected. What issues have you encountered? What have you learned that gives you confidence that in your next launch, maybe the Model 3, you can actually ramp that up significantly quicker?

ELON MUSK: Yes, I think that's a great question. The mistake we made with the Model X, which I really think we've taken to heart at Tesla, is that we put too many new features and technologies, too many great things all at once into a product. In retrospect, it would have been a better decision to do fewer things with the first version of the Model X, and then roll in the capabilities and features, new technologies over time in subsequent years. I do think there was some hubris there with the X.

The net result, however, is that I think the Model X is an amazing car -- honestly, think it's probably -- I think it's the best car ever. I'm not sure anyone's going to make a car like this again. I'm not sure Tesla would make a car like this again. Yes, it's -- I would be surprised if -- if somebody buys the X, particularly as the software gets refined, if it's not the product they love more than any product they have ever bought, I would be surprised.

JB STRAUBEL: Maybe it's worth also commenting that even some of the most innovative features on X that caused some challenges in Q4 have really been largely overcome today.

ELON MUSK: Yes, that's true.

JB STRAUBEL: The operation of the falcon door, the sourcing and supply of the large glass wind screen. These things are working very well, and are not a bottleneck at this point.

ELON MUSK: Exactly. Some of the things that caused us issues are somewhat counter-intuitive. They're not the obvious things. For at least a few weeks, maybe three or four weeks, actually, the constraint was the chrome finish on the bright work around the window, the front window. Okay, and you think like how on earth could that be the constraint? But it was.

JB STRAUBEL: It was seals.

ELON MUSK: Seals. Yes, the seals have been a huge bane. Essentially, the seals had to be redesigned. Then the seals that we did have had to be re-worked by hand in order to fit correctly. Yes, seals were a bane. We had a lot of issues with obviously secondary seat, but we've now in-sourced that capability. Yes, we really don't see any fundamental issues.

EMMANUEL ROSNER: Okay. It sounds like it's basically mostly behind you. As we move forward into the year, you're talking about this Model X production rate of a thousand vehicles a week in Q2. Is that an exit rate, or is that an average for Q2? Can you more generally give us how you see the overall mix for the year of S versus X play out in terms of deliveries?

ELON MUSK: Some of the stuff you have as good a crystal ball as we do. Let's see, 1,000 a week would probably be a peak production week in Q2. Average, I don't know what the average is going to be exactly, but maybe 700 or 800, something like that. That's -- I think we feel confident of hitting 1,000 a week certainly towards the mid to end of Q2. Then for the exact mix, I think we need to see how customers react when both cars are in the showrooms, and we will adjust accordingly. But we expect a combined delivery number, average over the year of 1,600 to 1,800 per week.

EMMANUEL ROSNER: Perfect. Thank you very much.

OPERATOR: Thank you. Our next question comes from the line of Colin Lincoln of UBS. Your line is open.

COLIN LINCOLN, ANALYST, UBS: Great, thanks for taking my questions. Can you walk through what are the key short-term drivers, because you're still -- of cash flow, sorry -- still burning $200 million this quarter. Is this really all volume to get back -- to get cash-flow positive by Q2? You also touch on CapEx. You have it -- you're saying it's going to be flat to down, but it seems like there's an awful lot of work going on in the Company. How do you keep CapEx down as you have all these growth plans?

JASON WHEELER: Yes, sure. The key drivers on cash-flow positive, as I said in the earlier comments, it was a great step. The operations -- the businesses selling cars and energy products is now producing enough cash for us start to pay for our investments. If you look at the Q4 dynamics, that cash flow from core operations as we're calling it produced 40% to 45% of the cash that we needed for the CapEx in the quarter. That is certainly a big piece of it, too.

Another piece of it, as I mentioned, is going to be operating leverage. We need to be very diligent about how we grow operating costs, certainly. The other big element to it is certainly continuing to drive costs down on the vehicles. There's lots of ways to do that. We are getting better at our manufacturing processes, we're reducing scrap, we're reducing excess and obsolescence. As we talk about it in the letter, the car continues to be more and more reliable. That reduces our warranty. That actually has a cash impact when the cars show up less at the service centers.

ELON MUSK: Yes, in fact, I would like to re-emphasize that. We are seeing dramatic improvements in reliability and reductions in servicing needs This is important. Sorry, go ahead.

JASON WHEELER: Yes. No, absolutely. Then the other piece, you talk about CapEx and how can it be down? Well, we made a bulk of the investments that we need for Model X in 2015. In 2016 we're going to continue to invest, but will really towards the back half of the year start to see some initial investment in Model 3. We continue to invest in the Gigafactory to get to where we want to be with production there. Then we'll continue to expand the service center, the retail locations, and the Supercharger network, as well. But there is a lot of the big pieces that we needed to spend in CapEx to get to where we are today were spent in the past.

ELON MUSK: Yes. I think it's important to bear in mind that the overall market for SUVs and sedans is roughly the same. Globally, it's split almost 50/50. The X is like half of our volume. If you set a Company up to produce x -- and -- let me use the variable x. If you set a Company up to produce a certain amount of revenue, and then it produces maybe just over half that amount of revenue, but has the cost basis associated with it, then obviously things will not be pretty from a cash flow and profitability standpoint, necessarily is going to be true. But then as X production rises, then that changes, then we achieve the target revenue with the -- with a reasonable cost basis, and the whole picture changes dramatically for profitability and cash flow.

JASON WHEELER: Absolutely. The only other last thing I would add, too, we've had significant run-up investment over the last couple years. Now it's time to absorb that and look for greater capital efficiency.

COLIN LINCOLN: Got it. One final question. Sorry, just one final question. Can you remind us if we're -- are you still on track for storage of 400 million to 500 million this year, and 400 million to 500 million next year? Is that still on track?

ELON MUSK: JB, do you want to comment on that? One (technical difficulty) thing I'd say with respect to energy, we do see this being a very enormous market, but we're -- it's an exponential growth market. Exactly where the calendar falls on that S curve exponential makes quite a big difference on revenue. It will be heavily weighted to the fourth quarter, JB do you want to add anything?

JB STRAUBEL: Yes, that's exactly right. It's not a linear extrapolation throughout the year at all. I think we're being fairly cautious in trying to make sure that we don't over-promise here, and understand what's going to happen in Q4. It's a little tricky to know how that will grow.

Production is on track. We feel really good about that. Production started off as planned in the Gigafactory in Q4. Deliveries are on track. We're starting shipments of power walls and power packs worldwide. We're growing out the sales operations and sales teams around the world. From an execution point of view, I think we feel really good with where we're at. It's early days to predict how exactly that exponential growth is going to really integrate.

COLIN LINCOLN: Okay. Thank you very much.

OPERATOR: Thank you. Our next question comes from the line of Patrick Archambault of Goldman Sachs. Your line is open.

PATRICK ARCHEMBAULT, ANALYST, GOLDMAN SACHS: Okay. Yes, thanks. Good afternoon, and good evening from our end. I wanted to build on Emmanuel's question. Can you tell us what is the current run rate of X production? Where do we stand today towards the middle of February? Can we talk a little bit about how you get to that ramp? It sounds like 1,000 is the target that would obviously mathematically get you to think about half your production. That's pretty much full ramp.

It seems like that's a pretty big distance from where you are now. Maybe we can walk through the pieces that get you there in terms of training employees, getting the supply base in order, getting some of the quality issues resolved? That would be my first question.

ELON MUSK: I don't think we want to comment at that level of granularity. Unless people understand how our production works, they will reach incorrect conclusions. We will stick to what our projections are, and leave it at that.

PATRICK ARCHEMBAULT: Okay. In terms of another ramp-oriented question, if I may, it does seem that given the forecast that you have for I think 16,000 deliveries this year, getting to --

JASON WHEELER: This quarter.

PATRICK ARCHEMBAULT: For this quarter, excuse me. Getting to 80 to 90 would imply a run rate that's about 40% higher than where you are in Q1. But you also made a comment that inventories may -- that a lot of that is going to be international, and there may be some in process inventory being built out to service that. Maybe we can talk a little bit about that ramp?

ELON MUSK: Yes, the international stuff is mostly Q2. That's really where the international ramp starts. There's still inventory in process for of course, North America, because it takes longer to get a car to the east coast, particularly for like a blizzard or something. That's certainly a factor in finished goods, but finished goods necessarily ramps as we fill the pipeline for overseas sales, which is next quarter.

PATRICK ARCHEMBAULT: Okay, thank you.

OPERATOR: Thank you. Our next question comes from Dan Galves of Credit Suisse. Your line is open.

DAN GALVES, ANALYST, CREDIT SUISSE: Thanks for taking my questions. First one has to do with operating expenses. Hopefully I'm not getting the numbers wrong, but it seems like 20% growth in 2016 versus 2015 implies relatively flat versus the Q4 run rate? Is that achievable to essentially keep the operating expenses pretty consistent throughout 2016?

JASON WHEELER: Yes, certainly. This is Jason. Yes, we definitely believe we can do that. There was a bit of a dog's breakfast in Q4. We had some things in there. I'll give you a couple of examples. We had some aged receivables from some service revenues in Europe that we ended up having to write off. That was one thing. We had some R&D tooling that had come to the end of its useful life that we had to write off, as well. There is some noise in the Q4 number, for sure. I'm very confident in the projection in the forecast that we've given for 2016 relative to 2015.

DAN GALVES: Okay, great. Yes, no problem. One other, if I could. There's been a lot of negative chatter about Gigafactory related to signing up of other partners, precursor partners, supply agreements for access to raw materials, and the general size of the plant. I was wondering if you could give us an update on where you stand, and if you see any challenges to get up to the 35 gigawatt hours of cell production by 2020, 50 of packs?

JB STRAUBEL: Sure. General relative to that initial forecast and timelines, we feel pretty comfortable on where we're at. There has been a lot of drama and a lot of negativity in the reporting on this. Some around the head count recently that I think a lot of people picked up on.

Maybe just to talk about that one in particular, that recent hiring head count discussion queued off of numbers that we reported that were effective essentially in the middle of 2015. Those were essentially compared against where we predicted to be at the end of 2015. They weren't even really apples to apples. In our very most recent report that we made with the governor's office of economic development, we had reported around 272 net hires for the year at the end of 2015, against -- we had a target of 300.

The general plan is executing actually quite closely to what we had laid out back in 2014. I think because it's a fast growth, we have to be really careful at what snapshot in time you actually look at, and what you compare that against.

We still have the same confidence. We're still on track to produce 15 gigawatt hours of cells, and -- I'm sorry, 35 gigawatt hours of cells and 50 gigawatt hours of packs -- 15 of that going to Tesla Energy, the rest going to Model 3 in vehicles. That still is on track, and we're on track to start cell production towards the end of this year.

DAN GALVES: Okay, thanks very much.

ELON MUSK: Basically, to the best of our knowledge, you should not worry about the Gigafactory as a constraint on Model 3. That does not appear to be anywhere near the critical path for Model 3.

If I can say a few words about the Gigafactory in Nevada and the incentives and all that. One of the most bothersome things that I see in the media is over-representation of the Nevada incentives. The thing to bear in mind for the $1.3 billion in incentives for Nevada is that in order for us to achieve that, we have to develop about $100 billion in revenue from the Gigafactory. Those incentives occur over 20 years, representing approximately a 1% discount on the cost of the Gigafactory.

The reason it's a big number -- and I should say a disproportionate -- it is a big number in the absolute sense, but it is disproportionately small relative to incentives that say Boeing would receive for keeping an aircraft factory in Washington. The reason it's this big is because the Gigafactory will be the largest-footprint building in the world when it is done. Our Tesla Fremont factory is currently number two. If you're curious, number one is flower auction house in the Netherlands. You can look this up on Wikipedia. It makes sense that if something is the biggest thing on earth, it's probably going to have incentives that are big in the absolute, but small in relative terms.

The fundamental driver of the decision -- not the exclusive driver, but the primary driver of the decision -- was pace of execution for the Gigafactory. That was the primary reason for Nevada over other options. That -- I believe that -- this decision is bearing fruit, because we are seeing it move at a very good pace.

DAN GALVES: Okay, thanks, guys. Welcome, Jason. Sorry.

JB STRAUBEL: All of those incentives are also performance-based.

ELON MUSK: Yes, exactly.

JB STRAUBEL: We don't receive them unless we execute along the path toward the milestones.

ELON MUSK: Right. Even some of the ones we do receive have claw-back provisions. Essentially, like I wrote a blog about this. There is no way for Nevada to lose. The way Nevada set up the incentive structure, it is a no-lose proposition for them. They did an awesome job on behalf of their state. You can read the blog that I wrote called the house always wins, which is true. Anyway, it's really annoying to see this stuff misrepresented in the press.

DAN GALVES: Got it. Thank you.

JEFFERY EVANSON: Next question, please?

OPERATOR: Yes sir. Our next question comes from the line of John Murphy of Bank of America Merrill Lynch. Your line is open.

JOHN MURPHY, ANALYST, BOFA MERRILL LYNCH: Good afternoon, guys. A first question, Elon, you made a very interesting comment about the Model X being the best car ever produced. It sounds like you think it might be better than the Model S.

ELON MUSK: Maybe I'm biased, obviously.

JOHN MURPHY: It's your newest car, so it makes sense -- or newest vehicle, I should say, so it makes sense. But as you look at getting that production ramped up and availability out there to consumers, what would the selling point be on the Model S then? Could you get this mix significantly above 50% cross-overs or Model X, because the price premium is not that great? Why wouldn't you sell a whole lot more Model X than Model S, and could you?

ELON MUSK: Yes, I think this is a question of owner preference. I personally still prefer to drive the Model S over the X, because I'm a -- I like the lower position of a sedan. The S, in terms of performance, is about 10% better in an acceleration and handling or what-not than the X.

It really depends on owner optimization. If you like a high seating position, an amazing amount of room and functionality, a feeling of high visibility -- because one of the best features, maybe the best feature of the X is the cockpit-style front windshield, which gives you this amazing panoramic view as you are driving. A lot of people like that in an SUV, and that's the reason they buy that. It really depends on personal preference. We'll see what the results are once we actually put the vehicle in the stores and people take test drives.

JOHN MURPHY: When you think about all the content you're putting in the X and the upgradability of the S and the X over time, how do you think about planned obsolescence, which is a real necessary part of almost any business to generate incremental sales from your existing customer base?

ELON MUSK: Our view of planned -- we don't plan to obsolete things. We just relentlessly make things better. For example, for the S, there's an average of 20 improvements per week. Most of these are little tiny nuance things that most people wouldn't notice, but it is a continuous improvement process. That's why I say when people say when should they buy a Model S, like what model year, we don't really have model years. We keep improving the car. If you want to wait until the car stops improving, you will be waiting forever.

JOHN MURPHY: Okay, one follow-up on the cash flow for 2016. Obviously a lot of progress has been made more recently. As we think about the positive net cash flow and the increase in the cash balance on a year-over-year basis, will that include -- I'm trying to be clear, here -- the potential draw on the ABL over time as that's needed to run the business, or does that net cash increase not include whatever draw that happens on the ABL in 2016?

JASON WHEELER: That includes the draw on the ABL [to finance initiatives].

JOHN MURPHY: Okay. Thank you very much.

OPERATOR: Thank you. Our next question comes from Jamie Albertine of Stifel. Your question, please?

JAMIE ALBERTINE, ANALYST, STIFEL NICOLAUS: Great. Thanks for taking the question. On the Model 3, if I may, I think a lot of folks are trying to do work as it relates on the margin trajectory over time. It's clearly going to be volume-dependent and timing around the launch. I was wondering if you could help us understand, given that it's one-third of the transaction price of roughly your initial Model X deliveries, what are some of the efficiencies you're hoping you can draw upon, beyond the battery cost reductions? What are you leveraging in the Model 3 from investments you've already made, and the knowledge you have around initial launch costs on the higher priced vehicles at this point?

ELON MUSK: I think the way to think of the cost difference is really that the Model 3, being a sedan, it is about 20% lighter than -- and actually, quite a bit less complex to manufacture than the Model S. The Model S was really the first car we ever made ourselves. It was -- we were designing to make it work, as opposed to designing it for ease of manufacturing, whereas the 3 is really designed for ease of manufacturing. Then we expect through economies of scale and general design improvements to get another 30% improvement. That's where the 50% improvement comes relative to the S. So $35,000 versus $70,000, 3 versus S, is the way to think about the difference.

Our default plan, as we've done in the past, is that the initial sales are relatively highly optioned versions of the car. Because obviously, we've got to pay back the investment of all the tooling and everything. It makes sense to have the higher-optioned versions first. That's what we did with the S, and obviously again with the X. While it was unfortunate the way the X pricing got reported, that they reported the fully optioned Signature series as though it was the base price volume number in some publications. This is just a misunderstanding of how things work. I think it's also normal to see this in many other industries. If Intel comes out with a new CPU or a faster CPU, or NVIDIA comes out with a new graphics card, in the beginning it's a lot more expensive, and then over time the price drops.

JAMIE ALBERTINE: Just a clarification, Elon, on economies of scale. Should I think about that -- the running through the paint shop, as an example, given you said the 10,000-unit-per-week goal there? And then separately, should we expect -- when should we expect to start hearing about the Model 3 production line? Where do you within the facility plan to build it, at what point? Is it going to be the same lead time as we saw with the Model X? Thanks.

ELON MUSK: Yes, there will be a production ramp for the 3. It's always been tricky in the past to predict those production ramps, but yes. Do you guys want to add?

JB STRAUBEL: I think in the development plan that we have now, we have substantially more time and, place holder put into the schedule to really refine the product ahead of the production ramp. To a question that came earlier, that is something that we have really taken to heart in the launch of the X. As we look to higher volumes and what we hope will be a steeper ramp with model 3, I think we've learned some important lessons on how to do that well and having a really robust pilot built in the plant and enforcing rigorous numbers there.

JAMIE ALBERTINE: Great, thank you guys, so much.

OPERATOR: Thank you. Our next question comes from Andrea James of Dougherty & Company. Your line is open.

ANDREA JAMES, ANALYST, DOUGHERTY & COMPANY: Thanks for taking my questions and welcome, Jason. Just a practical one about the factory. You have different choke points at different points in time. It's been general assembly, it's been the cells. Last count it was body lines 1 and 2. Just asking about the status of body line 2 and when you hope to migrate Model S production on to that body line.

ELON MUSK: I think we are getting too much into the internal decisions of Tesla. If we say something that's related to an internal decision of Tesla, it can over constrain our decisions and we need to have some flexibility there. So, we would prefer not to comment on the details of when different production lines are moving around.

ANDREA JAMES: Okay. Then maybe longer term, then, what is your updated thinking on the cost per kilowatt hour by the end of the decade, especially as you source your raw materials at the Gigafactory?

ELON MUSK: That is quite a sensitive number, but it's less than what we see most people estimating. We see most people overestimating cost per kilowatt hour, but that is a proprietary number.

ANDREA JAMES: And I think the past you have said you would be disappointed if it was not below $100?

ELON MUSK: Yes. In the long term, yes.

ANDREA JAMES: Thank you for taking my questions.

OPERATOR: Thank you. Our next question comes from Ryan Brinkman of JPMorgan. Your question, please.

RYAN BRINKMAN, ANALYST, JPMORGAN: Yes, thanks for taking my call. Question for Jason, probably. Other automakers sometimes talk about minimum cash. The amount of cash that they need to end a quarter with in order to fund intra-quarter working capital swings, even in the event total change in working capital were negligible. I'm curious what you think your minimum cash needs are and is that something you can share with the investment community? And then just more broadly, what total amount of cash or gross liquidity do you prefer to run the business with? Thanks.

JASON WHEELER: Sure, we don't go over the inner workings of how we do those calculations internally, but $1 billion is a nice comfort level. You see we are starting to make the moves on the ABL to give ourselves more flexibility there. And just to reiterate a comment that I made at the beginning, cash is king, and I'm walking around collecting it.

RYAN BRINKMAN: Okay, great, and then just last question on the Gigafactory, you have already some given updates, but maybe could just talk about how much of the planned CapEx for 2016 relates to the Gigafactory? And then maybe an update on the relationship with your partners there, maybe Panasonic or any others, how those relationships are progressing relative to their expected future contributions. Thanks.

JASON WHEELER: Sure, it's a great question. We are really excited about the Gigafactory and things are on schedule. We are not at this time going to break out the detailed CapEx plans. I gave it to you thematically earlier. Certainly Gigafactory, towards the end of the year we will start to see some Model 3 investment and throughout the year we will see investment in sales, service and the super charger network.

RYAN BRINKMAN: Great, thanks.

JON MCNEIL: Maybe just quickly on the Panasonic piece, they continue to be an excellent partner in the project. I think you have seen probably in recent months some additional statements from them with ongoing capital commitments to the project as planned. Those are happening in the right sequence. They have also started hiring for the project and training people. So, things are going as well as we can hope there.

RYAN BRINKMAN: Perfect. Thanks.

OPERATOR: Next question comes from Ben Kallo of Robert W. Baird. Your line is open.

TYLER FRANK, ANALYST, ROBERT W. BAIRD & COMPANY: Hi, guys. It's Tyler Frank on for Ben. Can you comment on the overall expectations for delivery throughout the year? If we back out the [16,000] for Q1, looks like about 23,000 [fourth] quarter for Q2 through Q4. Which seems like you should be there with production given the Model X expectations and the Model S production expectations as well?

ELON MUSK: I know you would love to have more granularity, but it's difficult for us to give you granularity that we ourselves don't have -- that's excessive precision. I don't want to give false precision. We feel good about the overall number, but it might be -- it might move around as to how it gets that overall number. And there is always unforeseen things that occur. That's why we need some flexibility, that we don't provide false precision then people hold us to false precision.

TYLER FRANK: Okay, thank you. And then can you comment on what you are seeing for overall demand in the China market and then what markets you expect to move into next and how that ramp will go?

ELON MUSK: Yes, China is a -- is not a huge market for us and hasn't been historically. It is something that we expect in the long term will be a big market and ultimately, probably our biggest market. I think there is a lot of long-term opportunity there. It's difficult to say what is going to happen with China in the short term except that it doesn't have a big effect on Tesla yet. Long term, it will be.

In terms of new markets, I'm real excited to launch in Mexico this year. I will be heading out to Mexico City and we are going to -- I think there is actually quite a bit of opportunity there. Some of our customers -- we actually do have customers in Mexico already, but having a significant presence there I think is going to be great and some of our most supportive customers are actually in Mexico.

TYLER FRANK: A quick follow-up. There's been some rumors and commentary that the Model 3 launch may not be an actual full vehicle. Can you talk about what we should expect at launch's end and at the end of March?

ELON MUSK: Yes, we are trying to decide whether we should show all the cards or keep a few cards close to the vest. I haven't made the decision yet.

TYLER FRANK: Great, thank you.

OPERATOR: Thank you. Our next question comes from Rod Lache from Deutsche Bank.

ROD LACHE, ANALYST, DEUTSCHE BANK: You commented earlier, Elon, on the Model S versus the Model X demanding personal preference on passenger car versus SUV, and I was just wondering if you have any thoughts on whether Model S demand would or could be affected once the Model 3 is revealed? Do you think those vehicles ultimately go to different customers, or is there a plan to avoid cannibalization there?

ELON MUSK: I think they are different market segments. Much as say the BMW 7 series and 5 series are -- they're a different market segment from the 3 series. Makes you think of the Model 3 as a really competing in the BMW 3 series or AUDI A4 market. And if you want the ultimate machine, you really want to get the Model S. But the Model 3 will be a great car.

JB STRAUBEL: Maybe also just as an anecdote. There was a lot of concern when we launched the X of cannibalization of Model S demand. And we actually saw just the opposite, which was the increased interest and awareness and just customer engagement actually drove higher Model S sales, even as the X was launched. And those are actually much closer in terms of vehicle capabilities, as we just talked about.

ROD LACHE: Yes, that makes sense. I was hoping just on the financial side, can you give us just a little bit of a sense of how challenging it would be -- it will be to get to that 25% Model X gross margin? And can you comment at all on how you are expecting for the overall Company gross margins would look this year. Are you expecting them to be able to stay above 25%, even with the Model X ramping?

JON MCNEIL: Sure. So, as we said in the letter, 25% by the end of the year for Model X. Sorry. I'm a little under the weather, and 30% for the Model S. You can do the math on what the blended rate will look like. In terms of getting to 25% for Model X, the way you have to think about it, we have many years of history with the Model S right now and that is learning that can certainly be applied to what we are doing with Model X. So, we are comfortable that we are going to be able to drive gross margin in the right direction with Model X significantly throughout the year.

ELON MUSK: Yes, in the long run we expect the gross margins of the S and X to converge around the 30% number, so that they should -- in the long run, both will be around 30%. That is our target. It's just, as Jason was saying, because the X is a newer vehicle, we are earlier in the learning curve for the S than the X.

ROD LACHE: Sounds like it's not -- you are benefiting from some learning curves, so the margins even initially could be okay, north of the 20% range? Is that a reasonable expectation, then ramping up to that level? Or is it a more challenging kind of ramp?

ELON MUSK: I really look at it, where does it end up as opposed to what happens in the very near term. It's hard for us to predict exactly where it is in the near term. Think of that S curve, and say, where are you on the S curve? If you have a rapidly changing slope on a curve, it's really hard to say, okay, let's pick a date. Because you could move it by a week and have a huge difference.

ROD LACHE: Right.

ELON MUSK: That's why it's hard for us to give you an exact number, but we kind of know where the S curve will end up. And as it starts to asymptote, then it becomes much more predictable.

ROD LACHE: Okay. Great, thank you.

OPERATOR: Thank you. Our next question comes from Dana Hull of Bloomberg News. Your line is open.

DANA HULL, ANALYST, BLOOMBERG NEWS: Thank you very much. As you think out four to five years, to 2020 when you want to produce 500,000 cars each year, can you get there without building another assembly plant or a second Gigafactory?

ELON MUSK: Yes. Specifically, the Fremont plant is at historically has produced almost 500,000 cars a year. Whether it was at GM -- I can hear your keys quite loudly. When it was a Toyota GM plant it produced almost 500,000 cars a year. We are comfortable that it can get back to that level. And then the Gigafactory is designed to support 500,000 cars a year worth of batteries plus have15-gigawatt hours left over for stationary storage.

DANA HULL: No need for a second Gigafactory (technical difficulty)?

ELON MUSK: Correct, no need for a Gigafactory, correct.

DANA HULL: And then for Jason, shareholder letter says you plan to open about 80 retail locations and service centers and energize about 300 new super charger locations. Can you give us some commentary on where exactly those new service centers and retail locations might be? Is it mostly the Northeast of the US, or also globally?

JASON WHEELER: Sure, I think the general theme is two pronged. We are densifying in markets where we already exist and where demand has increased significantly, we have got to put service centers. And we try to actually predict ahead of that where we are going to need those. But as Elon referenced, we are opening new markets this year, but I think in general we are going deeper in markets where we are. And in addition we are opening a significant number of stores in China and in the Northeast of the US as we increase our awareness and our share in those markets. You will see service centers and retail locations opening across all the markets, including Europe.

JEFFERY EVANSON: Why don't we go to the next question.

OPERATOR: Thank you. Our next question comes from Mike Ramsey of the Wall Street Journal. Your line is open.

MIKE RAMSEY, ANALYST, WALL STREET JOURNAL: Hi. I guess I was hoping you could give me an encapsulated feeling on the quarter. It's a mixed bag from an outsider's perspective. The losses were pretty high and maybe higher than what people expected, but you are giving a very aggressive forecast. Do did you feel like the Company is on the right track and that you are past some of your hiccups? I'm looking for a 40,000-foot analysis.

ELON MUSK: Yes, I feel very good about things right now. The last several months have been quite excruciating, I would say. Many late nights and weekends. But I think we are through the worst of it at this point.

MIKE RAMSEY: Okay. And I had wanted to ask a little bit about also your plans for consolidation. Dana asked whether the Gigafactory could handle the Model 3. I am curious. I haven't been there. There are so many folks working over there now that aren't even building cars. You have engineers and stuff there. Can you give me a little idea about whether and when you might have to think about consolidating your operations in the Bay Area? Excuse me. I'm a little under the weather as well.

ELON MUSK: I'm not sure what you mean by consolidating. We are spread out because in addition to Fremont factory complex and our headquarters in Palo Alto, we do have a number of other facilities in the Bay Area. But man, I'm not sure how we would consolidate. We would have to build a real big facility for that.

MIKE RAMSEY: You might just keep taking over buildings all around. Okay. All right. Thanks a lot. Appreciate it.

ELON MUSK: Okay. Yes, I think 7 million square feet of real estate at this point around the Bay Area, something like that.

JASON WHEELER: And we've seen the Gigafactory actually being a helpful pressure outlet for some things in the Bay Area.

ELON MUSK: Plus expansion in the Lathrop/Stockton area.

JASON WHEELER: Going the other way.

JEFFERY EVANSON: Latiffe, next question, please?

OPERATOR: Next question is from Dee-Ann Durbin of Associated Press. Your line is open.

DEE-ANN DURBIN, ANALYST, THE ASSOCIATED PRESS: Hi, thanks for taking the call. Considering now that the Chevy Volt is going to go on sale at the end of this year, so that will be a full year that it's on sale before Model 3 arrives, has it taken any wind out of your sails? Or do you think, again, that these are very different customers? If you are comparing to an AUDI A4, for example, are people still going to be attracted to the Model 3, even though they will have that option on the market quite a while before the Model 3 arrives?

ELON MUSK: Well, I would point you to the market share of large luxury vehicles, or large premium sedan sales in the US that I talked about earlier in the call. We currently outsell everyone in that category. And had a 51% market growth last year where everyone else declined and the market as a whole declined. If Model 3 is at all similar in its market segment, it doesn't seem like we are going to be demand constrained.

DEE-ANN DURBIN: Okay. And I know you don't do any marketing, but I'm wondering if you would ever possibly reconsider that? It struck me when you were saying that you aren't where you could be on the East Coast, and that may be because people need some more educating about how the car performs in the snow or whatever. Do you think there is ever a point at which you might reconsider and do some very targeted marketing in places where you think you could do better?

ELON MUSK: Yes, I don't think it's in the -- we'll do that in the near term, but in the long term, I think I could see us doing advertising where that advertising was interesting, entertaining and people don't regret seeing it, which unfortunately is not the case for most advertising. So, if there is something interesting and artistic or like it's entertaining, we don't waste people's time if they saw it. And also, I think we need to have a more affordable high-volume car before that makes sense, like the Model 3, so it is more accessible. If we do mass media, it's more likely that somebody could buy the car. That is when it would be something that we would consider.

DEE-ANN DURBIN: Okay. Thank you very much.

ELON MUSK: All right.

OPERATOR: Thank you, our next question is from the line of Phil LeBeau of CNBC. Your line is open.

PHIL LEBEAU, ANALYST, CNBC: Thank you. Elon, I'm curious if you are noticing any impact in terms of reservations, orders, in terms of the market volatility that we are seeing, the growing questions about instability in our economy, elsewhere, fall off in the wealth effect, if you will. Are you guys noticing any slow down in the pace of orders?

ELON MUSK: Jon, do you want to --

JON MCNEIL: Phil, it's a great question and actually, the answer is no, the demand is very strong. We are up significantly over 2014 in the same period. And for both S and X, we -- both the order rate on S and the conversion rate to orders on X has been very strong. And we are not seeing that impact at this point in time across really all of our markets, both domestic and international.

ELON MUSK: That said, we don't want to be complacent about demand generation. And as we mentioned, there is a bunch of stores opening in markets where we really haven't had a store or any kind of meaningful store. Our store in Manhattan, you basically need to be Sherlock Holmes to find it. Unless you hunt us down, you won't find the store.

I think we obviously need to change that and put stores where people are likely to encounter them. Like a fishing boat or something, you want to be where the fish are. Not in some sort of random barren location. So, that's kind of what we are doing. We are not complacent about demand, and just in case we see things take a turn for the worse, we want to overshoot our demand generation by our stores.

PHIL LEBEAU: Thank you.

JEFFERY EVANSON: All right, everyone. That concludes the Q&A session of the call. Thank you so much for joining us today, and we look forward to seeing you all in the future.

ELON MUSK: Thanks, everyone.

OPERATOR: Ladies and gentlemen, you may disconnect your lines at this time. That does conclude your call. Have a great day.

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