TESLA MOTORS INC
Form 10-Q
August 05, 2016

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 June 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-34756

Tesla Motors, Inc.

(Exact name of registrant as specified in its charter)

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

3500 Deer Creek Road

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

(650) 681-5000

(Registrant's telephone number, including area code)

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

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

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

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

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

As of July 29, 2016, there were 148,692,605 shares of the registrant's Common Stock outstanding.

TESLA MOTORS, INC.

FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2016

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Forward-Looking Statements

The discussions in this Quarterly Report on Form 10-Q contain forward-looking statements reflecting our current expectations that involve risks and uncertainties. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, future profitability, future delivery of automobiles, projected costs, expectations regarding demand and acceptance for our technologies, future acquisitions, growth opportunities and trends in the market in which we operate, prospects, plans and objectives of management and the statements made below under the heading “Management Opportunities, Challenges and Risks.” The words “anticipates”, “believes”, “could”, “estimates”, “expects”, “intends”, “may”, “might”, “plans”, “projects”, “will”, “v expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, the risks set forth in Part II, Item 1A, “Risk Factors” in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission. We do not assume any obligation to update any forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Tesla Motors, Inc.

Consolidated Balance Sheets

(in thousands)

(unaudited)

	June 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$3,246,301	$1,196,908
Restricted cash and marketable securities	24,525	22,628
Accounts receivable	178,594	168,965
Inventory	1,609,607	1,277,838
Prepaid expenses and other current assets	144,678	115,667
Total current assets	5,203,705	2,782,006
Operating lease vehicles, net	2,533,726	1,791,403
Property, plant and equipment, net	3,993,250	3,403,334
Restricted cash	71,621	31,522
Other assets	66,650	59,674
Total assets	$11,868,952	$8,067,939
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$1,114,878	$916,148
Accrued liabilities	558,212	422,798
Deferred revenue	558,816	423,961
Resale value guarantees	227,838	136,831
Customer deposits	679,834	283,370
Current portion of long-term debt and capital leases	626,826	627,927
Total current liabilities	3,766,404	2,811,035
Long-term debt and capital leases	2,620,002	2,021,093
Deferred revenue	533,253	446,105
Resale value guarantees	1,779,509	1,293,741
Other long-term liabilities	612,344	364,976
Total liabilities	9,311,512	6,936,950
Commitments and contingencies (Note 10)		
Convertible senior notes (Notes 8)	37,146	47,285
Stockholders' equity:		

Preferred stock; $0.001 par value; 100,000 shares authorized; no shares issued and outstanding	—	—
Common stock; $0.001 par value; 2,000,000 shares authorized as of June 30, 2016 and December 31, 2015; 148,015 and 131,425 shares issued and outstanding as of June 30, 2016 and December 31, 2015	148	131
Additional paid-in capital	5,383,731	3,409,452
Accumulated other comprehensive income (loss)	34,193	(3,556)
Accumulated deficit	(2,897,778)	(2,322,323)
Total stockholders' equity	2,520,294	1,083,704
Total liabilities and stockholders' equity	$11,868,952	$8,067,939

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

Tesla Motors, Inc.

Consolidated Statements of Operations

(in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues				
Automotive	$1,181,852	$878,090	$2,207,916	$1,771,410
Services and other	88,165	76,886	209,149	123,446
Total revenues	1,270,017	954,976	2,417,065	1,894,856
Cost of revenues				
Automotive	909,282	666,386	1,688,598	1,298,131
Services and other	85,959	75,220	201,223	123,282
Total cost of revenues	995,241	741,606	1,889,821	1,421,413
Gross profit	274,776	213,370	527,244	473,443
Operating expenses				
Research and development	191,664	181,712	374,146	348,866
Selling, general and administrative	321,152	201,846	639,362	397,211
Total operating expenses	512,816	383,558	1,013,508	746,077
Loss from operations	(238,040)	(170,188)	(486,264)	(272,634)
Interest income	2,242	247	3,493	431
Interest expense	(46,368)	(24,352)	(86,993)	(50,926)
Other income (expense), net	(7,373)	13,233	1,804	(9,072)
Loss before income taxes	(289,539)	(181,060)	(567,960)	(332,201)
Provision for income taxes	3,649	3,167	7,495	6,207
Net loss	$(293,188)	$(184,227)	$(575,455)	$(338,408)
Net loss per share of common stock, basic and diluted	$(2.09)	$(1.45)	$(4.22)	$(2.68)
Weighted average shares used in computing net loss per share of common stock, basic and diluted	139,983	126,689	136,330	126,320

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

Tesla Motors, Inc.

Consolidated Statements of Comprehensive Loss

(in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$(293,188)	$(184,227)	$(575,455)	$(338,408)
Other comprehensive income (loss):				
Unrealized net gain on derivatives and short-term marketable securities, net of tax	22,928	4	43,733	208
Foreign currency translation adjustment	(2,300)	1,157	(5,984)	(14,990)
Other comprehensive income (loss)	20,628	1,161	37,749	(14,782)
Comprehensive loss	$(272,560)	$(183,066)	$(537,706)	$(353,190)

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

Tesla Motors, Inc.

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2016	2015
Cash Flows From Operating Activities		
Net loss	$(575,455)	$(338,408)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	339,692	168,501
Stock-based compensation	156,969	86,361
Amortization of discount on convertible debt	41,696	33,712
Inventory write-downs	29,725	15,950
Disposal of property and equipment	11,563	4,991
Non-cash interest and other operating activities	16,167	6,048
Foreign currency transaction (gain) loss	(8,081)	16,771
Changes in operating assets and liabilities, net of impact of business acquisition		
Accounts receivable	(1,426)	62,832
Inventories and operating lease vehicles	(1,217,931)	(706,220)
Prepaid expenses and other current assets	19,494	(3,385)
Other assets	(7,447)	(8,355)
Accounts payable and accrued liabilities	212,949	61,261
Deferred revenue	165,144	116,812
Customer deposits	398,555	19,573
Resale value guarantee	253,710	143,216
Other long-term liabilities	65,407	29,030
Net cash used in operating activities	(99,269)	(291,310)
Cash Flows From Investing Activities		
Purchases of property and equipment excluding capital leases, net of sales	(511,579)	(831,225)
Maturities of short-term marketable securities	16,667	-
Business acquisition	-	(12,260)
Increase in other restricted cash	(58,761)	(11,696)
Net cash used in investing activities	(553,673)	(855,181)
Cash Flows From Financing Activities		
Proceeds from issuance of common stock in public offerings	1,701,734	-
Proceeds from issuance of convertible and other debt	1,108,000	168,246
Repayments of other debt	(578,683)	-
Collateralized lease borrowing	384,525	196,535
Proceeds from exercise of stock options and other stock issuances	110,478	58,871
Principal payments on capital leases	(18,270)	(13,901)
Common stock and debt issuance costs	(15,765)	(5,244)
Net cash provided by financing activities	2,692,019	404,507

Effect of exchange rate changes on cash and cash equivalents	10,316	(13,056)
Net increase (decrease) in cash and cash equivalents	2,049,393	(755,040)
Cash and cash equivalents at beginning of period	1,196,908	1,905,713
Cash and cash equivalents at end of period	$3,246,301	$1,150,673
Supplemental noncash investing activities		
Acquisition of property and equipment included in accounts payable and accrued liabilities	324,982	265,970
Additionally estimated fair value of facilities under build-to-suit lease	172,770	40,468

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

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Tesla Motors, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Note 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 energy products. We have wholly-owned subsidiaries in North America, Europe and Asia. The primary purpose of these subsidiaries is to market, manufacture, sell and/or service our vehicles and energy products.

Note 2 - Summary of Significant Accounting Policies

Public Offerings

In May 2016, we completed a public offering of common stock and sold a total of 7,915,004 shares of our common stock for total cash proceeds of approximately $1.7 billion, net of underwriting discounts and offering costs.

Acquisition

On July 31, 2016, we entered into a definitive agreement to acquire SolarCity Corporation, which designs, finances and installs solar power systems. Pursuant to the definitive agreement, each issued and outstanding share of the common stock of SolarCity would be converted into the right to receive 0.110 (the Exchange Ratio) shares of Tesla common stock. SolarCity options and restricted stock unit awards would be converted into corresponding equity awards in respect of Tesla common stock based on the Exchange Ratio, with the awards retaining the same vesting and other terms and conditions as in effect immediately prior to consummation of the Merger. This acquisition is subject to various closing conditions, including the receipt of the affirmative vote from each company of a majority of non-interested stockholders voting at a meeting of stockholders and certain regulatory approvals.

Basis of Consolidation

The consolidated financial statements include the accounts of Tesla and its wholly-owned subsidiaries. Intercompany balances and transactions between consolidated entities have been eliminated.

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 and accompanying notes. Estimates are used for, but not limited to, determining the selling price of products and services in multiple element revenue arrangements and determining the amortization period of these elements, residual value of operating lease vehicles, inventory valuation, warranties, fair value of financial instruments, depreciable lives of property and equipment, inputs used to value stock-based compensation including volatility, expected terms of stock option awards and forfeiture rates, income taxes, and contingencies. Actual results could differ from those estimates.

Unaudited Interim Financial Statements

The accompanying consolidated balance sheet as of June 30, 2016, the consolidated statements of operations and consolidated statements of comprehensive loss for the three and six months ended June 30, 2016 and 2015 and the consolidated statements of cash flows for the six months ended June 30, 2016 and 2015, and other information disclosed in the related notes are unaudited. The consolidated balance sheet as of December 31, 2015, was derived from our audited consolidated financial statements at that date. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in our Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission.

The accompanying interim consolidated financial statements and related disclosures have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments necessary for a fair statement of the results of operations for the periods presented. The 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.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued an accounting update which amends the existing accounting standards for revenue recognition. The new guidance provides a new model to determine when and over what period revenue is recognized. Under this new model, revenue is recognized as goods or services are delivered in an amount that reflects the consideration we expect to collect. In March 2016, the FASB issued an ASU, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the principal versus agent guidance in the new revenue recognition standard. In April 2016, the FASB issued an ASU, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance on accounting for licenses of intellectual property and identifying performance obligations in the new revenue recognition standard. In May 2016, the FASB issued an ASU, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedient, which clarifies the transition, collectability, noncash consideration and the presentation of sales and other similar taxes in the new revenue recognition standard. The guidance is effective for fiscal years beginning after December 15, 2017; early adoption is permitted for periods beginning after December 15, 2016. The new standard is required to be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. We have not yet selected a transition method and are evaluating the impact of adopting this guidance.

In April 2015, the FASB issued new authoritative accounting guidance on simplifying the presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We have retrospectively adopted this standard as of March 31, 2016, and as a result, on the December 31, 2015, consolidated balance sheet we reclassified $9.6 million as a reduction in prepaid expenses and other current assets, along with $15.0 million reduction in other assets, with a corresponding reduction in the aggregate carrying value of the Company's long term debt liabilities. Similarly, as a result of the change in carrying value of long term debt, $5.2 million was reclassified out of additional paid in capital and into mezzanine equity on the December 31, 2015 consolidated balance sheet.

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016 - 02, Leases (Topic 842). The new standard is effective for reporting periods beginning after December 15, 2018 and early adoption is permitted. The standard will require lessees to report most leases as assets and liabilities on the balance sheet, while lessor accounting will remain substantially unchanged. The standard requires a modified retrospective transition approach for existing leases, whereby the new rules will be applied to the earliest year presented. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, "Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

Revenue Recognition

We recognize revenue for products and services when: (i) a persuasive evidence of an arrangement exists; (ii) delivery has occurred and there are no uncertainties regarding customer acceptance; (iii) pricing or fees are fixed or determinable; and (iv) collection is reasonably assured.

Vehicle sales include standard features, customer selected options and accessories, and specific other elements that meet the definition of a deliverable under multiple-element accounting guidance including free internet connectivity, free access to our Supercharger network, and free future over the air software updates. These deliverables are valued on a stand-alone basis and we recognize their revenue over our performance period, which is generally the eight-year life of the vehicle, except for internet connectivity which is over the free four year period. If we sell a deliverable separately, we use that pricing to determine its fair value; otherwise, we use our best estimated selling price by considering costs used to develop and deliver the service, third party pricing of similar options, and other information which may be available.

As of June 30, 2016, we had deferred $55.9 million, $66.1 million, $42.0 million, and $3.7 million related to the purchase of vehicle maintenance and service plans, access to our Supercharger network, internet connectivity, and future software updates, respectively. As of December 31, 2015, we had deferred $53.6 million, $49.5 million, $32.4 million, and $2.7 million related to these same performance obligations, respectively.

Resale Value Guarantees and Other Financing Programs

Vehicle sales to customers with a residual value guarantee

Through June 30, 2016, we offered resale value guarantees or similar buy-back terms to all customers who purchase vehicles and who financed their vehicle through one of our specified commercial banking partners. Subsequent to June 30, 2016, this program is available only in certain international markets. Under this program, customers have the option of selling their vehicle back to us during the guarantee period for a determined resale value. Guarantee periods generally range from 36 to 39 months. Although we receive full payment for the vehicle sales price at the time of delivery, we are required to account for these transactions as operating leases. The amount of sale proceeds equal to the residual value guarantee is deferred until the guarantee expires or is exercised. The remaining sale proceeds are deferred and recognized on a straight line basis over the stated guarantee period. The guarantee period expires at the earlier of the end of the guarantee period or the pay-off of the initial loan. We capitalize the cost of these vehicles to operating lease vehicles on our Consolidated Balance Sheets and depreciate their value, less salvage value, to cost of automotive revenue over the same period.

In cases when a customer retains ownership of a vehicle at the end of the guarantee period, the resale value guarantee liability and any remaining deferred revenue balances related to the vehicle are settled to automotive revenue and the net book value of the leased vehicle is expensed to costs of automotive revenue. In cases when customers return the vehicle back to us during the guarantee period, we purchase the vehicle from the customer in an amount equal to the resale value guarantee and settle any remaining deferred balances to automotive revenue and we reclassify the net book value of the vehicle on our balance sheet to pre-owned vehicle inventory. As of June 30, 2016 and December 31, 2015, $227.8 million and $136.8 million of the guarantees were exercisable by customers within the next twelve months.

Vehicle sales to leasing partners with a residual value guarantee

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

At the end of the lease term, we settle our liability in cash by either purchasing the vehicle from the leasing partner for the residual value guarantee amount, or paying a shortfall to the guarantee amount the leasing partner may realize on the sale of the vehicle. Any remaining balances within deferred revenue and resale value guarantee will be settled to automotive revenue. In cases where the bank retains ownership of the vehicle after the end of our guarantee period, we expense the net value of the leased vehicle to costs of automotive revenue. The maximum cash we could be required to pay under this program, should we decide to repurchase all vehicles is $597.7 million at June 30, 2016.

As of June 30, 2016 and December 31, 2015, we had $851.9 million and $527.5 million of such borrowings recorded in resale value guarantees and $210.5 million and $120.5 million recorded in deferred revenue liability, respectively.

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

Account activity related to our resale value guarantee and similar programs consisted of the following for the periods presented (in thousands):

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
Operating Lease Vehicles		
Operating lease vehicles—beginning of period	$1,909,310	$1,556,529
Net increase in operating lease vehicles	291,036	705,017
Depreciation expense recorded in cost of automotive revenues	(57,568)	(102,386)
Additional depreciation expense recorded in cost of automotive revenues as a result of early cancellation of resale value guarantee	(2,571)	(5,657)
Increases to inventory from vehicles returned under our trade-in program	(13,626)	(26,922)
Operating lease vehicles—end of period	$2,126,581	$2,126,581
Deferred Revenue		
Deferred revenue—beginning of period	$800,968	$679,132
Net increase in deferred revenue from new vehicle deliveries and reclassification of collateralized borrowing from long-term to short-term	165,875	391,639
Amortization of deferred revenue and short-term collateralized borrowing recorded in automotive revenue	(108,852)	(206,600)
Additional revenue recorded in automotive revenue as a result of early cancellation of resale value guarantee	(3,424)	(6,420)
Recognition of deferred revenue resulting from return of vehicle under trade-in program	(2,883)	(6,067)
Deferred revenue—end of period	$851,684	$851,684
Resale Value Guarantee		
Resale value guarantee liability—beginning of period	$1,775,498	$1,430,573
Net increase in resale value guarantee	270,436	651,935
Reclassification from long-term to short-term collateralized borrowing	(23,216)	(46,042)
Additional revenue recorded in automotive revenue as a result of early cancellation of resale value guarantee	(3,318)	(5,819)
Release of resale value guarantee resulting from return of vehicle under trade-in program	(12,053)	(23,300)
Resale value guarantee liability—end of period	$2,007,347	$2,007,347

Vehicle Leasing Program

We offer a leasing program in the United States, Canada, the UK and Germany. Qualifying customers are permitted to lease a vehicle directly from Tesla for 36 or 48 months. At the end of the lease term, customers have the option of either returning the vehicle to us or purchasing it for a determined residual value. We account for these leasing transactions as operating leases and recognize leasing revenues over the contractual term and record the depreciation of these vehicles to cost of automotive revenues. As of June 30, 2016 and December 31, 2015, we had deferred $42.1 million and $25.8 million of lease-related upfront payments which will be recognized on a straight-line basis over the contractual term of the individual leases. Lease revenues are recorded in automotive revenue and were $23.9 million and $40.6 million for the three and six months ended June 30, 2016. Lease revenues for the three and six months ended June 30, 2015, were $9.3 million and $15.9 million, respectively.

Warranties

We provide a manufacturer’s warranty on all new and certified pre-owned vehicles, production powertrain components and systems, and energy products we sell. We accrue a manufacturer’s warranty reserve which includes our best estimate of the projected costs to repair or to replace items under warranty. These estimates are based on actual claims incurred to-date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain and changes to our historical or projected warranty experience may cause material changes to our warranty reserve in the future. The portion of the warranty provision expected to be incurred within 12 months is classified as current within accrued liabilities, while the remaining amount is classified as long-term within other long-term liabilities.

Accrued warranty activity consisted of the following for the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Accrued warranty—beginning of period	$198,705	$155,301	$180,754	$129,043
Warranty costs incurred	(24,459)	(17,287)	(40,163)	(29,073)
Net changes in liability for pre-existing warranties, including expirations and foreign exchange impact	3,250	567	6,634	11,329
Provision for warranty	38,963	26,014	69,234	53,296
Accrued warranty—end of period	$216,459	$164,595	$216,459	$164,595

Our warranty reserves do not include projected warranty costs associated with our vehicles subject to lease accounting, as costs to repair these vehicles are expensed as incurred. For the three and six months ended June 30, 2016, warranty costs incurred for vehicles subject to lease accounting were $2.6 million and $5.1 million, and for the three and six months ended June 30, 2015, costs were $2.4 million and $4.2 million. Warranty expense is recorded as a component of cost of automotive revenue.

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 for excess or obsolete inventories based upon assumptions about current and future demand forecasts. If our inventory on hand is in excess of our future demand forecast, the excess amounts are written off.

We also review inventory to determine whether its carrying value exceeds the net amount realizable upon the ultimate sale of the inventory. This requires us to determine the estimated selling price of our vehicles less the estimated cost to convert inventory on hand into a finished product. After 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.

Should our estimates of future selling prices or production costs change, additional and potentially material increases to this reserve may be required. A small change in our estimates may result in a material charge to our reported financial results.

Concentration of Risk

Credit Risk

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents, restricted cash and accounts receivable. Our cash equivalents are primarily invested in money market funds with high credit quality financial institutions in the United States. At times, these deposits and securities may be in excess of insured limits. We invest cash not required for use in operations in high credit quality securities based on our investment policy. Our investment policy provides guidelines and limits regarding credit quality, investment concentration, investment type, and maturity that we believe will provide liquidity while reducing risk of loss of capital. Our investments are currently of a short-term nature and include U.S. treasury bills.

As of June 30, 2016 and December 31, 2015, our accounts receivable were derived primarily from amounts to be received from financial institutions and leasing companies offering various financing products to our customers, sales of regulatory credits, as well as the development and sales of powertrain components and systems to automotive original equipment manufacturers (OEMs). As of June 30, 2016, we have two customers who individually account for 16% and 11% of our accounts receivable, respectively.

Supply Risk

The majority of our suppliers are currently single source suppliers, despite efforts to qualify and obtain components from multiple sources whenever feasible. The loss of any single or limited source supplier or the disruption in the supply of components from these suppliers could lead to vehicle design changes, increased costs and delays in vehicle deliveries to our customers, which could hurt our relationships with our customers and result in negative publicity, damage to our brand and a material and adverse effect on our business, prospects, financial condition and operating results.

Stock-Based Compensation

We use the fair value method of accounting for our stock options and restricted stock units (RSUs) granted to employees and our Employee Stock Purchase Plan (ESPP) to measure the cost of employee services received in exchange for the stock-based awards. The fair value of stock options and ESPP are estimated on the grant date and offering date using the Black-Scholes option-pricing model. The fair value of RSUs is measured on the grant date based on the closing fair market value of our common stock. The resulting cost is recognized over the service period, which is generally four years for stock options and RSUs and six months for the ESPP. Stock-based compensation expense is recognized on a straight-line basis, net of estimated forfeitures.

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.

For performance-based awards with a vesting schedule based entirely on the attainment of both performance and market conditions, stock-based compensation expense is recognized for each pair of performance and market conditions over the longer of the implicit or derived service period of the performance and market conditions, beginning at the point in time that the relevant performance condition is considered probable of being met.

Derivative Financial Instruments

In November 2015, we implemented a program to hedge the foreign currency exposure risk related to certain forecasted inventory purchases denominated in Japanese yen. The derivative instruments we use are foreign currency forward contracts and are designated as cash flow hedges with maturity dates of 12 months or less. We do not enter into derivative contracts for trading or speculative purposes.

The bank counterparties in all contracts expose Tesla to credit-related losses in the event of their nonperformance. However, to mitigate that risk, Tesla only contracts with counterparties who meet the Company’s minimum requirements under its counterparty risk assessment process. Tesla monitors ratings, credit spreads, and potential downgrades on at least a quarterly basis. Based on our on-going assessment of counterparty risk, the Company will adjust its exposure to various counterparties. We generally enter into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. However, we do not have any master netting arrangements in place with collateral features.

Comprehensive Loss

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Other comprehensive income (loss) consists of unrealized gains and losses on derivatives, our available-for-sale marketable securities, and foreign currency translation adjustment that have been excluded from the determination of net loss.

Net Loss per Share of Common Stock

Our basic and diluted net loss per share of common stock is calculated by dividing net loss by the weighted-average shares of common stock outstanding for the period. Potentially dilutive shares, which are based on the number of shares underlying outstanding stock options and warrants as well as our convertible senior notes, are not included when their effect is antidilutive.

The following table presents the potential weighted common shares outstanding that were excluded from the computation of diluted net loss per share of common stock for the periods presented.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Employee share based awards	11,345,742	14,339,572	13,538,610	14,396,259
Convertible senior notes	2,345,823	2,517,573	2,150,258	2,301,823
Warrants issued May 2013	998,101	1,177,659	702,123	858,019

Since we expect to settle the principal amount of our outstanding convertible senior notes in cash, we use the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on diluted net income per share of common stock when the average market price of our common stock for a given period exceeds the conversion price of $124.52, $359.87 and $359.87 per share for the convertible senior notes due 2018 (2018 Notes), convertible senior notes due 2019 (2019 Notes), and convertible senior notes due 2021 (2021 Notes).

Income Taxes

There are transactions that occur during the ordinary course of business for which the ultimate tax determination is uncertain. As of June 30, 2016 and December 31, 2015, the aggregate balances of our gross unrecognized tax benefits were $119.7 million and $99.3 million. $115.5 million and $95.7 million of these aggregate balances would not give rise to changes in our effective tax rate since these tax benefits would increase a deferred tax asset which is currently offset by a full valuation allowance.

Note 3 - Fair Value of Financial Instruments

The carrying values of our financial instruments including cash equivalents, marketable securities, accounts receivable, accounts payable, and accrued liabilities 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 follow a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows: (Level I) observable inputs such as quoted prices in active markets; (Level II) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level III) unobservable inputs in which there is little or no market data which requires us to develop our own assumptions. This hierarchy requires us to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. Our financial assets that are measured at fair value on a recurring basis consist of cash equivalents and marketable securities.

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 identical securities. Our restricted short-term marketable securities are classified within Level I of the fair value hierarchy.

As of June 30, 2016 and December 31, 2015, the fair value hierarchy for our financial assets that are carried at fair value was as follows (in thousands), and unrealized gains (losses) on all financial assets for all periods presented were less than $1.0 million:

	June 30, 2016				December 31, 2015			
	Fair Value	Level I	Level II	Level III	Fair Value	Level I	Level II	Level III
Money market funds	$2,761,729	$2,761,729	$ —	$ —	$297,810	$297,810		