

Tesla, Inc.
Form 10-Q
August 04, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

Commission File Number: 001-34756

Tesla, Inc.

(Exact name of registrant as specified in its charter)

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

3500 Deer Creek Road

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

(650) 681-5000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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

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

As of July 31, 2017, there were 166,887,023 shares of the registrant’s common stock outstanding.

TESLA, INC.

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

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

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Tesla, Inc.

Consolidated Balance Sheets

(in thousands, except for par values)

(unaudited)

	June 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$3,035,924	\$3,393,216
Restricted cash	118,369	105,519
Accounts receivable, net	453,539	499,142
Inventory	2,438,111	2,067,454
Prepaid expenses and other current assets	313,501	194,465
Total current assets	6,359,444	6,259,796
Operating lease vehicles, net	3,600,821	3,134,080
Solar energy systems, leased and to be leased, net	6,218,504	5,919,880
Property, plant and equipment, net	8,399,229	5,982,957
Intangible assets, net	380,847	376,145
Goodwill	43,766	—
MyPower customer notes receivable, net of current portion	472,663	506,302
Restricted cash, net of current portion	358,445	268,165
Other assets	209,986	216,751
Total assets	\$26,043,705	\$22,664,076
Liabilities		
Current liabilities		
Accounts payable	\$2,359,316	\$1,860,341
Accrued liabilities and other	1,510,744	1,210,028
Deferred revenue	913,398	763,126
Resale value guarantees	342,824	179,504
Customer deposits	603,540	663,859
Current portion of long-term debt and capital leases	716,533	984,211
Current portion of solar bonds and promissory notes issued to related parties	100,000	165,936
Total current liabilities	6,546,355	5,827,005
Long-term debt and capital leases, net of current portion	7,122,862	5,860,049
Solar bonds issued to related parties, net of current portion	100	99,164
Convertible senior notes issued to related parties	2,444	10,287
Deferred revenue, net of current portion	1,035,579	851,790
Resale value guarantees, net of current portion	2,493,024	2,210,423

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Other long-term liabilities	2,259,538	1,891,449
Total liabilities	19,459,902	16,750,167
Commitments and contingencies (Note 14)		
Redeemable noncontrolling interests in subsidiaries	367,377	367,039
Convertible senior notes (Notes 11)	1,688	8,784
Equity		
Stockholders' equity		
Preferred stock; \$0.001 par value; 100,000 shares authorized; no shares issued and outstanding	—	—
Common stock; \$0.001 par value; 2,000,000 shares authorized; 166,863 and 161,561 shares issued and outstanding as of June 30, 2017 and December 31, 2016, respectively	163	161
Additional paid-in capital	8,774,212	7,773,727
Accumulated other comprehensive gain (loss)	10,961	(23,740)
Accumulated deficit	(3,679,584)	(2,997,237)
Total stockholders' equity	5,105,752	4,752,911
Noncontrolling interests in subsidiaries	1,108,986	785,175
Total liabilities and equity	\$26,043,705	\$22,664,076

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

Tesla, Inc.

Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues				
Automotive sales	\$ 2,013,852	\$ 1,030,224	\$ 4,048,912	\$ 1,932,116
Automotive leasing	272,764	151,628	527,304	275,800
Total automotive revenues	2,286,616	1,181,852	4,576,216	2,207,916
Energy generation and storage	286,780	3,947	500,724	26,675
Services and other	216,161	84,218	408,887	182,474
Total revenues	2,789,557	1,270,017	5,485,827	2,417,065
Cost of revenues				
Automotive sales	1,472,578	827,231	2,969,227	1,540,380
Automotive leasing	175,433	82,051	341,459	148,218
Total automotive cost of revenues	1,648,011	909,282	3,310,686	1,688,598
Energy generation and storage	203,762	8,159	355,535	26,272
Services and other	271,169	77,800	485,045	174,951
Total cost of revenues	2,122,942	995,241	4,151,266	1,889,821
Gross profit	666,615	274,776	1,334,561	527,244
Operating expenses				
Research and development	369,774	191,664	691,814	374,146
Selling, general and administrative	537,757	321,152	1,141,212	639,362
Total operating expenses	907,531	512,816	1,833,026	1,013,508
Loss from operations	(240,916)	(238,040)	(498,465)	(486,264)
Interest income	4,785	2,242	7,875	3,493
Interest expense	(108,441)	(46,368)	(207,787)	(86,993)
Other (expense) income, net	(41,208)	(7,373)	(59,306)	1,804
Loss before income taxes	(385,780)	(289,539)	(757,683)	(567,960)
Provision for income taxes	15,647	3,649	40,925	7,495
Net loss	(401,427)	(293,188)	(798,608)	(575,455)
Net loss attributable to noncontrolling interests and				
redeemable noncontrolling interests in subsidiaries	(65,030)	—	(131,934)	—
Net loss attributable to common stockholders	\$ (336,397)	\$ (293,188)	\$ (666,674)	\$ (575,455)
Net loss per share of common stock attributable to common				
stockholders, basic and diluted	\$ (2.04)	\$ (2.09)	\$ (4.07)	\$ (4.22)
Weighted average shares used in computing net loss per share	165,212	139,983	163,679	136,330

of common stock, basic and diluted

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

Tesla, Inc.

Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net loss attributable to common stockholders	\$ (336,397)	\$ (293,188)	\$ (666,674)	\$ (575,455)
Unrealized gain (loss) on derivatives:				
Change in net unrealized gain	—	22,928	—	43,733
Less: Reclassification adjustment for net losses into				
net loss	—	—	(5,570)	—
Net unrealized gain (loss) on derivatives	—	22,928	(5,570)	43,733
Foreign currency translation adjustment	31,730	(2,300)	40,271	(5,984)
Other comprehensive income	31,730	20,628	34,701	37,749
Comprehensive loss	\$ (304,667)	\$ (272,560)	\$ (631,973)	\$ (537,706)

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

Tesla, Inc.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Cash Flows From Operating Activities		
Net loss	\$(798,608)	\$(575,455)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	765,773	339,692
Stock-based compensation	219,759	156,969
Amortization of debt discounts	64,151	41,696
Inventory write-downs	71,255	29,725
Loss on disposal of property and equipment	53,572	11,563
Foreign currency transaction loss (gain)	29,394	(8,081)
Loss on the acquisition of SolarCity	11,571	—
Non-cash interest and other operating activities	57,023	16,167
Changes in operating assets and liabilities, net of effect of business combinations		
Accounts receivable	77,043	(1,426)
Inventories and operating lease vehicles	(1,121,155)	(1,217,931)
Prepaid expenses and other current assets	(113,192)	19,494
MyPower customer notes receivable and other assets	26,339	(7,447)
Accounts payable and accrued liabilities	13,234	212,949
Deferred revenue	208,685	165,144
Customer deposits	(71,064)	398,555
Resale value guarantee	176,505	253,710
Other long-term liabilities	59,732	65,407
Net cash used in operating activities	(269,983)	(99,269)
Cash Flows From Investing Activities		
Purchases of property and equipment excluding capital leases, net of sales	(1,511,692)	(511,579)
Maturities of short-term marketable securities	—	16,667
Purchase of solar energy systems, leased and to be leased	(418,792)	—
Increase in restricted cash	(102,528)	(58,761)
Business combination, net of cash acquired	(109,147)	—
Net cash used in investing activities	(2,142,159)	(553,673)
Cash Flows From Financing Activities		
Proceeds from issuance of common stock in public offering	400,175	1,701,734
Proceeds from issuance of convertible and other debt	2,408,586	1,108,000
Repayments of convertible and other debt	(1,412,286)	(578,683)
Repayments of borrowings under solar bonds issued to related parties	(165,000)	—
Collateralized lease borrowings	335,675	384,525
Proceeds from exercise of stock options and other stock issuances	158,913	110,478

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Principal payments on capital leases	(36,857)	(18,270)
Common stock and debt issuance costs	(13,688)	(15,765)
Purchase of convertible note hedges	(204,102)	—
Proceeds from settlement of convertible note hedges	251,850	—
Proceeds from issuance of warrants	52,883	—
Payments for settlement of warrants	(208,193)	—
Proceeds from investment by noncontrolling interests in subsidiaries	583,433	—
Distributions paid to noncontrolling interests in subsidiaries	(123,873)	—
Net cash provided by financing activities	2,027,516	2,692,019
Effect of exchange rate changes on cash and cash equivalents	27,334	10,316
Net (decrease) increase in cash and cash equivalents	(357,292)	2,049,393
Cash and cash equivalents, beginning of period	3,393,216	1,196,908
Cash and cash equivalents, end of period	\$3,035,924	\$3,246,301
Supplemental noncash investing and financing activities		
Acquisition of property and equipment included in liabilities	\$1,021,692	\$324,982
Estimated fair value of facilities under build-to-suit leases	\$173,075	\$172,770

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

Tesla, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 – Overview

Tesla, Inc. (“Tesla”, the “Company”, “we”, “us” or “our”) was incorporated in the State of Delaware on July 1, 2003. We design, develop, manufacture and sell high-performance fully electric vehicles and design, manufacture, install and sell solar energy generation and energy storage products. Our Chief Executive Officer, as the chief operating decision maker (“CODM”), organizes the Company, manages resource allocations and measures performance among two segments: (i) automotive and (ii) energy generation and storage.

Note 2 – Summary of Significant Accounting Policies

Unaudited Interim Financial Statements

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

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

Reclassifications

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

Resale Value Guarantees and Other Financing Programs

Vehicle sales to customers with a resale value guarantee

Prior to June 30, 2016, we offered resale value guarantees or similar buy-back terms to all customers who purchase vehicles and who financed their vehicles through one of our specified commercial banking partners. Since June 30, 2016, this program is available only in certain international markets. Under this program, customers have the option of

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

In cases where a customer retains ownership of a vehicle at the end of the guarantee period, the resale value guarantee liability and any remaining deferred revenue balances related to the vehicle are settled to automotive leasing revenue and the net book value of the leased vehicle is expensed to costs of automotive leasing revenue. If a customer returns the vehicle to us during the guarantee period, we purchase the vehicle from the customer in an amount equal to the resale value guarantee and settle any remaining deferred balances to automotive leasing revenue, and we reclassify the net book value of the vehicle on our balance sheet to pre-owned vehicle inventory. As of June 30, 2017 and December 31, 2016, \$222.9 million and \$179.5 million, respectively, of the guarantees were exercisable by customers within a 12-month period from each such date.

Vehicle sales to leasing partners with a resale value guarantee

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

At the end of the lease term, we settle our liability in cash by either purchasing the vehicle from the leasing partner for the resale value guarantee amount or paying a shortfall to the guarantee amount the leasing partner may realize on the sale of the vehicle. Any remaining balances within deferred revenue and resale value guarantee will be settled to automotive leasing revenue. In cases where the leasing partner retains ownership of the vehicle after the end of our guarantee period, we expense the net value of the leased vehicle to costs of automotive leasing revenue. The maximum amount we could be required to pay under this program, should we decide to repurchase all vehicles, was \$1.09 billion as of June 30, 2017, including \$119.9 million within a 12-month period from such date.

As of June 30, 2017 and December 31, 2016, we had \$1.48 billion and \$1.18 billion, respectively, of such borrowings recorded in resale value guarantees and \$342.1 million and \$289.1 million, respectively, recorded in deferred revenue liability. As of June 30, 2017 and December 31, 2016, we had a total of \$47.1 million and \$57.0 million, respectively, in account receivables from our leasing partners.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Operating Lease Vehicles				
Operating lease vehicles—beginning of period	\$ 2,732,399	\$ 1,909,310	\$ 2,462,061	\$ 1,556,529
Net increase in operating lease vehicles	252,553	291,036	666,914	705,017
Depreciation expense recorded in cost				
of automotive leasing revenues	(93,161)	(57,568)	(172,017)	(102,386)
Additional depreciation expense recorded in cost				
of automotive leasing revenues as a result of				
early cancellation of resale value guarantee	(3,792)	(2,571)	(12,215)	(5,657)
Additional depreciation expense recorded in cost				
of automotive leasing revenues result of				
expiration	(31,467)	—	(72,899)	—
Increases to inventory from vehicles returned				
under our trade-in program and exercises of				
resale value guarantee	(20,868)	(13,626)	(36,180)	(26,922)
Operating lease vehicles—end of period	\$ 2,835,664	\$ 2,126,581	\$ 2,835,664	\$ 2,126,581
Deferred Revenue				
Deferred revenue—beginning of period	\$ 1,010,502	\$ 800,968	\$ 916,652	\$ 679,132
Net increase in deferred revenue from new vehicle				
deliveries and reclassification of collateralized				
borrowing from long-term to short-term	166,176	165,875	404,863	391,639
Amortization of deferred revenue and short-term				
collateralized borrowing recorded in automotive				
leasing revenue	(165,518)	(108,852)	(303,186)	(206,600)
Additional revenue recorded in automotive leasing				
revenue as a result of early cancellation of resale				
value guarantee	(615)	(3,424)	(2,352)	(6,420)
Recognition of deferred revenue resulting from	(3,945)	(2,883)	(9,377)	(6,067)

return of vehicle under trade-in program, expiration, and exercises of resale value guarantee					
Deferred revenue—end of period	\$ 1,006,600	\$ 851,684	\$ 1,006,600	\$ 851,684	
Resale Value Guarantee					
Resale value guarantee liability—beginning of period	\$ 2,692,593	\$ 1,775,498	\$ 2,389,927	\$ 1,430,573	
Increase in resale value guarantee	143,598	270,436	562,319	651,935	
Reclassification from long-term to short-term collateralized borrowing	(67,097)	(23,216)	(115,481)	(46,042)	
Additional revenue recorded in automotive leasing revenue as a result of early cancellation of resale value guarantee	(2,106)	(3,318)	(8,248)	(5,819)	
Release of resale value guarantee resulting from return of vehicle under trade-in program and exercises	(19,634)	(12,053)	(39,833)	(23,300)	
Release of resale value guarantee resulting from expiration of resale value guarantee	(31,394)	—	(72,724)	—	
Resale value guarantee liability—end of period	\$ 2,715,960	\$ 2,007,347	\$ 2,715,960	\$ 2,007,347	
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, 2017 and December 31, 2016, the aggregate balances of our gross unrecognized tax benefits were \$235.0 million and

\$203.9 million, respectively, of which \$228.2 million and \$198.3 million, respectively, would not give rise to changes in our effective tax rate since these tax benefits would increase a deferred tax asset that is currently fully offset by a valuation allowance.

Net Loss per Share of Common Stock Attributable to Common Stockholders

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

	Three Months Ended June 30,		Six Months Ended	
	2017	2016	June 30, 2017	2016
Stock-based awards	9,038,397	11,345,742	10,434,764	13,538,610
Convertible senior notes	2,792,247	2,345,823	2,972,278	2,150,258
Warrants	801,673	998,101	736,567	702,123

Concentration of Risk

Credit Risk

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

Supply Risk

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

Warranties

We provide a manufacturer's warranty on all new and certified pre-owned vehicles, production powertrain components and systems and energy products we sell. In addition, we also provide a warranty on the installation and components of the solar energy systems we sell for periods typically between 10 to 30 years. We accrue a warranty reserve for the products sold by us, which includes our best estimate of the projected costs to repair or replace items under warranty. These estimates are based on actual claims incurred to date and an estimate of the nature, frequency and costs of future claims. These estimates are inherently uncertain given our relatively short history of sales, and changes to our historical or projected warranty experience may cause material changes to the warranty reserve in the future. In addition, during the three months ended June 30, 2017, we recorded an \$8.9 million increase to the accrued warranty balance as a result of foreign currency exchange rate fluctuations. The warranty reserve does not include projected warranty costs associated with our vehicles subject to lease accounting and our solar energy systems under lease contracts or power purchase agreements, as the costs to repair these warranty claims are expensed as incurred. The portion of the warranty reserve expected to be incurred within the next 12 months is included within accrued liabilities and other while the remaining balance is included within other long-term liabilities on our consolidated balance sheets. Warranty expense is recorded as a component of cost of revenues. Accrued warranty activity consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Accrued warranty—beginning of period	\$ 306,951	\$ 198,705	\$ 266,655	\$ 180,754
Warranty costs incurred	(25,384)	(24,459)	(48,400)	(40,163)
Net changes in liability for pre-existing warranties,				
including expirations and foreign exchange impact	8,915	3,250	2,653	6,634
Provision for warranty	52,797	38,963	122,371	69,234
Accrued warranty—end of period	\$ 343,279	\$ 216,459	\$ 343,279	\$ 216,459

For the three and six months ended June 30, 2017, warranty costs incurred for vehicles accounted for as operating leases or collateralized debt arrangements were \$7.4 million and \$13.5 million, respectively, and for the three and six months ended June 30, 2016, such costs were \$2.6 million and \$5.1 million, respectively.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, to replace the existing revenue recognition criteria for contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, Deferral of the Effective Date, to defer the effective date of ASU No. 2014-09 to interim and annual periods beginning after December 15, 2017, with early adoption permitted. Subsequently, the FASB issued ASU No. 2016-08, Principal versus Agent Considerations, ASU No. 2016-10, Identifying Performance Obligations and Licensing, ASU No. 2016-11, Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting, ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, and ASU No. 2016-20, Technical Corrections and Improvements, to clarify and amend the guidance in ASU No. 2014-09. We will adopt the ASUs on January 1, 2018. We are continuing to assess the impact of adopting the ASUs on our financial position, results of operations and related disclosures and have not yet determined whether the effect will be material.

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

In March 2016, the FASB issued ASU No. 2016-06, Contingent Put and Call Options in Debt Instruments, to clarify when a contingent put or call option to accelerate the repayment of debt is an embedded derivative. The ASU is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted. Adoption of the ASU is modified retrospective. We adopted the ASU on January 1, 2017, but the ASU did not have an impact on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, to simplify the accounting for the income tax effects from share-based compensation, the accounting for forfeitures and the accounting for statutory income tax withholding, among others. In particular, the ASU requires all income tax effects from share-based compensation to be recognized in the consolidated statement of operations when the awards vest or are settled, the ASU permits accounting for forfeitures as they occur, and the ASU permits a higher level of statutory income tax withholding without triggering liability

accounting. Adoption of the ASU is modified retrospective, retrospective and prospective, depending on the specific provision being adopted. We adopted the ASU on January 1, 2017. Our gross U.S. deferred tax assets increased by \$909.1 million as a result of our adoption, which was fully offset by a corresponding increase to our valuation allowance. In addition, we now account for forfeitures as they occur.

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

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

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

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

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

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

Note 3 – Business Combinations

Grohmann Acquisition

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

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

Fair Value of Assets Acquired and Liabilities Assumed

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

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

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

Assets acquired:	
Cash and cash equivalents	\$ 334
Accounts receivable	42,947
Inventory	10,031
Property, plant and equipment	44,030
Intangible assets	21,723
Prepaid expenses and other assets, current and non-current	1,998
Total assets acquired	121,063
Liabilities assumed:	
Accounts payable	(19,975)
Accrued liabilities	(12,403)
Debt and capital leases, current and non-current	(9,220)
Other long-term liabilities	(10,049)
Total liabilities assumed	(51,647)
Net assets acquired	69,416
Goodwill	40,065
Total purchase price	\$ 109,481

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

Identifiable Intangible Assets Acquired

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

June 30, 2017	
Fair	Useful
Value	Life

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

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

SolarCity Acquisition

On November 21, 2016, we completed our acquisition of SolarCity for a total purchase price of \$2.1 billion in stock. We are currently finalizing our estimates of the fair values of the solar energy systems, leased and to be leased, identifiable intangible assets,

deferred revenue, deferred taxes and noncontrolling interests assumed. Fair value adjustments recorded during the measurement period (a period not to exceed 12 months) may have a material impact on our consolidated financial statements. During the three months ended March 31, 2017, we recorded an \$11.6 million measurement period adjustment to the acquisition date fair values of certain assets as previously reported in our Form 10-K for the year ended December 31, 2016. The measurement period adjustment was recorded as a loss to other income (expense), net, in our consolidated statement of operations, to effectively reduce the gain on acquisition initially recognized during the period ended December 31, 2016.

Note 4 – Goodwill and Intangible Assets

Goodwill increased to \$43.8 million from December 31, 2016 to June 30, 2017 due to our acquisition of Grohmann and the impact of foreign currency translation adjustments.

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

	June 30, 2017			Net Carrying Amount	December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Other		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Finite-lived intangible assets:							
Developed technology	\$125,889	\$(10,384)	\$1,180	\$116,685	\$113,361	\$(1,740)	\$111,621
Trade name	45,275	(5,455)	167	39,987	43,500	(967)	42,533
Favorable contracts and leases, net	112,817	(4,751)	690	108,756	112,817	(864)	111,953
Other	34,099	(5,532)	20	28,587	26,679	(3,473)	23,206
Total finite-lived intangible assets	318,080	(26,122)	2,057	294,015	296,357	(7,044)	289,313
Indefinite-lived intangible assets:							
IPR&D	86,832	—	—	86,832	86,832	—	86,832
Total indefinite-lived intangible assets	86,832	—	—	86,832	86,832	—	86,832