BARON CAPITAL

July 27, 2018

Market Commentary: Tesla, Inc.'s Recent Performance and Outlook

During the second quarter of 2018, the share price of Tesla, Inc. increased on positive management commentary around production ramp, an internal letter suggesting production of roughly 3,500 vehicles/week (now up to 7,000 vehicles/week), and rapid deployment of a new general assembly line for Model 3. A staffing cut boosted investor confidence in Tesla's ability to meet its goal of finishing the year without needing to raise incremental external cash. Lastly, new information on battery pricing pointed to a price advantage over competitors. Since then, several new important developments provide additional confidence that Tesla will achieve its goals, in our view.

- **Production milestones achieved**

  Over the past few weeks, Tesla reached 5,000 Model 3 vehicles/week and a total of 7,000 vehicles/week for all models vs. 2,000 vehicles/week before launching the Model 3 program. At the current rate, Tesla can produce 250,000 Model 3 vehicles (350,000 vehicles in total) per year.

  This is a critical milestone as Model 3 is an important growth engine for Tesla, which should support significant improvements to profitability and allow Tesla to become a mass manufacturer, continuing to drive towards its ultimate goal of clean transportation. Tesla expects to reach 6,000 vehicles/week by late next month, above market expectations. In order to solve production ramp up issues on its original production line, Tesla deployed an addition production line, called GA4, which it was able to ramp extremely rapidly to approximately 1,000 vehicles/week. We believe this line can offer a more balanced approach to automation of the production line, solving a lot of the issues Tesla faced during its initial ramp up phase.

- **Next milestone is profitability. Management remains confident**

  Management remains confident it will meet significant milestones and maintains confidence in GAAP positive net income and cashflow in 3Q18 and 4Q18. This has the potential to dramatically change the risks around the Tesla's growth profile as it becomes a self-funded company, reducing liquidity risks significantly.

- **Model 3 order book is healthy**

  Net reservation numbers for Tesla's three models remain strong. With growing production capacity, the opening of the Model 3 design center to new buyers, and soon-to-be-available test drives, we expect demand for the Model 3 to increase even more. We also expect the company will launch a smaller battery, lower range vehicle before the end of 2018 – expanding the addressable market.

- **China plant: larger than expected and the potential to almost double planned capacity in the U.S.**

  The company announced that it reached an agreement with the local administration in Shanghai to open a facility that can produce 500,000 vehicles per year, bigger than Tesla's current annual capacity of roughly 350,000 per year. China is a leading and important electric vehicle market and we expect the factory to allow Tesla to capture additional share in this growing market and to mitigate recent pressure from the increased import tax of vehicles from the U.S. to China. The factory is significantly larger than had been expected and can offer substantial upside to consensus estimations.

- **We believe Tesla's early commitment to electric will mitigate implications of potential competition from other original equipment manufacturers (OEMs)**

  As a leading electric vehicle supplier, Tesla was the first OEM to reach the 200,000 electric vehicle deliveries mark in the U.S. We believe that Tesla's commitment to electric vehicles will allow it to continue to present a cost advantage in the near future and believe this will not have fundamental negative impact on Tesla's results. Customers are expected to benefit from the full federal incentive of $7,500 until the end of 2018 and portions of this incentive until the end of 2019.

- **Braking test are aligned with safety requirements and supplemented by advanced technology**

  Tesla discontinued what management believed to be a redundant and limited test called "brake and roll test." This was highlighted in the media as a risky move. Tesla noted that it test drives every single Model 3 on its test track, during which it conducts rigorous quality checks, including brake tests. We believe Tesla's tests are rigorous, meet regulations and do not put customer lives at risk.

  Discussion with management implies that, as Tesla's vehicles are managed by computers, brakes are regularly checked for braking efficiency, ensuring the vehicles' brakes are working as expected as long as the vehicle is on the road. Management also noted that effectively all (99.7%) of Tesla's vehicles pass the brake test while brake issues with the remaining 0.3% of vehicles are not due to machine limitations.

Portfolio holdings as a percentage of net assets as of June 30, 2018 for securities mentioned are as follows: **Tesla, Inc.** - Baron Opportunity Fund (3.2%), Baron Partners Fund (13.4%*), Baron Fifth Avenue Growth Fund (1.3%), Baron Focused Growth Fund (14.0%), Baron Energy and Resources Fund (8.0%), Baron Global Advantage Fund (1.4%).

**% of Long Positions*

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.