

Valor and Tesla Motors

by

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INTRODUCTION

On March 31, 2016, thirteen years after the company’s founding, Tesla Motors (“Tesla” or the “Company”) unveiled its much-awaited Model 3 compact sedan. The Model 3 would be Tesla’s first mass market electric car, with an expected range of 215 miles and a starting price of \$35,000.² Over 325,000 pre-orders were placed in the first week alone.³ The team at Valor Equity Partners (“Valor” or the “Firm”), the first institutional investor in Tesla, celebrated the launch and viewed its success as an endorsement of their investment strategy and a testimony to the value of its contribution to Tesla during the early stages of the Company’s development.

From 2005 to 2008, Valor invested \$14.5 million in Tesla through its first and second funds. The Valor team worked more than 630 man-days over the life of the investment, collaborating with Tesla on key growth and cost initiatives. That investment of time and money ultimately generated almost \$140.0 million for Valor’s funds. Although Valor exited its investment by 2012, Valor continued to maintain a close relationship with Tesla and its CEO, Elon Musk. The Valor team remained proud of its work with Tesla, particularly its efforts to help Tesla create a sales infrastructure and scale its business.

Tesla had greatly evolved since Valor’s first investment in 2005 and continued to surprise the auto industry with its innovation, execution capabilities, and market valuation. While Musk played the crucial role in leading Tesla, the team at Valor strongly supported him and Tesla management on several mission critical initiatives during Tesla’s early years. In particular, the

¹ Chicago Booth Professor Steven N. Kaplan prepared this case. The case was reviewed and approved before publication by a company designate. Some information and facts have been disguised. The case has been developed solely for educational purposes. Cases are not intended to serve as endorsements, or illustrations of effective or ineffective management. Copyright ©2017 by Steven N. Kaplan.

² “Model 3,” Tesla Motors, Inc., <https://www.teslamotors.com/model3>.

³ “The Week that Electric Vehicles Went Mainstream,” Tesla Motors, Inc., April 7, 2016, <https://www.teslamotors.com/blog/the-week-electric-vehicles-went-mainstream>.

Valor team played an important role in designing the sales process for Tesla’s first model—the Tesla Roadster—the success of which served as a major milestone for Tesla and helped fuel the Company’s growth. Valor developed a sales infrastructure, optimized the hiring and training of sales force personnel, and built out the sales process to instill accountability and consistency. Valor’s work on the Roadster sales helped Tesla sell the full production run of the vehicle and laid the foundation for Tesla’s subsequent sales processes.

VALOR EQUITY PARTNERS: AN OVERVIEW

Founded in 2001 by Antonio Gracias, Valor Equity Partners was a private equity firm with \$2.2 billion of regulatory assets under management. Headquartered in Chicago with additional offices in San Francisco and New York, Valor had a 19-person team that included seven investment professionals and eight dedicated operations professionals. The Firm had grown considerably from its initial \$120.0 million SBIC Fund I and was currently investing from its \$490.0 million Fund III.

Gracias and Valor’s leadership team began their careers as owner-operators, originally buying “fixer-uppers” and turnarounds, fixing them, and transforming them into high growth companies. By 2016, Valor had become an operational growth investment firm focused on non-control and control investments in high growth companies across various stages of development. According to Gracias, Valor “looks for people that are product experts and want to go from growth to fast growth.”⁴

Valor’s portfolio at the time, all of which met its growth criteria, included companies across a range of industries: SpaceX, the global leader in space launch services; Renovate America, the leading provider of PACE financing for home energy efficiency improvements in California; Sizzling Platter, one of the country’s largest restaurant operators and the largest franchisee of Little Caesars’ pizza restaurants; and Manduka, the leading brand of premium yoga mats. **Exhibit 1** provides a list of Valor’s portfolio investments for Funds I through III.

Valor’s investment strategy involved using its idea generation capability, unique relationship-based deal sourcing strategy, and operationally-focused team to identify potential investments in growth companies that had excellent market opportunities, where the transition to a technology-enabled economy was an important growth driver, but were experiencing internal constraints to accelerated growth and improvement. Key elements of the strategy included:

- Valor viewed portfolio companies as its customers and investors as its partners.

⁴ Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

- Valor focused on the consumer, services, and manufacturing sectors, and identified growth markets with excellent long-term demand fundamentals within these sectors.
- Valor invested in non-cyclical, high-growth companies with demonstrated product-market fit, attractive customer bases, and excellent managers who have a proven track record of success.
- Valor looked to drive improvement and lower execution risk at these companies through clearly defined operational value-add. **Exhibit 2** presents Valor’s value-add opportunities identification framework.
- Valor sought an asymmetric risk-return profile to generate best-in-class returns for investors.

Valor believed this strategy was unusual if not unique. In an environment where willingness to provide capital was no longer differentiating, Valor believed access to its operational project expertise was an attractive proposition for its customers—forming the core of the team’s ability to fundamentally influence portfolio companies. All senior members of the team were involved in both the investment and operational sides of the business. Valor’s operations team implemented projects across three primary areas:

1. Sales: improving channels to increase sales;
2. Process Improvement: applying lean enterprise principles; and
3. Tech-Enablement: leveraging basic applied technologies to improve productivity.

Valor’s investment strategy was enhanced by its extensive proprietary relationship network and deep expertise in the consumer, services, and manufacturing sectors and supported by a robust internal research function.

Including its pre-fund period, Valor had a 20+ year track record across 36 companies built through 79 investments. Valor had a history of building value through market cycles from tangible improvements, not from financial engineering or the aggressive use of leverage. It had consistently compounded capital at 30%+ (gross) and 20%+ (net) annual rates. **Exhibit 3** provides details of Valor’s historical performance. That performance compared favorably to other private equity funds raised at the same time.

TESLA MOTORS

Tesla Motors, named after the prolific inventor Nikola Tesla, was founded in July 2003 with the goal of commercializing electric vehicles (“EVs”). The founders employed a contrarian development strategy. While most car companies spent billions in an effort to develop and produce an entry-level mass-market electric car, the Tesla team decided to first go to market with a high-priced, low-volume, premium sports car and then work their way down the cost curve

towards mass-produced, economy-priced vehicles as technology and consumer demand advanced. As Musk stated in 2006, the Company's goal was to "Build a sports car. Use that money to build an affordable car. Use that money to build an even more affordable car."⁵

From its founding, Tesla took a differentiated approach to the development of battery technology. Most auto manufacturers were working to build a new, large single battery. Instead, Tesla leveraged existing lithium-ion battery technology and worked to improve the safety of bundling a large number of these cells together. Tesla's technology could safely bundle thousands of lithium-ion 18650 cells together to create a large enough battery for their vehicles. This technique had the potential to keep costs low while making its car much safer than electric cars being developed by competing auto manufacturers.

In April 2004, Elon Musk became the largest investor in Tesla with an investment of \$6.5 million of his personal capital as part of a \$7.5 million Series A round.⁶ Musk was also appointed Chairman of Tesla's Board of Directors. Tesla was Musk's first foray into the automotive industry. Though initially not involved in day-to-day operations, Musk actively participated in major engineering and business decisions and acted as Tesla's primary brand ambassador.

An engineer by training, Musk was a successful serial entrepreneur. His first success was Zip2, a company he co-founded and sold to Compaq for over \$300 million. After that, he founded X.com which merged with Confinity and became PayPal. PayPal was sold to eBay in 2002 for \$1.5 billion. **Exhibit 4** provides more detail on Musk's career.

By February 2005, Tesla needed additional capital as the Company continued to invest in new technology but was having difficulty raising a \$13.0 million Series B round. Much of the difficulty stemmed from the significant uncertainties surrounding the viability of Tesla's business concept. Tesla was still developing its first commercial vehicle, a high-end sports car named the Roadster, with planned delivery for early 2006.⁷ The Company had developed a drivable proof-of-concept vehicle, but was experiencing issues fine-tuning its battery technology and did not yet have a product to sell. To many, a marketable electric vehicle still seemed to be an unattainable goal.

VALOR'S INVESTMENT IN TESLA: THE EARLY YEARS

Musk reached out to Gracias (and Valor), an investor whom he trusted and had worked with in the past, to gauge the Firm's interest in participating in the 2005 Series B round. Gracias and

⁵ Musk, Elon, "The Secret Tesla Motors Master Plan (just between you and me)," August 2, 2006, <https://www.tesla.com/blog/secret-tesla-motors-master-plan-just-between-you-and-me>.

⁶ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 154.

⁷ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 158.

Musk had a long-standing relationship. The two were introduced by Gracias' former law school classmate and the COO of PayPal, David Sacks. Gracias had invested in PayPal in 2000 through Valor's predecessor organization.

While Tesla aligned well with Valor's manufacturing and high-end consumer focus, it was earlier stage than Valor's previous fund investments. In assessing Tesla, Valor first needed to better understand the nearly nonexistent, but potentially large, market for EVs. Valor's market demand projections were favorable; Valor forecast that the market for EVs would grow rapidly thanks to increased environmental sensitivity among consumers and volatility in gas prices. Tighter environmental regulations and carbon credits also were altering the economics of electric car production as government agencies recognized that electric vehicles lowered greenhouse gas emissions relative to traditional automobiles and sought to incentivize production of these environmentally sound vehicles. In addition, Valor saw the potential to revolutionize costly car distribution channels through Tesla's direct-to-consumer sales model.⁸

Led by Tim Watkins, an engineer who had previously founded and led an operations consulting firm, Valor performed extensive technical due diligence and came away confident in the value of Tesla's battery pack, powertrain, and software technologies. **Exhibit 4** provides bios of the key players involved in Valor's work with Tesla.

The Roadster's innovative design was poised to resolve many fundamental problems with electric vehicles, including zero to sixty acceleration time, speed, mile range per battery charge, and attractive style. Most critically, the Company's proprietary battery technology was designed to mitigate the considerable safety risks associated with the overheating of car batteries while also increasing battery life to make EVs more viable for everyday use. At the same time that the Valor team had confidence in Tesla's product and growth potential, their diligence also determined that the Company's valuable IP could likely be sold to large automakers even if Tesla failed to build its own cars, thereby limiting downside risk.

Valor also identified several challenges facing Tesla where Valor's operational expertise could be deployed. These included increasing production efficiency, building out the sales infrastructure, improving human capital, and manufacturing at scale.⁹

Finally, the investment in Tesla would be a minority, non-control investment. To that point, Valor had primarily participated in control investments. As a minority investor, Valor needed to

⁸ Valor Equity Partners, Tesla Motors Investment Case Study, 4.

⁹ Valor Equity Partners, Tesla Motors Investment Case Study, 5.

be certain that Tesla's management was aligned with Valor's desired level of operational involvement.¹⁰

Confident in its market assessment, as well as its ability to effectively partner with Tesla's management team, Valor invested \$2.0 million from its Fund I in the \$13.0 million Series B capital raise in May 2005. Valor was granted one seat on the Tesla board. **Exhibit 5** provides the timeline of all Valor investments in Tesla.

In July 2005, heat sensitivity testing found that the lithium ion battery technology presented a strong risk of thermal runaway and potential fire.¹¹ Tesla quickly formed a task force to deal with this issue. By May 2006, Tesla had redesigned the structure of its battery pack to include thermal monitoring and management, and had produced an engineering prototype of the Roadster that greatly impressed investors.¹² In June 2006, Valor invested another \$1.0 million from its first fund.

The next month, Tesla released a second Roadster prototype, drawing much media and consumer attention. The car's price was estimated at \$90,000 with a range of 250 miles per charge.¹³ Around this time, then CEO Eberhard announced that Roadster deliveries were set to begin in November 2007, instead of early 2006 as originally planned. Significant issues with the Roadster's transmission, difficulty producing the car's carbon fiber body panels, and an inefficient supply chain design that tied up working capital all contributed to the delay.¹⁴

Most worrisome were unforeseen cost overruns. In the spring of 2007, at the request of Elon Musk, Valor performed an intensive production cost assessment for the Roadster. The analysis indicated that the actual cost of materials for each Roadster could be as high as \$120,000. This figure took Tesla's management (and board) by surprise—they had previously estimated the costs at \$68,000.¹⁵ This considerable discrepancy resulted, in part, from data accuracy challenges related to the Company's transition to a new ERP system and, in part, from oversight due to management's focus on other initiatives. To achieve profitability without sacrificing product quality, the target production cost for the Roadster needed to be set at \$65,000 per unit.¹⁶

¹⁰ Chris Murphy, Interview, May 6, 2016.

¹¹ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 158.

¹² Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 161.

¹³ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 162.

¹⁴ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 158.

¹⁵ Valor Equity Partners, Tesla Motors Investment Case Study, 11; Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 169.

¹⁶ Valor Equity Partners, Tesla Motors Investment Case Study, 11.

Despite the setbacks, in May 2007, Valor still believed in the original investment thesis and that Tesla could solve its cost problems. Accordingly, Valor made its third investment in Tesla—a \$3.0 million investment from Fund I.

A few months later, it became clear that there was a need for a management change at the top. Musk cited Eberhard’s mismanagement of production costs and failure to disclose the severity of the situation to the board as reasons for replacing him as CEO with Michael Marks in August 2007.¹⁷ At the same time, Musk felt that Eberhard’s deep knowledge of the Roadster made him an essential part of the Tesla team and better-suited for the new role of President of Technology.

In October 2007, Valor began work to help Tesla reduce the Roadster’s production costs. Leveraging the findings of their earlier cost assessment, Valor’s team meticulously analyzed the Company’s bill of materials and engineering processes to identify areas that could produce savings and move Tesla closer to their cost goal. This initiative ultimately generated an estimated \$70.0 million in cost savings over the life of the Roadster (2008 – 2011).¹⁸

Despite these efforts, by the end of 2007, Tesla had missed its November Roadster delivery target. And, again, Tesla went through a management transition. Ze’ev Drori was hired to replace Michael Marks as the CEO. Eberhard left the company. He believed that Valor’s findings had been exaggerated and had grown resentful of Musk. Tesla continued to face challenges with the Roadster: problems with the body panels remained unresolved and the transmission needed to be completely redesigned.¹⁹

In February 2008, still believing in the investment thesis, Valor committed the remaining tranche of \$1.0 million from its Fund I and made a further \$6.0 million investment from its Fund II. That same month, the first Roadster was delivered. Appropriately, the owner of the first vehicle was Musk himself.

In the first quarter of that year, Valor helped redesign the supply chain structure. Outsourcing to reduce the costs per part was the traditional manufacturing path used by many companies. In Tesla’s case, however, Valor determined that shipping parts around the world led to overall increased costs, implementation lags, and poor quality control. With Valor’s assistance, Tesla transferred its battery facility from Southeast Asia to the United States. Valor led the repatriation process and managed the build-out of the U.S. manufacturing team. Valor’s redesign also led to lower working capital requirements on the order of \$20.0 million.

¹⁷ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 171.

¹⁸ Valor Equity Partners, Tesla Motors Investment Case Study, 11; Vance, Ashlee, “From Tesla to Dunkin Donuts, One Firm’s Quest to Fine-Tune the World,” *Bloomberg Business*, April 4, 2014.

¹⁹ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 173.

Shortly following the release of the first Roadster, Musk began the redesign of the transmission. He transitioned the car from a two-gear model that was incompatible with the electric drivetrain to a single-gear model. This required significant alterations to other Roadster components in order to maintain the acceleration speed and excitement of a traditional two-gear sports car. A reliable powertrain was crucial to the commercial viability of the Roadster. This effort not only resolved a significant engineering issue, but also contributed to cost reductions by reducing the price of the gear box from approximately \$40,000 to \$1,500.

In the second half of 2008, as the transmission constraint was being eliminated, Valor addressed the next bottleneck. The body panel manufacturer that produced the bespoke carbon fiber bodies of the first four Roadsters was unable to produce at the scale necessary to complete the remainder of the 2,500-vehicle production run. When the UK-based panel manufacturer resigned, the Valor and Tesla teams sprung to action. They promptly retrieved the remaining materials from the former manufacturer and moved production to Sotira's facility in France. Sotira was the manufacturer of fiberglass body panels for the Lotus Elise. However, the Tesla Roadster required carbon fiber body panels—a technology Sotira had not yet mastered. Valor led a project at Sotira to help build out this capability. Valor built a local quality management team in France and managed the installation and launch of the carbon fiber manufacturing process. This helped Tesla scale the Roadster production while simultaneously reducing costs at an extremely critical juncture.²⁰

Tesla concurrently experienced another cash shortage. Tesla had churned through two CEOs, had failed to meet its Roadster delivery date targets, and had exceeded the originally estimated Roadster development costs of \$25.0 million by \$115.0 million.²¹ Additionally, the recession had hit and other well-established auto manufacturers were struggling to remain solvent. In order to survive, Tesla set out to raise a \$40.0 million round.

Still, Valor remained confident in its original investment thesis and strongly believed in Musk as a leader. Gracias and Watkins cited Musk's extraordinary resilience, exceptional engineering and problem solving capabilities, impeccable ability to assemble and motivate talented teams, and consistency in execution as reasons for continued support.²²

In October 2008, Musk replaced Ze'ev Drori as CEO. In November 2008, Valor made an additional \$1.5 million investment from its Fund II. Musk concurrently invested \$70.0 million of his own money as a sign of his faith in the company.

²⁰ Valor Equity Partners, Tesla Motors Investment Case Study, 12.

²¹ Vance, Ashlee, *Elon Musk: Tesla, SpaceX, and the Quest for a Fantastic Future*, 179.

²² Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

Many investors had been hesitant to invest in another round of financing. Valor was the only one of Tesla's investors ready to reinvest of its own volition. This allowed Valor substantial influence over the deal terms. The Valor team structured the investment as a convertible security, providing protection via seniority in the capital structure as well as meaningful upside potential. The deal also was structured such that investors in previous rounds were significantly diluted if they did not to participate in the round. Ultimately, most other existing investors decided to reinvest to prevent the dilution of their holdings.

By the end of 2008, through Elon Musk's leadership and Valor's contributions, Tesla had overcome multiple operational challenges to begin Roadster production. Planned Roadster production totaled 2,500 vehicles, with pre-sale reservations from early adopters totaling 1,000 vehicles. The Company focused its resources on delivering finished Roadsters to customers on its existing reservation list.

SELLING THE ROADSTER: VALOR'S INVOLVEMENT IN THE SALES PROCESS

By early 2010, Tesla was approaching the fulfillment of its existing reservations, but few new orders were coming in. The company did not have the sales infrastructure to sell the remaining 1,500 vehicles in the 2,500-vehicle production run. As Watkins noted, a plan for generating new sales was "at that point, the most pressing need for the business."²³ The Tesla sales team, aware that Tesla's future was dependent on additional Roadster sales, agreed. By this time, the Valor team had established a reputation within Tesla for their analytical and objective problem solving capabilities.²⁴ With Musk's endorsement, the Valor team set out to resolve the sales issue.

Valor envisioned the sales process as a "Sales Machine." This framework draws analogies to the stages of the sales process from those of a manufacturing process. Sales leads were the raw material Tesla would feed into the "factory" (its sales infrastructure), which would then generate a sale, and finally see Tesla deliver the product to the customer. In Valor's opinion, this was a classic theory of constraints applied to an information problem, an approach that intuitively resonated with the engineer in Elon Musk.

Valor quickly realized sales lead generation was not the source of the bottleneck. Tesla had 300,000 potential sales leads thanks to Tesla's and Musk's brands, inbound inquiries, website traffic, word-of-mouth advertising, PR events, etc. This represented a large multiple of the additional 1,500 sales required. The constraint was Tesla's ability to convert sales leads to completed sales. Valor, therefore, realized Tesla needed to focus on building selling processes.

²³ Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

²⁴ Miki Sofer, Interview, April 10, 2016; Meridith Perry, Interview, April 24, 2016.

Valor believed there is a moment in the sales cycle of every product when the customer decides that they want to make the purchase. This moment is referred to as the “Sales Event.” Valor described this moment as the instance when the customer makes an emotional connection with the product—the “wow” moment when the desire to purchase is established. The Sales Event is *not* the moment when the check is written or the credit card is swiped. That comes later, sometimes much later. Purchase still requires selling through many potential obstacles.

The point Valor emphasized was that without the Sales Event, selling through those obstacles is difficult, and the sales cycle will at a minimum be extended and face a higher probability of failure. Valor viewed the identification of the Sales Event as a straightforward task. A few hours of conversation with key managers, sales team members, engineers, and designers led Valor to identify the test drive as the Sales Event in the Roadster’s sales cycle.

After identifying the Sales Event, a company must change its decision making to maximize the frequency of delivery of the Sales Event. Watkins noted that this is “much harder and takes much longer,” as compared to the initial identification of the Sales Event.²⁵ In the case of Tesla, this meant designing a system, not to sell cars, but rather to maximize the delivery of test drives. Although this strategy may seem obvious in retrospect, it is worth noting that no automotive manufacture before or since had tried to build a test drive system of this nature. In fact, many of the high-end auto manufacturers Tesla competed with would actively discourage customers from test driving their vehicles. In the new Roadster sales process, an instance of a customer leaving a Tesla experience without a test drive was considered a sales team failure. Gracias noted that “the whole system was optimized around giving test drives.”²⁶

This new focus required a significant cultural and behavioral shift at Tesla. Prior to Valor’s involvement, Tesla spent its sales and marketing budget on events and activities that built the brand and generated sales leads. Valor and Tesla needed to work together to determine how to effectively convert sales leads to commitments to *purchase* the product. So the Company had to put their sales and marketing budget to alternative uses. Furthermore, Tesla had to invest in a test drive fleet of approximately 40 Roadsters, a system for managing the aging of that fleet, infrastructure for selling test drive vehicles, etc.

In summary, Valor worked to set up a sales infrastructure that was designed to maximize the number of test drives to customers by strategically drawing on the previously generated leads.

After establishing the need to maximize the delivery of test drives, Valor quickly realized that brick-and-mortar stores were not a cost-efficient method of achieving this objective. Valor

²⁵ Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

²⁶ Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

believed that a model where salespeople would bring the car to an office or residence for a test drive would be more convenient and would resonate with consumers, while requiring less initial investment and providing a higher ROIC. Valor dubbed this team the Asset Lite Sales Force.

Tesla had already committed to a direct sales model. This approach bypassed the need for showrooms, inventory, and other capital-intensive investment, allowing funds to be deployed to build out service centers and other necessary infrastructure. The direct sales model was also easier to scale and more flexible to deploy.

Valor then worked with Tesla to build a screening mechanism to identify and harvest the most promising leads. Valor instilled critical processes and procedures, particularly systematic reminders to follow-up with leads and improvements in the path with which internal lead miners would advance a lead to the outside sales manager for a test drive.²⁷ Finally, Valor created a recruiting and training program that enabled Tesla to staff and develop an effective sales team.

After conducting research on the target market and the most successful existing sales team members, Valor concluded that the profile of an ideal sales candidate for Tesla differed from the profile of a traditional car salesperson. Valor zeroed in on recent graduates from top-tier universities who were competitive, worked well in team settings, and typically had little or no experience in traditional auto sales.²⁸ Watkins or Gracias personally interviewed and evaluated each new candidate as well as existing sales team members.²⁹

Crucially, Tesla was able to attract top talent because of the brand that Musk and Tesla had built and because the sales associate roles offered significant upward mobility. “People wanted to work at the Company because of the Company’s mission and because it was a great business,” explained Gracias.³⁰ This sentiment was echoed by members of the Roadster sales team who found the entrepreneurial opportunity empowering.³¹ Moreover, salespeople were incentivized with Tesla equity and other prizes granted quarterly or annually to those with the highest performance.³²

Once candidates were offered jobs, they were put through a training program designed by Valor and overseen by Watkins. The system was an apprenticeship model, with each new hire helping call approximately 3,000 leads for the first six months before being sent elsewhere to be a sales lead for a defined geographic region. Sales associates were trained to speak fluently about

²⁷ Miki Sofer, Interview, April 10, 2016.

²⁸ Meridith Perry, Interview, April 24, 2016.

²⁹ Meridith Perry, Interview, April 24, 2016.

³⁰ Antonio Gracias and Tim Watkins, Interview, March 4, 2016.

³¹ Miki Sofer, Interview, April 10, 2016; Meridith Perry, Interview, April 24, 2016.

³² Miki Sofer, Interview, April 10, 2016; Meridith Perry, Interview, April 24, 2016.

Tesla’s engineering details to gain credibility with potential buyers. Valor used its framework to help communicate each critical step of the sales process to new members of the sales force.

In addition, Valor worked to identify the single clear message to be consistently communicated to customers through the sales efforts. Valor used a tool called The Pyramid of Messaging to structure its approach to messaging. The Pyramid had four parts of communication: Vision, Plan, Message and Campaign. Once the messages at all levels of the Pyramid were agreed upon by senior management, they were shared with the sales organization to be used with customers. This ensured consistent messaging in each and every communication (see Tesla Messaging Pyramid in **Exhibit 6**).³³

Valor designed a sales strategy to optimize the number of sales subject to other constraints. The pull-through rate from test drives to sales was 20 to 1, while Tesla could produce 50 Roadsters a month. So the system and targets for sales associates were optimized to deliver the targeted level of sales each month. Each test drive adhered to a scripted playbook, developed and implemented by Valor. Valor emphasized consistency across test drive experiences and used software to track critical performance metrics.

The sales force build out was implemented quickly and immediately led to results. Over 30 salespeople were hired in the first twelve months of the program. The Vice President of Sales & Ownership Experience position was created to lead this sales force. Valor designed a strategy playbook and the tracking metrics that enabled Tesla to optimize around the number of sales events to ensure maximum sales in line with production. Valor estimated that quarterly bookings tripled once this system was put in place, and Tesla was able to sell the full 2,500-vehicle production run of the Roadster by the end of 2011 (see **Exhibit 7** for quarterly sales from 2009 – 2011).³⁴

One Tesla sales associate close to the project stated that Valor’s systematic, analytical, hands-on approach to the sales process made them an absolutely critical party to the success of the Roadster sales.³⁵ Not only did Valor understand the issues with the sales process and create a strategy to resolve these issues, they supported the Tesla team by immersing themselves in the day-to-day execution of this strategy.³⁶ Another sales associate appreciated Valor’s ability to judiciously assess which parts of the business model needed reform—allowing successful units to

³³ Valor Equity Partners, “Sales and Marketing System Build.”

³⁴ Valor Equity Partners, Tesla Motors Investment Case Study, Appendix.

³⁵ Meridith Perry, Interview, April 24, 2016.

³⁶ Meridith Perry, Interview, April 24, 2016.

continue autonomously, troubled units to get the attention they needed, and the Company's culture to remain intact.³⁷

Each Tesla team member interviewed asserted the same key takeaway: the Roadster sales, and consequently Tesla's future growth, would not have been possible without Valor's partnership.

POSTSCRIPT

With sales of the Roadster on track, Tesla turned its attention to developing the Model S. The Model S, first announced in mid-2008, was meant to signal Tesla's entry into the mid-volume luxury car segment.³⁸ Valor returned to Tesla's Silicon Valley headquarters to help structure the sales process, as the scale and scope of the Model S far outpaced that of the Roadster. Valor leveraged the work it had done for the Roadster, including the sales tracking process, recruiting, and the sales playbooks. Most importantly, Valor reiterated the objective of maximizing test drives, which endures to this day. This strategic guidance helped the Company sell 75,000 Model S vehicles in the first three years of production (2012 – 2015).³⁹

Tesla's vehicles continued to move down the cost curve. Following the success of the Model S, Tesla introduced its first SUV, the Model X for which production began in 2015. The Company used the same sales infrastructure as the Model S.⁴⁰ Finally, in early 2016 Tesla unveiled plans for its Model 3, its first truly mass market EV (see **Exhibit 8** for sales and events timeline from 2003 – 2015).

The Valor team continued to celebrate Tesla's victories, no longer as investors, but as supporters of the Company's vision and its management. Gracias remains as Tesla's lead independent director.

"I'd like to thank Valor for being a key investor. And not just an investor, but a strategic partner. I don't think we would've made it without their help, so thank you."

Elon Musk, Chairman, Product Architect, & CEO, Tesla Motors⁴¹

³⁷ Ricardo Reyes, Interview, April 15, 2016.

³⁸ "Tesla Debuts Electric Car for the Masses," *CBC.ca*, March 27, 2009, <http://www.cbc.ca/news/technology/tesla-debuts-electric-car-for-the-masses-1.816478>.

³⁹ Cobb, Jeff, "Tesla Due to Sell 75,000th Model S This Month," June 16, 2015, <http://www.hybridcars.com/tesla-due-to-sell-75000th-model-s-this-month/>.

⁴⁰ "Tesla CEO Musk Launches Model X Electric SUV: 'Safest SUV Ever,'" September 30, 2015, <http://www.greencarcongress.com/2015/09/20140930-modelx.html>.

⁴¹ Musk, Elon, Speech, Economic Club of Chicago, April 12, 2012.

Exhibit 1: Valor Portfolio Companies in Funds I through III

Company	Fund	Date of Initial Investment	Active (Yes/No)
Premier Card Solutions, LLC	Fund I	Mar-03	No
Astral Brands, Inc.	Fund I	Aug-03	No
Fibrex Cordage, LLC	Fund I	Oct-03	No
Tewa Wood Moulding, LLC	Fund I	Jul-04	No
Cherry Creek Tree Farms, LLC	Fund I	Oct-04	No
SRH Holdings, LLC (Source)	Fund I	Mar-05	No
VMSG Holdings, LLC (Mikohn)	Fund I	May-05	No
Tesla Motors, Inc.	Fund I	May-05	No
Mountain High Resort Associates, LLC	Fund I	Jul-05	No
Woods Restoration Holdings, LLC	Fund I	Nov-05	No
Sizzling Platter, LLC	Fund I	Jun-06	No
Sizzling Platter, LLC	Fund II	Aug-07	Yes
Smith Gas Field Services, LLC	Fund II	Dec-07	No
Tesla Motors, Inc.	Fund II	Feb-08	No
Life Care Partners, LLC (Family Home Health Services)	Fund II	Mar-08	Yes
North American Coatings, Inc.	Fund II	May-08	No
ASDC Holdings, LLC (All Smiles)	Fund II	Jun-10	No
Space Exploration Technologies Corp.	Fund II	Oct-10	Yes
SolarCity Corporation	Fund II	Feb-12	Yes
Marathon Pharmaceuticals, Inc.	Fund II	Aug-13	Yes
Fooda, Inc.	Fund III	Nov-13	Yes
Addepar, Inc.	Fund III	Mar-14	Yes
Space Exploration Technologies Corp.	Fund III	Apr-14	Yes
Renovate America, Inc.	Fund III	Apr-14	Yes
Porch.com, Inc.	Fund III	Jan-15	Yes
Manduka Holdings, LLC	Fund III	Jul-15	Yes
Premise Data Corporation	Fund III	Sep-15	Yes
Eatsa	Fund III	May-16	Yes

Exhibit 2: Valor Value-Add Opportunity Framework

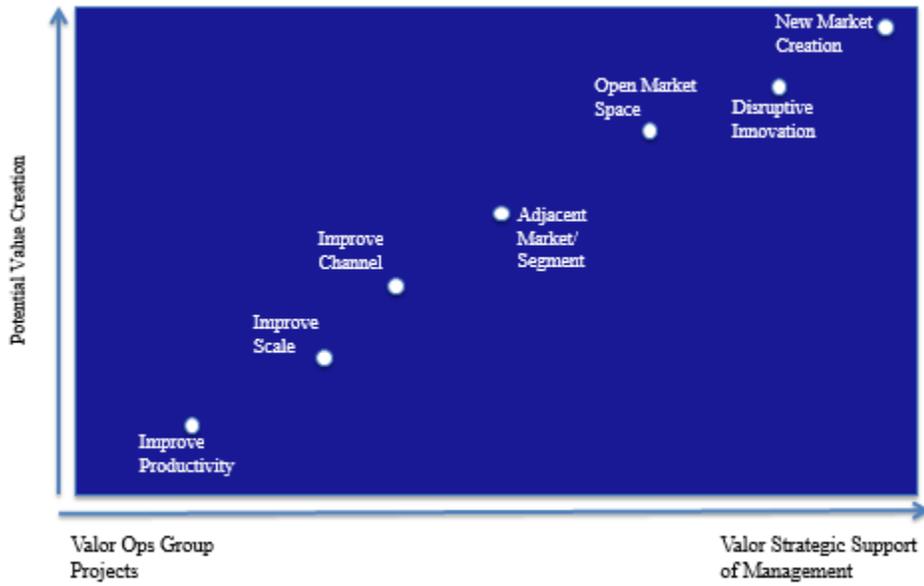


Exhibit 3: Valor Historical Performance

(Performance as of March 31, 2016)

Fund	Vintage Year	Capital Committed (millions)	Net IRR	Net MOIC	Burgiss Private IQ			
					Median Fund IRR	Top Quartile Fund IRR	Median Fund MOIC	Top Quartile Fund MOIC
Valor Equity Fund I	2002	\$120	20%	2.3	15%	24%	1.9	2.3
Valor Equity Fund II	2007	\$300	24%	2.7	10%	15%	1.5	1.8
Valor Equity Fund III	2013	\$490	16%	1.2	na	na	na	na

Exhibit 4: Key People Involved in the Tesla-Valor Partnership

Elon Musk: Musk was the CEO, product head and main brand ambassador of Tesla Motors. He joined the Company as the Chairman and the biggest shareholder by leading the Series A investment in 2004. Initially, Musk played a crucial role in setting the direction of the Company while remaining away from day-to-day operations. In 2008, while Tesla was going through a difficult phase, Musk invested \$70M of his personal wealth to save Tesla and became the CEO.

An engineer by training, Musk was a serial entrepreneur involved with numerous technology ventures. He had an impressive track record of building innovative technology companies and selling them for handsome sums followed by reinvestment of his wealth in his next venture. He started his entrepreneurial journey in 1995 with Zip2, a primitive Yelp! and Google Maps hybrid. The company was sold to Compaq for \$307M. In 1999, he founded X.com, a payment technology company, that later became PayPal. PayPal was acquired by eBay for \$1.5B. In 2002, he invested \$100M to co-found SpaceX, an aerospace manufacturer and space transport service company, with a goal to reduce the cost of space travel and colonization of Mars. He is the CEO and CTO of SpaceX. He was also the largest shareholder of SolarCity, a provider of solar electricity services, co-founded by Musk's cousins in 2006.

Antonio Gracias: Gracias was the Founder, Managing Partner, and Chief Investment Officer of Valor. Gracias founded Valor in 2001. He had over twenty years of experience in private equity investing. Antonio served as Lead Independent Director at Tesla Motors and was a director of several Valor portfolio companies, including Space Exploration Technologies (SpaceX), Marathon Pharmaceuticals, Solar City, and Porch.com. Antonio is the Chairman of Valor's Investment Committee.

Prior to founding Valor, Gracias was the Founder and Managing Member of MG Capital where he acquired and acted as CEO for a number of manufacturing and technology related companies. At MG Capital, together with the team that is still together at Valor today, he developed the operational skills that Valor uses to help its portfolio companies achieve scale and enhance their value. Prior to MG Capital he worked for Goldman, Sachs & Co.

Gracias earned a joint B.S. and M.S.F.S. (honors degree) in International Finance and Economics from the Georgetown University School of Foreign Service. He also studied corporate structures and economic development at Waseda University in Tokyo. Prior to completing his Masters, Gracias returned to Japan as a Nikko Securities Fellow. Gracias earned a J.D. from the University of Chicago Law School.

Timothy Watkins: Watkins was a partner at Valor and leads the Firm's operational improvement function, focusing on active management of portfolio companies in conjunction

with existing management teams. His additional responsibilities included investment selection and analysis. Watkins served as a member of Valor's Investment Committee.

Watkins had over 30 years of operational change management and private equity investing experience. Prior to joining Valor, Watkins served as a Vice President at MG Capital. During his tenure at MG Capital, Watkins specialized in operational due diligence and implementing post-closing operational improvements.

Prior to joining MG Capital, Watkins served as a Principal Consultant for Westworks Ltd., a consulting organization providing operational systems support to manufacturing organizations. Clients ranged from middle market companies to members of the Fortune 500, including Ford Motor Company and 3M.

Prior to consulting, Watkins held manufacturing and engineering management positions at Robinson Nugent, a leading connector manufacturer, and Renishaw PLC, a UK-based manufacturer of machine tool systems.

Watkins earned a B.S. in Mechanical Engineering (1st Class Honors) from Bradford University and an M.S. in Industrial Robotics from the Cranfield Institute of Technology, Great Britain. Watkins was a Chartered Professional Engineer.

Exhibit 5: Tesla Funding and Valuation History

Funding Round	Date	Total Round (millions)	Pre-Money (millions)	Post-Money (millions)	Valor Investment (millions)	Valor Shares (millions)	Price per Share	Valor Fund
Series A	Apr-04	\$3.6	\$7.3	\$10.9				
Series B	May-05	\$12.9	\$22.2	\$35.1	\$2.0			Valor Equity Fund I
Series C	Jun-06	\$40.0	\$47.6	\$87.6	\$1.0			Valor Equity Fund I
Series D	May-07	\$45.0	\$219.6	\$264.6	\$3.0			Valor Equity Fund I
Convertible Debt	Feb-08	\$40.0			\$7.0			Valor Equity Fund I and Fund II
Convertible Debt	Nov-08	\$71.5			\$1.5			Valor Equity Fund II
Corporate Equity	May-09	\$258.2	\$344.8	\$603.0				
IPO	Jun-10	\$276.0	\$1,310.0	\$1,586.0		4.91	\$17.00	
Post-IPO	12/31/2010						\$26.63	
	12/31/2011						\$28.56	
	12/31/2012						\$33.87	
	12/31/2013						\$150.43	
	12/31/2014						\$222.41	
	12/31/2015						\$240.01	

Valor's Tesla Economics	Invested (millions)	Returned (millions)	MOIC	IRR
Valor Equity Fund I	\$7.0	\$73.8	10.4	51%
Valor Equity Fund II	\$7.5	\$64.8	8.6	112%

Source: Pitchbook

Exhibit 6: Tesla Pyramid of Messaging

VISION

Accelerate the advent of sustainable transport by bringing compelling mass market electric vehicles to market as soon as possible.

MASTER PLAN

- Build a sports car
- Use the earnings to build an affordable car
- Use those earnings to build an even more affordable car

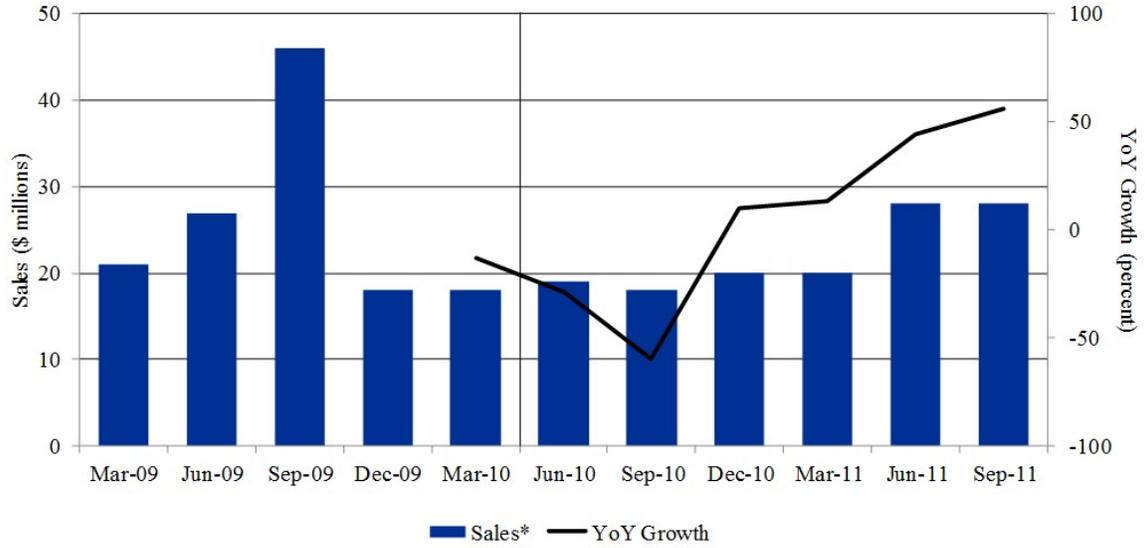
MESSAGE

Guilt free desire

CAMPAIGNS

- Rule the Diamond Lane
- You know you want it

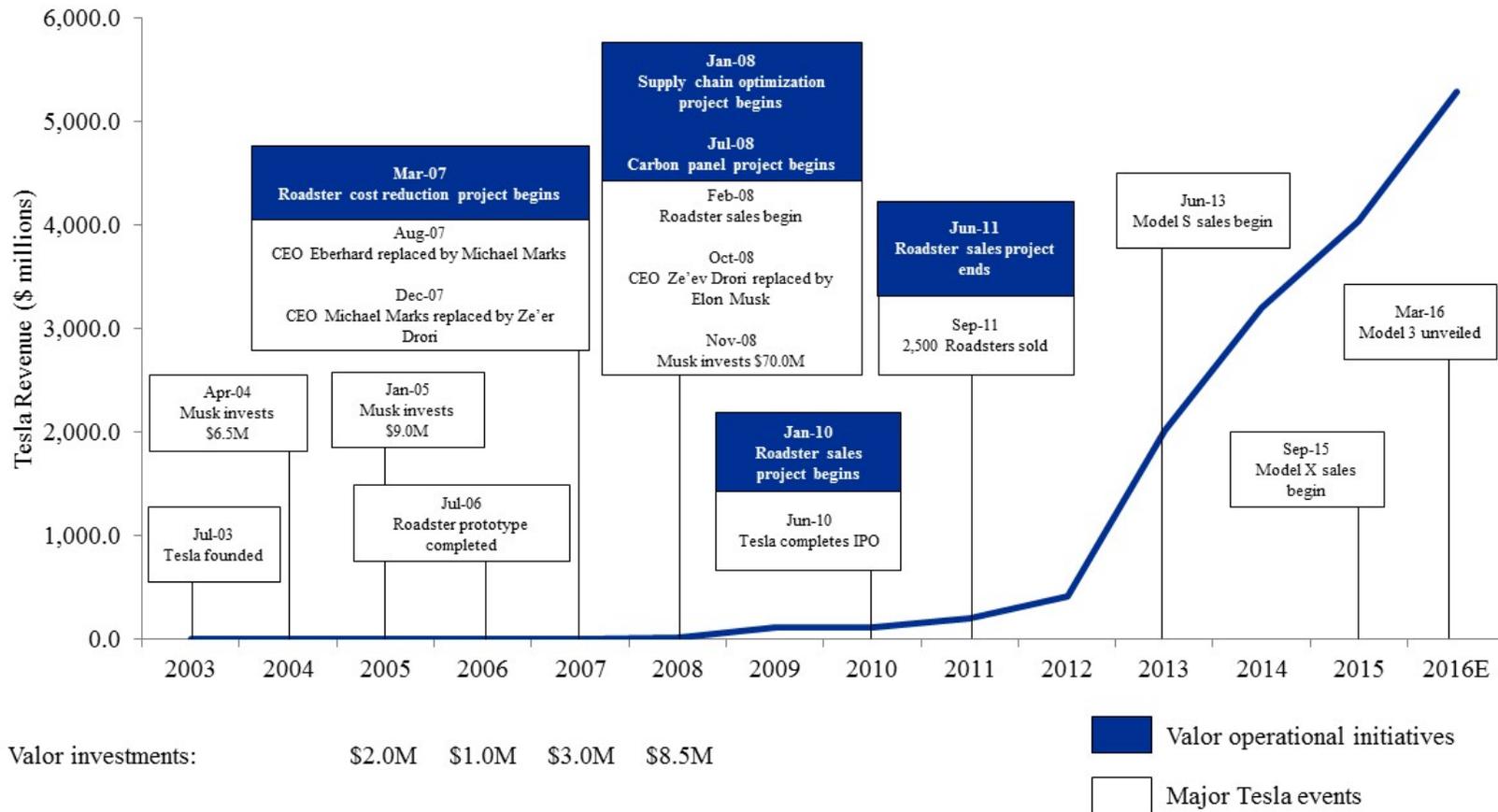
Exhibit 7: Tesla Quarterly Sales (2009 – 2011)



* Includes vehicle, options, and related sales; excludes sales of powertrain and development services.

Source: Tesla Motors Inc. Prospectus filed pursuant to form 424(b)(4) and 10-K

Exhibit 8: Tesla Revenue and Major Company Events



Source: Tesla Motors Inc. Prospectus filed pursuant to form 424(b)(4) and 10-K; S&P Capital IQ

Exhibit 9: Tesla Income Statement (2005 – 2011)

(\$ in '000s)	Year Ended December 31,						
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Revenue:							
Automotive sales*	—	—	73	14,742	111,943	97,078	148,568
Development services	—	—	—	—	—	19,666	55,674
Total revenues	—	—	73	14,742	111,943	116,744	204,242
Cost of Revenue:							
Automotive sales	—	—	9	15,883	102,408	79,982	115,482
Development services	—	—	—	—	—	6,031	27,165
Total cost of revenues	—	—	9	15,883	102,408	86,013	142,647
Gross profit (loss)	—	—	64	(1,141)	9,535	30,731	61,595
Operating Expenses:							
Research and development**	10,009	24,995	62,753	53,714	19,282	92,996	208,981
Selling, general and administrative	1,820	5,436	17,244	23,649	42,150	84,573	104,102
Total operating expenses	11,829	30,431	79,997	77,363	61,432	177,569	313,083
Loss from operations	(11,829)	(30,431)	(79,933)	(78,504)	(51,897)	(146,838)	(251,488)
Interest income	224	938	1,749	529	159	258	255
Interest expense	—	(423)	—	(3,747)	(2,531)	(992)	(43)
Other income	—	59	137	(963)	(1,445)	(6,583)	(2,646)
Loss before income taxes	(11,605)	(29,857)	(78,047)	(82,685)	(55,714)	(154,155)	(253,922)
Provision for income taxes	—	100	110	97	26	173	489
Net profit (loss)	(11,605)	(29,957)	(78,157)	(82,782)	(55,740)	(154,328)	(254,411)

*incl zero emission vehicle credit sales of \$3,458, \$8,152, \$1,275 and \$506 for the years ended Dec 31, 2008 and 2009 and three months ended Mar 31, 2009 and 2010

**net of development compensation of \$23,249 for the year ended December 31, 2009

Source: Tesla Motors Inc, Prospectus filed pursuant to form 424(b)(4) and 10-K

Exhibit 10: Tesla Balance Sheet Statement (2005 – 2011)

(\$ in '000s)	As of December 31,						
	2005	2006	2007	2008	2009	2010	2011
Consolidated Balance Sheet Data:							
Cash and cash equivalents	5,827	35,401	17,211	9,277	69,627	99,558	255,266
Short-term marketable securities	—	—	—	—	—	—	25,061
Restricted cash-current	—	—	—	—	—	73,597	23,476
Property and equipment, net	1,622	7,512	11,998	18,793	23,535	114,636	298,414
Working capital (deficit)	4,587	8,458	(28,988)	(56,508)	43,070	150,321	181,499
Total assets	7,856	44,466	34,837	51,699	130,424	386,082	713,448
Convertible preferred stock warrant liability	—	227	191	2,074	1,734	—	—
Common stock warrant liability	—	—	—	—	—	6,088	8,838
Capital lease obligations, less current portion	—	—	18	888	800	2,830	2,830
Long-term debt	—	—	—	—	—	71,828	268,335
Convertible preferred stock	20,384	60,173	101,178	101,178	319,225	—	—
Total stockholders' equity / (deficit)	(13,995)	(43,923)	(117,846)	(199,714)	(253,523)	207,048	224,045

Source: Tesla Motors Inc, Prospectus filed pursuant to form 424(b)(4) and 10-K