**Final Comments on Tesla's DCF Model: Examining Assumptions and Valuation**

**Reviewing the DCF Model for Tesla**

In our previous lesson, we determined a target price per share for Tesla. The DCF model is now ready, but it is important to review and understand the reasons behind the lower valuation obtained. The current market price is significantly higher than the one calculated in our base case scenario. This does not necessarily indicate an error in the model, but it is a reason to examine the numbers with extra care.

**Revenue and Profit Growth vs. Cash Flow Trends**

The model assumes that revenues increase gradually over time, which is clearly visible in the profit and loss statement. Gross profit and EBIT also grow gradually, and the same is valid for net income. However, the cash flow sheet presents a different picture: the company's unlevered free cash flow peaks in 2023 and then gradually starts to decrease. This is unusual and should be considered a yellow or red flag. Ideally, the cash flow pattern should resemble the gradual growth seen in the profit and loss statement.

**Reasons for Decreasing Unlevered Free Cash Flow**

There are two main reasons for the observed result:

**1. Heavy and Perpetual CapEx Assumptions**

The model assumes very heavy investments in CapEx. According to these assumptions, Tesla continues to spend heavily on CapEx in perpetuity, which significantly impacts the calculation of continuing value. The assumption is that property, plant, and equipment would depreciate in ten years. Nevertheless, every year, Tesla continues to invest 24% of its existing property, plant, and equipment to buy new PP&E. This is unrealistic, as it implies Tesla will continue to invest and grow its CapEx forever, negatively affecting unlevered free cash flow. A more balanced CapEx spending plan should be considered, especially towards the last years of the explicit forecast period.

**2. High Other Liabilities as a Percentage of Revenue**

The second reason for the strange behavior of cash flows is related to other liabilities. The balance sheet shows that other liabilities are planned to develop in line with revenues. Specifically, the assumption is that they are 20% of revenues, which may be too high. The cash flow sheet reveals the significant impact that the sum of all other liabilities has on unlevered free cash flow, and it is easy to see that the positive amount tends to decrease as the forecasting period progresses. This occurs because, for cash flow purposes, the difference in other liabilities is calculated as a percent of revenue. As revenue growth declines and stabilizes towards the end, the difference becomes smaller. In essence, this item, which is not well understood, has a huge impact on the forecast. The right approach is to compare Tesla with mature auto producers to determine what portion of revenues their other liabilities account for. This approach was used earlier for PP&E and OpEx.

**Importance of the Last Year of Projections**

These two reasons explain the decreasing unlevered free cash flow towards the end of the forecast period. The last year of projections is very important, as it serves as the basis for calculating continuing value. This has a major influence on the company's valuation. In this case, continuing value forms over half of enterprise value. If the last year's cash flow is understated, then continuing value represents a lower than usual portion of the company's overall equity value.

**Task: Adjusting Assumptions and Analyzing Impact**

You are encouraged to modify the assumptions for CapEx and other assets and liabilities. Share how the new assumptions impacted your results on the course discussion board. A short comment along with your new results could earn you a special gift. Your feedback is highly anticipated.

**Key Takeaways**

* The DCF model for Tesla shows a lower valuation than the current market price, which warrants careful examination of the model's assumptions.
* Heavy and perpetual CapEx assumptions and high other liabilities as a percentage of revenue are the main reasons for decreasing unlevered free cash flow.
* The last year of projections is crucial as it significantly influences the continuing value and overall company valuation.
* Adjusting assumptions for CapEx and other liabilities can have a major impact on the results, and comparing Tesla to mature auto producers is recommended for more realistic forecasting.