The Valuation Times

Will Corporate Tax Cuts Impact Valuations?

Corporate tax reform may occur at some point with President Trump's administration planning tax cuts for individuals and companies. It is interesting to assess the probable impact of corporate tax cuts on company valuations.

Under a Discounted Cash Flow approach to valuation, the free cash flows of a firm in future years are discounted to present value, which represents the value of a firm. The outstanding debt is then deducted to derive the equity value or share price. For profitable companies that are taxable and have no debt, the impact of a tax cut is straightforward – an increase in free cash flows and equity value. However, for leveraged companies, the tax rate cut impacts the discount rate or the Weighted Average Cost of Capital (WACC). Assuming other factors such as the Cost of Equity component do not change, as the tax rate reduces, the cost of debt component in the WACC calculation increases. In this situation, the impact on valuation is not straightforward and depends on whether the increase in cash flows or the increase in discount rate plays the dominant role in the valuation calculation.

As interest expense is a tax deduction, the reduced corporate rates may cause leverage to decline. When analyzing industries that are more levered, such as utilities and real estate, the cost of debt will increase as well as the overall debt to equity ratio (or leverage) will reduce. However, this may also affect the Cost of Equity component by affecting the beta for leveraged companies as the levered beta will be lowered. Levered equity beta incorporates the business and financing risks undertaken by the company. The decline in levered beta will reduce the cost of equity for the company under the Capital Asset Pricing Model. However, a company may choose to maintain its leverage level and borrow more to compensate for the increase in equity. In that case beta will not change nor will the Cost of Equity component. In view of the above, for a leveraged company in certain industries, the impact of tax cuts on company valuation will not necessarily be positive.

Jason Forsyth of FFG Valuations to Present at CalCPA event

The OC/LB chapter of CalCPA is hosting an event on September 20 entitled *What to Present to the IRS to Support Valuations and Their Discounts* delivered by Mr. Jason Forsyth, President of FFG Valuations, Inc.

The presentation will cover IRS sensitivities related to valuation discounts and the areas in the appraisal report that the IRS will most likely target.

Mr. Jason Forsyth is a valuation expert in the areas of estate and gift tax planning, transaction advisory, and corporate finance including opinions that often require sophisticated financial modeling of complex securities and derivatives.

The event is eligible for the following CPE credits: CPE 2.00, MCLE 1.50, CFP 2.00, To attend the presentation, please follow this link to register with CalCPA for the event.

FFG Valuations, Inc., founded in 2008, provides professional valuation advisory and financial reporting services to publicly and privately-held companies and individuals. With capabilities and expertise on par with larger firms, FFG applies personalized attention to every engagement.

Please contact us via phone or email if you have a question or just want to chat.
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