Updating Historical Cash Tax Rates from 2017-2019

As part of our commitment to providing the best and most transparent company valuation models, we are constantly reviewing and adapting our processes and methodologies to changing market conditions and accounting rules. We recently discovered an opportunity to improve historical Cash Tax Rates to more accurately reflect the lower corporate tax rates realized after the 2017 Tax Cuts and Jobs Act (TCJA).

This report explains the update and details the impact it has on our models and equity and credit ratings.

When You Will See the Change: Thursday, December 17

This update will go into effect on our site the morning of Thursday, December 17.

The Update: Lowering Cash Tax Rates from 2017-2019

To calculate a firm's cash tax rate, we use a three-year normalized rate based on reported taxes adjusted for annual changes in reserves. In late 2017, after the passage of The Tax Cuts and Jobs Act, the corporate tax rate dropped from 35% to 21%.

Because we use a three-year average to calculate cash tax rates, our models did not immediately reflect the impact of this change. Now, as companies report three years of lowered tax rates due to the TCJA, our Cash Tax Rates in the current period appear significantly lower than historical periods.

To better reflect the realized drop in tax rates and place less weight on tax rates from before the tax cut in our normalized average Cash Tax Rate calculation, we're reducing our Cash Tax Rates by the following:

- 12/22/17 and 12/21/18 lowered by 30%
- 12/22/18 through 12/21/19 lowered by 17.5%
- 12/22/19 through 6/30/20 lowered by 10%
- After 6/30/20 there will be no change to the Cash Tax Rate as our normalized average Cash Tax Rate calculation will already capture three years of lowered corporate tax rates.

Impact on our Models

As a result of these changes, we expect aggregate net operating profit after-tax (NOPAT) across our coverage universe will be impacted as follows:

- Fiscal 2017 NOPAT will increase by ~10%
- Fiscal 2018 NOPAT will increase by ~5%
- Fiscal 2019 NOPAT will increase by ~2%.

We also expect economic earnings, economic book value, and return on invested capital (ROIC) to increase in these historical periods, but to a lesser extent, given that these metrics are driven by NOPAT.

Overall, we anticipate little to no change to a ticker's current Risk/Reward rating, since the current period already reflects lower Cash Tax Rates. However, we do expect tickers with low NOPAT relative to the change in year-over-year reserves will be more impacted than most.

We'll provide a list of all tickers impacted in the current period on or before December 16, 2020.

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Disclosure: David Trainer, Kyle Guske II, Alex Sword, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

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We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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