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 is has on our models and equity and credit (coming soon) 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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The HBS & MIT Sloan paper, Core Earnings: New Data and Evidence, shows how our superior data drives uniquely comprehensive and independent debt and equity research.

This paper compares our analytics on a mega cap company to other major providers. The Appendix details exactly how we stack up.

Learn more.

Quotes from HBS & MIT Sloan professors on our research:

Get better research:

"…the NC dataset provides a novel opportunity to study the properties of non-operating items disclosed in 10-Ks, and to examine the extent to which the market impounds their implications." – page 20

Pick better stocks:

"Trading strategies that exploit cross-sectional differences in firms' transitory earnings produce abnormal returns of 7-to-10% per year." – Abstract

Avoid losses from using other firms' data:

"…many of the income-statement-relevant quantitative disclosures collected by NC do not appear to be easily identifiable in Compustat…" – page 14

Build better models:

"Core Earnings [calculated using New Constructs' novel dataset] provides predictive power for various measures of one-year-ahead performance…that is incremental to their current-period counterparts." – page 4

Exploit market inefficiencies:

"These results … suggest that the adjustments made by analysts and Compustat to better capture core earnings are incomplete. Moreover, the non-core items identified by NC produce a measure of core earnings that is incremental to alternative measures of operating performance in predicting an array of future income measures." – page 26

Fulfill fiduciary duties:

"An appropriate measure of accounting performance for purposes of forecasting future performance requires detailed analysis of all quantitative performance disclosures detailed in the annual report, including those reported only in the footnotes and in the MD&A." – page 33-34

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