

2018 Tax Reform

The Implications for Valuation

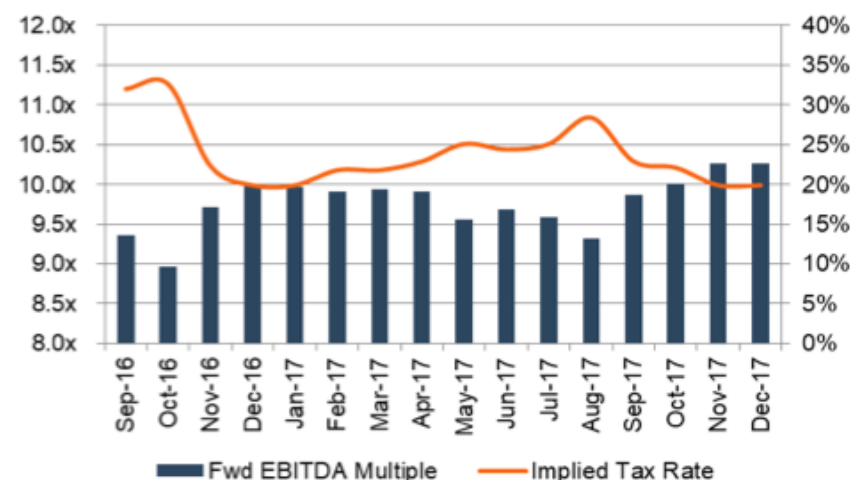
JANUARY 2018

Market Backdrop

While equity markets did not make a sharp move upon passage of the tax bill in December 2017, the prospect of significant corporate tax reform was likely a contributing factor to the rally in stock prices during 4Q16 and throughout 2017. The S&P 500 advanced 24% during the period, while the median forward EBITDA multiple for small- and mid-cap shares expanded nearly a full turn, ending 2017 at approximately 10.3x.

Our analysis suggests that, all else equal, the expansion in forward EBITDA multiples corresponds to expectations for a material reduction in corporate tax rates. Data from private company transactions is trickling in; anecdotally, transaction multiples we observed in 2017 often exceeded prior benchmarks.

Consistent with the view that markets are generally efficient, the new lower corporate tax rates seem to have been priced in to the market shortly after election day. While some doubt regarding the likelihood of passage was evident over the summer months, optimism regarding the tax bill returned to the markets during 4Q17.



Significant Corporate Changes

Changes that will influence cash flows

Tax Rate

Corporate tax rate reduced to 21% from 35%

Deductibility of Capital Investment

Through 2022, companies will be able to deduct capital investment as made rather than over time through depreciation charges

Deductibility of Interest

Interest expense deduction limited to 30% of EBITDA through 2021, and 30% of EBIT thereafter

Foreign Income

U.S. taxes due only on U.S. income, with one-time tax to allow repatriation of existing foreign retained earnings

NOL Carryforward Limitations

Max out at 80% of taxable income for year, no expiration

Like-Kind Exchanges

Changes to availability

Corporate valuations are a function of expected cash flows, risk, and growth. While the reduction in tax rates triggers the most obvious revision to expected cash flows, other provisions of the bill may also significantly influence cash flows for individual companies.

Other significant provisions noted to the left should be evaluated on a company-by-company basis to determine what effect, if any, the changes will have on expected cash flows.

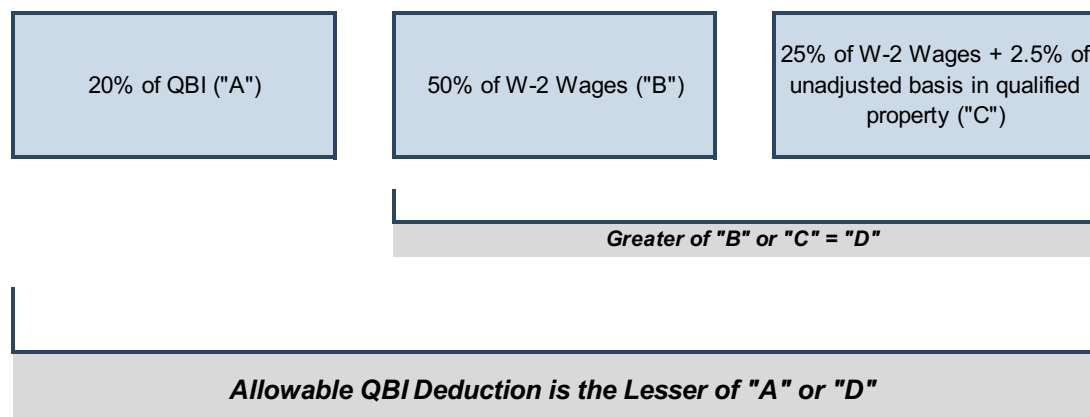
Appraisers with deep experience in the relevant industry are best positioned to evaluate the potential effects.

Treatment of Pass-Through Entities

Deduction limited by wages and/or property

Lower corporate tax rates reduce the relative tax benefits of the S election. The tax bill provides for a qualifying business income (“QBI”) deduction of up to 20% of pass-through income as a means of partially restoring the benefit of the S election.

Availability of the QBI deduction is limited by the nature of the subject business and the income of the shareholder.



	Entities Other Than Specified Service Businesses	Specified Service Businesses (excludes Architects and Engineers)
<p>Large Operating Businesses</p> <p><i>Typical shareholder income > \$415k</i></p> <p><i>50% of W-2 Wages > 20% of pre-tax income</i></p>	<p>Shareholders likely eligible for full 20% deduction against pass-through income.</p>	<p>Shareholders not eligible for deduction.</p>
<p>Large Asset Holding Entities</p> <p><i>Typical shareholder income > \$415k</i></p> <p><i>50% of W-2 Wages < 20% of pre-tax income</i></p>	<p>If compensation base is small, may not be able to take full 20% deduction. Limited to 25% of W-2 wages + 2.5% of cost basis in "qualified property"</p>	<p>Not applicable.</p>
<p>Small Businesses</p> <p><i>Typical shareholder pass-through income < \$415k</i></p>	<p>If shareholder income is <\$315k, eligible for full 20% deduction regardless of other limitations. Exceptions phase out ratably to shareholder income of \$415k</p>	<p>If shareholder income is <\$315k, eligible for full 20% deduction regardless of other limitations. Exceptions phase out ratably to shareholder income of \$415k</p>

The Bottom Line

Impact on Valuation

Enterprise Valuation

Does a lower corporate tax rate make corporations more valuable, all else equal? **Yes**. Will all else always be equal? No. Appraisers will need to carefully consider the effect of the new tax law not just on rates, but on growth expectations, reinvestment decisions, the use of leverage, operating margins, and the like for individual companies.

Pass-Through Valuation

What effect does the new tax law have on the value of minority interests in pass-through entities, all else equal? **It depends**. The resulting differential between corporate and personal rates and the availability of the QBI deduction may cause some business owners to re-evaluate the merits of the S election. The ultimate effect on valuation will depend on the subject company's distribution policy, the length of the expected holding period, and the perceived risk associated with the S election.

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