Indé Global
Business Appraisers

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Valuation updates | Valuation of tax attributes

This thought leadership paper provides insights on the impact of tax attributes - NOL's in particular, on valuation.

Approaches to valuation:

In any business valuation the subject matter being valued is the 'business along with its operational net assets'. For example, the operating level of working capital and the operating assets that are required to produce those cash flows that are eventually discounted to a present value forms a part and parcel of the valuation.

Often, as appraisers, we need to look at the non-operating assets and liabilities that sit on the balance sheet as at the valuation date and add the fair value of such assets or liabilities to the value of the business to arrive at the enterprise value or equity value as the case may be.

Several tax attributes such as net operating losses *(NOL's)*, future amortization of intangibles, future depreciation of property, plant and equipment, research and development credits, foreign tax credits existing as of the valuation date presents itself as a critical element while arriving at the value of businesses that have these accumulated losses or credits from prior years.

This month's article addresses the rationale that we as appraisers use to measure the value of tax attributes while valuing a business.

Valuation of tax attributes:

Tax attributes are an asset of a company, just as property, plant and equipment are assets. However, tax attributes are an asset that many buyers do not automatically consider. Demonstrating the real and reliable tax savings that can be generated by the utilization of the corporation's tax attributes increases the value of a corporation, and thus, the negotiating leverage.

By modelling the projected utilization of a corporation's tax attributes, one can demonstrate that the corporation's tax attributes have significant value, which should be included in the valuation of the corporation.

It is important to seek advice from experienced mergers and acquisitions tax professionals who can provide an expedient, yet thorough, analysis of the present value of the corporation's tax attributes.

Treatment of NOL:

One of the most common tax attributes that an appraiser deals with are NOLs. Subject companies being valued have past losses which need to be incorporated in the valuation model to derive the appropriate value. NOL's can either be valued by considering the tax savings while computing the free cash flows, or can be separately added to the value derived from operating activities.

Let us understand the valuation of NOLs with a case study:

ABC International Inc. *("ABC")* needs to determine the enterprise value of its business as of December 31, 2016. ABC in the past has made accumulated losses of approximately $ 20 million, which are set to retire on December 31, 2019. ABC has provided detailed projections and expect to be profitable from FY 2017. The value derived using the discounted cash flow approach *(not considering the effect of NOLs)* is derived to be $ 25 million. Since the company has accumulated losses, which will result in a lower tax outflow in future years, such accumulated losses need to be assigned some value. The value derived is then to be added to the $ 25 million computer using the free cash flows of ABC.

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The following table illustrates the computation of value of the NOL's:

Particulars	Projected *(amounts in $ mn)*			
	2017	2018	2019	2020
Profit before tax	2.0	5.0	8.0	10.0
NOL utilized (A)	2.0	5.0	8.0	-
Unutilized NOL as at the year end	18	13	5	-
Tax outflow avoided (A x 40%)	0.8	2.0	3.2	-
Present value factor	0.91	0.83	0.75	0.68
Present value of tax savings	0.7	1.7	2.4	-
Sum of present value of tax savings	**4.8**			

Since, the NOLs expire in FY 2019, the company does not get the benefit of tax savings FY 2020 onwards. The present value of tax savings amounting to $ 4.8 million will be added to $ 25 million computed using the discounted cash flow approach. Whether the present value of tax savings need to be added to a value derived using a market based valuation model would depend upon the existence of NOLs in the comparable companies being considered in the market based valuation approach. If the comparable companies have NOLs, it is assumed that the market based valuation approach takes into consideration the value of the NOLs and thus the subject companies valuation need not be adjusted for the present value of tax savings. However, if the comparable companies do not have any NOLs, it may be appropriate to add the present value of the tax savings to the value derived.

The illustrations explain the importance of assigning values to the tax attributes of the subject entity. The computation of other tax attributes would be very similar to the computation of tax savings on NOLs, and thus should not be ignored in a valuation exercise.

About us:

Indé Global Inc. specializes in international business valuation and tax advisory and is a member firm of KNAV International Ltd ('KNAV').

Our team comprises of over 350 professional executives with office in India, USA, Canada, Netherlands, Switzerland, France, UK and Singapore. Our valuation services encompass business valuation, intellectual property valuation and valuations for financial reporting purposes.

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