

Commercial Insights

STRATEGIES AND EXPERTISE FOR YOUR COMPANY

Summer
2018



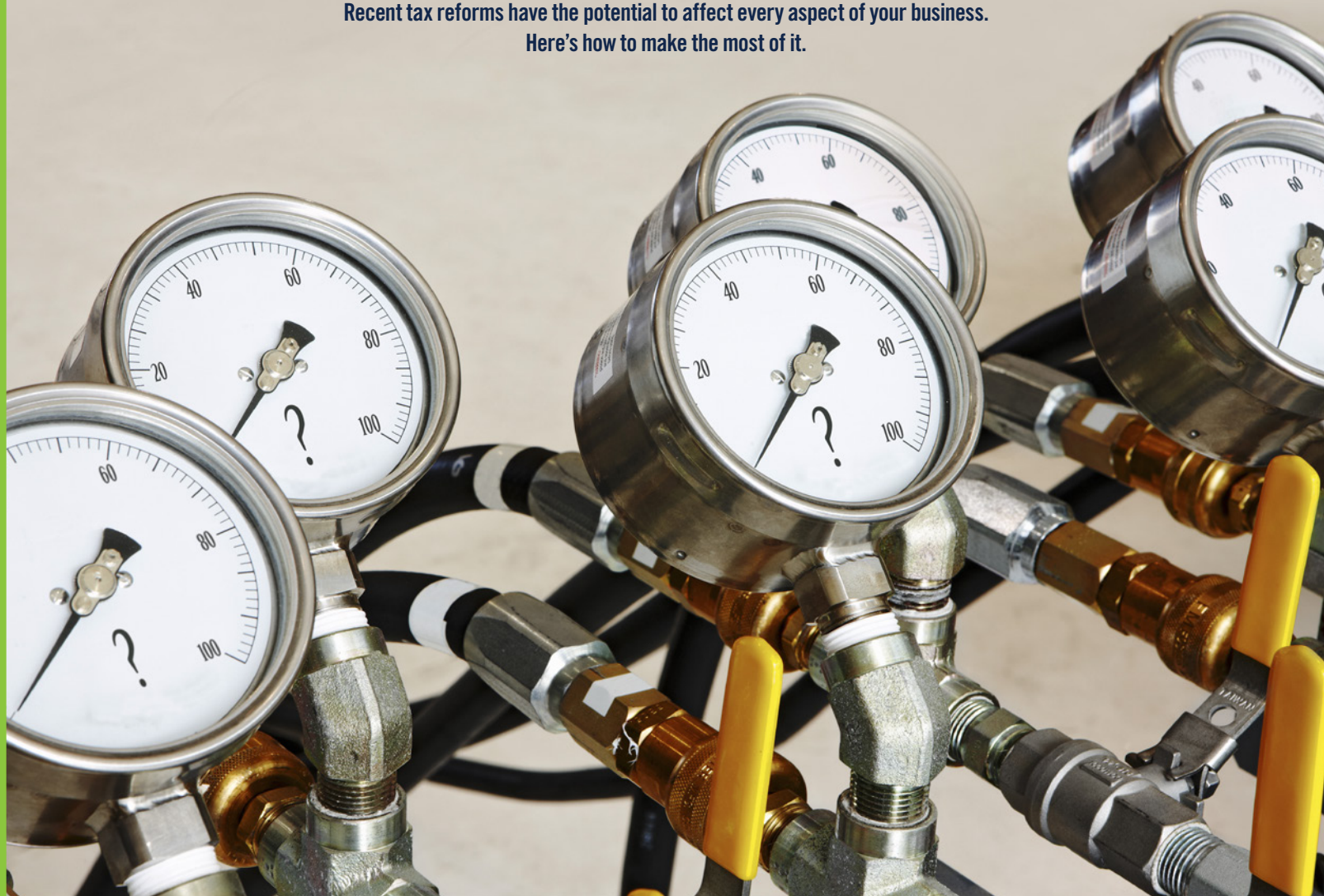
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ANALYZING THE NEW TAX CODE

Recent tax reforms have the potential to affect every aspect of your business.
Here's how to make the most of it.



Welcome



When you run a business, you have a wide range of partnerships and relationships, and one of those relationships is with the government. Now, with the new tax reforms, that relationship has changed.

To help you unpack this highly complex change and its many implications, this issue of *Regions Commercial Insights* is filled with fine-toothed examination and farsighted analysis for you and your business. In “Analyzing the New Tax Code,” we go right to the heart of the biggest impacts of these changes. In addition to several other stories exploring what these reforms mean for different aspects of your business, we also look at opportunities they may present in “Investing Your Company’s Tax Surplus.”

At the same time, we know that focusing on one single aspect of your business can be its own kind of risk for an owner-operator. That’s why we pull back the lens to explore issues like your outreach efforts, in “Marketing and Growth: Making the Connection,” and the ins and outs of buying or selling your enterprise in “Assisting With Milestones and Transitions.”

Given the many responsibilities and relationships in your life, this issue mirrors the myriad problems you often need to focus on in a single day. In that way, we believe it’s an expression of Regions’ commitment to your success in a business environment that’s always changing.

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A New View on Equipment Financing

Recent tax code changes mean that you should reconsider a handful of factors when deciding whether to buy or lease.

How will the Tax Cuts and Jobs Act affect business equipment financing? “Initially it will be a balancing act between 100% depreciation and the interest expense disallowance,” says Will Perry, President, Regions Equipment Finance. Before making decisions, Perry says, companies will have to consider their income, access to liquidity, current debt load and whether they’re public or private.

The most relevant tax code changes include the following:

- **100% first-year expensing** (bonus depreciation) in 2018 and beyond, decreasing 20% each year from 2023 until its elimination in 2027.

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- **Limit of 30% interest expense deductibility** on debt based on earnings before interest, taxes, depreciation and amortization (EBITDA), or net earnings. This will shift to 30% of the more restrictive EBIT in 2022, which doesn’t include depreciation and amortization.

Companies with lower EBITDA and high debt may be affected most because limits on interest expense deductibility will make loans more expensive. For instance, manufacturing firms with high fixed costs and lower EBITDA may find it more tax efficient to shift ownership to a third-party lessor instead of purchasing equipment outright.

- **Net operating losses (NOLs)**, which are taken when a company’s tax deductions are greater than its taxable income, are restricted to 80% of taxable income and can be carried

forward indefinitely. Previously, NOLs could be applied 100% to the two previous years or carried forward for up to 20 years.

An equipment finance group can assist companies in monetizing unexpired NOLs via a sale leaseback, resulting in cash to their bottom line. Shifting asset ownership can result in lower lease payments—which in turn preserves cash, because the lessor can take 100% depreciation on used assets—and tax efficiency, as the lease stream is not subject to the interest expense calculation.

Regions Equipment Finance has run dozens of scenarios on the impact of the new tax code. But the bottom line? “It’s ultimately going to boil down to each company’s individual situation and how they measure success,” Perry says. ▲

BUSAKORN PONGARNIT/GETTY IMAGES

COVER: ED DARACK/GETTY IMAGES

Liquidity and Debt: Finding the Right Balance

Keeping a handle on debt, cash flow and liquidity risk can be essential to keeping your enterprise afloat.

Managing short- and long-term debt while maintaining liquidity is perhaps the most important part of a corporate treasurer's job.

Below are tips to help create a cash and liquidity risk strategy that works for your company.

Adopt the right mindset

The risk of nonpayment from suppliers, covenants on loans and unstable markets can pose challenges to a business.

It's essential to understand the difference between cash management and liquidity management in order to manage debt or excess cash to maintain appropriate liquidity positioning. "Cash management is your 'payment and receivables' function," says Jason T. Sweatt, CTP, Senior Vice President and Liquidity and Deposits Manager at Regions Bank.

In contrast, proper liquidity management ensures that a company has enough liquidity from

receivables, cash or borrowing capacity to pay bills.

Build your tech toolkit

"To manage both cash and liquidity risk, you must have good reporting," Sweatt says. That means knowing the location of your company's cash, so you can plan to pay your bills.

For a small business, online banking, accounting tech and cash flow forecasting software can foster good reporting. Bigger companies typically need an enterprise resource planning (ERP) system for accounting.

These larger enterprises need sophisticated banking tools like real-time money reporting, in addition to using advanced fraud-prevention services.

Minimize cash and liquidity risk

Take stock of your cash flow and liquidity frequently, so you can prevent problems. Are there any clients at risk of not paying you? Is there a chance you won't be able to make payroll or pay an unexpected bill? "It gets back to understanding

what the actual risks are in your business," says Sweatt.

Plan for market fluctuations

In case of an unexpected crisis, such as a large invoice, make sure you have enough cash on hand to run the business. Avoid market risk altogether on these emergency funds.

A business line of credit can also be an important source of funds in case of an emergency. "Even large corporations ensure access to liquidity, such as a line of credit," Sweatt says. "They may not have drawn on that line in years, but they have it just in case." For any reserves you have invested, put a written investment policy in place, Sweatt says, to help prevent sudden or emotional reactions to changes in market conditions.

Keep learning

Ask your banker about products that can optimize your credit line use. Some can automatically ensure that you have enough cash in your account on any given day, so you aren't unnecessarily incurring interest. ▲



Thriving Amid a Sea of Change

Change is inevitable. It may bring growth or new challenges, but if navigated successfully, it can also sharpen our skills and open up new opportunities.

The Spring issue of Private Wealth *Insights* takes a look at the myriad changes you may be facing.

Investors looking for new investment opportunities can read up on the potential of technology-augmented farming and on how the new tax code may affect their portfolios. Business owners can find tips for smoothly transitioning into new leadership roles, and learn what tax reform could mean for their short- and long-term strategies. There are even thoughtful examinations of the salient issues for those entering retirement or experiencing divorce.

For all of these changes, this issue provides perspective on how they can impact our personal goals and finances, and how to adjust to get the most out of them.

Regions Commercial Bankers and your Wealth Advisor can help you find ways to keep your financial plan aligned with your goals, no matter what changes may come your way. Look for the Spring issue of Private Wealth *Insights* at regions.com/insightsmag

DANIEL GRIZEL/GETTY IMAGES

Understanding Blockchain

You may only know blockchain as one of this decade's great financial buzzwords. But blockchain is far more than that. It's a type of distributed ledger system, which means that it allows for a transaction verification without the need of a clearinghouse or a centralized source for data.

While originally developed for the digital currency bitcoin, blockchain has potential applications across many industries, including financial services, real estate and health care. Plus, since the technology is difficult to compromise, it's ideal for preventing fraud to the ledger and maintaining data accuracy. While the ledger is hard to hack, that does not mean the transactions on either end cannot be the victims of cyber thefts.

WHAT IS BLOCKCHAIN?

It's a type of distributed ledger that verifies transactions using a peer-to-peer network, rather than a centralized authority.



Money transfer is requested.



Peer-to-peer computers (known as nodes) are alerted.



Each node validates the transaction using the same algorithms.



This is recorded as a "block," added to the chain of previous transactions.



The chain is virtually unalterable, providing security to the ledger.



The transaction is complete.

WHO IS ALREADY USING BLOCKCHAIN?

21.5M

Individual users owned 21.5M blockchain wallets by the end of 2017.

69%

Approximately 69% of banks are experimenting with blockchain technology.

SAVE BILLIONS

By 2025, blockchain could save investment banks billions annually.

WHAT INDUSTRIES MIGHT USE BLOCKCHAIN?

Blockchain technology could have a profound effect in a variety of sectors, including:



INSURANCE:

Offering transparency and ease of filing claims



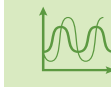
LEGAL:

Allowing for securing and verifying documents



FOOD DISTRIBUTION:

Providing an accurate and more transparent chain of provenance



STOCK TRADING:

Reducing the middlemen (and fees) in trades



HEALTH CARE:

Improving recordkeeping and data security



REAL ESTATE:

Improving asset verification with faster transaction times



FINANCE:

Enabling faster, possibly less expensive transactions with more security

Sources: Harvard Business Review, The Ian Martin Group, Federal Reserve Bank of Chicago, Bloomberg, Deloitte, iQ by Intel, Statista, Infosys, Accenture



Marketing and Growth: Making the Connection

Marketing is essential to future growth. And with new technology, it's easier to see if—and how—it's working.

Marketers have spent recent years under the measurement microscope. Without clear—and fast—results, marketing programs may find themselves under scrutiny. The Gartner CMO Spend Survey 2017–18 reported a drop in marketing budgets after three years of growth. Budgets went from 12.1% of company revenue in 2016 to 11.3% in 2017. The reason? Lack of focus on capturing marketing's goals and the inability to link it to marketing metrics, according to Gartner experts.

The bottom line, however, is that marketing is an essential part of your business growth plan. So how will you quantify the right returns for your own efforts? Is your marketing program the right one for your business goals?

For best practices and insights into crafting a proven approach that tracks the power of your marketing strategy and spend, we turned to Michele Elrod, Executive Vice President and Head of Marketing at Regions Bank. In her work with commercial businesses and companies of all sizes since joining Regions in 2006, she and her team have learned what works and what doesn't when it comes to quantifying the value of marketing.

Many business owners find it challenging to prove that their marketing plans are working over time. How do you advise business leaders on what to measure as they think about short-term versus long-term marketing goals?

It doesn't happen overnight. Short-term views are campaign-oriented and have tactics with direct results, whether it be email, mail or digital, with control groups that you can benchmark. They can have interim measurement and constant test-and-learn strategies, where you're constantly changing as a result.

The long-term view is attribution, where you take the continuous building of data to understand production, marketing and the correlation among all three. Then you build the models

to understand how each medium or channel is performing.

In a 24/7 world where the most precious commodity for any marketer is their target audience's time and attention, how do you recommend business owners break through with marketing?

We actually think the message is more important than the medium. We can adjust the mediums, but we need to do a lot of research and understanding from a customer's point of view and a prospect's point of view about the message. And we need to understand how that message plays out in the customer journey.

So we think it's understanding your consumer, following the voice of the consumer or prospect, continuously testing and learning, even with the messaging, and making sure you understand if it resonates.

What are the key performance indicators (KPIs) you've found most relevant to measuring a business' marketing accomplishment and track record, in both digital and traditional nondigital channels?

Any company should understand what it takes to produce a widget, what the value of that widget is to them. And then you should look at your marketing costs to sell that widget. As a company, you have to decide what return you expect from your marketing, and set those as your KPIs and desired outcomes.

What lessons have you learned through your own marketing measurement KPI efforts to get to your own best practices?

All of our direct marketing pays back in less than 12 months. And we measure that. We measure cost per account. We measure one-year revenue produced as a result of the incremental accounts that we generate. We measure five-year revenue as a result of the incremental accounts that we generate. And we measure year over year, and trend quarter over quarter. We look at it on a monthly basis, so we can make adjustments if we need to. In addition, we have a bigger

picture of attribution metrics—what role does each medium or channel play in producing results? Eventually, when you are operating in real-time marketing, campaign measurements and control groups will not accurately reflect the contribution of individual mediums or internal channels, and having attribution modeling in place will be necessary.

With so much data pouring in, it's easy to become overwhelmed. What would you recommend business owners and marketers do to start to use data better and smarter in their marketing measurement efforts?

You can have paralysis from too much data. So first thing, decide what it is you

want to achieve with your marketing. Just pick one result. If it's sales of a certain product, then that's your KPI. Did your sales increase year over year, month over month? Did you acquire those widgets for a cost per account or cost per widget that was acceptable? Do you know what it costs you, so now you know what you're spending to get it? ▲

Speak to your Regions Commercial Banker about:

- Developing strategic plans that meet your business goals
- Guidance for properly implementing strategic plans
- Crafting a capital management strategy for expansion

Marketing Makeup

The role of CMO as technologist has become as important as the marketing aspect," says Michele Elrod, Executive Vice President and Head of Marketing at Regions Bank.

From automation to infrastructure and reporting, technology solutions are extremely valuable for marketers. Here are four steps for making the most of technology.

1 Map your journey. No matter the size of your business or your industry, everyone needs a road map—and getting it right takes time. "We've spent the last five years improving our marketing technology stack," Elrod says. "Each company needs to understand what the road map is for their technology."

2 Build your database. A robust customer database is priceless when it comes to understanding the wants and needs of both customers and prospects. But simply collecting information isn't enough. "You have to have the tools on top of that database to access it," Elrod says. Tools can help you automate campaign reporting in real time and give more internal staff access to reporting results so they can evolve their strategies.

3 Find great partners. Technology and data vendors can customize solutions so that you're getting the data you need, when you need it. For Regions, this means that when a customer calls the contact center, the customer service representative knows what's important to them at that exact point, and has a way to respond.

4 Consider how you're organized. You may need to tweak teams and processes to integrate technology at every level. But getting technology right means helping everyone shift their mindset to a tech-first approach. Elrod says: "The expectation is driven home that all people use research and input to drive development, whether that's development of an initiative or of a message."

ANALYZING THE NEW TAX CODE

Recent tax reforms have the potential to impact every aspect of your business. Here are a few key elements to focus on.

On Dec. 20, 2017, Congress approved a sweeping \$1.5 trillion tax bill that changed tax rates for corporations, provided new breaks for private businesses and reorganized the individual tax code. The reform was the biggest overhaul of the U.S. tax system since 1986. For owners of small- and medium-size businesses, it was cause for celebration—mixed, perhaps, with a certain amount of head-scratching.

Many benefits for businesses were immediately apparent. The federal corporate tax rate dropped from 35% to 21%. There's a new 20% deduction for pass-through income. And rates for many taxpayers decreased, potentially benefiting business owners and employees alike.

But some changes are not so advantageous. For example, under the new law many deductions have been reduced or eliminated. Other changes are buried deep in the tax code, or hold implications that won't be fully understood until a period of trial and error has passed. As Daniel Hoverman, Managing Director of Regions Securities, says, "The new tax bill has a lot of nice, shiny perks for businesses. But it's not a cohesive act of regulation."

To get a handle on this monster of a bill, it helps to identify the most significant changes for small- and medium-size businesses.

The New Pass-Through Deduction

Fully 95% of U.S. businesses are so-called pass-through entities, according to 2014 Treasury Department data. These companies include most of those organized as sole proprietorships, S corporations, LLCs and partnerships, and their profits are taxed according to the owners' personal rate. Under the new tax plan, their owners can deduct 20% of pass-through income, providing they meet certain requirements. Consequently, the maximum individual tax rate on pass-through income decreases from 37% to 29.6%.

"That leaves a lot of extra cash for business owners to invest in new employees, higher salaries, more benefits and equipment upgrades," says Hoverman.

There are some limitations to the new deduction rule, though. "The biggest winners are smaller sole proprietorships and employee-driven businesses of all sizes," says Robert Ricketts, a professor of accounting at Texas Tech University's Rawls College of Business. That's

because the full 20% deduction is available only to single taxpayers with an income of \$157,000 or less, and to married couples with a joint income of \$315,000 or less. For businesses that bring in more money than that, eligibility—and the amount of the deduction—depends on a combination of income level and the type of business you own. Legislators tried to favor job creators, so businesses with W-2 wages or assets are generally better positioned for a pass-through deduction. The rules are complicated, though, so make sure to consult a professional.

The New Corporate Tax Rate

Under the new tax law, the corporate tax rate on profits plunges from 35% to 21%. On the one hand, it opens up opportunities for growth for all C corporations. On the other hand, the 20% pass-through deduction—combined with other changes for pass-through businesses—gives many pass-

through businesses greater net tax benefits. Accordingly, some companies may want to consider restructuring.

“It will be interesting to see how this plays out,” says Hoverman. “A lot of it depends on how long you plan to keep money in the corporate entity.”

Time horizon is key here because, while the corporate rate cut is permanent, the pass-through deductions phase out in 2025 (barring further changes to the law). If you’re unsure about which business structure is most advantageous, says Hoverman, be sure to model out various scenarios with a financial professional.

Property Savings

The number 179 is important to remember. That’s because Section 179 of the tax code has significantly changed under the new law. Before, businesses could deduct up to \$500,000 of equipment. The new Section 179 law ups that limit to \$1 million. For businesses with

“The biggest winners are smaller sole proprietorships and employee-driven businesses of all sizes.”

ROBERT RICKETTS, Professor of Accounting, Texas Tech University, Rawls College of Business

large, expensive equipment, these deductions could result in substantial savings that could lead to expansion.

Even more significant—at least for the next five years—may be new bonus depreciation provisions. Under the new law, businesses can take 100% bonus depreciation—with no one-dollar cap—on qualified property bought between Sept. 17, 2017, and Jan. 1, 2023, after which the provision will be phased out. Moreover, bonus depreciation can now be used for both used and new property.

“For most purchases made until 2023, bonus depreciation will save more money than Section 179,” says Ricketts. “Let’s say I pay 20% down on a machine for my business and finance the rest of it. With bonus depreciation, there’s a good chance my immediate tax benefits will exceed the down payment. That positive cash flow in the year I make the purchase should provide a huge incentive to expand.”

Ricketts notes that the cap in Section 179 necessarily limits the benefit—\$1,000,000 is the



In addition to many businesses being cautious about incurring leverage, he says, some business owners may be more tempted to sell equity in their companies rather than creating financial leverage in traditional debt-driven buyout transactions.

Other Considerations

Other changes to the tax law are more specific and will affect fewer companies. For example, some benefits are targeted toward farmers, while others are aimed at other industries. And businesses with profits overseas will face a territorial tax system with potentially higher rates than they currently pay. Manufacturers with plants in Mexico, for example, likely have to pay more under the new rules.

Discovering the nooks and crannies of the tax code that affect your business is a hard but necessary task. Work with financial and tax professionals to determine how best to position your business with regard to the new regulations. And with much of the law phasing out in a few years, be sure to have both a short- and a long-term plan.

“This is a work in progress for most businesses,” says Hoverman. “Lawyers and accountants are scrambling to figure out just what the new law will mean. But no one will know until a tax year or two has gone by.” Until then, he says, take advantage of the clear benefits and try to minimize any drawbacks. ▲

“Lawyers and accountants are scrambling to figure out just what the new tax law will mean.”

DANIEL HOVERMAN, Managing Director, Regions Securities

An even more consequential change could be new rules about the deductibility of interest on debt payments. Previously, businesses could deduct any and all interest on debt; but starting this year, a business can only deduct interest on debt up to 30% of its EBITDA—that is, its earnings before interest, taxes, depreciation and amortization. And in 2022, it will be capped at 30% of earnings before interest and taxes but after depreciation and amortization—resulting in smaller deductions.

“For a long time, financing with debt has been worthwhile for businesses because the interest deduction shields that cash flow from tax,” says Hoverman. “Now a lot of companies are going to ask: If you can’t deduct the interest, why have it in the first place?”

maximum deduction. But with bonus depreciation, there is no cap, so it has the potential to save much more money.

The bottom line? Both the revised Section 179 and the new bonus depreciation rules will allow small and midsize companies to make more purchases and save money doing it.

Changes to Certain Deductions

The new tax law isn’t all good news, however. The elimination of certain individual tax deductions include business expenses like travel costs and membership dues for professional organizations. And the deductibility of state and local taxes is now limited to \$10,000.

Does the New Tax Law Change How Business Owners Save for Retirement?



Some business owners would do well to reconsider their retirement savings plans in the face of last year’s tax reform. With lower tax rates and the potential to deduct more income, some could find their current tax rate to be lower than the regular income rate at which future IRA withdrawals would be taxed. For these people, investing in Roth IRAs could make sense.

One change brought into play by the new tax law, however: Investors can no longer recharacterize a Roth IRA conversion. Under the old law, anyone who converted to a Roth IRA could undo the conversion before October 15 of the following year, thereby generating lower tax liability in

some situations. Now, converting to a Roth IRA won’t make sense under as many circumstances as before, and business owners will have to look closely at their finances to see if it will benefit them.

For those without a retirement plan, the pass-through deduction income limits could provide the incentive to set one up. That’s because contributing to a SEP, SIMPLE or 401(k) could bring the taxable income of some people below those thresholds. With savings exposed to growth in a retirement plan and a 20% pass-through deduction limiting tax liability, this scenario is a win-win for entrepreneurs.

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Sectors to Watch in the New Tax Landscape

Regions strategists and analysts have studied the new tax code and its ramifications to identify sectors that may hold promise for investors.

The Tax Cuts and Jobs Act (TCJA) passed largely based on its promise to boost the bottom line for U.S. corporations and consumers. But things could end up looking pretty good for investors, too.

Some sectors might be better positioned to benefit from the new tax landscape than others are, says Fran Allen Smitherman, Director of Equity Research at Regions Investment Management. “We are the most positive on companies and sectors that do the majority of their business in the United States,” she says.

“Globally, the United States has been one of the least competitive countries, in terms of corporate tax rates,” adds Chris Watson, Director of Value Strategies and Portfolio Manager for the Regions Investment Management equity team. “The new tax rate is impacting domestic corporations and putting them on more even footing with competitors based overseas.”

All Eyes on the Consumer

The TCJA’s new corporate tax ceiling of 21%—the previous cap was 35%—favors U.S.-based companies with high domestic earnings, says Smitherman.



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She and Watson tend to be bullish on businesses driven by U.S. consumers, which include retail, entertainment, travel, home construction and home supply companies.

“With about 90% of taxpayers expected to receive a higher paycheck, we think that will help the consumer discretionary sectors from a spending standpoint as well,” Smitherman says.

The TCJA’s cuts to mortgage interest deductions caused jitters in the real estate market. But Smitherman believes that the new law, which caps interest deductions on new mortgages at \$750,000, won’t affect most first-time home buyers. “We’re more focused on the millennial generation moving into the housing market and spending on home improvement. Home builders are focusing on a younger generation that has yet to buy their first home. That’s where we’re hoping to see the tailwind.”

Wide-Ranging Impact

But those poised to benefit aren’t limited to just the consumer discretionary sectors. The TCJA is also likely to be a boon for financial, telecom and travel companies, which have traditionally contended with high tax rates.

Health-care companies could also do well in the new tax regime, including managed care and hospitals. “There’s a great deal of optimism right now,” says

Smitherman. “I believe it has to do with the benefits we’ll see from tax reform.”

The Good News Isn’t Universal

Not every sector stands to reap rewards in the new reforms, however. “We’re a little more cautious on utilities,” says Smitherman, in part because many of them may have to pass any tax cuts on to customers through lower rates.

Companies with strong international holdings, including many major pharmaceutical firms and certain technology companies, also stand to see fewer benefits from the TCJA. The law’s repatriation provision, however, allows firms with offshore holdings to bring

their cash to the United States at a one-time 15.5% tax rate—something many blue-chip tech companies are expected to take advantage of.

“It’s a positive thing,” says Watson. “We’ve talked for years about how many of these companies have cash trapped overseas. But the repatriation of cash really frees things up. Some of these companies are talking about doing things that could be very good for the U.S. economy now that this cash is unlocked.”

Portfolio Positioning

The new tax cuts won’t necessarily change the markets, but they may well serve as a catalyst for growth for some companies. At Regions, Smitherman and

Watson look first and foremost to invest in companies with attractive valuations, solid fundamentals, good balance sheets and good management teams to add to Regions’ portfolio model, so managers can act accordingly. ▲

Speak to your Regions Commercial Banker about:

- Whether your portfolio has exposure to sectors that might be poised for growth
- Your current asset allocation—and whether market volatility keeps you up at night
- If the new tax landscape means you should make changes to your financial strategy

Long-Term Light Amid Short-Term Volatility

Think the market is overvalued? Just wait until the tax cuts and bank deregulation kick in.

While modeling the impact of tax reform on markets can be tough, Chris Watson, Director of Value Strategies and Portfolio Manager for the Regions Investment Management equity team, says the increased earnings created by the tax cuts—with some companies projecting earnings-per-share increases of as much as 10%—may stabilize what a number of investors worry is an inflated market. Those concerns have been on display since February’s sharp sell-off in the markets.

“There’s been some talk of valuations that were starting to look a little rich,” Watson says. “Well, when you add 10% to that earnings number, those valuation metrics don’t look quite as rich. That gives you room to grow.”

Watson points to early signs that the cuts are indeed generating growth. “We’ve already seen companies start to announce bonuses. You’re starting to see employee paychecks go up. These changes should flow through the economy.” There’s one more potential multiplier looming in the near future that Watson thinks could strengthen the economy and the markets: deregulation.

“One thing I’m bullish on is bank deregulation. If you combine tax returns—more money in consumer hands—with deregulation and the impact it could possibly have on the financial industry, it really has the potential to unlock a lot of trapped capital that’s out there,” Watson says. “When you get things that are good for the consumer and the economy, the market usually reacts.”



DANIEL HOVERMAN
Managing Director,
Regions Securities

Investing Your Company's Tax Surplus

There are myriad ways to deploy your tax cut cash. The best options depend on your industry, corporate structure and goals.

“

We're seeing more M&A interest, particularly on the strategic level.”

DANIEL HOVERMAN,
Managing Director,
Regions Securities

The Tax Cuts and Jobs Act of 2017 lowers the corporate tax rate to 21%. That's significant for companies that had been paying the full corporate tax rate of 35%. Perhaps the most difficult question is figuring out what to do with the windfall:

- Share buybacks and dividend hikes
- Deleveraging or paying down debt
- Sharing it with employees
- Expansion through hiring
- Capital spending on equipment
- Acquiring or merging with another firm

BILLIONS IN BUYBACKS

According to a Morgan Stanley survey, the most popular choice for using tax cut money has been share buybacks and dividends. Mergers and acquisitions are also popular, as are capital investments and employee bonuses and raises.

“A lot of clients are using the money to pay down debt at least while they figure out what to do with the extra cash,” says Daniel Hoverman, Managing Director, Regions Securities, and an experienced advisor on mergers and acquisitions (M&As).

WILL THE LAW LIMIT LEVERAGE?

“We're also seeing more M&A interest, particularly on the strategic level,” Hoverman says. But Hoverman also expects private equity to be somewhat less aggressive in the long term and for M&A activity to move more toward strategic buyers.

The reason lies in the tax law's reduction of interest deductibility on M&A to 30% of EBITDA (earnings before interest, taxes, depreciation and amortization). By 2022, the law further winnows the deduction to 30% of the earnings before interest and taxes (EBIT) only. These tighter limits on interest tax deductibility will make debt-financed mergers more costly.

BENEFITS FOR ENERGY, RETAIL AND FINANCIAL FIRMS

Industries most likely to benefit from lower tax rates are those where companies have paid the full 35% corporate tax rate. Other industries likely to benefit include those that don't receive significant R&D credits.

According to Hoverman, those parameters mean companies most likely to benefit from the tax cut include energy companies, retailers and financial services companies, including banks and asset management firms.

HELPING TO RESOLVE UNCERTAINTIES AND UNKNOWN

“Tax reform wasn't adopted as part of a more thoughtful, cohesive framework, and how the law is applied to some areas isn't clear,” Hoverman says.

Individually owned businesses are considering their optimal corporate structure to best take advantage of lower pass-through tax rates, Hoverman says.

S corporations and LLCs are pass-through entities, in which business owners' profits are taxed at their personal income tax rate. The tax reform created new deductions that may help shield some of this income from the rates applicable to personal income. But C corporations, which are entities separately taxed from their owners, will receive the permanent reduction in corporate tax rate from 35% to 21%.

“Based on previous tax changes, we expect a crescendo of activity to build up before the IRS makes rule changes that address the most favorable interpretations,” Hoverman says. ▲



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Assisting With Milestones and Transitions

When their two small businesses were in transition, they turned to Regions for investing and estate planning guidance.

When their businesses were in transition, two business owners turned to Regions for investing and estate planning guidance, in addition to the advice they were already receiving as commercial banking clients.

As astute as owners are about their own operations, they may not have much depth in managing their personal investments. And when there's a business transition, business and personal finances often collide.

When a large company approached the owner of a seafood distributor in Orlando, Florida, to buy his business, he knew the offer was too good to pass up.

For the owner, the financial challenge was providing an inheritance for his young son without thwarting his ambitions. “Understandably, he wanted him to build his own career and goals,” says Erik Bonnett, Vice President

and Trust Advisor for Regions Private Wealth Management. After his work with Regions, the client's estate plan now includes an irrevocable trust for his son that, after the client's death, will become a lifetime trust.

In another case, the president of a vinyl products and flooring manufacturing company in northwestern Georgia wanted to transfer the business to his son, explains Jim Halverson, Senior Vice President, Commercial Banking with Regions.

“He knew he had the business succession need, but I think it was overwhelming for him to try to deal with it,” Halverson says.

In addition, the client needed help providing wealth equalization for his other two children, who do not work at his company. With Regions, he developed a road map to help him achieve his objectives. This includes the future transition of his company to his son, through a stock transfer, and an estate plan

“

When there's a business transition, business and personal finances often collide.”

that has been adjusted to ensure equal treatment for all of his children.

LEARNING THE ROPES ON INVESTING

For both Regions clients, what began as commercial banking relationships turned into deeper connections.

For 30 years, the seafood business owner had reinvested his profits into the business and was wary about investing in equities. But after reviewing the client's financial goals and risk profile, the Regions team educated him about balanced investing and split his portfolio between equities and municipal bonds.

Comparatively, the manufacturing company president kept two-thirds of his wealth in cash, according to Kim Churchill, Vice President and Wealth Advisor for Regions Private Wealth Management. Churchill and her colleagues explained that his investment portfolio could withstand more risk—and now his portfolio is balanced between equities and fixed income.

Because of its wealth of resources, Regions was able to help these business owners successfully navigate the complexities of taxes, investing and estate planning that come with any business transition. ▲



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