U.S. Tax Reform to Benefit Beverage, Auto, Refining Sectors

Even before U.S. President Donald Trump signed the Tax Cuts and Jobs Act into law in December 2017, every industry sector had to look at the impending tax overhaul from a personalized business perspective to determine how it was going to impact day-to-day as well as long-term operations. According to February reports from Moody's Investors Service and Fitch Ratings, the latest tax reform is mostly credit positive for several sectors, but still doesn't rid them of all woes.

Large beverage companies based in the U.S., such as Coca-Cola Company and PepsiCo Inc., are among those that will benefit from the reform. Recently, Moody's reported, both companies have experienced increases in their gross debt/EBITDA as a result of borrowing to fund shareholder returns and additional cash needs. With billions in cash overseas, the tax overhaul allows both beverage companies to bring this cash home without tax cost, therefore, adding hundreds of millions of dollars to their free cash flow every year.

Despite the obvious and substantial benefit, Moody's said a plausible outcome facing the companies will require them to use this cash to "boost shareholder returns" as a means to improve earnings per share through stock buybacks. Other options for cash use include large share repurchases, large dividend increases or special dividends.

"Any change to their credit profile will depend upon their financial policy decisions," Moody's Senior Vice President Linda Montag said in the report. "Incorporated into current ratings for both companies is the expectation of applying repatriated cash towards debt reduction, and so while leveraging freed-up cash to reduce debt won't result in positive ratings movement for either company, failure to use cash to repay debt could have a negative ratings impact."

In the automotive sector, the majority of U.S. parts suppliers will also see positive impacts thanks to their own modest leverage profiles, capital intensive nature and high effective tax rates. This is generally seen in large Moody's Baa- or Ba-rated suppliers to original equipment manufacturer (OEM), such as Lear Corporation, Tenneco Inc. and Goodyear Tire and Rubber Company.

Moody's Analyst Inna Bodeck explained in another report that the new interest deductibility cap—30 % of EBITDA—will potentially affect 16 of the 37 auto suppliers rated by the credit rating agency. Meanwhile, the reduced corporate tax rate and ability to immediately write off 100% of capital spending over the next four years will only put half of those 16 auto suppliers at risk of being "worse off." The cap on interest deductibility will change from 30% EBITDA to 30% EBIT in 2022, but will have a significant reduction on the number of suppliers that benefit under the tax law.

"We [also] suspect that U.S. auto suppliers will continue to reinvest a significant portion of foreign earnings in those local markets," said one of the report's authors, Harold Steiner, "while some high yield suppliers will be able to use the repatriated cash to pay down debt and use it for investment opportunities."

Earnings from the fourth quarter of 2017 have already shown benefits to the refining sector, said Fitch Ratings, which predicts more boosted earnings from the lowered statutory tax rate this year. Unlike exploration and production (E&P) companies, the refining sector will reap the tax law benefits due to its prior practice of paying cash tax.

Increased tax-related cash flows might also be partially used to help support refiner distribution politics, Fitch reported.

—Andrew Michaels, editorial associate