UBS

Global Research

March 2017

UBS Quants Conference

Fundamental equity analytics

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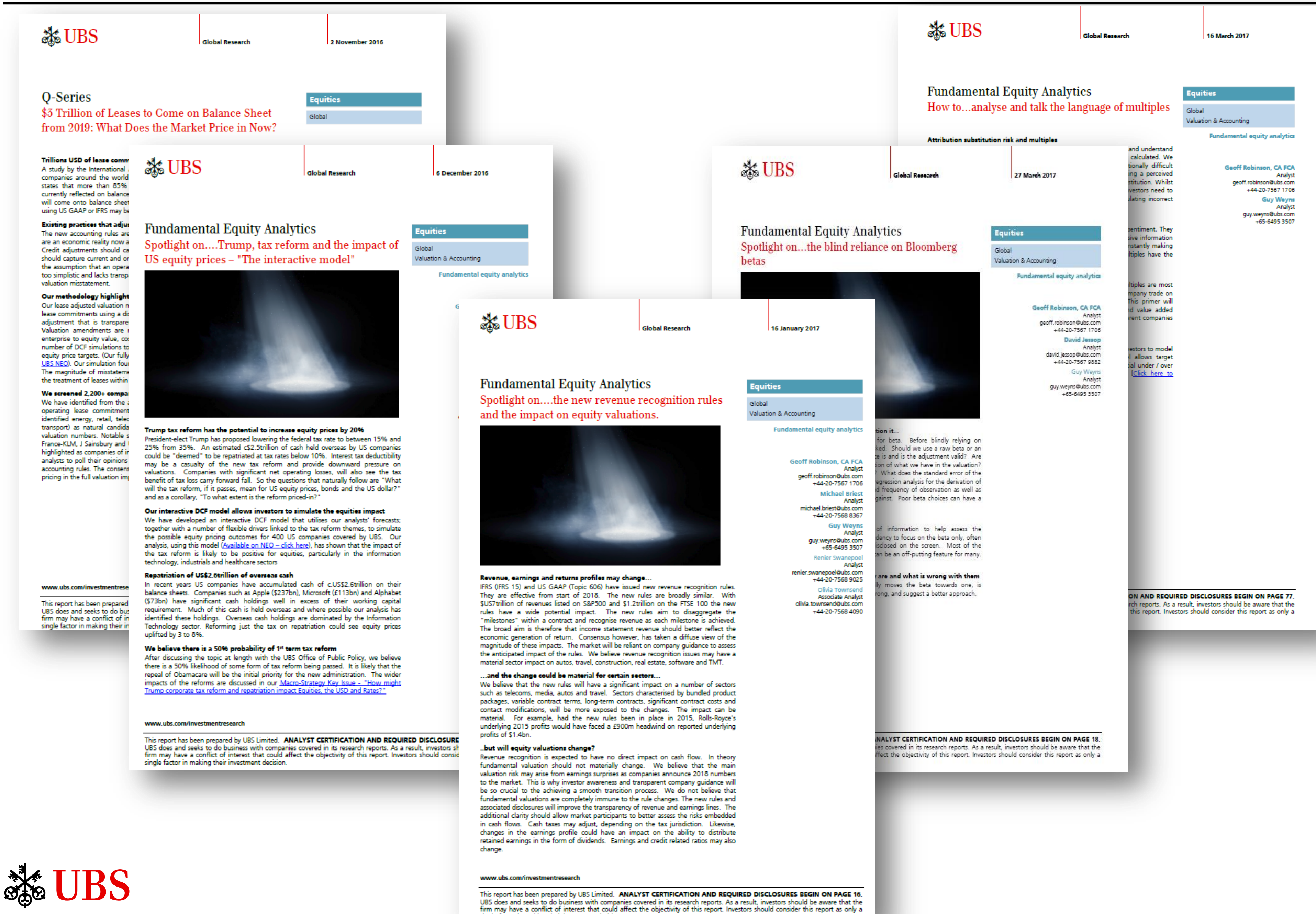
Fundamental Equity Analytics



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Section 1

Q Series – How could US border tax adjustment reform impact equity prices?

UBS

UBS | Global Research | 8 February 2017

Q-Series

How could US border tax adjustment reform impact equity prices?

Equities

Global
Valuation & Accounting

Fundamental equity analytics

Border tax adjustment reform could potentially disrupt global value chains

If border tax reform becomes effective it will shift the pricing balance of goods and services entering and leaving the US. This is not just a US company issue – it is a global value chain issue. The pricing impact is complicated by the ability of companies to absorb or pass on the tax reform pricing impacts to customers as well as by the potential foreign exchange reaction. Both factors can mitigate or amplify the valuation impacts of the reform. The proposed border tax adjustment reform will increase costs faced by import-reliant US companies (semi & semi hardware, tech hardware, autos, consumer durables & apparel and capital goods). The border reform may benefit US export-reliant companies in the form a border tax rebate.

Stormy waters ahead before the legislation becomes effective

We believe that the present form of the border tax adjustment legislation has a low probability of being passed into law by Congress and being World Trade Organisation ("WTO") compliant. Reaction to non-compliance may lead to clashes with the WTO and/or a need to restructure the tax reform proposals. From a currency perspective, we think the introduction of BAT will likely lead to a stronger USD, perhaps to the tune of 4-5%.

Assessing the impact on individual companies not a naïve exercise

The proposed tax reform could have implications for costs of goods sold, tax rebates for exports, interest deductibility and cost of capital (tax shield). In addition, macro feedback loops from FX moves and inflation do complicate the exercise over the medium term. Our model allows users to flex all these key variables to gauge the impact of tax reform on the equity value of 500 stocks across our coverage universe. A fully interactive model is available for download. Click here for access

Individual companies impact analysis (US, EMEA and APAC)

Import-reliant US companies (such as Ralph Lauren, Best Buy, Hershey, Under Armour) are vulnerable to border tax reform. Conversely, export-reliant US companies (such as General Electric, Coca Cola, Boston Scientific) may benefit from the reform. The implications of these reforms are not confined to US companies. International companies (such as Shire, Compass, Wolseley, ASE, HTC) that export to the US could be affected by an import border tax. We have adopted a bottom-up approach in our assessment. However, as we have highlighted, second-degree impacts such as foreign-exchange movements can complicate the view.

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Q Series – How could US border tax adjustment reform impact equity prices?

- It has been an interesting week…
- House GOP health bill collapse
  - Obamacare repeal – after seven years of preparation
  - Illustrates how it is hard to rewrite legislation
  - Tax impact of the repeal of Obamacare
- Little choice but to move on to tax reform
  - Tax reform is a key economic growth driver for the US (election pledge)
  - Issues:
    - Cutting taxes and increasing government debt (budget neutrality)
    - Tax break elimination – push back
    - Border tax adjustment (dollar injection into the tax coffers)
    - Freedom Caucus – politically could be harder to get tax reform through

Q Series – How could US border tax adjustment reform impact equity prices?

Main points

- Tax reform overview
  - Simplified code (cash-based)
  - Lower marginal tax rates (effective rates)
  - Cash repatriation
  - Repeal of "temporary" interest deductibility
  - Border tax reform
- Creates uncertainty
  - What has been priced in?
  - What happens if?
  - Fundamental reaction

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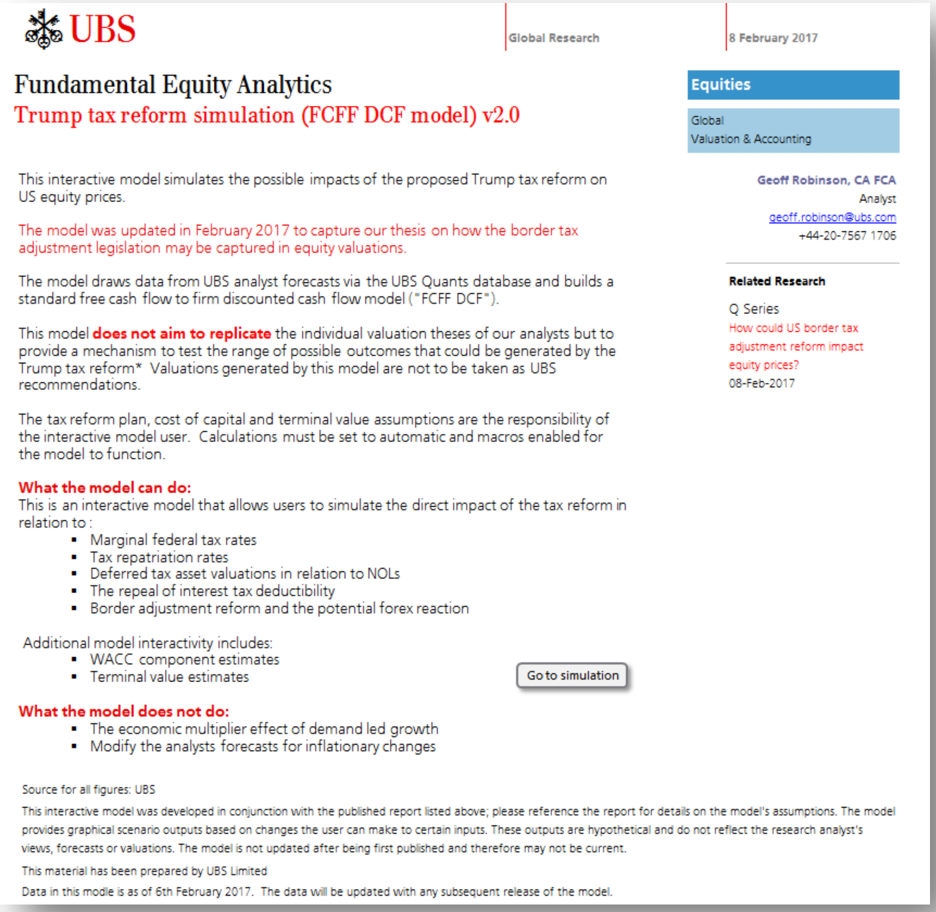
Source: UBS

Q Series – How could US border tax adjustment reform impact equity prices?

Valuation implications

- Lower tax rates
- Cash repatriated
- Import border tax charge
  - Impact of pricing
  - Volume implications
  - Dollar appreciation
- Export border tax rebate
  - Benefit passed on
  - Demand impact

Trump tax reform simulation



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Fundamental Equity Analytics

Trump tax reform simulation (FCFF DCF model) v2.0

Equities

Global
Valuation & Accounting

This interactive model simulates the possible impacts of the proposed Trump tax reform on US equity prices.

The model was updated in February 2017 to capture our thesis on how the border tax adjustment legislation may be captured in equity valuations.

The model draws data from UBS analyst forecasts via the UBS Quants database and builds a standard free cash flow to firm discounted cash flow model ("FCFF DCF").

This model **does not aim to replicate** the individual valuation theses of our analysts but to provide a mechanism to test the range of possible outcomes that could be generated by the Trump tax reform* Valuations generated by this model are not to be taken as UBS recommendations.

The tax reform plan, cost of capital and terminal value assumptions are the responsibility of the interactive model user. Calculations must be set to automatic and macros enabled for the model to function.

What the model can do:
This is an interactive model that allows users to simulate the direct impact of the tax reform in relation to :

- Marginal federal tax rates
- Tax repatriation rates
- Deferred tax asset valuations in relation to NOLs
- The repeal of interest tax deductibility
- Border adjustment reform and the potential forex reaction

Additional model interactivity includes:

- WACC component estimates
- Terminal value estimates

Go to simulation

What the model does not do:

- The economic multiplier effect of demand led growth
- Modify the analysts forecasts for inflationary changes

Source for all figures: UBS

This interactive model was developed in conjunction with the published report listed above; please reference the report for details on the model's assumptions. The model provides graphical scenario outputs based on changes the user can make to certain inputs. These outputs are hypothetical and do not reflect the research analyst's views, forecasts or valuations. The model is not updated after being first published and therefore may not be current.

This material has been prepared by UBS Limited

Data in this modle is as of 6th February 2017. The data will be updated with any subsequent release of the model.

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Related Research

Q Series
How could US border tax adjustment reform impact equity prices?
08-Feb-2017

Source: UBS

Q Series – How could US border tax adjustment reform impact equity prices?

UBS

Version 2.0 February 2017

Geoff Robinson, CA FCA - geoff.robinson@ubs.com

Trump tax reform simulation for Apple Inc.

Reset inputs

○ Sectors
◉ Companies

Filter companies by sector: ALL SECTORS

1. Company search

- Ameren Corp.
- American Eagle Outfitters Inc.
- American Electric Power, Inc.
- American Midstream Partners LP
- American Tower Corporation
- Amerigas Partners LP
- AMN Healthcare Services
- Analog Devices Inc.
- Anthem Inc.
- Apple Inc.
- Applied Materials Inc.
- Arista Networks Inc
- Ashford Hospitality Trust
- Ashland Global Holdings Inc
- AT&T Inc.
- athenahealth Inc
- Atkore International Group Inc
- Atmos Energy Corp
- Autodesk Inc.
- AutoZone Inc.
- Avista Corp

Bridge analysis presentation: % of total

		flex
2. Lower marginal federal tax rates		
Post-tax reform blended effective cash tax rates *	25.0%	
3. Cash repatriation		
a. How much of total cash is held overseas? **	80.0%	
b. What will the tax rate on overseas cash repatriation be?	8.5%	
c. What multiple could repatriated cash generate?	1.0x	
4. Border tax adjustments (BTA)		
a. What is the border tax adjustment rate?	25.0%	
b. Apply border tax adjustment reform to the model?***	☑ Yes	
c. What percentage of revenues wil be exported?	30.0%	
d. What percentage of costs of sales wil be imported?	60.0%	
e. How much of import BTA passed on to customers (higher prices)?	15.0%	
f. How much of export BTA passed on to customers (lower prices)?	25.0%	
5. Dollar currency reaction to tax reform		
Demand elasticity to forex movement (impact on revenues)	5.0%	
Dollar appreciation (depreciation) impact on imported cost base	(3.0%)	
6. Stock price output		
Stock price as at 3rd February 2017 (Cell can be overwritten)	129.08	
Simulated net equity impact of tax reform	(5.46)	
Simulated net equity impact of tax reform (% Δ of current stock price)	(4.2%)	

Source: UBS

UBS

Q Series – How could US border tax adjustment reform impact equity prices?

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Simulated net equity impact of tax reform (breakdown)

Per share incr (decr) (tax repatriation)	7.7%
Per share incr (decr) from lower marginal rates of tax	0.3%
Impact on the terminal value	0.2%
Equity value DTA reduction	--
Per share impact of the net export benefit	24.5%
Per share impact of the net import cost	(33.4%)
Per share impact of dollar forex adjustment (revenue)	0.9%
Per share impact of dollar forex adjustment (costs)	(4.7%)
Per share incr (decr) from other long term effects	(0.1%)

Source: UBS

UBS

Section 2

Biography

Geoff Robinson CA FCA

- Fundamental equity analytics @ UBS

- Research:
  – Q-Series – "How could US border reform impact equity prices"
  – Q-Series – "$3 trillion of leases to come on balance sheet from 2019 – What does the market price in now?"
  – "Spotlight on the new revenue recognition rules and the impact on fundamental valuation"

- Previous employment history:
  – LBO investor
  – Consultancy firm partner
  – PriceWaterhouse

- Memberships:
  – Fellow of the Institute of Chartered Accountants in England and Wales (FCA)
  – Member of the Institute of Chartered Accountants in Australia and New Zealand (CA)
  – Chartered member of the Institute of Securities and Investment (Chartered MCSI)

- Publications:
  – The Complete Research Analyst
  – The Complete Investment Banker
  – The Complete Financial Modeller
  – The Investment Banker's Handbook

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Buy	FSR is > 6% above the MRA.	45%	29%
Neutral	FSR is between -6% and 6% of the MRA.	39%	27%
Sell	FSR is > 6% below the MRA.	15%	16%
Short-Term Rating	**Definition**	**Coverage**[3]	**IB Services**[4]
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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