

UBS Quants Conference

Fundamental equity analytics

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Fundamental equity analytics

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Fundamental Equity Analytics



Global Research

2 November 2016

Q-Series

\$3 Trillion of Leases to Come on Balance Sheet from 2019: What Does the Market Price in Now?

Equities

Global

Trillions USD of lease comm
A study by the International companies around the world states that more than 85% currently reflected on balance will come onto balance sheet using US GAAP or IFRS may be

Existing practices that adjust
The new accounting rules are an economic reality now as Credit adjustments should capture current and or the assumption that an operator too simplistic and lacks transparency valuation misstatement.

Our methodology highlights
Our lease adjusted valuation n lease commitments using a discount adjustment that is transparent Valuation amendments are enterprise to equity value, co number of DCF simulations to equity price targets. (Our fully UBS.NEQ). Our simulation four The magnitude of misstatement the treatment of leases within

We screened 2,200+ companies
We have identified from the operating lease commitment identified energy, retail, telecom transport) as natural candidate valuation numbers. Notable France-KLM, J Sainsbury and highlighted as companies of analysts to poll their opinions accounting rules. The consensus pricing in the full valuation impact

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Global Research

6 December 2016

Fundamental Equity Analytics

Spotlight on....Trump, tax reform and the impact of US equity prices - "The interactive model"

Equities

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Valuation & Accounting

Fundamental equity analytics



Trump tax reform has the potential to increase equity prices by 20%
President-elect Trump has proposed lowering the federal tax rate to between 15% and 25% from 35%. An estimated \$2.5 trillion of cash held overseas by US companies could be "deemed" to be repatriated at tax rates below 10%. Interest tax deductibility may be a casualty of the new tax reform and provide downward pressure on valuations. Companies with significant net operating losses, will also see the tax benefit of tax loss carry forward fall. So the questions that naturally follow are "What will the tax reform, if it passes, mean for US equity prices, bonds and the US dollar?" and as a corollary, "To what extent is the reform priced-in?"

Our interactive DCF model allows investors to simulate the equities impact
We have developed an interactive DCF model that utilizes our analysts' forecasts, together with a number of flexible drivers linked to the tax reform themes, to simulate the possible equity pricing outcomes for 400 US companies covered by UBS. Our analysis, using this model ([Available on NEO - click here](#)), has shown that the impact of the tax reform is likely to be positive for equities, particularly in the information technology, industrials and healthcare sectors

Repatriation of US\$2.6 trillion of overseas cash
In recent years US companies have accumulated cash of cUS\$2.6 trillion on their balance sheets. Companies such as Apple (\$237bn), Microsoft (\$113bn) and Alphabet (\$73bn) have significant cash holdings well in excess of their working capital requirement. Much of this cash is held overseas and where possible our analysis has identified these holdings. Overseas cash holdings are dominated by the Information Technology sector. Reforming just the tax on repatriation could see equity prices uplifted by 3 to 8%.

We believe there is a 50% probability of 1st term tax reform
After discussing the topic at length with the UBS Office of Public Policy, we believe there is a 50% likelihood of some form of tax reform being passed. It is likely that the repeal of Obamacare will be the initial priority for the new administration. The wider impacts of the reforms are discussed in our [Macro-Strategy Key Issue - "How might Trump corporate tax reform and repatriation impact Equities: The USD and Rates?"](#)

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Global Research

16 March 2017

Fundamental Equity Analytics

How to...analyse and talk the language of multiples

Equities

Global
Valuation & Accounting

Fundamental equity analytics

Attribution substitution risk and multiples

27 March 2017



Global Research

Fundamental Equity Analytics

Spotlight on...the blind reliance on Bloomberg betas

Equities

Global
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and understand calculated. We tionally difficult ing a perceived situation. Whilst visitors need to ating incorrect

sentiment. They live information instantly making multiples have the

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Global Research

16 January 2017

Fundamental Equity Analytics

Spotlight on....the new revenue recognition rules and the impact on equity valuations.

Equities

Global
Valuation & Accounting

Fundamental equity analytics

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Revenue, earnings and returns profiles may change...
IFRS (IFRS 15) and US GAAP (Topic 606) have issued new revenue recognition rules. They are effective from start of 2018. The new rules are broadly similar. With US\$2.6 trillion of revenues listed on S&P500 and \$1.2 trillion on the FTSE 100 the new rules have a wide potential impact. The new rules aim to disaggregate the "milestones" within a contract and recognise revenue as each milestone is achieved. The broad aim is therefore that income statement revenue should better reflect the economic generation of return. Consensus however, has taken a diffuse view of the magnitude of these impacts. The market will be reliant on company guidance to assess the anticipated impact of the rules. We believe revenue recognition issues may have a material sector impact on autos, travel, construction, real estate, software and TMT.

...and the change could be material for certain sectors...

We believe that the new rules will have a significant impact on a number of sectors such as telecoms, media, autos and travel. Sectors characterised by bundled product packages, variable contract terms, long-term contracts, significant contract costs and contract modifications, will be more exposed to the changes. The impact can be material. For example, had the new rules been in place in 2015, Rolls-Royce's underlying 2015 profits would have faced a £900m headwind on reported underlying profits of \$1.4bn.

...but will equity valuations change?

Revenue recognition is expected to have no direct impact on cash flow. In theory fundamental valuation should not materially change. We believe the main valuation risk may arise from earnings surprises as companies announce 2018 numbers to the market. This is why investor awareness and transparent company guidance will be so crucial to the achieving a smooth transition process. We do not believe that fundamental valuations are completely immune to the rule changes. The new rules and associated disclosures will improve the transparency of revenue and earnings lines. The additional clarity should allow market participants to better assess the risks embedded in cash flows. Cash taxes may adjust, depending on the tax jurisdiction. Likewise, changes in the earnings profile could have an impact on the ability to distribute retained earnings in the form of dividends. Earnings and credit related ratios may also change.

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Section 1

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

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

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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

UBS Global Research 8 February 2017

Fundamental Equity Analytics

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

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

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.

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

Equities

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Valuation & Accounting

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Related Research

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

[Go to simulation](#)

Source: UBS

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



Version 2.0 February 2017

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

Trump tax reform simulation for Apple Inc.

- ☐ 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

Reset inputs

2. Lower marginal federal tax rates

Post-tax reform blended effective cash tax rates *

25.0%

flex

3. Cash repatriation

- a. How much of total cash is held overseas? **
b. What will the tax rate on overseas cash repatriation be?
c. What multiple could repatriated cash generate?

80.0%

8.5%

1.0x

4. Border tax adjustments (BTA)

- a. What is the border tax adjustment rate?
b. Apply border tax adjustment reform to the model?***
c. What percentage of revenues will be exported?
d. What percentage of costs of sales will be imported?
e. How much of import BTA passed on to customers (higher prices)?
f. How much of export BTA passed on to customers (lower prices)?

25.0%

☒ Yes

30.0%

60.0%

15.0%

25.0%

5. Dollar currency reaction to tax reform

- Demand elasticity to forex movement (impact on revenues)
Dollar appreciation (depreciation) impact on imported cost base

5.0%

(3.0%)

6. Stock price output

- Stock price as at 3rd February 2017 (Cell can be overwritten)
Simulated net equity impact of tax reform
Simulated net equity impact of tax reform (% Δ of current stock price)

129.08

(5.46)

(4.2%)

Source: UBS



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

2. Lower marginal federal tax rates
Post-tax reform blended effective cash tax rates * flex

3. Cash repatriation
a. How much of total cash is held overseas? **
b. What will the tax rate on overseas cash repatriation be?
c. What multiple could repatriated cash generate?

4. Border tax adjustments (BTA)
a. What is the border tax adjustment rate?
b. Apply border tax adjustment reform to the model?*** ☒ Yes
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Demand elasticity to forex movement (impact on revenues)
Dollar appreciation (depreciation) impact on imported cost base

6. Stock price output
Stock price as at 3rd February 2017 (Cell can be overwritten)
Simulated net equity impact of tax reform (5.46)
Simulated net equity impact of tax reform (% Δ of current stock price) (4.2%)

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

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"
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 - Consultancy firm partner
 - PriceWaterhouse
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 - 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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12-Month Rating	Definition	Coverage ¹	IB Services ²
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.

KEY DEFINITIONS: **Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS Limited: Geoff Robinson.

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Valuation Method and Risk Statement

This presentation represents UBS's interpretation of the accounting rules (IFRS) and regulations as applied to leasing, revenue recognition and taxes. We have made reference to annual reports to illustrate the treatment of these structures within the financial statements. Such references do not represent an agreement with the disclosed treatments and are used for illustrative purposes only.

The immediate risk in relation to the subject-matter covered by the UBS Fundamental Equity Analytics team, arise from the existence of accounting standard, valuation and modelling techniques that are open to interpretation and application.

At the time of writing, we believe the issues raised in this research to be relevant to investors, but this may change. Additionally, this research should not be read as a complete or definitive account of all relevant issues. Although we attempt to address all significant or nascent issues, these may not always be apparent, and these may change over time.

Finally, this document should not be interpreted to mean that all the issues addressed in our research have a financial impact.

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