

# US Equity and Derivatives Strategy

## Repatriation Redux

### Equity Strategy

#### Americas

#### More (Cash) is Better

In our 2014 series on overseas cash, politics and M&A ([More Money](#), [More M&A](#), [More Politics](#), [More M&A](#), [More M&A – Derailed?](#)) we put forth the idea that in a world of rising uncertainty, rising (albeit slowly) interest rates, highlighted by episodic market volatility, cash becomes increasingly important for investors and corporates alike. Despite two years of zero earnings growth, cash balances continue to climb. This is particularly true of offshore "trapped" cash, estimated to be over \$1.1Trn for the S&P 500 ex-Financials. This offshore cash, were it to be "unlocked" via repatriation, would likely be used to fund growth initiatives (M&A or capex) or shareholder returns in the form of share buybacks (buybacks have begun to outperform once again) and dividends.

#### Politics as Catalyst?

After years of fruitless discussion amid the partisan politics in Washington, repatriation, perhaps as part of broader tax reform and/or fiscal stimulus, appears to be an initiative which both Democrat and Republican presidential candidates have mooted as possible in a new administration. While political compromise has been in short supply in DC, the notion that both sides of the aisle are open to repatriation increases the probabilities of such legislation under Divided and United government in 2017. The prospect of repatriation combined with investors' high degree of certainty that the Fed hikes rates in December reduces the near term challenges to the S&P 500, allowing attention to shift to the likelihood of renewed earnings growth in Q4 and in 2017.

#### Value for the Money

In this note and in the 10/10 document [UBS Tactical Q-Trades Repatriation Redux](#), we suggest a list prospective "Repatriation Winners" - UBS Buy rated stocks with 10% or more of market cap in offshore cash and which, on average, trade at a 1x valuation discount to both the S&P 500 and their respective sector. Many of these names are found in the Technology and Health Care sectors, US Equity and Derivatives Strategy overweights. Details pp. 6-7.

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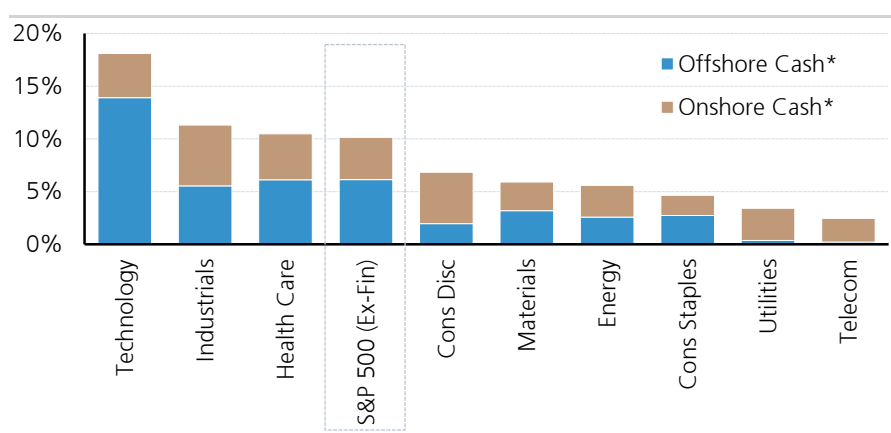
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**Figure 1: Cash and Marketable Securities Onshore vs. Offshore, % of Mkt Cap**

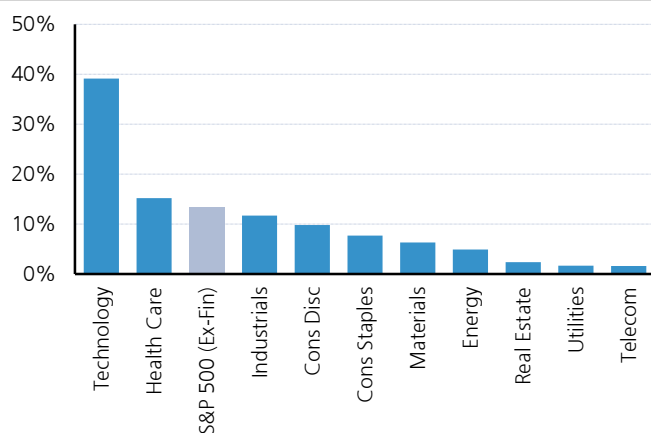


Source: Bloomberg, UBS

# More (Cash) Is Better

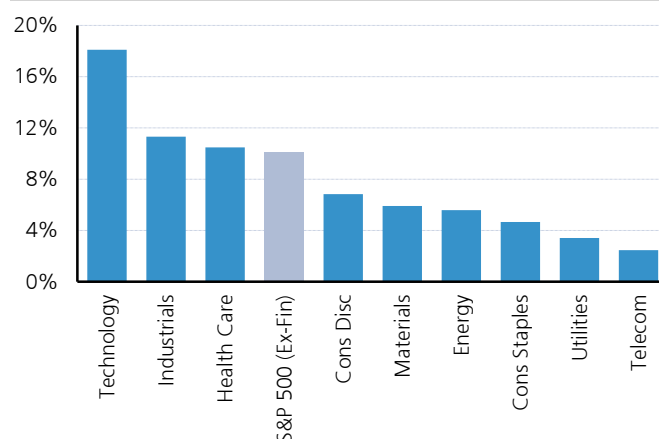
In our 2014 series on overseas cash, politics and M&A ([More Money, More M&A](#); [More Politics, More M&A](#); [More M&A – Derailed?](#)) we put forth the idea that in a world of rising uncertainty, cash becomes increasingly important for investors and corporates alike. Despite a weak earnings environment, corporate cash balances have continued to climb, currently representing 13.3% of total assets, or 10.1% of the S&P 500 market cap (ex-financials).

**Figure 2: Cash & Marketable Securities, % of Assets**



Source: Bloomberg, FactSet, UBS

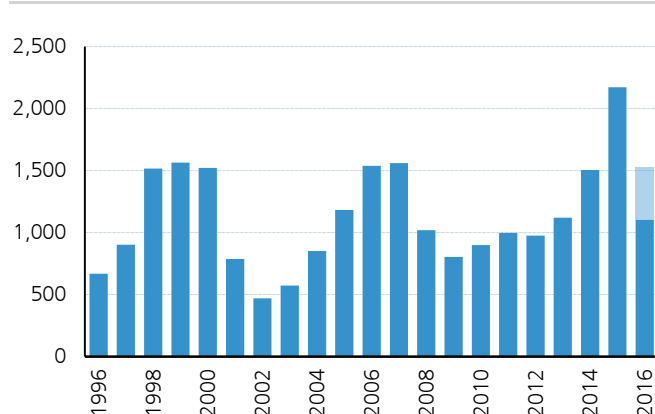
**Figure 3: Cash & Marketable Securities, % of Market Cap**



Source: Bloomberg, FactSet, UBS

Available cash and balance sheet flexibility not only helps to maintain/build on corporate confidence, but it also provides the ability to pursue attractive growth opportunities and generate attractive capital returns to shareholders via dividends and buybacks – as we've continued to see during the current cycle.

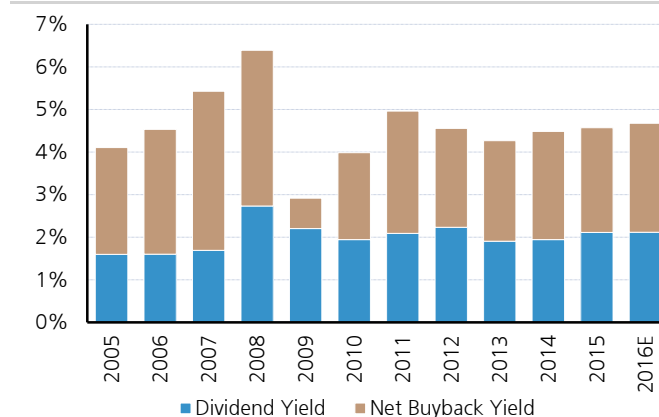
**Figure 4: M&A Volume – More M&A On the Way?**



Source: Dealogic, UBS

Note: Shaded estimate for 2016 assumes year-over-year (y/y) decline for Q4 2016 remains consistent with the y/y decline witnessed through the end of Q3 2016.

**Figure 5: S&P 500 Annual Total Yield**

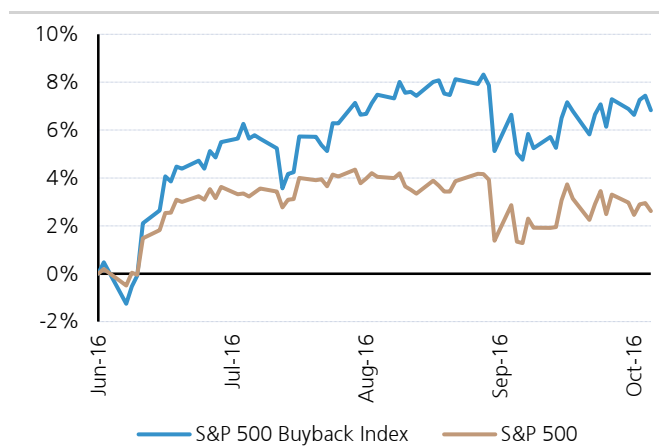


Source: FactSet, UBS

Most encouraging as a signalling mechanism to corporate managements that the efficacy of buybacks as a return strategy to shareholders has resumed is the

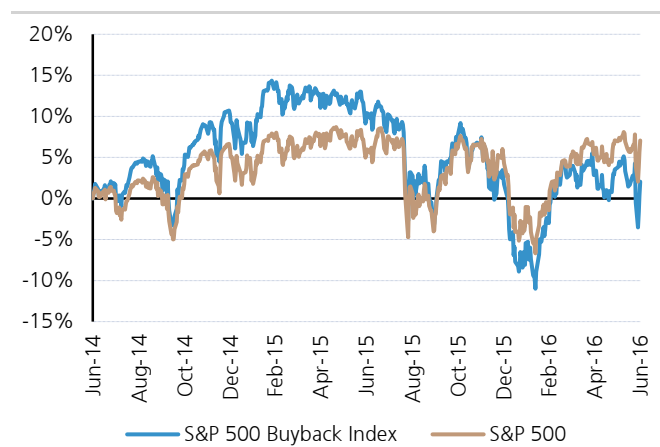
outperformance of buyback stocks (SPBUYUP Index) in the wake of the UK Referendum after two years of below market performance (Figures 6 and 7).

**Figure 6: Return of Buyback Outperformance...**



Source: Bloomberg, UBS

**Figure 7: ...After two fallow years**



Source: Bloomberg, UBS

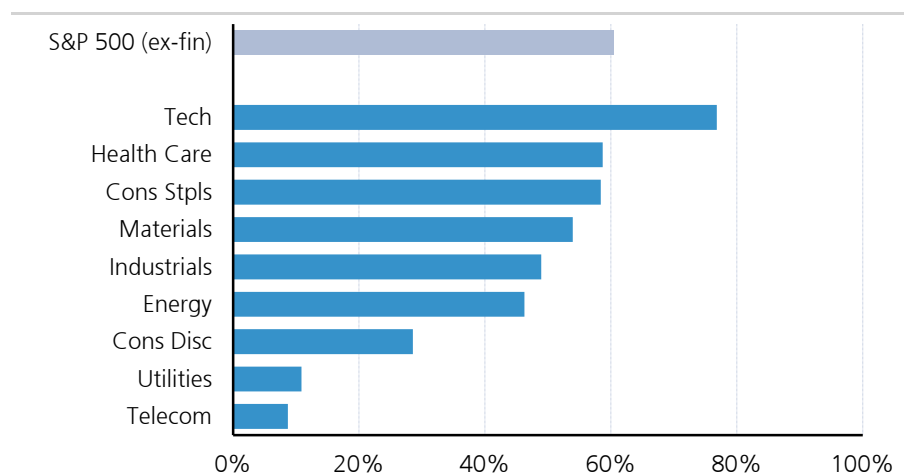
Despite rising cash balances, a significant portion of the cash for US corporates remains essentially "locked" overseas. Hence, not all cash can be considered "equal" in our view.

US companies that hold cash in one or more of their foreign subsidiaries, in many cases, consider their offshore profits (and the associated cash generated abroad) to be permanently reinvested abroad so as to avoid paying a higher US tax rate when repatriating the money.

But just how much cash is abroad?

Looking at the S&P 500 constituents (excluding financials), we estimate over \$1.1 trillion is likely "locked" to fund operations and growth initiatives abroad, or to consider cross-border M&A opportunities. According to company filings and estimates, the total overseas cash component accounts for over 60% of the available cash and marketable securities for non-financial S&P 500 companies, with technology and healthcare companies leading the way.

**Figure 8: Overseas Cash (as % of Total Cash) by Sector – S&P 500**



Source: Bloomberg, FactSet, Individual Company Filings, and UBS.

Note: Overseas cash figures collected from individual company filing footnotes as of FY 2015. In certain cases where the company does not explicitly disclose the figure, the approximate amount has been estimated.

The list below highlights the 40 S&P 500 companies with the largest estimated offshore cash balances (nominal) – although we only includes companies that either explicitly reference offshore cash or allude to a general range.

**Figure 9: S&P 500 Top 40 Offshore Cash List**

Ticker	Company	Sector	Analyst	Rating	Estimated Offshore Cash (\$m)	Offshore Cash % of Market Cap	Offshore Cash % of Total Cash
AAPL	Apple Inc.	Information Technology	Steven Milunovich	Buy	186,900	29.8%	90.9%
MSFT	Microsoft Corporation	Information Technology	Brent Thill	Buy	94,400	20.8%	97.8%
CSCO	Cisco Systems, Inc.	Information Technology	Steven Milunovich	Buy	56,500	35.7%	93.5%
ORCL	Oracle Corporation	Information Technology	Brent Thill	Buy	45,300	28.4%	83.3%
GOOGL	Alphabet Inc. Class A	Information Technology	Eric Sheridan	Buy	42,900	7.9%	54.8%
JNJ	Johnson & Johnson	Health Care	Matt Miksic	Buy	38,200	11.6%	99.5%
AMGN	Amgen Inc.	Health Care	-	-	29,000	23.0%	92.4%
QCOM	QUALCOMM Incorporated	Information Technology	Stephen Chin	Neutral	27,900	27.9%	90.2%
KO	Coca-Cola Company	Consumer Staples	Stephen Powers	Buy	17,900	9.9%	89.9%
MDT	Medtronic Plc	Health Care	Matt Miksic	Buy	17,700	14.8%	90.9%
HPQ	HP Inc.	Information Technology	Steven Milunovich	Neutral	15,690	58.1%	90.0%
GILD	Gilead Sciences, Inc.	Health Care	Marc Goodman	Buy	15,700	15.7%	59.9%
PFE	Pfizer Inc.	Health Care	Marc Goodman	Buy	13,290	6.5%	57.1%
MRK	Merck & Co., Inc.	Health Care	Marc Goodman	Buy	11,413	6.4%	85.0%
INTC	Intel Corporation	Information Technology	Stephen Chin	Buy	11,100	6.1%	35.5%
PEP	PepsiCo, Inc.	Consumer Staples	Stephen Powers	Buy	11,100	7.3%	92.4%
PG	Procter & Gamble Company	Consumer Staples	Stephen Powers	Buy	11,000	4.6%	94.7%
HPE	Hewlett Packard Enterprise Co.	Information Technology	Steven Milunovich	Buy	8,858	23.5%	90.0%
PCLN	Priceline Group Inc	Consumer Discretionary	Eric J Sheridan	Buy	9,800	13.4%	92.5%
V	Visa Inc.	Information Technology	Ben Herbert	Buy	7,400	3.8%	78.7%
BMJ	Bristol-Myers Squibb Company	Health Care	Marc Goodman	Buy	7,200	8.6%	80.6%
LLY	Eli Lilly and Company	Health Care	Marc Goodman	Neutral	7,120	7.8%	56.6%
EBAY	eBay Inc.	Information Technology	Eric J Sheridan	Buy	7,000	19.4%	82.4%
DOW	Dow Chemical Company	Materials	John E Roberts	Buy	6,494	10.7%	75.7%
UTX	United Technologies Corporation	Industrials	David E Strauss	Buy	6,014	7.1%	85.0%
F	Ford Motor Company	Consumer Discretionary	Colin Langan	Buy	5,950	12.2%	16.0%
AMZN	Amazon.com, Inc.	Consumer Discretionary	Eric J Sheridan	Buy	5,800	1.5%	29.3%
CAT	Caterpillar Inc.	Industrials	Steven Fisher	Neutral	5,300	10.2%	82.0%
ABT	Abbott Laboratories	Health Care	Matt Miksic	Neutral	5,206	8.1%	85.0%
WDC	Western Digital Corporation	Information Technology	John Roy	Neutral	4,900	29.0%	92.7%
CTSH	Cognizant Technology Solutions	Information Technology	Diviya Nagarajan	Neutral	4,506	14.6%	91.0%
CELG	Celgene Corporation	Health Care	-	-	4,488	5.5%	68.5%
NTAP	NetApp, Inc.	Information Technology	Steven Milunovich	Sell	4,425	45.3%	88.1%
NKE	NIKE, Inc. Class B	Consumer Discretionary	Michael Binetti	Buy	4,200	4.8%	70.9%
DD	E. I. du Pont de Nemours and Co	Materials	John Roberts	Buy	4,200	6.9%	67.7%
PYPL	PayPal Holdings Inc	Information Technology	Eric Sheridan	Neutral	4,200	8.8%	73.3%
BIIB	Biogen Inc.	Health Care	-	-	3,500	5.2%	56.6%
ADBE	Adobe Systems Incorporated	Information Technology	Brent Thill	Buy	3,390	6.2%	85.0%
MA	MasterCard Incorporated	Information Technology	-	-	3,300	2.9%	49.0%
GLW	Corning Incorporated	Information Technology	Tejas Venkatesh	Neutral	3,266	13.2%	71.0%

Source: Bloomberg, FactSet, Individual Company Filings, and UBS.

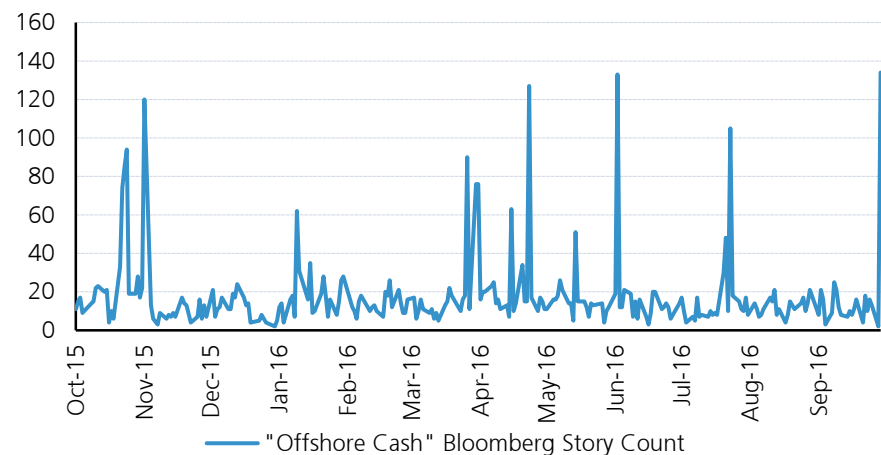
Note: Overseas cash figures collected from individual company filing footnotes as of FY 2015. In certain cases where the company does not explicitly disclose the figure, the approximate amount has been estimated.

## Politics as Catalyst?

Up until recent Treasury proposals that addressed "earnings stripping" and essentially limited M&A inversions, the discussion around offshore cash focused on the pace of deal activity. However, with the upcoming US Presidential Election on 11/8, the dialogue around offshore cash and its uses has once again picked up steam, as both candidates have discussed repatriation as a manner to fund an

increase in fiscal spending. Encouragingly, given that both candidates have floated the potential for repatriation it is reasonable to believe that some type of initiative could still be enacted even in the event that control of the Executive and Legislative branches of government remain politically divided.

**Figure 10: Renewed Interest in Offshore Cash**



Source: Bloomberg, UBS

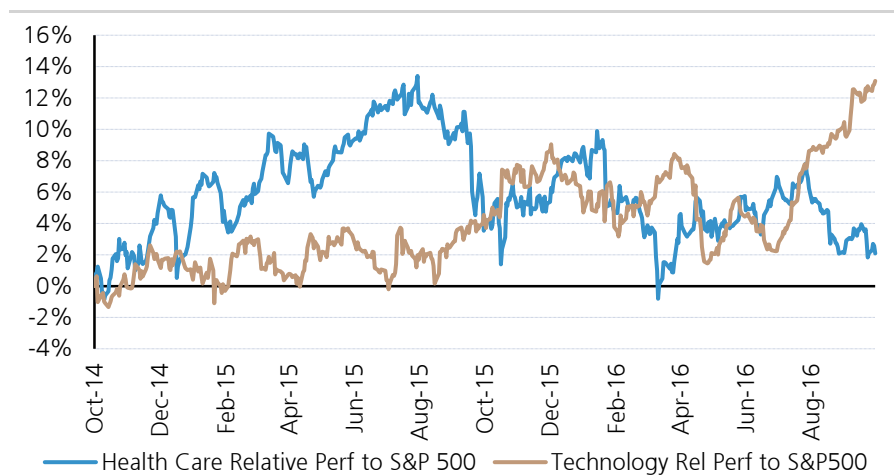
So what would repatriation look like? According to our colleagues in Washington, the current scenarios being discussed would likely be deemed repatriation in which corporations would be taxed (net of foreign tax credits) on all of their offshore cash regardless of whether the funds were actually re-domiciled in the US. This is different than the 2004 repatriation holiday which is estimated to have resulted in \$300m in repatriated funds – the majority of which was used to fund capital returns to shareholders.

So what would happen this time around? While estimates vary about the size of the corporate offshore cash hoard, many believe it is in excess of \$2trn (the Joint Committee on Taxation (JCT), pegs the number at \$2.6trn and a figure as high as \$5trn has been mooted during the course of presidential campaign rhetoric) – our estimate of \$1.1trn looks only at non-financial S&P 500 companies, or 60% of total cash (offshore + onshore) balances. And while the specifics would depend on the ultimate legislation, we would expect, similar to 2004, that a significant amount of the overseas cash balances (perhaps 75% or greater) would be repatriated and used to continue to repurchase shares and pay dividends, but also to increase the pace of M&A and growth capex, of which the latter has been a missing component in the current cycle.

## Value for the Money

In the case of reform involving some sort of agreement around repatriation, we would expect the sectors with the highest offshore cash balances (both nominal and as a percentage of market cap) located in lower relative tax jurisdictions to benefit. As a result, we would expect Technology and Healthcare to broadly outperform (Figure 8 above) – further aided by the sectors' attractive growth profile and structural tailwinds.

**Figure 11: A Tale of Two Cash Rich Sectors**



Source: Bloomberg, UBS

At the single-stock level, we provide a list of 16 UBS Buy-rated companies with estimated offshore cash and marketable securities accounting for greater than 10% of their respective market caps.

**Figure 12: Repatriation Winners**

Ticker	Company	Sector	UBS Analyst	Total Cash (% of Mkt Cap)	Offshore Cash (% of Mkt Cap)	Discount vs S&P 500 (NTM P/E)	Discount vs Sector (NTM PE)
JNJ	Johnson & Johnson	Health Care	Matt Miksic	11.8%	11.7%	0.4x	1.9x
CSCO	Cisco Systems Inc	Information Technology	Steven Milunovich	38.3%	35.8%	-3.7x	-3.9x
PCLN	The Priceline Group Inc	Consumer Discretionary	Eric Sheridan	14.5%	13.4%	2.7x	1.6x
ROK	Rockwell Automation Inc	Industrials	Shannon O'Callaghan	13.9%	12.5%	3.4x	3.6x
RL	Ralph Lauren Corp A	Consumer Discretionary	Michael Binetti	13.5%	13.8%	1.3x	0.3x
MSFT	Microsoft Corp	Information Technology	Brent Thill	21.5%	21.0%	2.8x	2.5x
LRCX	LAM Research Corp	Information Technology	Stephen Chin	25.2%	13.6%	-2.4x	-2.7x
GE	General Electric Co	Industrials	Shannon O'Callaghan	39.3%	19.2%	1.0x	1.2x
ORCL	Oracle Corp	Information Technology	Brent Thill	34.2%	28.5%	-2.2x	-2.5x
GILD	Gilead Sciences Inc	Health Care	Marc Goodman	26.4%	15.8%	-9.9x	-8.4x
AAPL	Apple Inc.	Information Technology	Steven Milunovich	33.5%	30.4%	-3.9x	-4.2x
MDT	Medtronic plc	Health Care	Matt Miksic	16.4%	14.9%	1.0x	2.5x
F	Ford Motor Co	Consumer Discretionary	Colin Langan	76.2%	12.2%	-9.4x	-10.5x
MU	Micron Technology Inc	Information Technology	Stephen Chin	30.8%	14.8%	-2.1x	-2.4x
MOS	Mosaic Co	Materials	John Roberts	14.8%	15.1%	9.6x	10.0x
HPE	Hewlett Packard Enterprise Co	Information Technology	Steven Milunovich	26.5%	23.8%	-5.4x	-5.7x

Source: FactSet, Bloomberg, UBS

## **Valuation Method and Risk Statement**

Past performance is not indicative of future returns. Investing in equities globally poses country, industry and company-specific risks. Valuations can be impacted by changes in the macroeconomic landscape as well as financial market stability.



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Buy	FSR is > 6% above the MRA.	45%	28%
Neutral	FSR is between -6% and 6% of the MRA.	39%	25%
Sell	FSR is > 6% below the MRA.	15%	17%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
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 30 September 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.

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#### Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Apple Inc.</b> <sup>6c, 7, 13, 16, 22</sup>	AAPL.O	Buy	N/A	US\$114.06	07 Oct 2016
<b>Cisco Systems Inc.</b> <sup>4, 6a, 6b, 7, 16</sup>	CSCO.O	Buy	N/A	US\$31.47	07 Oct 2016
<b>Ford Motor Co.</b> <sup>7, 16, 18a</sup>	F.N	Buy	N/A	US\$12.29	07 Oct 2016
<b>General Electric Co</b> <sup>6b, 6c, 7, 16, 18b</sup>	GE.N	Buy	N/A	US\$29.08	07 Oct 2016
<b>Gilead Sciences</b> <sup>16, 18c</sup>	GILD.O	Buy	N/A	US\$75.24	07 Oct 2016
<b>Hewlett Packard Enterprise</b> <sup>6c, 7, 16</sup>	HPE.N	Buy	N/A	US\$22.34	07 Oct 2016
<b>Johnson &amp; Johnson</b> <sup>2, 4, 6a, 6b, 7, 16</sup>	JNJ.N	Buy	N/A	US\$119.24	07 Oct 2016
<b>LAM Research Corp.</b> <sup>16</sup>	LRCX.O	Buy	N/A	US\$100.35	07 Oct 2016
<b>Medtronic PLC</b> <sup>6a, 6b, 6c, 7, 16, 18d</sup>	MDT.N	Buy	N/A	US\$85.96	07 Oct 2016
<b>Micron Technology Inc.</b> <sup>16</sup>	MU.O	Buy	N/A	US\$17.61	07 Oct 2016
<b>Microsoft Corp.</b> <sup>4, 6a, 6b, 6c, 7, 16</sup>	MSFT.O	Buy	N/A	US\$57.80	07 Oct 2016
<b>Mosaic Co</b> <sup>5, 16</sup>	MOS.N	Buy	N/A	US\$24.58	07 Oct 2016
<b>Oracle Corporation</b> <sup>2, 4, 16</sup>	ORCL.N	Buy	N/A	US\$38.71	07 Oct 2016
<b>Ralph Lauren</b> <sup>6c, 7, 12, 16</sup>	RL.N	Buy	N/A	US\$103.01	07 Oct 2016
<b>Rockwell Automation Inc.</b> <sup>16</sup>	ROK.N	Buy	N/A	US\$119.70	07 Oct 2016
<b>The Priceline Group Inc.</b> <sup>16</sup>	PCLN.O	Buy	N/A	US\$1,479.82	07 Oct 2016

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Additional Prices: Alphabet Inc., US\$775.08 (07 Oct 2016); Amgen Inc, US\$167.50 (07 Oct 2016); Qualcomm Inc., US\$68.19 (07 Oct 2016); Coca-Cola, US\$41.73 (07 Oct 2016); HP Inc, US\$15.58 (07 Oct 2016); Pfizer Inc., US\$33.56 (07 Oct 2016); Merck & Co., US\$62.77 (07 Oct 2016); Intel Corp., US\$38.10 (07 Oct 2016); PepsiCo Inc, US\$105.99 (07 Oct 2016); Procter & Gamble, US\$90.00 (07 Oct 2016); Visa Inc, US\$82.88 (07 Oct 2016); Bristol-Myers Squibb, US\$55.43 (07 Oct 2016); Lilly (Eli) & Co., US\$82.09 (07 Oct 2016); eBay, US\$31.62 (07 Oct 2016); Dow Chemical, US\$52.99 (07 Oct 2016); United Technologies Corp., US\$100.58 (07 Oct 2016); Amazon.com, US\$839.43 (07 Oct 2016); Caterpillar Inc., US\$88.47 (07 Oct 2016); Abbott Laboratories, US\$42.97 (07 Oct 2016); Western Digital Corp, US\$58.67 (07 Oct 2016); Cognizant Technology Solutions, US\$50.35 (07 Oct 2016); Celgene Corp, US\$104.07 (07 Oct 2016); NetApp Inc, US\$34.75 (07 Oct 2016); Nike Inc., US\$51.79 (07 Oct 2016); E I du Pont de Nemours and Co, US\$68.35 (07 Oct 2016); PayPal Holdings Inc, US\$39.88 (07 Oct 2016); Biogen Inc, US\$305.59 (07 Oct 2016); Adobe Systems Inc., US\$108.64 (07 Oct 2016); MasterCard Inc, US\$102.25 (07 Oct 2016); Corning Inc., US\$23.78 (07 Oct 2016); Source: UBS. All prices as of local market close.

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