While the arrival of a new year and political administration brings uncertainty to the corporate tax code, trade agreements, and regulation, one topic that continues to gain traction is the repatriation of foreign profits. Such a tax holiday is not without precedent; in 2004, roughly $312B was brought back to American soil by 843 corporations. Although in the coming months, political forces will waffle back and forth as to the magnitude of the tax break, now is the time to build a capital allocation strategy for the repatriated funds that considers both the preferences of your shareholders and long-term target investors.

Ipreo’s Corporate Analytics group specializes in situational shareholder analysis and investor targeting in order to tailor your capital allocation strategy based on your current/prospective shareholders, industry, and market trends. Whether you strengthen your balance sheet, re-invest in your business, or return the capital to your shareholders, we can assist in determining how this decision will impact your investor base. Below we’ve isolated a few representative cases of capital allocation around the repatriated cash in 2004 and highlighted how situational analytics assists in determining the effects of capital allocation on your shareholder base.

**STRENGTHEN YOUR BALANCE SHEET: LONG-TERM EFFECTS OF PAYING DOWN DEBT**

Eli Lilly and Company brought home $9.5B during the 2004 tax holiday. In Q4 2004, Eli Lilly increased its cash balance by approximately $3.3B and in following quarter, paid down $1.9B (30%) of its outstanding long-term debt.

If your company were to use the repatriated capital to pay down its long-term debt, the reduction of leverage will create increased investment opportunity, as many investors have leverage caps that may have prevented a prior investment in your security. Ipreo’s unique ownership database allows us to evaluate the portfolios of the broader investor universe to identify such opportunities.

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INVEST IN THE BUSINESS: ACQUISITION OR R&D

In the years following the 2004 tax holiday, two mergers occurred between companies that were within the top 20 to repatriate capital: Pfizer with Wyeth and Merck with Schering-Plough. While it’s difficult to attribute either merger directly to income repatriation, with nearly $2.5T in Fortune 500 profits abroad as of 2015, a tax holiday will have major impacts on 2017’s M&A environment. Repatriating such a significant amount of capital will likely drive up M&A valuations as many multinational corporations will be flush with cash, thereby also opening the door to activist pressure for both the acquirer and target to hold off for a better valuation.

For a complex structural change such as a merger or acquisition, Ipreo first performs an analysis of both company’s shareholder bases to pinpoint any exposure to an activist campaign. The team completes a robust historical and pro forma fundamental evaluation to assess the key drivers of the investment community’s valuations. Then, based on quantitative and qualitative considerations, Ipreo will evaluate which current and prospective shareholders are most likely to buy or sell shares due to the evolving nature of the business.

When allocating more capital towards research and development, there are several ways to position the investment story considering the perceptions of the investment community and the allocation strategies of your peers. The Ipreo Corporate Analytics team can help you identify the investment drivers of your shareholder base to help you facilitate the right investment story for the Street.

RETURN CAPITAL TO SHAREHOLDERS: DIVIDEND OR STOCK BUYBACK

Between 2005 and 2006, stock buybacks by the top 15 repatriating companies increased by 38%. The strategy employed by Motorola Solutions, Inc. provides the most resonating example as its cash balance increased by $4.1B during 2005. Motorola did not buy back any stock between 2002 and 2004; however, once flush with cash, Motorola spent $4.0B on stock buybacks between Q2 2005 and Q3 2006.

Motorola Solutions, Inc. Usage of Cash ($M), 4Q04 - 3Q06

Source: FactSet

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When structuring an extraordinary return to your shareholders, it’s imperative to recognize whether they would prefer it by way of a dividend or via stock buybacks. Ipreo’s Suitability and portfolio sensitivity tools allow us to analyze how heavily portfolio managers weigh dividend payments or stock buybacks into their investment decisions.

2015 PROFITS HELD OFFSHORE

Of the $312B repatriated as a result of the 2004 tax holiday, $157B came from the Healthcare and Technology sectors. Although U.S. corporations are not required to disclose their offshore profits, in 2015 aggregate estimates approached $2.5T with the Healthcare and Technology industries again leading the pack.

Note: graph includes the top 50 Fortune 500 companies with funds offshore

RECENT CASH USAGE BY THE HEALTHCARE AND TECHNOLOGY SECTORS

Given the high overseas cash reserves in the Healthcare and Technology sectors, if history were to repeat itself, it is especially vital for companies operating within these sectors to have a sound plan for allocating the repatriated income. Over the past two years, both the Healthcare and Technology constituents of the S&P500 have taken on more long-term debt while leaving capital expenditures and R&D expenses fairly constant. While dividends paid have steadily increased over time, stock repurchases have fluctuated. When comparing the most recent cash usage of the S&P500 Healthcare and Technology constituents to the total S&P 500, the Healthcare and Technology sectors have used a larger percentage of its cash to pay down long-term debt while the total S&P500 allocated more cash towards returning capital to shareholders.

As with all uncommon but anticipated occurrences, having an informed and actionable plan in place is imperative to the long-term strength of your company. A comprehensive understanding of peer strategies and investor preferences is pivotal to successfully positioning your security in the marketplace. Ultimately, partnering with Ipreo ensures that you’re prepared for all potential risks and opportunities that your company may face during this uncertain time.

LEARN MORE ABOUT OUR PREMIUM ANALYTICS SERVICES

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Source: FactSet