



September 2016

# Investment Insights from Silicon Valley

[www.allianztechnologytrust.com](http://www.allianztechnologytrust.com)

## Walter Price

**Lead Manager, Allianz Technology Trust.** With over 40 years of experience of investing in technology companies, Walter Price has witnessed the evolution of the technology sector from the birth of the personal computer to the arrival of the internet and now the shift to cloud computing. Based in San Francisco, giving him close proximity to many of the world's most innovative companies, he heads up the Global Technology Team which manages US\$4.5billion\* in assets.

\*Source: Allianz Global Investors GmbH as at September 2015.

## Apple's EU tax bill

Apple attracted headlines not solely for the launch of its new iPhone 7 this month, but also for an eye-popping €13bn tax bill from the European Commission. The EC ruled that the 'sweetheart deal' struck between the Irish Government and the US tech giant was illegal. Apple and the Irish Government have both defended their actions and promised to appeal.

Certainly, there is little doubt that this was an attractive deal for Apple. The Company paid an effective corporation tax rate of 0.005% in 2014 on its European profits. The question is whether the furore could damage Apple's bottom line and/or its brand.

We believe that the issue may finally help push US Congress to agree on the terms of its Repatriation tax deal. When agreed, this would allow US companies to bring back profits into the US at a reduced corporation tax rate. If it is reasonable, money currently residing overseas could flow back into the US, and potentially fuel higher dividends, share buybacks and support merger and acquisition activity. Nevertheless, Apple will have to acclimatise itself to paying a tax rate of 15-20% rather than zero, but it could get a tax credit against its EU bill.

We do not believe there will be brand damage. Apple is simply following a script that has been widely used by other companies. Intellectual property is moved into an offshore subsidiary that pays lower taxes. These lower taxes apply unless the money is brought back onshore. Companies

have been doing this for some time: Apple may be a high profile target, but its brand is unlikely to see much of a dent. Its share price has so far been unmoved by the furore.

## A technology M&A boom

Technology is currently a hot spot for merger and acquisition activity, but not always for the reasons people might think. Yes, there are big companies buying new and innovative companies to support their growth, but there is also considerable consolidation in certain, lower growth, parts of the market. This latter type of deal is epitomised by the semi-conductor industry.

Growth rates across the semi-conductor industry are relatively low: there is little operational leverage and little potential for organic revenue growth. At the same time, the cost of debt is extremely low. This has seen a wave of deals: Avago, for example, has bought a couple of smaller companies, such as Broadcom. It has borrowed to buy, securing interest rates of 6% and below, then aggressively cut costs after take-over and now plans to raise prices to pay back the debt. This has proved an effective model to grow earnings.

Inevitably there is still merger and acquisition activity among higher growth companies. In some cases higher growth stocks have been marked down significantly over the past few months, either because the growth rate has slowed, or the market has focused on profit as opposed to sales growth. In 2013, the revenue to market capitalisation was as high as 17x for some of these companies; at their low in February, it was less than five.

This is no recommendation or solicitation to buy or sell any particular security. A ranking, a rating or an award provides no indicator of future performance and is not constant over time.

**Allianz**   
Global Investors



For companies looking for lines of growth, this presents an opportunity. This was the catalyst behind the Salesforce.com/ Microsoft bidding war for LinkedIn, or for Demandware and Adobe, and for many smaller companies. For the acquiree company, it can be a good way to stem some employee restlessness, at a time when they might not have seen their share options grow for some time.

We believe any repatriation of foreign earnings to the US could fuel further merger and acquisition activity in the technology sector. Equally, currency may also be a spur for some companies, as it was in the deal for UK-based Arm holdings.

and this part of our portfolio is performing well. This includes companies such as Apple, IBM or Qualcomm. Income from treasuries is still at rock-bottom levels and investors are hungry for income. This trend is just as marked in the technology sector as it is elsewhere.

### The US election – a boom time for advertisers?

It will not have escaped investors' notice that there is an election imminent in the US. While we would not seek to call the result or comment on the candidates, it does have some implications for the stocks in which we invest. In particular, between the Election, the Olympics and the European Football Championships, there had been an expected surge in advertising, particularly in television and Facebook advertising.

Historically, election years have been a boom time for the advertising industry, but this time, they've been disappointed. This has a number of reasons: Donald Trump hasn't had to pay for a lot of media coverage, managing to create it on his own, while Hillary Clinton, perhaps recognising that television isn't her strongest media, also hasn't been running a lot of advertising. It certainly hasn't generated the boom people thought.

This has exaggerated the existing problems at many of the listed TV networks, which have already been contending with a shift from television to online video. Many networks are struggling to generate any growth at all and have seen their share prices come under increasing pressure this year.

### Samsung woes

With an exploding battery on the Note, one of its flagship products, and an ensuing product recall, it has been a difficult few months for Samsung. Nevertheless, we have used this as an opportunity to top up a little for the trust. Almost all the mobile companies have been forced to do product recalls at one point and there are plenty of reasons to believe Samsung should recover well from this shock.

A number of carriers have been offering 'sweetener' deals to get people to switch carriers. This has helped generate demand for phones. The Samsung Galaxy, which is the main competitor to the iPhone 7 hasn't had any problems. At the same time, many people are happy with the Note and it is generally well-reviewed

in spite of its problems. Samsung has decided to replace the whole phone rather than just the battery, which customers like.

Samsung understands the problem and knows how to fix it. It will be expensive, but this is reflected in the Samsung share price. Ultimately, it may even help its market share because the refurbished Notes will be available on the market at a discount. We believe Samsung will come out the other side.

---

All sources Allianz Global Investors GmbH unless otherwise noted. This is no recommendation or solicitation to buy or sell any particular security.

**Investing involves risk.** The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested. Competition among technology companies may result in aggressive pricing of their products and services, which may affect the profitability of the companies in which the Trust invests. In addition, because of the rapid pace of technological development, products or services developed by these companies may become rapidly obsolete or have relatively short product cycles. This may have the effect of making the Trust's returns more volatile than the returns of a fund that does not invest in similarly related companies. Past performance is not a reliable indicator of future results. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer and/or its affiliated companies at the time of publication. The data used is derived from various sources, and assumed to be correct and reliable, but it has not been independently verified; its accuracy or completeness is not guaranteed and no liability is assumed for any direct or consequential losses arising from its use, unless caused by gross negligence or wilful misconduct. A security mentioned as example above will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. This is a marketing communication issued by Allianz Global Investors GmbH, an investment company with limited liability incorporated in Germany, with its registered office at Bockenheimer Landstrasse 42/44, D-60323 Frankfurt/M. Allianz Global Investors GmbH is registered with the local court of Frankfurt/M under HRB 9340 and is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). Allianz Global Investors GmbH has established a branch in the United Kingdom, Allianz Global Investors GmbH, UK Branch, which is subject to limited regulation by the Financial Conduct Authority ([www.fca.org.uk](http://www.fca.org.uk)). Details about the extent of our regulation by the Financial Conduct Authority are available from us on request. Allianz Technology Trust PLC is incorporated in England and Wales. (Company registration no. 3117355). Registered Office: 199 Bishopsgate, London, EC2M 3TY.