Europe's Quiet Revolution

How European Companies Are Becoming Increasingly Shareholder-Friendly

LAZARD ASSET MANAGEMENT

In Focus

A combination of rising share buybacks, improved capital allocation, a greater focus on core business activities, and generous dividend payments suggests corporate Europe deserves to shed its reputation for not always placing shareholders' interests first.

- We believe European management teams have become more judicious in their approach to capital allocation and that greater internal competition now exists for capital within European companies.

- Allied to modest stock market valuations, especially relative to the super-charged US market, and Europe's lower market concentration risks, this improved focus on shareholder returns adds to the attractions of European equities.

- A quiet revolution is underway in corporate Europe as European companies increasingly put shareholders first. Valuations and fund flows suggest European equities continue to be ignored, but this means many investors are overlooking what we believe is the region's multi-year shift towards a genuine shareholder-return culture.

Four Trends Underpinning Europe's Improved Shareholder Focus

We identify four trends that we believe represent evidence of a more enlightened approach to shareholders by European companies: the rise of share buybacks, more judicious capital allocation, a focus on core business assets, and increased dividends.

1. The Rise of Share Buybacks

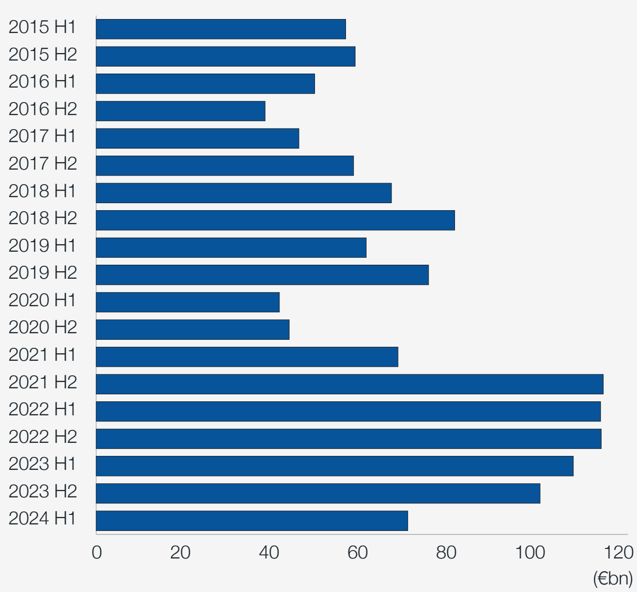
There has been a step change in share buybacks by European listed firms since the pandemic (Exhibit 1), up from €136 billion in 2019 to €208 billion by 2023 (latest full year). Interestingly, companies not traditionally associated with buybacks, such as firms with government-held stakes (e.g. Deutsche Telekom) or large family shareholdings (e.g. BMW), are now buying back their own stock.

Share buybacks have multiple benefits beyond their obvious impact of creating more buyers than sellers. First, they provide a guaranteed return, unlike a future project with an uncertain outcome. Second, they create a hurdle rate for internal investments to meet or beat. Third, a smaller equity base after buybacks means a company's future earnings and dividends are shared between fewer shareholders, enhancing earnings and dividends per share.

We believe the jump in share buybacks reflects a greater awareness among management teams of the returns on capital they can generate. For example, the current debate in some European banks about the comparative merits, in return on equity terms, of buybacks versus loan-making or organic investments would not have widely taken place in this sector a decade ago.

Exhibit 1.

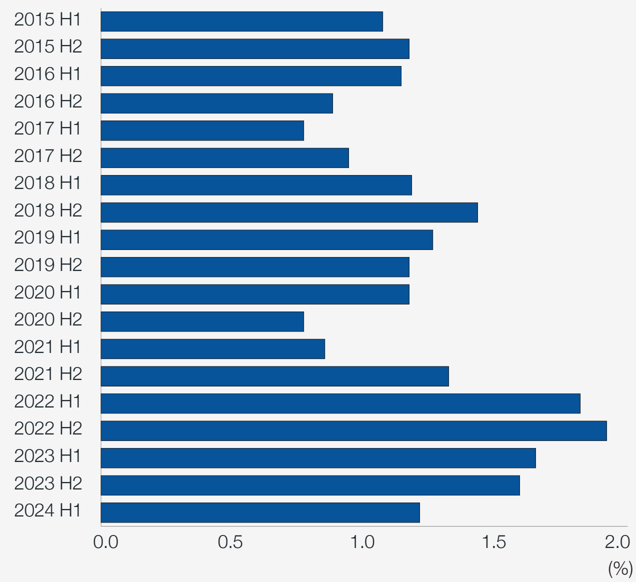
Share Buybacks Are at Elevated Levels in Europe



As of 10 December 2024. Source: Bloomberg.

Exhibit 2.

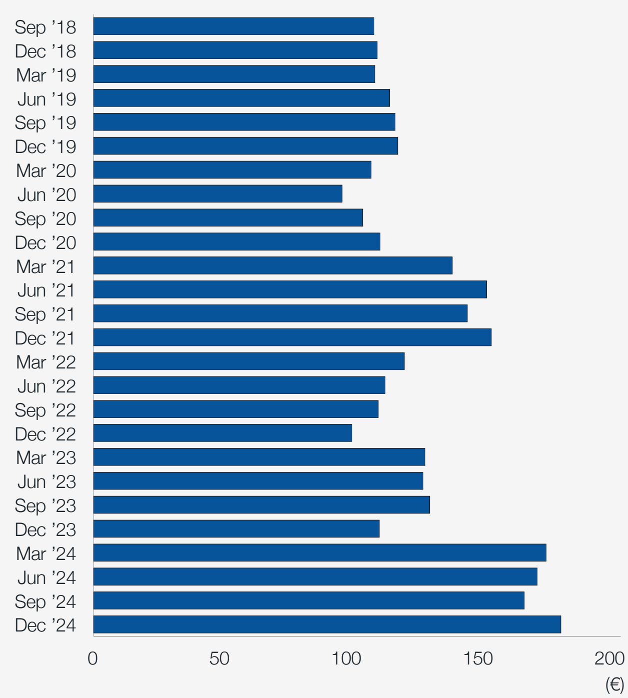
Europe's Rising Buyback Yield



As of 10 December 2024. Source: Bloomberg.

Exhibit 3.

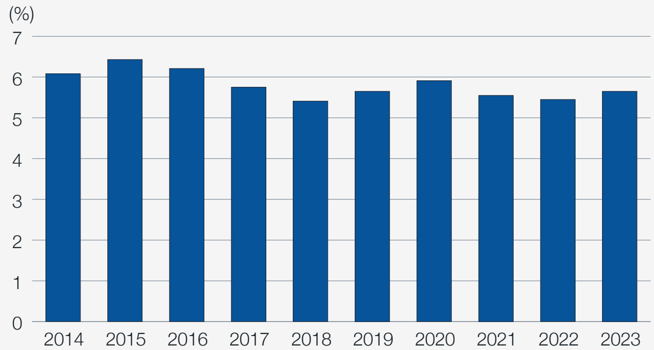
European Companies Are Generating More Free Cash Flow



As of 31 December 2024. Source: FactSet.

Exhibit 4.

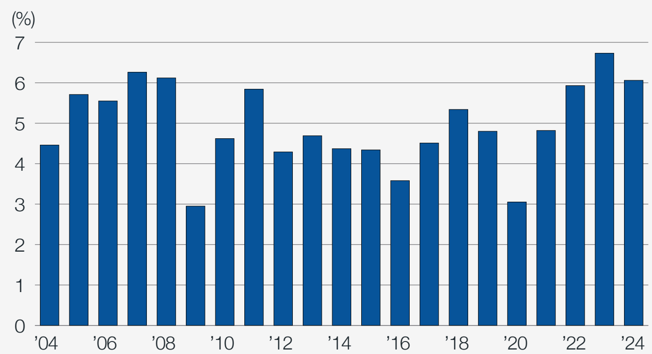
Capex as a Percentage of Revenue Has Stayed Broadly Flat for European Companies



As of 10 December 2024. Source: FactSet.

Exhibit 5.

Europe's Rising Returns on Invested Capital



As of 31 December 2024. Source: FactSet.

The buyback yield has also moved comfortably above 1%, a level it typically barely exceeded in the pre-pandemic period (Exhibit 2).

The growing popularity of buybacks is a logical consequence of modest European equity valuations: the MSCI Europe index currently trades on a 12-month forward price/earnings ratio of 13, below its long-term average. When companies think their shares are undervalued—and the stock market is proving slow to recognise the value on offer—it can make sense for management teams seeking a home for their excess cash to buy back their stock. And currently European firms have more spare cash, having recently generated higher levels of free cash flows (Exhibit 3).

2. Better Capital Allocation

We believe data points to a more disciplined approach to capital allocation by European management teams. Consider the fact that capital expenditure as a percentage of sales revenue has remained at broadly the same level over the past decade (Exhibit 4).

Yet returns on invested capital generated by European companies have been climbing over the past four years. They are now above pre-pandemic levels and are near a post-Global Financial Crisis high (Exhibit 5).

This is indicative of a more competitive environment for capital inside companies and demonstrates that European management teams have become more judicious in their approach to capital allocation. In our view, firms are showing less propensity for capital-destructive vanity projects and more awareness of the need to bolster investor returns.

This improvement is evident in areas of the market that were previously prone to capital-intensive projects, such as industrials. The growth of capital-light models (e.g., software and subscription services) may also be contributing to the uptick in returns on

Exhibit 6.

Corporate Europe's Spin-offs and Disposals in 2024

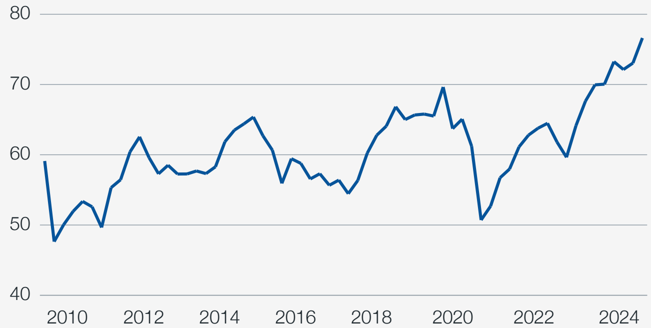
Company	Acquirer	Description
AXA	BNP Paribas	AXA sold its investment management division to BNP Paribas
Sanofi	Clayton, Dubilier & Rice	Selling 50% of Opella, its consumer healthcare business
WPP	KKR	WPP sold a majority stake in its PR business, FGS Global, to KKR
John Wood	Multiple buyers	John Wood sold two separate non-core divisions for $165 million
Novartis	Siemens Healthineers	Novartis sold its molecular imaging business for €200 million
Société Générale	Union Bancaire Privée (UBP)	Société Générale sold its UK and Swiss private banking divisions to UBP
Richemont	Mytheresa	Richemont spun off its online retailer, Yoox Net a Porter, to Mytheresa
Deutsche Bahn	DSV	Deutsche Bahn sold DB Schenker, its logistics business, to DSV
Unilever	–	Plans to spin off its ice cream business (€8 billion in sales) by the end of 2025
Hexagon	–	Hexagon is in the process of evaluating its asset life cycle intelligence business

As of 10 December 2024. Source: Bloomberg, FactSet.

Exhibit 7.

Dividends Continue to Rise in Europe

MSCI Europe: Dividends per Share (Next 12 Months – €)

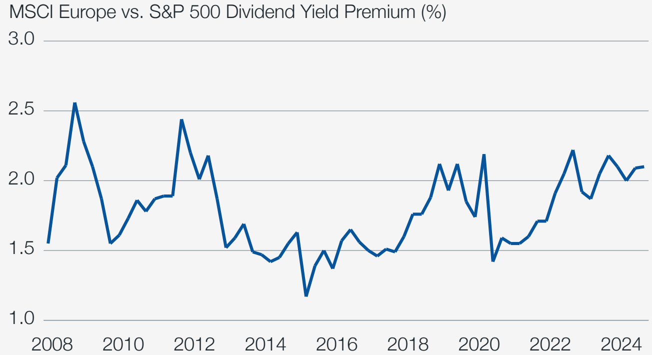


As of 10 December 2024. Source: FactSet.

Exhibit 8.

The European Dividend Yield Premium over US Equities

MSCI Europe vs. S&P 500 Dividend Yield Premium (%)



As of 10 December 2024. Source: FactSet.

invested capital. Europe is also replete with strong brands, especially in the luxury consumer sector, which can command premium pricing, high margins, and, therefore, high returns.

3. Core Assets over Peripheral Distractions

A recent feature of the European equity markets has been companies announcing spin-offs or sales of non-core assets and divisions (Exhibit 6).

Companies across the automotive, chemicals, financial, and household & personal care product sectors have either sold or separately listed peripheral businesses or announced their intentions to do so. These strategic moves allow management teams to focus on core operations and eliminate time-consuming distractions. Streamlining a business also provides investors with greater clarity about the operating performance, prospects, and intrinsic value of the main corporate business asset.

Shareholder-Focused Europe

More than Just a Valuation Play

Even allowing for a solid absolute performance since the pandemic, European stocks have remained firmly in the shade of all-conquering large-cap US equities. This is reflected in the subdued relative valuations of the region's listed companies versus their US counterparts. Unusually for capital markets, the improvement in financial productivity evident across the European equity market has not been matched with comparable improvements in valuations.

Beyond the region's modest valuations and much lower market concentration risks, we believe corporate Europe's enhanced focus on shareholder returns serves as a reminder that US equities are not the only option for investors. While the European stock market may lack the glamour and heft of the US, with its globally dominant Magnificent Seven and the potential for business-friendly policies from the incoming Trump administration, we believe the quiet revolution unfolding in European boardrooms offers a compelling reason for investors to revisit this currently overlooked asset class.

4. Dividend Strength

After a pause during the pandemic when management teams opted to preserve cash in the face of extreme uncertainty and an overnight collapse in demand for many firms, dividends have resumed their upward climb in Europe (Exhibit 7).

Robust dividends coupled with rising share buybacks are making for a powerful one-two cash return to shareholders of European companies: buybacks and dividends are offering a combined 5% yield.[1] Importantly, current balance sheet strength means management teams have not had to cut or cancel dividend payments to fund share buybacks.

The dividend picture in Europe continues to compare favourably with the US, where the dividend culture is less entrenched and buybacks are preferred. The dividend yield premium of European stocks over US equities has been climbing over the past decade (Exhibit 8).

Important Information

Notes

1. Source: Bloomberg, FactSet. Data as of 10 December 2024.

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