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Capital allocation on the Belgian stock market

1. Capital allocation

Capital allocation is a critical aspect of corporate strategy, encompassing the decisions made by business leaders on how to deploy financial resources to achieve strategic objectives and deliver value to shareholders. In today's dynamic and competitive business environment, effective capital allocation can be the difference between a company's success and its stagnation. It involves not only determining where to invest but also how to source the necessary capital, balancing demand and supply to optimise financial performance.

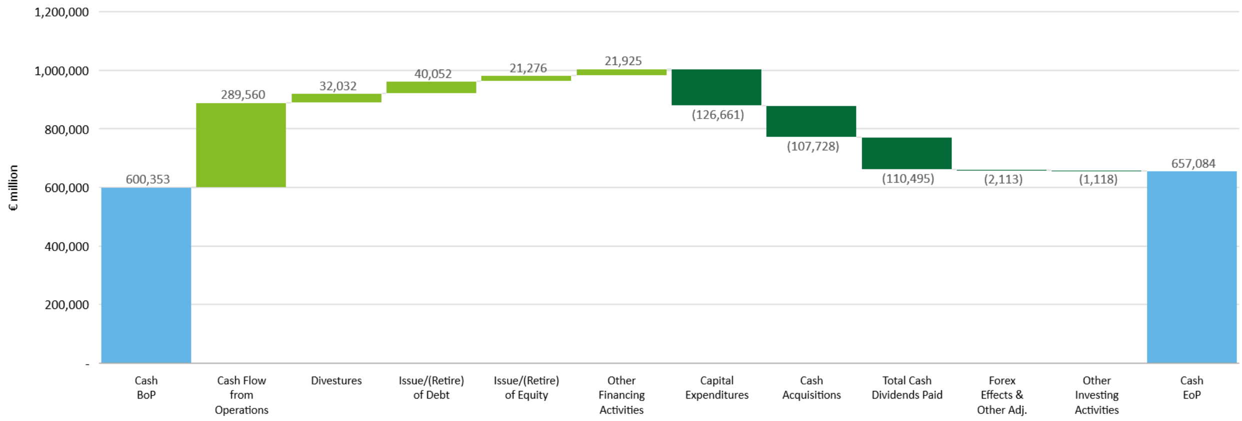
At its core, capital allocation is about making informed choices that align with the enterprise's long-term vision and goals. It requires a deep understanding of the company's strategic priorities, market opportunities, and risk landscape. By carefully managing capital allocation, companies can drive growth, enhance operational efficiency, and create sustainable value for stakeholders.

We will delve into the various facets of capital allocation, including investment in growth opportunities, mergers and acquisitions, research and development, and distributions to shareholders.

There are two sides to the capital allocation decision: the sources and the uses of capital.

- The sources of capital refer to the various means through which a company can obtain the financial resources necessary to fund its operations, investments, and growth initiatives. These sources can be divided into two parts: internal and external sources of funding. Internal sources refer to cash generated by the operational activities of the business. External sources refer to financing obtained from third parties, which can come in the form of debt, equity, or divestitures (selling business units or non-core assets to a third party). Generally, internal sources of funding constitute the largest part of a company's funding for most mature companies.
- The uses of capital can also be divided into two main sections: capital reinvested in the growth of the business and capital distributed to shareholders. Capital reinvested in the growth of the business refers mainly to capital expenditures, i.e., investments in assets meant to either sustain the current size of the business ("Maintenance CapEx") or to expand it ("Expansion CapEx"). Examples of such capital reinvested in the growth of the business include external acquisitions, research and development ("R&D"), working capital, and human capital. Capital distributed to shareholders refers mainly to dividend distributions, although share buybacks are often used as a popular mechanism to return capital to shareholders due to their beneficial tax impact compared to cash dividends. Because of data availability, this study incorporates share buybacks as part of the net raise in equity discussed in the sources of capital.

In the first step, we will examine the broad Belgian stock market by investigating the Bel All-shares index ("BelAllShares"), which comprises a list of 117 listed companies with significant activities in Belgium. We screened the companies and removed eight companies (Engie SA, ING Groep NV, Koninklijke Ahold Delhaize NV, Total Petrochemicals & Refining S.A./N.V., Vranken-Pommery Monopole Société Anonyme., Compagnie de Saint-Gobain S.A., Hybrid Software Group PLC, Avantium N.V.) because of the fact that they are not Belgian companies and we only want to capture the capital allocation decisions by Belgian companies. In the second step, we will assess which sectors demonstrate the strongest link between capital allocation and value creation. Finally, in the third step, we will conduct a deep dive into that sector.



2. Capital allocation BelAllShares 2014-2023

Capital allocation bridge:

Our bridge visually depicts the sources and uses of capital by the BelAllShares index over a 10-year period. The starting and ending points reflect the aggregate cash balance of constituents of the BelAllShares index in January 2014 and December 2023, respectively. Please note that due to an inherent difference in the way cash is measured in the balance sheet and the cash flow statement, the starting balance does not reconcile with the actual starting balance in 2014 but is rather replicated by the subtraction of the total cash flow from the end-of-period cash balance. The steps in between are composed of our building blocks of capital allocation, with capital inflows shown in light green and capital outflows shown in dark green.

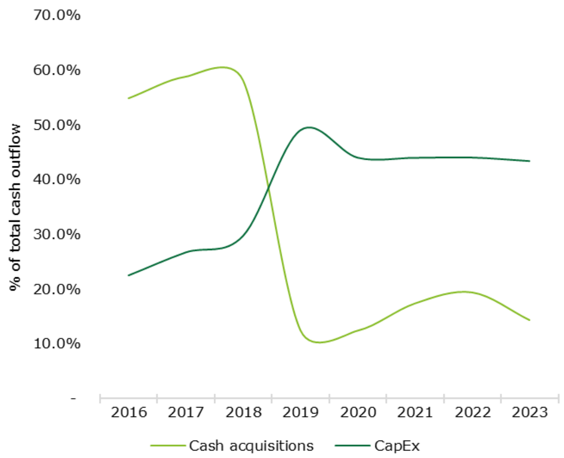
This bridge allows us to grasp the sources and uses of capital and hence understand how the listed companies making up the BelAllShares have allocated capital over the last 10 years.

A significant portion of cash was utilised in capital expenditures, amounting to €126,661 million or 36.4% of cash outflows. This indicates substantial investments in long-term assets, likely aimed at enhancing operational capacity and future growth.

Dividends paid amounted to €110,495 million, or 31.7% of cash outflows.

Additionally, cash acquisitions amounted to €107,728 million (30.9%), reflecting strategic investments in acquiring other businesses or assets to expand market presence and capabilities.

Contribution of cash acquisitions and CapEx in total cash outflows (3-year rolling average)



Looking at the evolution of cash acquisitions and capital expenditures over time, we can note the following:

- The significant cash acquisitions in 2016-2018 are an anomaly, primarily due to a large acquisition by AB InBev.
- Excluding this anomaly, cash acquisitions generally show variability but remain a smaller portion of total cash outflows.
- Conversely, capital expenditures (CapEx) consistently represent a substantial portion, reflecting ongoing investments in infrastructure and technological advancements.
- The overall trend suggests a strategic shift towards internal development and cautious acquisition strategies in recent years.

Turning our attention to the sources of cash, a significant portion of cash inflows was generated from operations, amounting to €289,560 million (71.5% of cash inflow). This substantial inflow underscores the BelAllShares' robust operational performance and their ability to generate consistent cash flow from core business activities. The strong cash flow from operations reflects efficient management, high sales volumes, and effective cost control measures, ensuring a steady stream of income to support various financial activities.

Another notable source of cash was divestitures, contributing €32,032 million (7.9%). This indicates that the BelAllShares companies strategically sold off certain assets or business units to streamline operations, focus on core competencies, or raise capital for other investments. Divestitures can also be part of restructuring efforts to improve overall financial health and operational efficiency.

The companies also raised funds through the issuance of debt, resulting in a net debt issuance of €40,052 million, which accounts for 9.9% of the total cash inflow. This reflects a strategic choice to utilise debt financing to support expansion, acquisitions, or other capital-intensive projects.

Additionally, the issuance of equity contributed €21,276 million to the cash inflows, representing 5.3% of the total cash inflow. This involved raising capital by issuing new shares to investors, which can be used to finance growth initiatives, reduce debt, or invest in new opportunities. Equity financing helps maintain a balanced capital structure and provides the BelAllShares companies with the necessary funds without increasing debt levels.

The relatively low figures for both debt and equity raises suggest a mature market characterised by strong operating performance and limited growth driven by new equity or debt.

Other financing activities also played a substantial role in cash inflows, contributing €21,925 million (5.4%) to the overall sources of capital. These activities could include returns from investments in securities, interest income, or proceeds from the sale of non-core assets. Such inflows highlight the BelAllShares' ability to generate additional income from its other financial activities.

To summarise, the companies in the BelAllShares have demonstrated robust financial management and strategic foresight by effectively generating substantial cash from operations and strategically utilising this cash for significant investments, acquisitions, and shareholder returns. They have maintained a strong cash balance to support future growth and stability.

3. The importance of capital allocation per sector

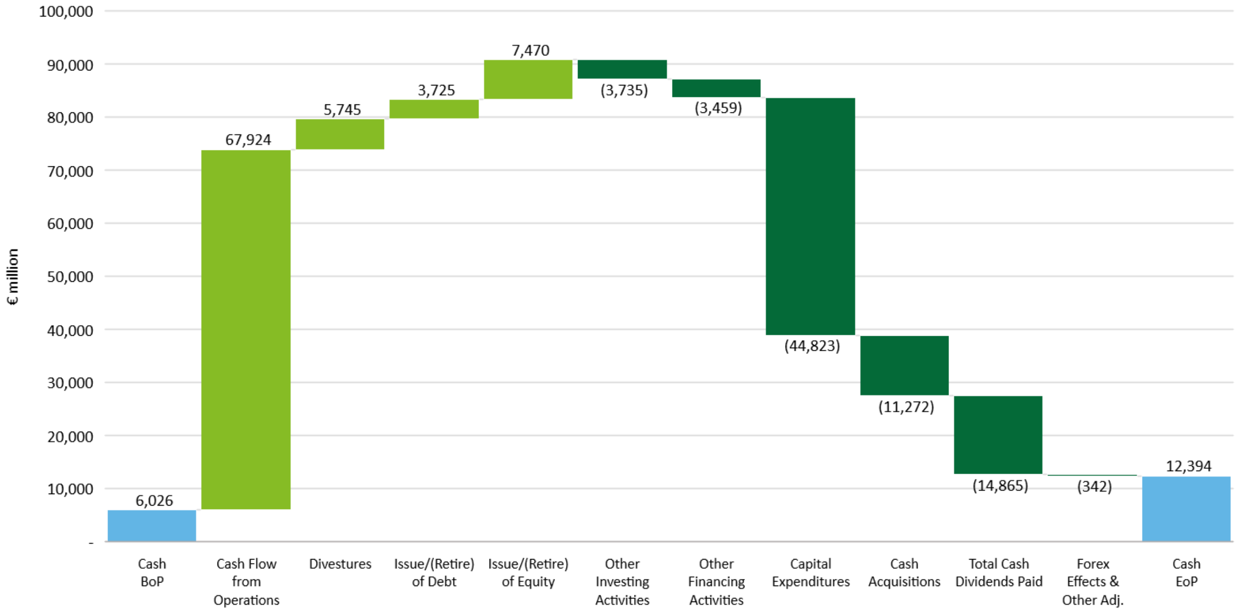
To estimate the importance of capital allocation for each sector, we will investigate the valuation quotient of each sector. The Valuation Quotient is defined as the total absolute value of the capital allocation decisions (cash acquisitions, divestitures, capital expenditures, dividends, net debt issued, net equity raised, other financing activities, other investing activities) performed by the companies within a sector divided by the total market capitalisation at the end of this analysis. The sectors under investigation, which are part of the BelAllShares, are the Consumer industry ("Consumer"), Energy, Resources and Industrials ("ER&I"), Financial Services and Investments ("FSI"), Life Sciences and Health Care ("LSHC"), and Technology, Media and Telecommunications ("TMT") sectors.

Valuation coefficient calculation per sector

€m	Capital Allocation Decisions	Valuation coefficient
Consumer	352,872	2.5
ER&I	159,475	2.9
FSI	276,199	2.8
LSHC	41,782	1.0
TMT	35,659	3.2

Source: Deloitte analysis, CapitalIQ

Firstly, we notice that only three out of the five sectors constitutes the largest part of the total capital allocation decisions, namely Consumer, ER&I, and FSI. Secondly, among these three, the ER&I sector appears to have a substantially higher valuation quotient than the other two. Based on this observation, we will delve deeper into the ER&I sector to identify any distinct trends compared to the BelAllShares.



4. Capital allocation in ER&I sector

Capital allocation is a cornerstone of strategic management in the Energy, Resources, and Industrials ("ER&I") sector. The unique characteristics of these industries—marked by high capital intensity, market volatility, technological advancements, and sustainability imperatives—make effective capital allocation essential for long-term success and resilience.

The ER&I sector is characterised by substantial capital investments in infrastructure, equipment, and technology. Projects often span several years, with significant upfront costs and extended payback periods. Strategic capital allocation ensures that these investments are directed towards initiatives that promise the highest returns and align with the company's long-term vision.

The ER&I sector is heavily influenced by fluctuating commodity prices and regulatory changes. Effective capital allocation helps companies navigate these volatilities by investing in cost-efficient technologies, diversifying asset portfolios, and maintaining financial flexibility. For instance, in the energy sector, balancing investments between traditional fossil fuels and emerging renewable technologies can mitigate risks associated with market and regulatory shifts.

Technological innovation is a driving force in the ER&I sector. Investing in research and development ("R&D") and adopting cutting-edge technologies can provide a competitive edge, enhance operational efficiency, and open new revenue streams. Strategic capital allocation towards innovation ensures that companies remain at the forefront of industry developments and can capitalise on new opportunities.

Sustainability and Environmental, Social, and Governance ("ESG") factors are increasingly critical in the ER&I sector. Companies face growing pressure to reduce their environmental footprint, improve social outcomes, and adhere to stringent regulatory standards. Strategic capital allocation towards sustainable practices, green technologies, and community development initiatives can enhance corporate reputation and meet stakeholder expectations.

Operational efficiency is paramount in the ER&I sector, where margins can be thin, and cost control is essential for profitability. Effective capital allocation drives efficiency by investing in cost-saving technologies, optimising asset utilisation, and improving supply chain management.

Below, we analyse the sources and uses of capital by the Belgian listed ER&I companies over a 10-year period.

On the sources side, one of the key takeaways is that the companies in the ER&I sector demonstrated balanced financing strategies, raising €3,725 million (4.4% of cash inflow) through the issuance of debt and €7,470 million (8.8%) from issuing equity. This balanced approach indicates a strategic use of both debt and equity to support growth initiatives and maintain financial flexibility.

Additionally, the amount of capital raised from debt and equity markets remains relatively limited compared to internally generated funds. This correlates with the general observation that the ER&I sector tends to be more mature and stable.

Moreover, we notice strong operational cash flow, with €67,924 million (80.0%) generated from operations, indicating robust performance and the ability to generate substantial cash from core business activities.

Further, strategic divestitures generated €5,745 million (6.8%), reflecting decisions to streamline operations by selling off certain assets and focusing on optimising the asset portfolio. For more trends on the evolving landscape of divestitures, refer to the 2025 Deloitte publication on divestments ([Divestments | Deloitte Belgium]).

Significant investments in growth were evident, with €44,823 million directed towards capital expenditures, highlighting substantial investments in long-term assets aimed at enhancing operational capacity and future (organic) growth. Additionally, €11,272 million was spent on cash acquisitions to expand market presence and capabilities (inorganic growth).

Lastly, the companies showed a strong commitment to shareholder returns, paying out €14,865 million in total cash dividends. This demonstrates the importance placed on maintaining shareholder satisfaction and confidence. Overall, the graph underscores the significance of strong operational performance, strategic asset management, balanced financing, significant growth investments, and a commitment to shareholder returns in the ER&I sector.

Comparing these results to the overall BelAllShares capital flow results, some remarks can be made. Please note that some of the companies included in this analysis have regulated asset bases, which could have an impact on the following results:

- The ER&I companies rely more heavily on cash flows from operations than the BelAllShares (80.0% vs. 71.5%).
- The BelAllShares companies rely more heavily on debt financing (9.9%) compared to the ER&I companies (4.4%). This indicates that BelAllShares companies are more inclined to use debt as a source of capital. This could possibly be explained by the easier access to debt financing due to their larger size.
- For the ER&I companies, a larger part of the uses of cash goes towards reinvestment in the business (cash acquisitions and capital expenditures) than for the BelAllShares companies (71.5% vs. 67.3%). This could be related to the fact that on average the companies in the ER&I sector tend to have more heavy asset bases, requiring more substantial CapEx investments than other sectors. Additionally, these companies face more scrutiny on the impact of strong sustainability requirements and the energy transition than others.
- In turn, the BelAllShares companies tend to distribute a larger portion of capital to their shareholders in the form of cash dividend payments (31.7% compared to 18.9% of total outflow)
- The other financing activities seem to be a source of cash for the BelAllShares companies and a use of cash for the ER&I companies. These other financing activities relate to cash interest paid, acquisition of non-controlling interest.

5. The Strategic Imperative of Efficient Capital Allocation

In conclusion, the importance of efficient capital allocation cannot be overstated. Companies that master the art of strategically deploying their financial resources are better positioned to achieve sustainable growth and long-term success. By focusing on nuanced opportunities and leveraging advanced analytical techniques, businesses can uncover hidden efficiencies and make more informed decisions. The ability to align capital allocation with strategic objectives not only enhances operational performance but also drives value creation for all stakeholders.

To ensure funds are channelled in the right direction and have the most impact, capital allocation should be embedded in all organisational processes. This integration ensures that every decision, from daily operations to long-term investments, is made with a clear understanding of its financial implications and strategic importance. As the business landscape continues to evolve, those who prioritise and refine their capital allocation strategies, embedding them into the core of their operations, will undoubtedly stand out in their respective industries.

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