

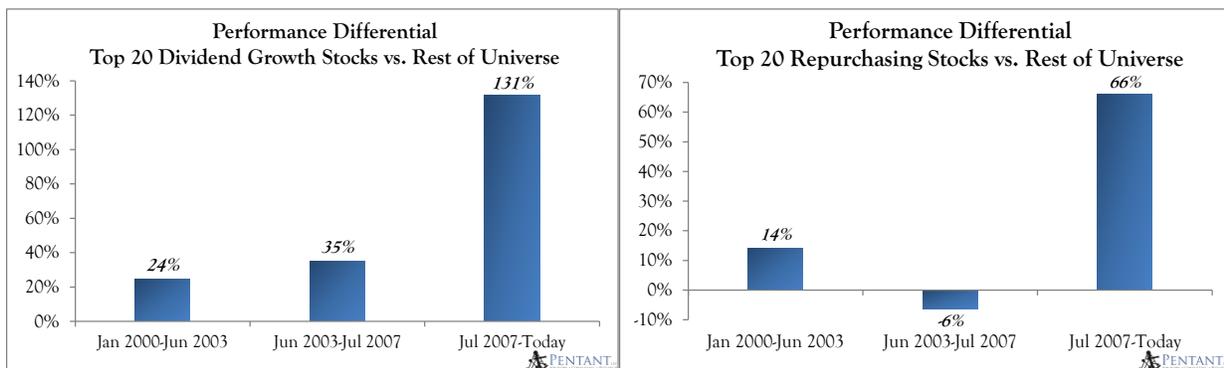
Capital Allocation – Giving It Back!

Executive Summary

We have recently published extensive work on the topic of corporate optimism – our findings indicate that management teams that are habitually over-optimistic about their businesses make poor capital allocation decisions that erode returns and result in chronic underperformance. One logical follow on to this analysis centers on the issue of capital allocation, particularly, would you be better off simply returning capital to shareholders? Our work on this topic focuses on the two main avenues of capital return to shareholders: dividends and share repurchase.

Of note, over the past 15 years, the top 20 dividend growth stocks within Industrials & Materials have significantly outperformed the rest of the universe, regardless of the rate environment. The top repurchasers only outperform in declining rate environments, and the magnitude of the outperformance is roughly half of that for the top dividend growth stocks.

For any management team, the charts below are hard to ignore – if you are not in one of the groups highlighted in either chart – why not? In the current very cheap debt market some companies can probably get away with lower than historic coverage ratios and still achieve the benefits of higher payouts and/or more buy back.



In the dividend work, we analyze the possibility of raising payouts at the expense of capital expenditures, to the extent allowed without depleting spending below maintenance levels. We analyze the alternative use of that cash as capital spending and how many years it would take at a normal return on capital to equal the TSR of an increase in the dividend today, assuming the stock sees only 50% of the upside implied if prices react to maintain current yields.

Pentant Disclaimer and Sources

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Sources:

All of the data shown in the charts in this report and mentioned through the text were obtained from publicly available sources and corporate reports, much of it aggregated through Capital IQ. We also use Bloomberg, IHS and government data bases.