NASHVILLE NOTES

Capital Distributions vs. Capital Incinerations

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Jeff Davis is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence; Mercer Capital, where Davis is the managing director of the financial institutions group; or StillPoint Capital, where Davis is a registered representative.

The late Richard Russell, publisher of the Dow Theory Newsletter, had an insightful saying about the US stock market: *Markets make opinions*. Given the hype around the Space Exploration Technologies Corp. initial public offering, and the company's post-IPO valuation of roughly $2 trillion versus $19 billion of revenue and negative EBITDA, opinions are decidedly bullish.

SpaceX beat OpenAI Inc. and Anthropic PBC to market, raising $86 billion before expenses, including exercise of the green shoe by underwriters. Like SpaceX, both of those companies apparently generate substantial losses. Not to worry, however. There is another market expression that is apropos: *When the ducks are quacking, feed them*.

The amount of capital that the hyper-scalers and smaller companies in and around the AI and "space" ecosphere have and will consume is astounding. The recent $80 billion equity raise by Alphabet Inc., anchored with a $10 billion investment from Berkshire Hathaway Inc., speaks to the stakes in this technology arms race. Alphabet, an asset-light model until the last couple of years, last raised equity via a public offering in 2006, two years after its IPO.

In 2023, Alphabet generated $102 billion of cash from operations that funded $62 billion of share repurchases and $32 billion of capital expenditures. In the 12 months ended March 31, the company generated $174 billion of cash from operations that funded $10 billion of common dividends (initiated in 2024), $31 billion of repurchases, and $109 billion of capital expenditures. Net free cash flow is positive, but the $80 billion equity raise points to future capex spending.

The math for other tech giants is similar. Amazon.com Inc. generated $149 billion of cash flow from operations in the last-12-months period that funded $151 billion of capital expenditures. Amazon plows all of its cash flow back into operations as the company does not pay a common dividend and has not repurchased shares. Oracle Corp., subject of some investor concern about its finances, produced $32 billion of cash from operations in the last-12-months period and incurred $56 billion of capex.

> ***Stock issuance by large tech companies stands in contrast to the big banks, which generate more capital than can be profitably reinvested.***

Wall Street expects others to tap the public equity markets for significant capital, so much so that equity issuance may exceed repurchases over the next couple of years, after years of shrinkage through relentless repurchases. If so, it will be an experiment in the impact on the equity market.

The issuance of shares by large tech companies stands in contrast to JPMorgan Chase & Co., Bank of America Corp., Wells Fargo & Co., Goldman Sachs Group Inc., Morgan Stanley and other large banks — and some regionals — that generate more capital than can be profitably reinvested. Ideally repurchases would occur at cheaper valuations, as was the case in 2023 and 2024, but valuations and profitability ebb and flow.

Jamie Dimon may not like repurchasing shares at around 3x tangible book value, but what are his choices with a 14.1% common equity Tier 1 ratio as of March 31, absent an expectation that the credit cycle is going to roll over soon? Besides, most CFOs would prefer to repurchase shares to lower the "per share" bar on a go-forward basis than pay special dividends.

The contrast will be highlighted this week when the Federal Reserve releases the results of its 2026 Comprehensive Capital Analysis and Review and Dodd-Frank Act stress test evaluation process. The banks will quickly follow the release with capital action announcements that will surprise no one in terms of dividend increases and share repurchases for the coming year.

The difference between banks and AI, "space" and technology companies more generally is striking and represents an inversion of past decades. Many banks had to recapitalize after 2008 by issuing common stock at low prices. Now they are repurchasing lots of shares because existing capital is high, or high enough, and internally generated capital exceeds what is needed for projected asset growth.

> ***Artificial intelligence companies' massive opportunities may live up to the hype, or prove to be economic busts.***

AI-related companies are spending and raising capital because they do not have enough capital relative to their massive opportunities, which may either live up to the economic hype or prove to be economic busts like over-investment in the railroads in the late 19th century and telecom in the late 20th century.

The punchline is that a banking industry once viewed as suspect in terms of capital adequacy has been a solid capital distributor for years, while an industry viewed as the most asset-light generator of wealth has become one of the world's largest capital consumers and possibly incinerators.

One permutation is that large banks may see their multiples expand somewhat until investors become convinced the credit cycle is turning. If so, the repurchases will stop then, too.

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