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Europe: Opportunity in Fragmentation

KEY TAKEAWAYS

- Despite its weaker historical growth relative to the U.S., Europe offers compelling investment opportunities for flexible capital providers because of its market fragmentation, lower valuations and less crowded capital markets. Even amidst the elevated uncertainty around tariffs and the prospect of a global trade war, we believe the underlying factors that make Europe an attractive market remain.
- Europe's public equity markets are near their steepest discount relative to the U.S. since 1990 in terms of both regular and sector-weighted P/E and PEG multiples.[1] Moreover, the cost of capital in Europe has become higher than in the U.S.
- Structurally, we expect the regulatory-induced de-risking by European banks to continue, which we believe will result in attractive buying and financing opportunities. Relative to U.S. banks, European banks retain a larger portion of loans but are increasingly looking to improve balance sheet returns through capital optimization. As a result, we expect to see more non-performing credit sales and synthetic risk transfer (SRT) transactions, and less competition for complex, bespoke financings.
- We also believe Europe is ripe with potential for driving operational improvements, especially among unlisted small and medium-sized enterprises (SMEs). Moreover, there is significantly less private capital in Europe chasing these opportunities, which leaves a void that minority equity and structured credit providers can fill.
- Despite weaker public equity market returns and GDP growth since 2000, European private equity returns have outperformed U.S. PE returns during the same period. We believe this is a function of Europe's relative private capital scarcity.
- We believe the factors driving private market outperformance—less capital chasing deals and more potential for "operational alpha"—will persist for the foreseeable future, making Europe an attractive market for opportunistic, flexible capital.

In recent years, there has been significant pessimism surrounding Europe due to its anemic economic trends: lower GDP and productivity growth than the U.S., and weak demographics.[2] The region's equity market currently trades at a 24% discount to the U.S. equity market, even after adjustments that neutralize the greater tech concentration in the U.S.[3] This discount is at the 95th percentile based on data since 1990.

We believe, however, that this European discount overstates what is warranted by fundamentals, and that there are compelling investment opportunities in public and private credit, equity, and real estate markets in Europe and the U.K.

> "The fragmentation and market inefficiencies…actually create attractive opportunities for flexible capital providers."

The fragmentation and market inefficiencies that characterize Europe's financial system, in our view, actually create attractive opportunities for flexible capital providers. Europe's regulatory capital regime is more punitive than the U.S. system. EU regulations—many of which were borne out of the Eurozone debt crisis to address cross-country variations in sovereign debt-to-GDP ratios and prevent disproportionate bailouts across the Eurozone—limit capital flow from banks and insurance companies across national borders. Additionally, European capital markets are not as active or deep as they are in the U.S., and European retail investors and pension funds are under-invested in risk assets compared to their U.S. counterparts.

European banks provide a much higher proportion of financing in Europe than their U.S. counterparts. At the same time, European banks are more constrained by regulation. In the current higher interest rate environment, balance sheet retrenchment means private capital is becoming a more compelling alternative for European borrowers. The opportunity is especially noteworthy for flexible credit providers, especially those that have the expertise to underwrite less traditional borrowers, offer bespoke terms and deploy capital faster than banks.

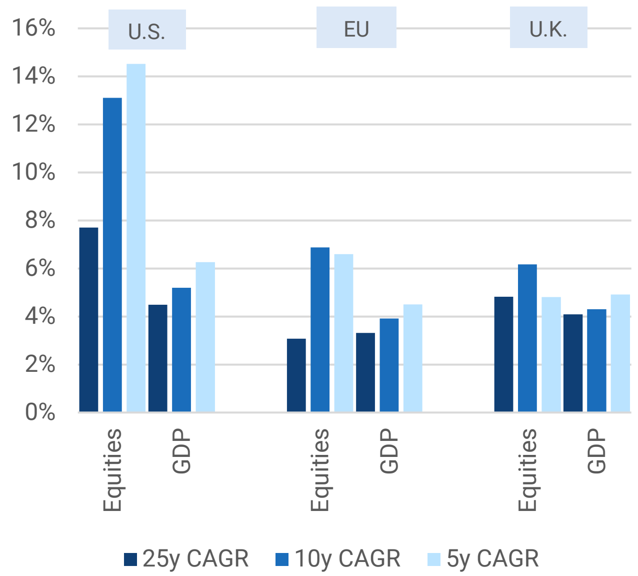
EUROPE LAGS…

The U.S. has outperformed Europe and the U.K. in both economic and market terms over the last 25 years, leading to the proliferation of the term "American exceptionalism." This outperformance has become even more stark over the last five fiscal years. Total U.S. equity returns grew at an annual rate of about 14% during this time period versus about 6% for European equities. U.S. nominal GDP grew at slightly over 6%, while nominal GDP growth in the EU was just over 4%. (See Exhibit 1). Even though Europe's market performance in Q1 2025 has inverted relative to the U.S. (+6.3% versus -4.6% respectively), Europe's medium and long-term performance remains relatively weak.

> "Even amidst the elevated uncertainty around tariffs and the prospect of a global trade war…the underlying factors that make Europe an attracive market remain."

Exhibit 1: U.S. Outperformance Since 2000

Total Equity Return and Nominal GDP Growth (2000-2024)



Source: S&P 500, MSCI Euro Area, FTSE All-Share index (UK), Eurostat, Federal Reserve, Bloomberg L.P.

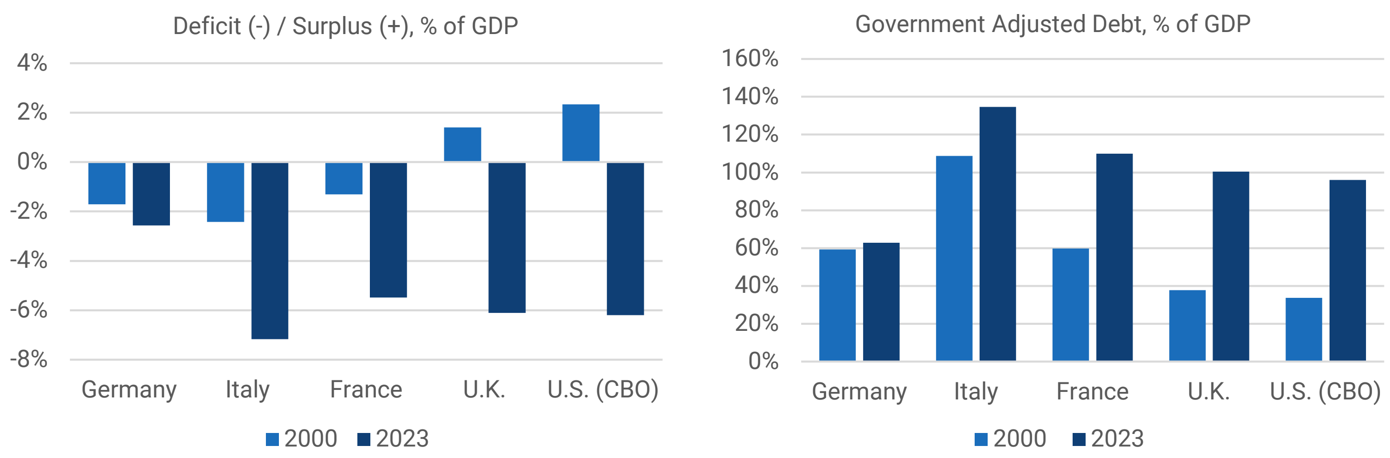
Much of the delta in economic and market performance between the U.S. and Europe can be explained by higher productivity growth in the U.S. A recent EU competitiveness report authored by Mario Draghi, former president of the European Central Bank, noted that the EU was, in labor terms, roughly 80% as productive as the U.S. in 2024, down from 95% in 1995.[4] In addition, since 2000, real disposable income in the U.S. has grown almost twice as much as in Europe. The difference in GDP per capita can be explained by the productivity gap (72%) and the labor gap (28%).[5] This manifests in U.S. companies' consistently higher corporate margins, growth and return on invested capital relative to companies in the U.K. and Europe.

Other attributes driving the U.S. economic and market outperformance include: less regulation, structural tailwinds from the 2017 tax cuts, significantly higher skew towards technology, benefits from immigration, economies of scale from having one large addressable market, and a federal government that has been very responsive with fiscal stimulus.

… BUT U.S. EXCEPTIONALISM MAY HAVE (DEBT) LIMITS

On the flip side, the U.S. has consistently run large fiscal deficits. Since 2000, U.S. debt-to-GDP has nearly tripled—from less than 35% in 2000 to almost 100% in 2023. (See Exhibit 2.)

Exhibit 2: U.S. Fiscal Position Has Deteriorated Dramatically Despite the "Exceptionalism"



Source: Eurostat, U.S. Congressional Budget Office.[6]

Lower defense spending in Europe explains a large part of this divergence. Since 2000, U.S. defense spending has ranged from about 3% to 4.5% of GDP, whereas the U.K. has been consistently below 2.5% and European countries in aggregate have been below 1.5%. European spending has fallen over time; between 1960 and 2000, defense spending in Europe was between 2-3% of GDP.[7] We note that defense spending has become a priority for many European countries in 2025.

Given the relative fiscal positions between Europe and the U.S., both European pessimism and American exceptionalism may be overstated. Hoover Institution historian Niall Ferguson posited in his white paper titled "Ferguson's Law" that any great power that spends more on debt service than defense risks ceasing to be a great power.[8] The U.S. violated Ferguson's Law in 2024.

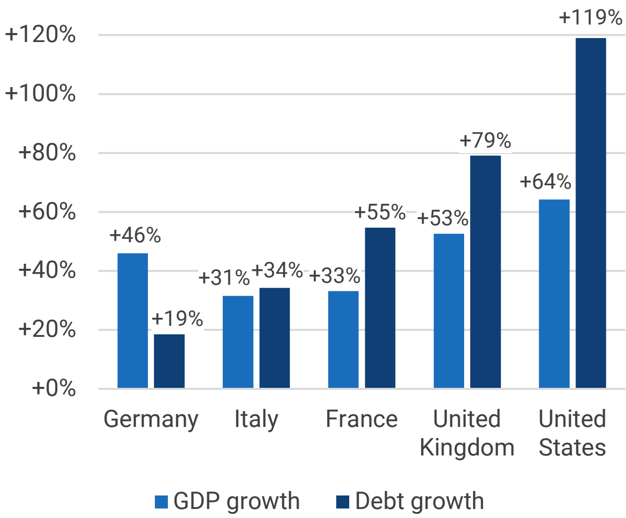
> "Given the relative fiscal positions between Europe and the U.S., both European pessimism and American exceptionalism may be overstated."

Europe, on the other hand, has been spending less relative to its growth. We analyzed the relationship between debt and GDP growth and found that, from 2013 through 2023, debt in Germany rose just 19% while its GDP rose 46%. In contrast, even though U.S. GDP growth outpaced European countries during that same period, U.S. debt growth was exceptional—nearly doubling the rate of its GDP growth. (See Exhibit 3.)

The Trump Administration appears to recognize that the U.S. is approaching the limit on how much more debt it can take on as a percentage of GDP. U.S. Treasury Secretary Scott Bessent recently called for the U.S. economy to undergo a "detox period" from fiscal stimulus in order to halt the current debt-growth trend.[9] Conversely, Germany has significantly more room to increase its debt relative to its growth—and defense spending, in particular. The German chancellor-in-waiting, Friedrich Merz, has been building momentum for political consensus and the necessary parliamentary support to raise the country's constitutional debt cap, which may fuel future economic growth.

Exhibit 3: Europe Has Spent Less Relative to its (Low) Growth

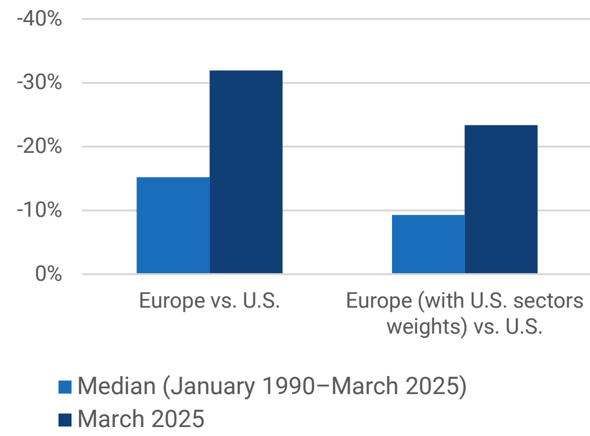
Government Debt and Nominal GDP Growth (2013-2023)



Source: Eurostat, U.S. Congressional Budget Office.[6]

Exhibit 4: Europe's Valuation Discount to the U.S. Near Its Steepest in 35 Years

12-Month Forward P/E Ratio: Europe vs. U.S. Discount (1990-Q1 2025)



Source: Datastream, STOXX, Worldscope, Goldman Sachs Global Investment Research. Consensus 12-month forward earnings.

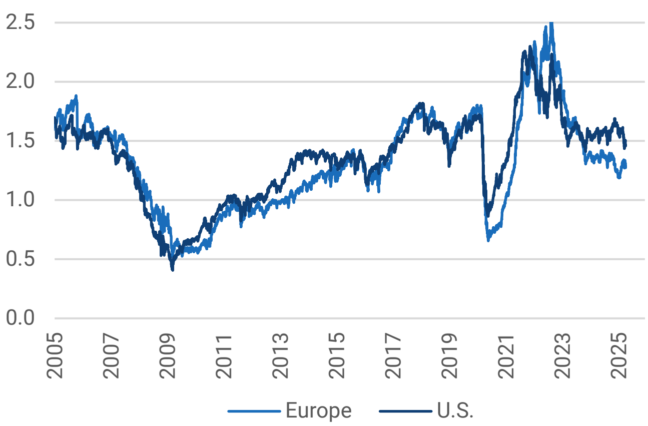
MIND THE (VALUATION) GAP

The superior U.S. equity market performance is partially explained by higher multiples of the S&P 500 Index versus the Stoxx 600 Index. U.S. valuations appear to have outgrown fundamentals, with aggressive earnings growth expectations priced in, which may portend a challenging outlook for U.S. equities. Comparatively, European valuations are near their steepest discount as compared to the U.S. going back to 1990. As measured by the 12-month forward P/E ratio of 13.8x for Europe versus 20.3x for the U.S., the European discount is currently about 32%. Even after sector weighting adjustments to address the greater concentration of technology companies in the U.S., the European discount is at 24%,[10] which is at the 95th percentile based on data since 1990, after reaching the 100th percentile in November 2024. (See Exhibit 4.)

The lower European valuations, however, are not explained by lower growth rates. The PEG ratio in Europe (1.27x) is lower than in the U.S. (1.47x). (See Exhibit 5.) Valuations in the U.K. are even lower; the current U.K. discount relative to the U.S., as measured by the 12-month forward P/E ratio, is 41%. It is 31% with sector weighting adjustments.[11]

Exhibit 5: Europe's PEG Ratio Is Also Lower

PEG Ratio: Europe vs. U.S. (2005-Q1 2025)



Source: Datastream, STOXX Worldscope, Goldman Sachs Global Investment Research.

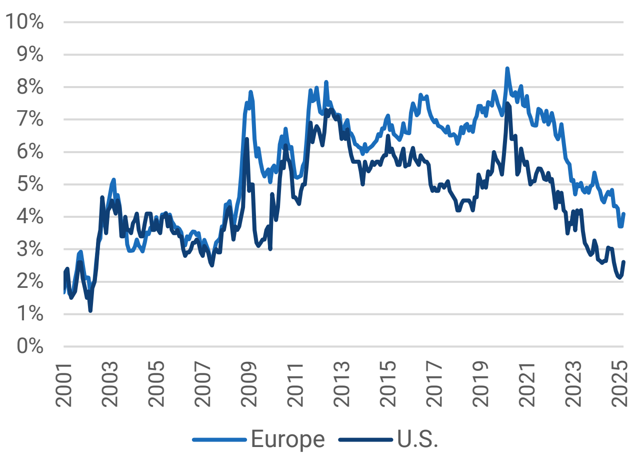
> "Even after sector weighting adjustments to address the greater concentration of technology companies in the U.S., the European discount is at 24%, which is at the 95th percentile based on data since 1990."

A HIGHER COST OF CAPITAL

The cost of capital is currently higher in Europe than in the U.S. The equity risk premium in Europe—as measured by the difference between the earnings yield and the corresponding risk-free rate—is 4.1%, higher than the 2.6% in the U.S. (See Exhibit 6.)

Exhibit 6: Europe's Higher Equity Risk Premium

Implied Equity Risk Premium: Europe vs. U.S. (2001-Q1 2025)



Source: Goldman Sachs Global Investment Research.

Credit spreads are also elevated in Europe versus the U.S. across leveraged loans (51 bps higher)[12] and direct lending (56 bps higher).[13] However, the higher spreads do not appear to be related to leverage. On average, the respective leverage ratios in Europe and the U.S. are comparable, both in the low 4s as a multiple of EBITDA. Even real estate cap rate spreads[14] and synthetic risk transfer spreads are higher in Europe.[15]

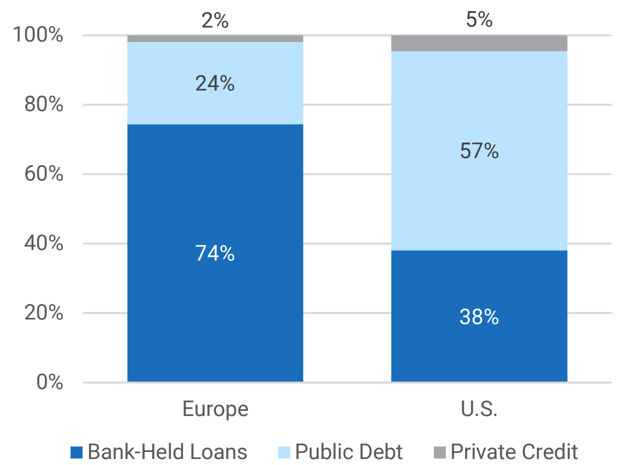
From an investor's perspective, we believe the higher cost of capital as measured by higher equity risk premiums and higher credit spreads, makes up for Europe's lower growth and renders it an attractive market.

BANKS TAKE ALL THE CREDIT

Europe is a bank-led financing market; European banks provide 74% of non-financial corporation credit. In contrast, financing is markets-led in the U.S., with U.S. banks providing just 38% of non-financial corporation credit and the balance coming from public and private credit markets. (See Exhibit 7.)

Exhibit 7: Europe's Financing Market Is Bank-Led; U.S. Financing Is Markets-Led

Corporate Financing Market Share By Source (as of Q3 2024)

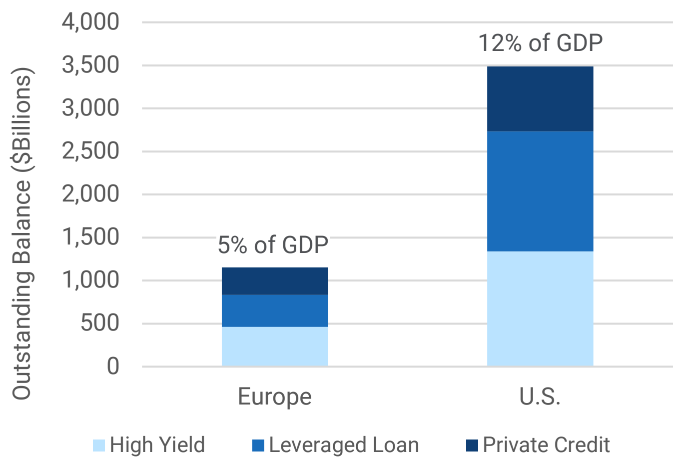


Source: Morgan Stanley, Haver Analytics, Cobalt.

The cumulative size of the high-yield bond, leveraged loan and private credit market in the U.K. and Europe—i.e., the "investor-owned leveraged credit market"—is approximately €1.1 trillion, or about 5% of GDP. The equivalent U.S. market is approximately $3.5 trillion in size and about 12% of the U.S. GDP. To put these two investor-owned leveraged credit markets in perspective, the European market is 34% of the U.S. market in nominal terms and about 42% in GDP terms.[16] (See Exhibit 8.)

Exhibit 8: Europe's "Investor-Owned" Leveraged Credit Market Dwarfed By the U.S. Equivalent

Outstanding Leveraged Credit Balance (Q2 2024)



Source: Pitchbook Data, Inc.; ICE BofA Bond Indexes; Preqin Ltd. private credit unrealized value; Eurostat, Federal Reserve.

Europe's more bank-led financing market is in part due to differences in the regulatory regime. In the U.S., external credit ratings cannot be used to assign exposure risk weights, which has encouraged U.S. banks to syndicate loans to investors rather than hold them. The net effect of this limitation is that bank lending in the U.S. is more capital-intensive than it is in Europe, where banks generally retain the loans they provide.[17] We believe this has also contributed to the growth of the U.S. private credit market.

> "Despite European banks' dominant role as credit providers, they are constrained by the regulatory environment, which limits their ability to extend credit to smaller businesses, riskier segments or more complicated underwrites."

Despite European banks' dominant role as credit providers, they are constrained by the regulatory environment, which limits their ability to extend credit to smaller businesses, riskier segments or more complicated underwrites. For example, a European bank in one jurisdiction might not extend credit based on collateral located in another jurisdiction. Or, a bank that specializes in asset-backed lending might not factor into its underwriting a borrower's operating cash flow or intangibles, thus offering insufficient credit to the borrower despite significant value coverage. In our view, these types of limitations create white space for alternative capital providers that can provide hybrid solutions.

TAKEAWAY FOR INVESTORS

The Bank Seller Dynamic in Europe

European banks hold a disproportionate amount of corporate credit but, due to regulations and associated capital charges, will sometimes exit situations that become challenging. This creates opportunity for credit investors that have experience with navigating restructuring processes in local jurisdictions, as well as the ability (and willingness) to structure transactions that could result in owning equity post-restructuring.

Spotlight on Atos

Atos is a French-listed, leading European IT-services company that specializes in infrastructure, big data management, cloud and cybersecurity, with €9.7 billion of revenues and €333 million of EBITDA in 2024. Facing an unsustainable capital structure with nearly 15x gross leverage, disappointing operating performance and a costly yet incomplete separation of its two main businesses, Atos entered French conciliation proceedings in March 2024. The Atos capital structure consisted of a mix of revolver, term loan and bond debt. The holder base varied dramatically across the different debt types, with the revolver and term loan primarily held by banks and the bonds primarily held by investment firms.

Because new money was required as part of the restructuring process, some of the legacy banks either chose not to participate or were unable to meet the expedited timeline, thus forgoing attractive economics and features such as elevation rights on existing debt. As a result, other holders in the same group as the banks received a higher allocation of new money (and the associated elevation rights) than members of the bond group, which did not benefit from a similar "bank dynamic."

In our December 2024 white paper, "*The Tides of Credit: Opportunity in Dispersion*," we discuss the dispersion—or very different paths and outcomes of recovery—that exist within a single capital structure as a result of a liability management exercise (LME) followed by a bankruptcy. Similarly, Atos exemplifies the ways in which bankruptcy recoveries can vary dramatically depending on whether creditors participate in new money financings. In the case of Atos, recoveries on the legacy debt (based on quoted markets) ranged from single-digit percentages (for legacy debt that did not participate in the new financing) to the 30s-to-40s (for legacy debt that participated). And because certain banks did not participate in the new money, some creditors had the ability to participate beyond their ratable allocations, further boosting recoveries.

This scenario would generally not exist in the U.S., as capital structures tend to be investor-owned (versus bank-owned) and therefore the regulatory overlay is not a factor. While mutual fund and collateral loan obligation (CLO) holders in the U.S. were sometimes "forced sellers" in distressed situations about 10 or 15 years ago, this dynamic no longer exists to the same degree; these holders have increasingly improved their workout capabilities and the flexibility of their mandates, allowing them to be active in restructurings when necessary.

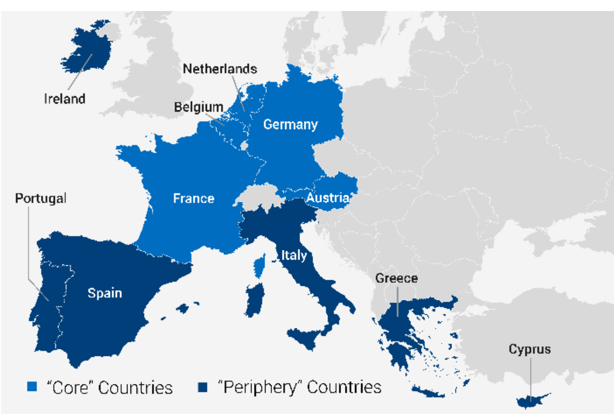
PIECING TOGETHER THE FRAGMENTS

Notwithstanding the formation of the EU as a single market, the regulatory regime in Europe constrains the free flow of bank and insurance capital beyond national borders, creating inefficiencies in capital deployment. This dynamic, combined with a more risk-averse culture relative to the U.S., has lessened competition, especially for more nuanced, cross-jurisdictional deals. As a result, we see potential opportunities for specialized investors that can navigate complexity, and the different laws and processes across the fragmented regulatory landscape.

Due to higher capital charges for non-domestic assets, bank and insurance capital in Europe does not always flow dynamically to the best opportunities. For example, a German insurer is advantaged to invest in German assets over French assets.

> "We see potential opportunities for specialized investors that can navigate complexity, and the different laws and processes across the fragmented regulatory landscape."

Similarly, a German bank is incentivized to focus on German mortgages, even if the opportunity in Portugal might be superior. Data from the European Insurance and Occupational Pensions Authority (EIOPA) show EU insurance companies' home-country bias as they favor domestic government bonds, equities and real estate in their investments.

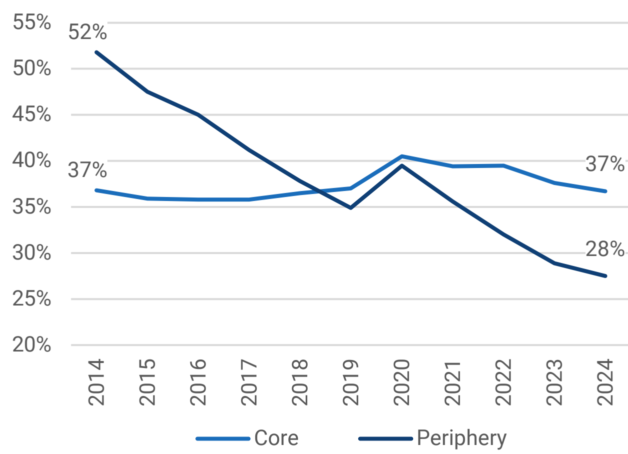


Post the Eurozone crisis, from 2014 to 2024, bank lending to non-financial corporations in what were then-termed "periphery" countries declined from over 50% to under 30% of the GDP of these countries, while outstanding loans as a percentage of "core" countries' GDP remained steady at around 37%. (See Exhibit 9.)

Over that same period, the "periphery" countries grew at roughly twice the rate as the "core" countries (around 2% annualized GDP growth in the "periphery" versus just over 1% for the "core"). (See Exhibit 10.) We believe this dynamic has resulted in the "periphery" countries being underbanked post the Eurozone crisis, creating significant opportunities for investors in countries like Portugal and Spain, where GDP growth has been accelerating.

Exhibit 9: Outstanding Loans in "Periphery" Countries Declined…

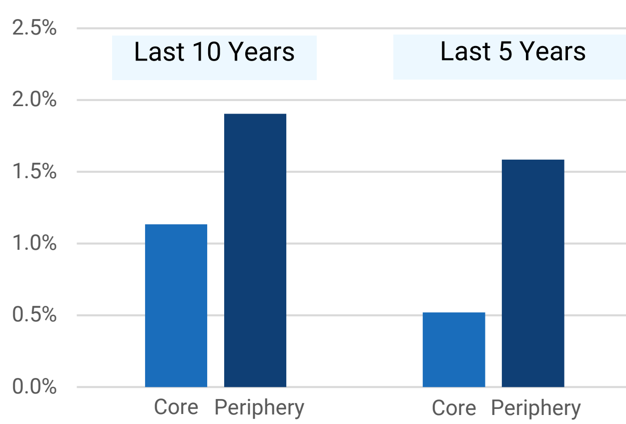
Bank Lending to Non-Financial Corporations (by country as % of GDP) (2014-2024)



Source: European Central Bank.

Exhibit 10: …While "Periphery" GDP Growth Outpaced "Core"

Annualized Real GDP Growth (2014-2024)



Source: European Central Bank.

TAKEAWAY FOR INVESTORS

Spotlight on Portuguese Real Estate Portfolio[18]

The opportunity to capitalize on the bank seller dynamic also applies to real estate. Post the Eurozone crisis, the "periphery" countries of Europe have been a source of opportunity for investors as local banks have sought to unload assets that were repossessed post the GFC.

In Portugal, as in other part of the "periphery," banks had over-extended credit to real estate developers and owners, and in many instances became the owners of these assets, occasionally alongside other banks. We characterize assets in these situations as "orphan" assets because the holder is not a typical owner and might not be willing to invest capital to maximize the assets' value.

Starting in 2020, a syndicate of Portuguese banks sought to unload a large portfolio of both hospitality and residential assets located primarily in the Algarve, a prime leisure destination in southern Portugal. In addition to its natural beauty, the coastline location benefits from low relative cost, low crime rates, consistent sunshine, English proficiency, solid flight volumes, and the infrastructure and amenities to support further development. This portfolio sale represented the largest of its kind in Portugal's history and stands out because of the high quality, well-located assets that its owners were unable or unwilling to optimize. The combination of the portfolio's diverse asset mix and its large size—as well as the challenge of complex negotiations with a consortium of banks, which limited the universe of potential buyers—contributed to an attractive valuation.

We believe this opportunity is representative of the ways in which banks can become "unnatural" owners of assets and, in turn, sellers of "orphan" assets to more opportunistic investors who have the patience, capital and experience to navigate complex transactions.

A MORE SECUR(ITIZED) TOMORROW?

Another example of Europe's less robust capital markets is its considerably smaller securitization market. In 2024, issuance accounted for just under 1% of GDP in Europe compared to almost 5% in the U.S.[19] As a corollary, the life insurance industry in Europe and the U.S. are of comparable size but the European life insurance industry holds less than 1% of investment assets in securitizations while U.S. counterparts hold 17%.[20]

The Draghi report noted that securitizations could "act as a substitute for lack of capital market integration by allowing banks to package loans originating in different Member States into standardized and tradeable assets that can be purchased also by non-bank investors."[21] Securitizations can help banks transfer risk, free up capital and increase lending capacity and velocity.

In fairness, part of the explanation for the differences in size of the securitization markets is attributable to the two regions' different mortgage markets. In the U.S., agency mortgages comprise the vast majority of the securitization market. They are guaranteed by government-sponsored enterprises (GSEs) Fannie Mae, Freddie Mac and Ginnie Mae, and benefit from an "implicit government guarantee." In Europe, the covered bond market acts as a replacement for mortgage-backed securitizations.

> "Due to higher capital charges for non-domestic assets, bank and insurance capital in Europe does not always flow dynamically to the best opportunities."

Covered bonds allow banks to sell bonds backed by both a pool of mortgage assets *and* a bank guaranty—for very low spreads. These covered bonds are sold primarily to insurance companies and pension funds but by retaining the guaranty, European banks are unable to fully transfer the risk. Interestingly, post-GFC, the covered bond market in Europe has grown while its securitization market has shrunk (in part due to capital charges that disfavor securitizations).

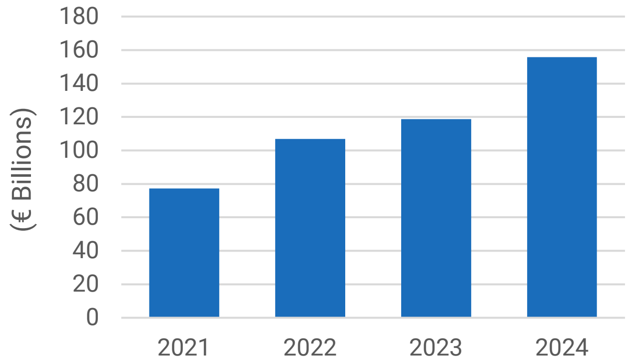
Lastly, with the implementation of Basel III, we believe European banks will continue to look for capital relief. One solution is the SRT securitization, which frees up regulatory capital by transferring the risk of a tranche of a loan portfolio to another investor. SRT transactions have been more prevalent in Europe than in the U.S. Many banks across Europe are deploying SRTs as a strategic tool to optimize capital efficiency—whether to navigate ongoing capital constraints that limit lending to key customer segments or to support strategic acquisitions, as highlighted in our spotlight example of Attica Bank.

> "Many banks across Europe are deploying synthetic risk transfer (SRT) transactions as a strategic tool to optimize capital efficiency."

SRT issuance in Europe was €156 billion in 2024, up from €77 billion in 2021. (See Exhibit 11.) Corporate and SME loans comprise the vast majority of underlying assets, with consumer loans as the next most prevalent asset class and exhibiting significant growth.[22]

Exhibit 11: Increasing European SRTs

Annual SRT Issuance (2021-2024)



Source: AFME Finance for Europe

TAKEAWAY FOR INVESTORS

Spotlight on Attica Bank

Even in the more esoteric world of structured products, the same bank seller dynamics exist. Banks are often looking to sell non-core assets or execute SRTs in order to free up regulatory capital. In many instances, these transactions facilitate growth objectives and have been important to the recovery of Europe's "periphery" economies post the Eurozone crisis.

In 2024, Attica Bank needed to unlock a share capital release in order to facilitate a merger with Pancreta Bank, a regional cooperative bank in Greece. To do so, Attica Bank sold two non-performing loan securitizations. In addition, the bank also strengthened its capital position by purchasing protection via a mezzanine tranche in an SRT transaction on a portfolio of approximately €200 million of performing corporate and SME exposures.

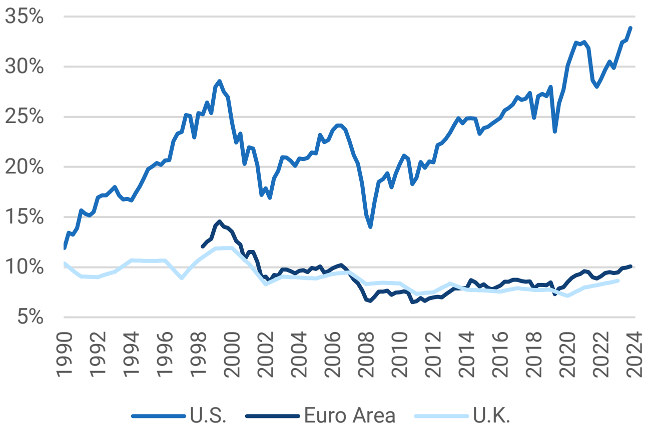
These regulatory capital-driven transactions, along with the acquisition of Pancreta Bank, catapulted Attica Bank to become the fifth largest bank in Greece and the main challenger to Greece's four "systemic" banks.

FEELING LESS INVESTED?

Beyond demographic and regulatory reasons, we believe there are cultural factors that explain Europe's slower growth, including a more risk averse orientation. European households have significantly lower rates of investing compared to the U.S. In 2024, households in Europe had around 10% of their financial wealth in listed equities; in the U.S., that number was 34%.[23] In 1990, these rates were much closer, but the gap widened post-GFC given Europe's slower recovery. (See Exhibit 12.) As of the end of 2024, households in Europe had around 32% of their assets in cash and cash equivalents versus 15% in the U.S.[24] Europe's lower level of household investment in capital markets, in our view, results in scarcer risk capital for productive private sector investments, which in turn can lead to slower growth, lower valuations and reduced liquidity.

Exhibit 12: European Households Have Less Wealth in Listed Equities Than U.S. Households

Listed Equities as a Percentage of Total Household Financial Assets (1990-2024)



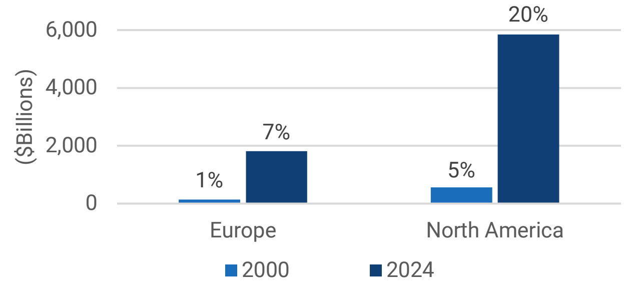
Source: Federal Reserve U.S. Financial Accounts (Sep 2024), ECB Euro Area Accounts (Sep 2024), U.K. National Accounts Blue Book (Dec 2023).

LESS CAPITAL, MORE RETURN

Just as there are dramatically lower rates of household investment in equities in Europe, there is also considerably less dedicated private equity and venture capital. Europe's dedicated private equity AUM is about one-third the size of North America's in both nominal and GDP terms. (See Exhibit 13.) Venture capital AUM in Europe is 73% lower than the U.S. as a percentage of GDP.[25] We believe this lack of dedicated private equity capital in Europe leaves space that minority equity and structured credit providers can fill.

Exhibit 13: Europe's PE Capital Is a Fraction of North America's in Nominal and GDP Terms

Private Equity AUM / % of GDP



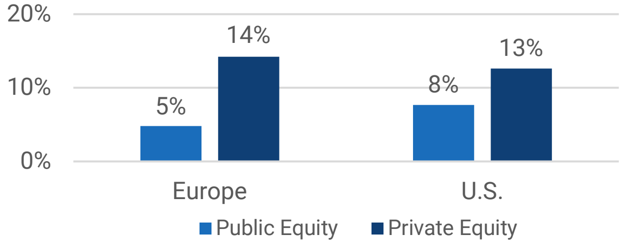
Source: Preqin Ltd., Eurostat, Federal Reserve, OECD, DKCM Research. PE AUM includes dry powder.

While Europe has proportionately less private capital than the U.S., private market returns in Europe have been strong—which we find noteworthy given Europe's weak public market performance. Since 2000, the European public equity market has underperformed the U.S. by 37%. Over that same period, European PE returns modestly exceeded U.S. PE returns.[26] (See Exhibit 14.) We believe this is attributable to advantages that local dedicated European investors have in sourcing deals in addition to generally less competition and lower entry points in European deals. In addition, lower institutional ownership in Europe suggests there may be greater opportunities to drive returns through growth, consolidation and margin improvement.

Moreover, what constrains organic public market growth in Europe can present opportunity for private investors to harness. Many European SMEs are deeply embedded in critical sectors. Even though these SMEs may have difficulties accessing traditional capital, they demonstrate resilience and growth potential. For example, some European SMEs may find it challenging to navigate the complexities of entering foreign markets. Private investors, especially those with global footprints, can help these SMEs grow and expand beyond their local markets. Also, many European SMEs are entrepreneur or family-owned and face succession challenges, which provides opportunities for capital providers who can enable succession.

Exhibit 14: Europe PE Returns Outperformed the U.S. While Its Public Equity Returns Underperformed

Private and Public Equity Returns (2000–Q3 2024)



Source: Bloomberg L.P., Cambridge Associates US Private Equity Index and Europe Private Equity Index by S&P Dow Jones Indices.

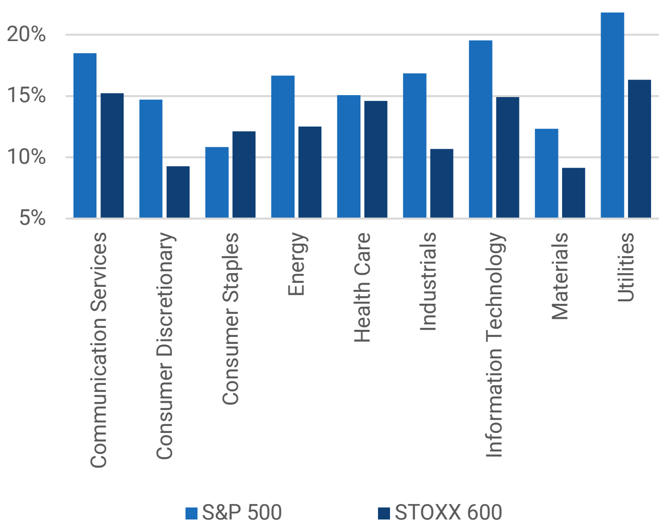
"OPERATIONAL ALPHA"

We also see a significant opportunity to improve profit margins and management-shareholder alignment—or "operational alpha"—at unlisted European SMEs, which are often the backbone of local economies.

Across nearly every sector, European public companies have lower median operating margins than their U.S. counterparts. (See Exhibit 15.) While some of this may be attributed to the labor productivity gap we highlighted earlier, we believe that Europe's under-investment in technology is a primary reason.[27] This dynamic is also at work with European private companies, which may potentially offer up some quick wins to drive growth and improve margins at these companies.

Exhibit 15: European Public Companies Have Lower Median Operating Margins

Median Operating Margins of U.S. (S&P 500) and Europe (STOXX 600) Listed Companies by GICS Sector



Source: Bloomberg L.P., last-twelve-month data as reported as of April 1, 2025.

Private capital in Europe also has the opportunity to drive the performance of European SMEs by optimizing financial alignment between management and shareholders. In Europe, stock awards are an under-indexed component of executive compensation compared to the U.S. In 2024, stock awards comprised 26% of European public company executive compensation; in the U.S., that number was 65%.[28] We believe private capital can be impactful by improving the compensation alignment between management and shareholders to better incentivize value creation.

LANDS OF OPPORTUNITIES

The fragmentation and inefficiencies across European markets create increased complexity for investors. While this complexity presents challenges, it also may offer opportunity for those who possess local market knowledge, a flexible mandate, the ability to navigate multiple jurisdictions, and the acumen to structure tailored solutions.

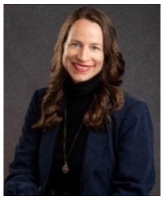
> "The economic uncertainty of the past few years…has created attractive opportunities for specialized investors…heightened volatility around tariffs and the trend toward deglobalization, in our view, will lead to more complexity, a greater dispersion of outcomes and more opportunity to unlock within Europe."

The prospect of increasing European regulation relative to the U.S. is likely to extend the bank deleveraging trend in Europe, leading to attractive financing opportunities. These could include SRTs, purchases of non-performing corporate and real estate loans from banks or bespoke financings to SMEs. The backdrop of more attractive equity valuations and higher credit spreads than in the U.S. adds to the relative appeal of the European market. The recent turbulence from geopolitics could amplify the trend of bank retrenchment.

In recent years, U.S. exceptionalism has often overshadowed opportunities in Europe. However, we believe that amid European pessimism, there are ample opportunities. The economic uncertainty of the past few years—driven by escalating geopolitical tensions, the energy crisis, persistent inflation and higher interest rates, along with the longer-term trend of European bank deleveraging—in our view, has created attractive opportunities for specialized investors. These investors can deploy capital into special situation and opportunistic investments in less crowded European markets. The heightened volatility around tariffs and the trend toward deglobalization, in our view, will lead to more complexity, a greater dispersion of outcomes and more opportunity to unlock within Europe.

ABOUT DAVIDSON KEMPNER

Davidson Kempner is a global investment management firm with more than $35 billion of assets under management. Backed by over 40 years of experience, our global teams invest across the capital structure, applying our research-driven investment process to evaluate and execute a diverse range of transactions across asset classes, geographies and market cycles. We combine our opportunistic, event-driven approach with a disciplined focus on downside protection, serving as an established sponsor with a strong track record of value creation. Our Firm has over 500 employees across seven offices: New York, Philadelphia, London, Dublin, Hong Kong, Shenzhen and Mumbai. Additional information is available at: www.davidsonkempner.com.



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[1] Goldman Sachs Global Investment Research, Datastream, March 31, 2025. PEG (price/earning-to-growth) multiple is the P/E (price-to-earnings) multiple divided by the 12-month forward earnings growth rate.
[2] The OECD (Organisation for Economic Co-operation and Development) forecasts 0.0% population growth for the European Union to 2030 (compared to 0.25% for the U.K. and 0.6% for the U.S.). The EU also has a higher percentage of above-65 population and is projected to have a 2.2% decline in working age population over the next five years.
[3] Goldman Sachs Global Investment Research, Datastream, March 31, 2025.
[4] Mario Draghi, "The Future of European Competitiveness," European Commission, September 2024.
[5] Draghi report. Source: AMECO 2024 based on GDP per capita, 2023 constant.
[6] We use Eurostat data for European countries and CBO data for the U.S. for comparability.
[7] Draghi report, Stockholm International Peace Research Institute (SIPRI), OECD.
[8] Niall Ferguson, "Ferguson's Law: Debt Service, Military Spending, and the Fiscal Limits of Power," Hoover Institution, February 21, 2025.
[9] Wall Street Journal, "Is Trump Taking a 'Liquidationist' Approach to the Economy?", March 12, 2025.
[10] Goldman Sachs Global Investment Research, Datastream Europe index versus Datastream U.S. index as of March 31, 2025.
[11] Goldman Sachs Global Investment Research, Datastream UK index versus Datastream U.S. index as of March 31, 2025.
[12] Pitchbook Data, Inc. as of March 31, 2025.
[13] KBRA DLD Europe Private Data Q42024 Insights & Outlook Report.
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[16] Pitchbook Data, Inc.
[17] Capstone bank analysts.
[18] Hospitality Investor, "Investor Profile: Davidson Kempner's 'patient capital' builds in Portugal," February 21, 2023.
[19] Draghi report; Financial Times, "Investors call for shake-up of Europe's 'failed' securitization market," February 21, 2025.
[20] Financial Times, "Investors call for shake-up of Europe's 'failed' securitization market," February 21, 2025.
[21] Draghi report, p. 64.
[22] AFME 2024 FY2024 Securitization Report.
[23] Federal Reserve Board Financial Accounts of the United States: Households and Nonprofit Organizations amounts outstanding at end Q3 2024, not seasonally adjusted. ECB Euro Area Accounts at end Q3 2024, Households balance sheet. U.K. National Accounts Blue Book, 2024: Households financial assets at end 2023. Listed shares ownership, plus 50% of the value of investment funds.
[24] US Financial Accounts (Table L.101); ECB Euro Area Accounts, January 2025; U.K. National Accounts Blue Book, 2024.
[25] Draghi report.
[26] Bloomberg L.P., Cambridge Associates US Private Equity Index and Europe Private Equity Index by S&P Dow Jones Indices. DK Analysis based on Cambridge Associates US Private Equity Index, by S&P Dow Jones Indices. The Cambridge Associates US Private Equity Index contains the historical performance records of 1,205 institutional quality private investment funds with vintage years between 2000 and 2021. All data through June 30, 2024. The information and data provided herein (the "data") is the proprietary property of Cambridge Associates, LLC, S&P Dow Jones Indices LLC and/or their respective affiliates (together, the "Data Provider"). Cambridge Associates, LLC and/or its affiliates calculate and administer the data but are not authorized as "administrators" under any relevant benchmark regulations or principles and the data cannot be used as a "benchmark" under such regulations or principles. The data has been licensed for use. The Data Provider does not make any warranties or representations as to the accuracy, fitness for purpose or results to be obtained by using the data and disclaims all liability in this regard.
[27] IMF Working Paper, "Europe's Productivity Weakness: Firm-Level Roots and Remedies," February 14, 2025. In addition to Europe's under-investment in technology, we note that the U.S.'s larger addressable market and economies of scale are also contributing factors.
[28] HOLT Lens © UBS. All rights reserved. Reproduced with permission. Underlying CEO Compensation data provided by ISS and Stoxx.