

The European Lower Mid-Market

Dynamics and trends



The European Lower Mid-Market represents an interesting investment destination with unique characteristics and opportunities. Europe is home to over 25 million SMEs, representing 99% of European private companies. However, only 21% of the Private Equity AuM is chasing such opportunities, offering not only a large investment universe but also a compelling opportunity set for long-term investors¹.

In this paper, we will discuss the characteristics of the European Lower Mid-Market and explore the related avenues for buyout investors.

Lower Mid-Market – Perimeter by company size

- **Enterprise Value (EV):** EUR 10 million to EUR 200 million.
- **Sales:** EUR 10 million to EUR 200 million.
- **EBITDA:** EUR 2 million to EUR 25 million.

Regional barriers

Linguistic and cultural barriers in Europe often hinder foreign Private Equity managers from effectively engaging with local founders and gaining access to the Lower Mid-Market. This results in a narrower competitive landscape predominantly composed of local funds.

Low entry valuation and strong alignment of interest

Acquiring small businesses usually comes at relatively lower entry valuation (Exhibit 1) due to their smaller scale, narrower market and often concentrated product offering. It's common for the seller to re-invest a considerable amount of the sale back into the company on top of earn-out mechanisms. This contributes to de-risking the transaction for the acquirer ensuring a strong alignment of interest, fostering collaborative growth strategies.

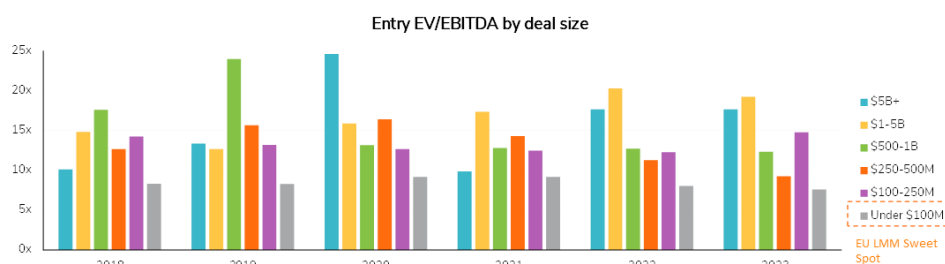


Exhibit 1 - Source: "Q2 2023 Global M&A Report" - PitchBook

¹ Sources: 10Y Fundraising trend in EU from "Q2 2023 European PE Breakdown" by PitchBook, Funds below \$500m are defined as Lower Mid-Market funds while above \$500m as Mid/Large Cap funds; European Commission data; OECD.Stats

Untapped growth potential in underinvested businesses

The Lower Mid-Market offers the opportunity to acquire sub-optimally managed small businesses and implement hands-on value creation plans alongside incentivized management teams. Financial sponsors, with a regional and/or sector focus, can internationalize their portfolio companies, scaling them to higher market segments through various initiatives.

- **Management:** Strategic recruitment to drive growth and efficiency.
- **Revenues:** Optimizing pricing and marketing for enhanced sales.
- **Profitability:** Streamlining cost structures to improve EBITDA margin.
- **Reporting and performance drivers:** Establishing professional systems for efficient operations and analytics.
- **Internationalization:** Expanding to international markets to unlock new revenue streams.

Longer time horizon

Investments in the Lower Mid-Market often entail a longer time horizon as transformative acquisitions require sufficient time to execute value creation plans, including organic and external growth, and prepare the company for exit.

Low penetration of private capital and large opportunity set

In the past decade, Europe has witnessed the establishment of over 1,300 Lower Mid-Market funds, while hosting 25 million SMEs. Over the same period, over 3,800 Lower Mid-Market funds have been raised in the US, for a market of 32 million SMEs. Therefore, on a relative basis, the European Lower-Mid Market has a larger pool of target companies than the US, setting attractive market dynamics (Exhibit 2).

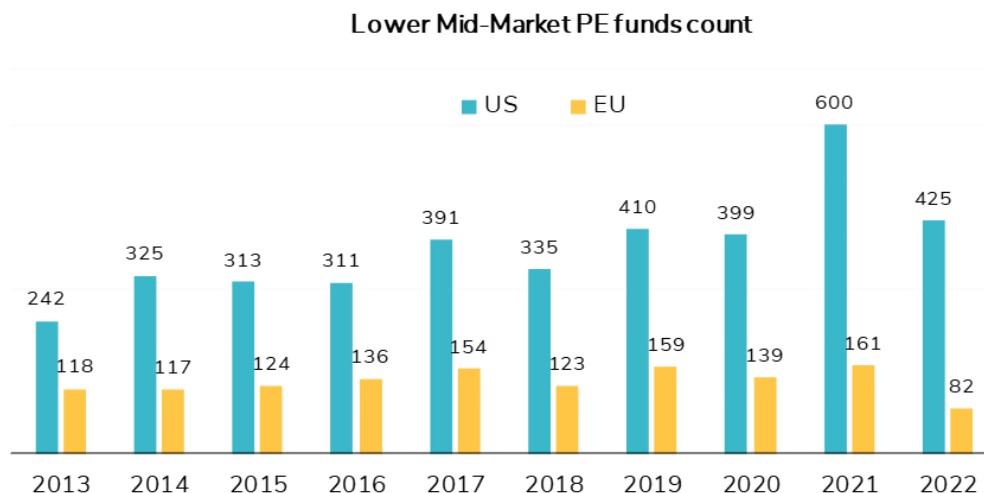


Exhibit 2 - Source: "Q2 2023 Annual Global Private Market Fundraising Report" - PitchBook

Succession issues

Ageing demographics, depicted in the chart below, underscores succession challenges in founder-led enterprises and open avenues for Private Equity intervention. In the absence of a natural family member successor, teaming up with skilled private equity capital can help unlock value through growth, professionalization and optimization initiatives in the transition phase to a full exit.

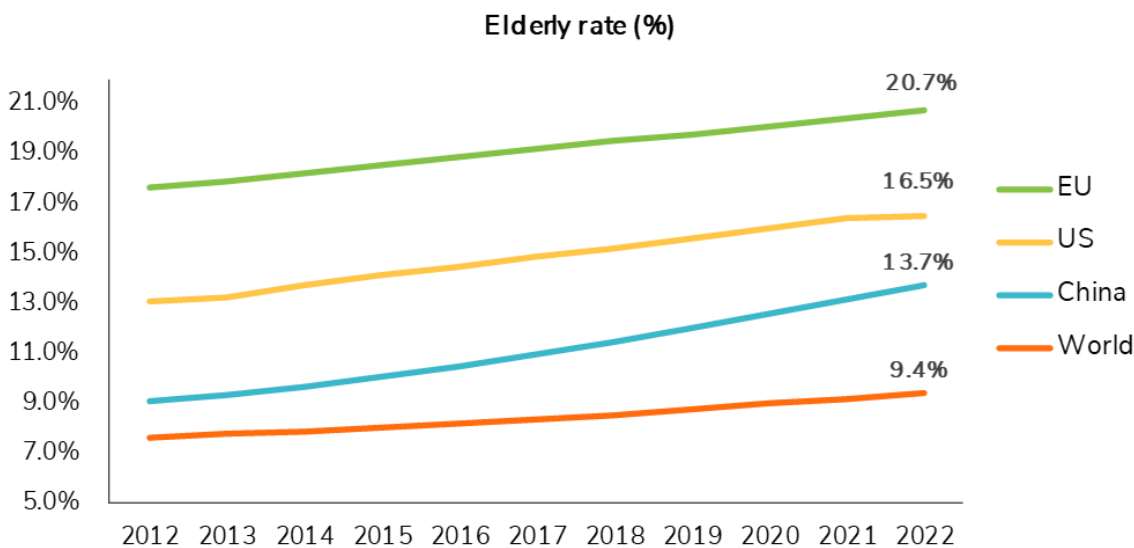


Exhibit 3 - Source: Data extracted on 24 Oct 2023 from OECD.Stat. Elderly rate defined as % of 65+ years old people over total population

Multiple expansion

Well executed transformative acquisitions often come with significant de-risking of the business (product, client, and international diversification) as well as improved efficiencies due to economies of scale and scope. Such initiatives can lead to significant re-rating of the valuation multiple at exit.

“Looking at the mid-market in a global context, the evidence suggests that Europe is the region to target currently, both because of the attractive valuations that are available and because of the potential for GPs to make a significant difference to their investees’ performance by helping them to globalise.”

Andrea Bonomi

CEO and Founder at Investindustrial²

² Source: “European mid-market private equity – Delivering the goods” by European Private Equity and Venture Capital Association (EVCA)

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