Dynamics of the liquidity slowdown in Private Equity

Exploring the key drivers behind the recent decline in PE exit activity

Liquidity in the Private Equity market has experienced a marked slowdown in recent years, reshaping the landscape for investors. This trend has been evident in both Europe and North America, with declining exit values and slower distributions affecting capital flows. However, the underlying drivers of this slowdown differ between regions, revealing important insights into the evolving dynamics of Private Equity.

As investors reassess their allocation strategies to face market uncertainty, one segment has demonstrated remarkable resilience: the Lower Mid-Market. This space continues to offer disciplined investors a combination of stability, growth, and risk mitigation, making it an increasingly attractive area for capital deployment.

Europe - A market of stability and opportunity

The European Private Equity market has experienced a moderate slowdown in exit activity, leading to lower-than-expected distributions in 2022 and 2023. However, the data highlights a key distinction:

- Exit values in 2022 declined by 32% compared to 2021, with no rebound in 2023.
- The number of exits, however, has remained relatively stable since 2021.

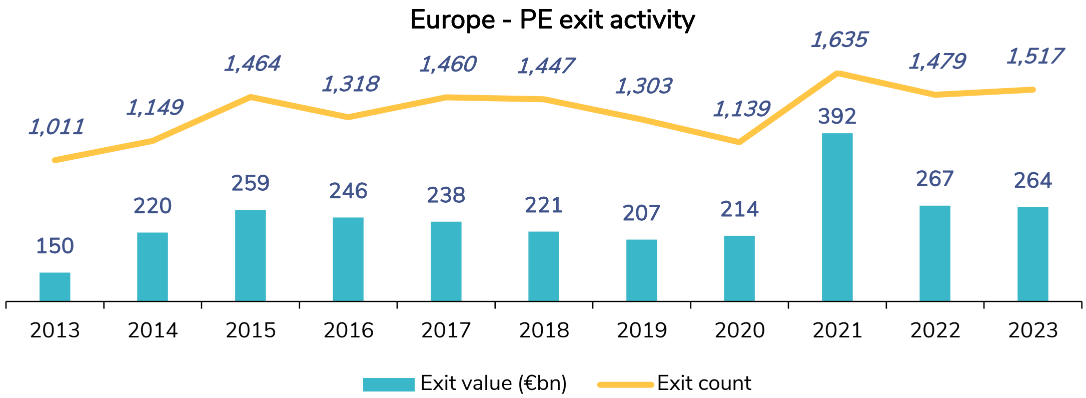

Exhibit 1 - Source: "2023 Annual European PE Breakdown "– PitchBook

This divergence between exit values and volumes underscores a fundamental shift: the slowdown is primarily driven by a sharp contraction in large-cap deals. Supporting this trend, data reveals that large-cap exit values in 2022 nearly halved (a 45% decline) compared to 2021, with no recovery in 2023.

By contrast, the European Lower Mid-Market has proven its resilience, maintaining stable exit values throughout 2021-2023. This reinforces the segment's reliability, consistently outperforming the more volatile large-cap sector. For investors seeking steady returns and a lower correlation to broader market turbulence, Europe's Lower Mid-Market remains a highly attractive opportunity.

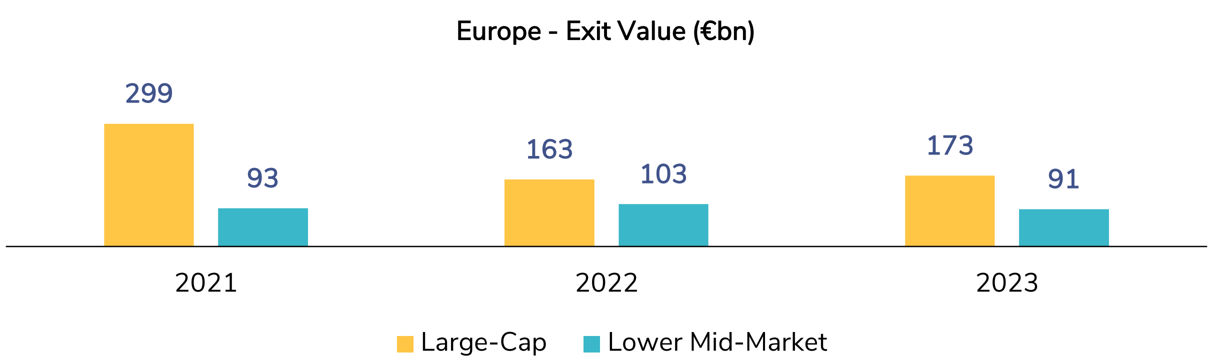

Exhibit 2 - Source: "2023 Annual European PE Breakdown"- PitchBook

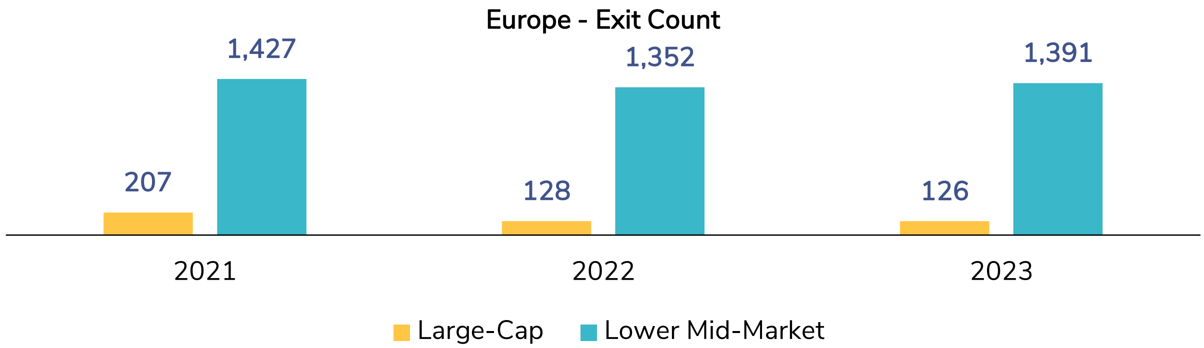

Exhibit 3 - Source: "2023 Annual European PE Breakdown"- PitchBook

North America - A more pronounced market slowdown

The US Private Equity market has faced an even steeper decline in exit activity, placing significant pressure on distributions:

- Exit values plummeted by 63% in 2022 compared to 2021 and declined by an additional 8% in 2023.
- The exits count fell, albeit less dramatically, down by 26% in 2022 and another 17% in 2021.

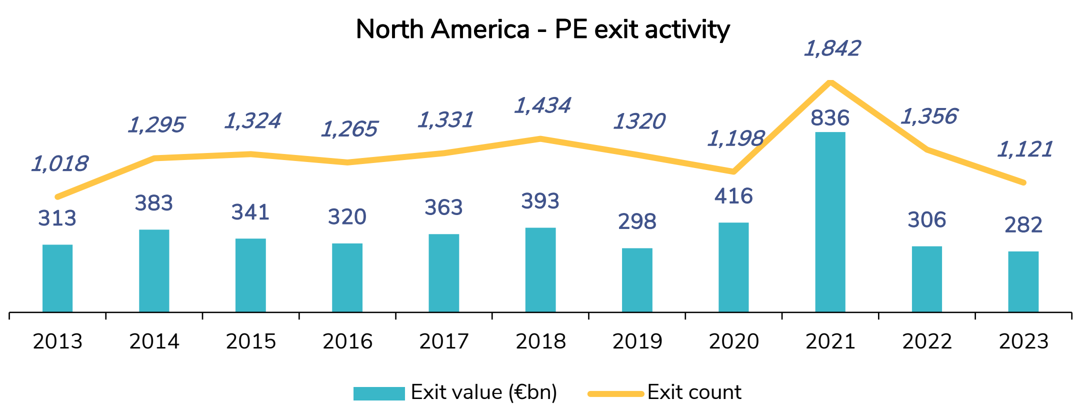

Exhibit 4 - Source: "2023 Annual US PE Breakdown" -PitchBook

As in Europe, the disproportionate decline in exit values versus volumes highlights the primary driver: a sharp contraction in large-cap exits. While the US Lower Mid-Market has also faced challenges, it has demonstrated far greater resilience compared to the large-cap space.

For investors navigating an uncertain environment, the Lower Mid-Market continues to offer a more reliable and attractive segment, standing out as a defensive play amidst broader market volatility.

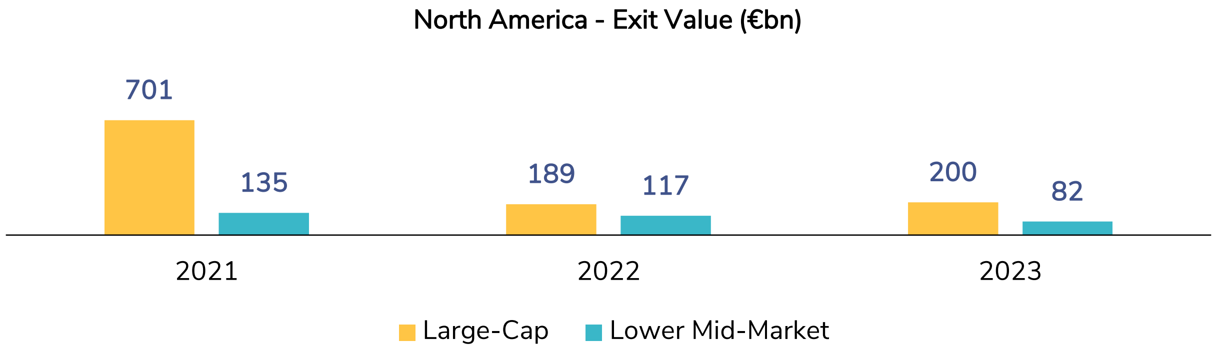

Exhibit 5 - Source: "2023 Annual US PE Breakdown"- PitchBook

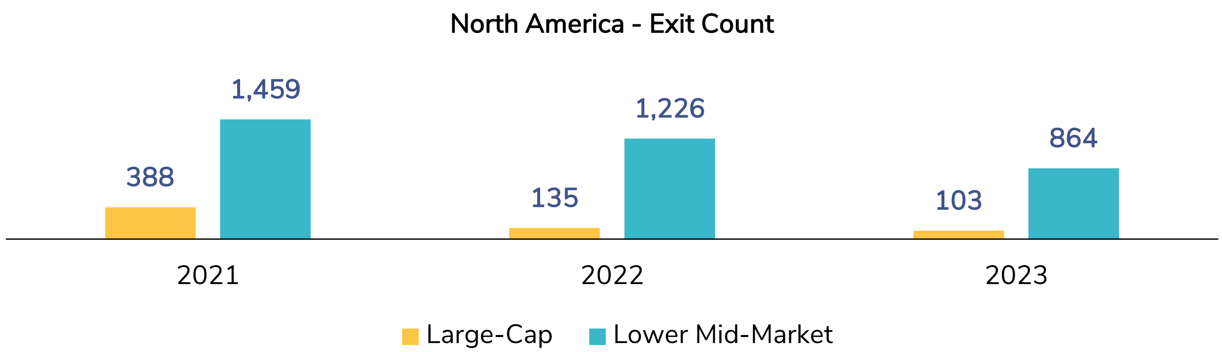

Exhibit 6 - Source: "2023 Annual US PE Breakdown"- PitchBook

Syz Capital view - Why the European Lower Mid-Market deserves attention

The current slowdown in distributions calls for increased investors' attention towards strategic allocation and downside protection.

While both Europe and North America have faced significant headwinds in exit activity, the slowdown was mostly driven by the large-cap segment. Further underscoring its enduring strength even amidst broader market challenges, the Lower Mid-Market has consistently maintained stable exit activity compared to the more volatile large-cap segment, where exit activity slowed considerably compared to 2021.

We think that the recent subdued exit activity in the large-cap space as opposed to the Lower Mid-Market has been driven by the following key factors.

- **Interest rate sensitivity:** Large-cap deals are highly sensitive to rising interest rates, as they rely more heavily on leverage. Higher borrowing costs not only reduce deal attractiveness but also directly impact exit multiples, as buyers apply lower valuations to account for increased financing costs.

- **Debt financing constraints:** The tightening of credit markets has disproportionately affected large-cap deals, where financing structures typically involve significant leverage. As banks and institutional lenders have pulled back, dealmaking has slowed.
- **Broader exit universe:** The Lower Mid-Market benefits from a significantly broader base of potential buyers simply due to the smaller deal sizes. There are more acquirers - ranging from strategic buyers to mid-sized PE-backed platforms and larger funds - capable of executing these transactions. In contrast, large-cap exits are inherently constrained by a smaller universe of buyers with the necessary scale and capital, making exit pathways more limited and sensitive to market disruptions.
- **Operational value creation over financial engineering**: The Lower Mid-Market relies more on operational improvements rather than financial engineering for value creation. This has allowed small & mid-cap funds to sustain deal flow even as capital market conditions tighten.

When comparing Europe with the US, the decline in Private Equity distributions is more severe for US funds, which have experienced a more pronounced drop in exit activity. We believe that Europe's better performance over the US can be attributed to the following reasons.

- **Valuation spread and lower entry multiples**: European PE deals typically trade at a lower EBITDA multiple than US transactions (i.e., 10.2x in Europe vs. 13.3x in the US in 2023, implying c. 23% discount). This valuation cushion allows for more flexibility in pricing exits, even in a downturn, whereas US funds face steeper corrections.
- **Gradual interest rate hikes:** Many European economies have seen a more gradual approach to interest rate hikes, which has softened the impact on valuations and dealmaking activity.
- **More supportive banking environment**: The European banking environment generally provides less aggressive terms for the PE industry, with local lenders often offering lower interest rates. Furthermore, European banks emphasize relationship-based lending, which can be particularly beneficial in supporting more complex financing cases.

This highlights an important opportunity: the European Lower Mid-Market has remained notably resilient, offering consistent exit activity despite broader market challenges.

By targeting uncorrelated, downside-protected strategies, forward-thinking investors can unlock strong value creation potential in the European Lower Mid-Market. With its balance of risk and reward, this segment is an essential component of a well-rounded Private Equity strategy in today's evolving market environment.

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