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IS THE AMERICAN *MID-MARKET* A GOOD OPPORTUNITY FOR EUROPEAN INVESTORS ?

Summary - Conclusion

Diversity of fund categories in the United-States

From a European perspective, the private equity industry is composed of two large categories: venture capital and buyout. In the United States, however, the categories are more diverse. The “non-venture” category comprises many types of partnerships, specializing in corporate investments, mezzanine, build-ups, growth, distressed assets...

Value creation and active ownership...

The variety of the American private equity industry reflects its maturity and differences from Europe in management objectives. American managers offer their subscribers strategies that are based on ‘value-creation’ which is obtained by active management or ‘active ownership’. Few managers push the pure buyout principle.

... which is different from a ‘1980s style buyout’

In the United States, the buyout market has not always had good press because it played an important role in the restructuring of American industry in the 1980s. From an American point of view a buyout, or at least a ‘1980s style buyout’, is an operation with an important leverage on a conglomerate of which the acquirer, after having restructured it, then strips the assets.

Growing interest for mid market funds...

The concept of mid-market funds is proving a growing success with American investors who want to continue investing in private equity and returning to the ‘real economy’. Following the implosion of the internet bubble, mid-market funds effectively offer an alternative to venture capital but are distinguishable nonetheless from ‘large corporate’ funds.

... where value creation strategies flourish

Mid-market funds are the field *par excellence* in which value creation strategies can flourish. The size of the American economy, its vast homogeneous market, its entrepreneurial dynamic make it possible to define investment concepts based on the acquisition of ‘under managed’ companies in which the investment manager can then expose the unseen potential. The American education and finance systems produce furthermore large numbers of business men and women who have, or who believe that they have, the necessary skills to implement such a strategy.

A sample of 242 realized transactions

Throughout this study we have aimed to deepen our knowledge of the American mid-market and to test the concepts which it is putting forward. In order to do this we have used both the available professional statistics and a sample of 242 realized transactions (mid-market investment funds either successfully exited or written off). This sample, albeit limited in its scope, provides some interesting pointers.

Our first finding is that the American mid-market confirms its potential: the market (circa 150,000 companies) is comparable to that of the entire European Community.

The potential is connected to the multiple arbitrage

M&A statistics show that the entry multiples are lower than those for large corporate. The profit potential is therefore much higher as the possibility exists that the company might change category and climb to a higher strategic value. In Europe, such multiple arbitrage is a much more delicate operation to manage.

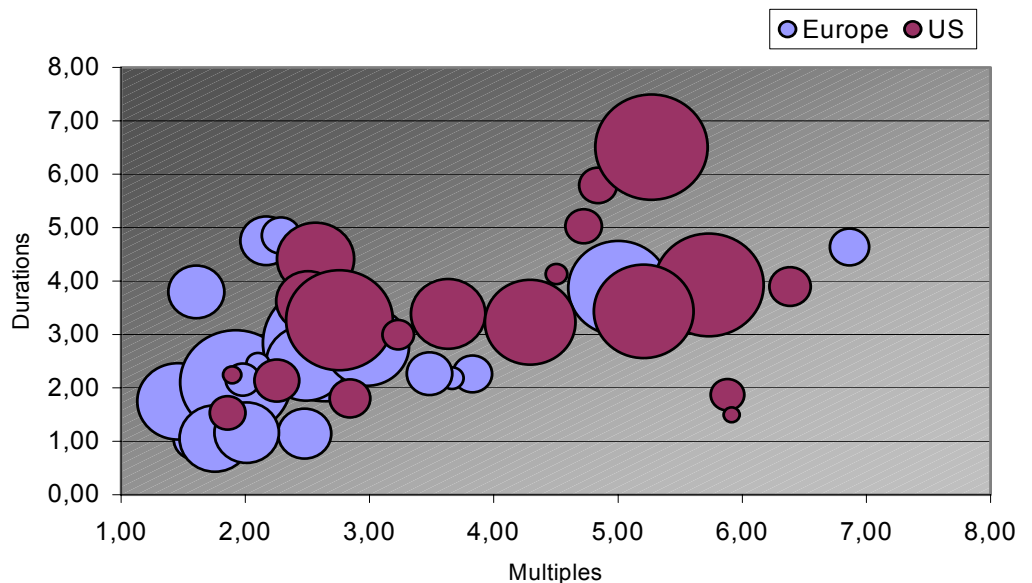
Comparison with our European sample....

We have compared the American sample with the performance of a European sample that was analyzed for our last study of the European buyout market. We should not, however, draw any conclusions from the slightly higher performance of the American sample as this is not representative of the profession as a whole. The analysis, however, of the structure of the transactions is instructive: the global multiple of the American sample is greater and the higher multiples are better represented in the sample. But the durations are longer and the performance cycles correlated with the valuation entry multiples are more accentuated.

... higher multiples but longer durations

This is how the strategy differences can be portrayed: in Europe (and especially in the United Kingdom which makes up a large part of our sample) mid-market buyouts remain above all financial transactions. In the United States the active management of the investments leads to significant modifications in the management and the operational focus of the companies. These strategies, when they are not penalized by excessive entry prices, produce high multiples but necessitate a longer implementation period.

Comparative Returns and Durations of US and European Funds



Diversification of management styles...

As a consequence the American mid-market offers a diversification for the European investor, both in geography and in management style. It promises higher multiples but necessitates greater patience and risk acceptance. However the investment choice within numerous propositions is not easy. The key element remains, as usual, the quality of the team, with a special consideration on its ability to implement the proposed active management strategy.

...but difficult choice within numerous propositions.