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Exploring European Buyout Multiples

Valuation differentials between the US and Europe, public and private markets, and among sectors

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- **Purchase price multiples for LBOs are diverging between the US and Europe.** European PE buyout multiples declined in 2022 in line with market expectations, whereas US buyout multiples trended higher thanks to the higher competition, larger investor pools, more stimulus, and a dominant tech sector, which all contributed to driving multiples higher in the US. We do not expect the divergence between European and US multiples to persist in the medium term and expect US multiples to contract similarly to those in Europe given the similar trajectory imposed by their respective central banks. The US should, however, keep trading at a small premium moving forward given some of the factors we outline in this note.

- **Public multiples no longer command a premium relative to private multiples.** We saw a crossover in multiples in recent times, effectively slowly eliminating the public premium. In the long-term, private equity will continue growing as an asset class and become increasingly more accessible to different industry players—from wealth managers looking to diversify their asset allocations, to institutional investors seeking to add private markets to defined contribution plans, to retail investors. As a consequence, PE will start dictating buyout multiple levels, and we expect the gap between public and private multiples to converge and the traditional premium associated with public markets to continue to disappear.

- **IT and healthcare drive median buyout multiples higher.** We expect these two sectors will continue fetching higher multiples than other sectors in the medium-to-long-term, although the median multiple in these sectors may correct in the short term due to the shift in monetary policy and credit conditions. Credit spreads are widening, borrowing costs are rising, and leverage is falling for buyout sponsors, all consequences of higher interest rates, which negatively impact buyout multiples.

- **EBITDA growth will be the key driver of outperformance.** The macroeconomic environment is moving PE strategies away from multiple expansion and leverage and focusing on revenue and margin growth. Manager selection will become ever more important for LPs, as they will need to pick those managers who are able to add value through growth in fundamentals and not simply through multiples expansion. Track records will be primordial and first-time managers will struggle.

Introduction

GPs are now looking to deploy close-to-record-high amounts of dry powder in this new environment, characterised by increasing rates and inflationary pressures, which are pushing buyout multiples lower. Yet competition has increased, with more GPs seeking the same assets in certain sectors and geographies, thus leading to pockets of higher valuation multiples—depending on where you look. Buying assets at a higher price makes it substantially harder to generate added value, especially in times of uncertainty and high volatility. In this note, we will explore the differences in buyout multiples between the US and Europe, between public and private markets, and across sectors focusing on tech and healthcare. We will also seek to understand the drivers behind returns and how these will pivot with the shift in the macroeconomic environment.

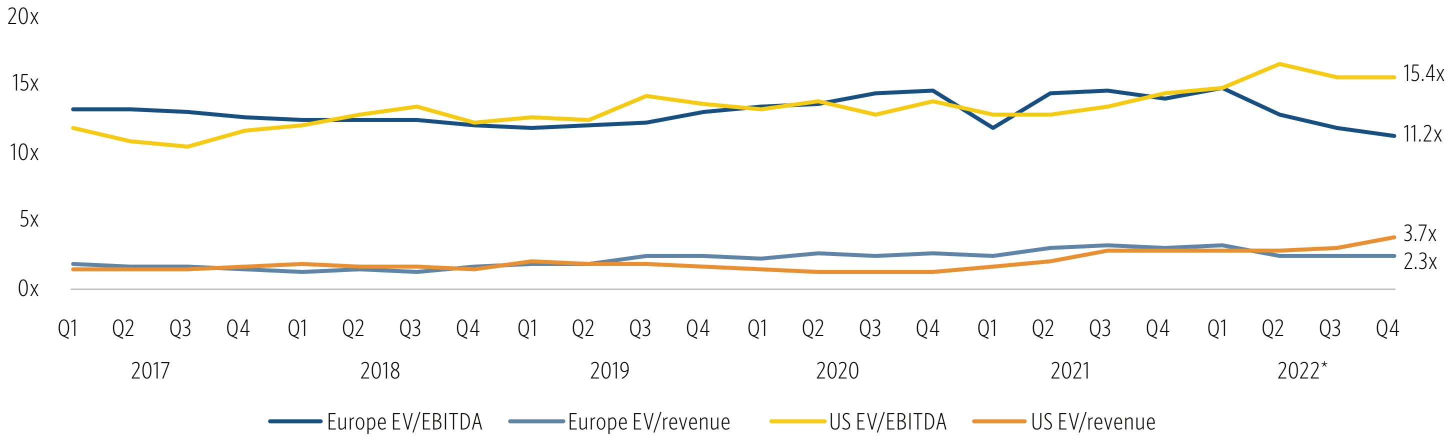
European and US private buyout multiples diverge

Current levels of multiples

Purchase price multiples in Europe and the US have diverged substantially in 2022. Rolling four-quarter EV/EBITDA multiples have trended lower in Europe, peaking in Q1 2022 at 14.6x and dropping sequentially to 11.2x in Q4. On the other side of the Atlantic, EV/EBITDA trended higher, peaking in Q2 2022, and only slightly plateauing in Q3 and Q4. A similar trend is present when we look at EV/revenue multiples. This is particularly surprising since both regions tracked each other for the best part of the last 15 years.

How can we explain this divergence?

Median US and European rolling four-quarter PE buyout multiples



Source: PitchBook | Geography: Europe & US
*As of December 31, 2022

In the absence of price, private market participants tend to look at EV/EBITDA among other metrics, which is also used in the public market sphere.

EV reflects the value of the company, meaning its equity plus its debt minus any cash. EBITDA is a measure of profitability that is not dependent on capital structure since it strips out interest, taxes, depreciation, and amortisation.

High competition, high multiples

The US is a larger, more liquid, less bureaucratic, more competitive market than Europe. PE in the US represents 60% of the world's PE AUM and is almost three times larger than Europe. The more competition in each market, the more likely higher multiples will be obtained when dealmaking.

When performing due diligence on a specific company, sponsors conduct a relative valuation among other types of valuations. They use previous multiples from similar transactions of private companies within the sector. They may also use current multiples from public companies. Sometimes, the sale of a company may happen through an auction process where potential buyers bid a multiple of EV/EBITDA. According to Bain & Company, 65% of North American buyouts in 2022 involved a formal auction.[1] For example, in March 2023, SAP announced its plan to divest of its 71% stake in publicly listed Qualtrics, which had its IPO three years earlier. A consortium led by Silver Lake took Qualtrics private after their bid for $12.5 billion was accepted, outbidding the competition. Auctions typically happen when a sponsor or company wishes to divest of an asset and is seeking the highest possible price tag, as illustrated by the Silver Lake example, which netted Qualtrics shareholders (including SAP) a 73% premium.[2]

For companies with no private earnings, we use EV/revenue (also called EV/sales), as it is much easier to gather since most companies publish their top-line sales numbers.

Dominant sectors dictate multiples

The US dominates the tech sector much more than Europe. Looking at EV/revenue multiples for the two regions, we see that multiples are trending higher for the US, peaking in Q4 2022 at 3.7x, while in Europe we have seen a drop in multiples since Q1, stabilising around 2.3x by year end. The same story can be told of EV/EBITDA, with the US generally displaying higher multiples than Europe because of its tech-heavy industry, which tends to fetch multiples from 15x to 30x and represents the bulk of US multiples. Recent 2022 examples in the 15x to 30x bucket of take-private deals included Switch for 16.9x EV/EBITDA, ManTech International for 16.4x, and Covetrus for 20.2x using a trailing-twelve months EBITDA. Enterprise software and IT services have pushed multiples higher within the IT sector (as opposed to hardware, for instance) in recent years as sponsors have shown appetite for these businesses with sticky subscription-based recurring revenue models, high revenue growth, and high margins. These businesses also showed robustness during the COVID-19 pandemic, as the world is becoming ever-more digital and requires mission-critical software on which to run. However, 2022 saw a correction in markets, especially within tech, pulling the sector back and forcing companies to focus on their fundamentals and operational efficiencies. Many of these newly founded companies may not have experienced a recession or monetary tightening, and there will be winners and losers emerging out of this new cycle. However, despite the bumpy ride that lies ahead for the sector in the next 12-18 months, tech will continue to be the dominant sector and driver of buyout multiples, pushing the median higher. Having said this, in the short term, we do expect to see the median level of multiples come down from an elevated base caused by a 12-year bull market.

1: "Global Private Equity Report 2023," Bain & Company, Hugh MacArthur et al., 2023, accessed March 27, 2023.
2: "Silver Lake to Acquire Software Company Qualtrics in $12.5bn Deal," Financial Times, Antoine Gara, March 13, 2023.

Top five tech buyouts by EV/EBITDA in 2022

Company name	Close date	EV/EBITDA multiple	Post value (€M/$M)	Country
Twitter	October 27	82.7x	$49,659.2	US
Basware	July 12	79.8x	€1,101.7	Finland
Momentum Software Group	June 15	59.4x	€169.6	Sweden
IntriCon	May 24	56.0x	$228.6	US
Datto	June 23	55.2x	$5,840.1	US

Source: PitchBook | Geography: Europe & US
*As of December 31, 2022
Note: Multiples over 100x EV/EBITDA have been excluded

Healthcare is another sector that has pushed multiples higher, even more so since the pandemic restated the importance for healthcare systems to be digitalised and data-driven. The race for a vaccine reminded us of the importance of R&D and the big pharma companies. But the sector also benefitted from outsiders realising the potential of digitalising healthcare. We saw the likes of Amazon buying One Medical for $3.9 billion and Microsoft purchasing Nuance for $18.8 billion, while PE firms also got involved with the buyouts of Medline and Inovalon in the past two years for $34.0 billion and $7.3 billion, respectively. Outsiders and most notably PE sponsors have helped push these multiples higher, as they have been flush with cash, having amassed record amounts of dry powder. IT and healthcare are increasingly becoming intertwined as the world digitalises its healthcare services (for more on this, please read our recently released Healthcare IT and Healthcare Services research reports). Again, within healthcare, auctions have pushed multiples higher. For example, the buyout of women's health business Theramex by Carlyle and PAI Partners for €1.4 billion fetched 57.6x EV/EBITDA. CVC, which previously owned the company, was looking to exit the business at around €1 billion, but thanks to an auction that saw sponsors outbid each other, it successfully fetched a better price, helping drive those multiples higher.[3]

Top five healthcare buyouts by EV/EBITDA in 2022

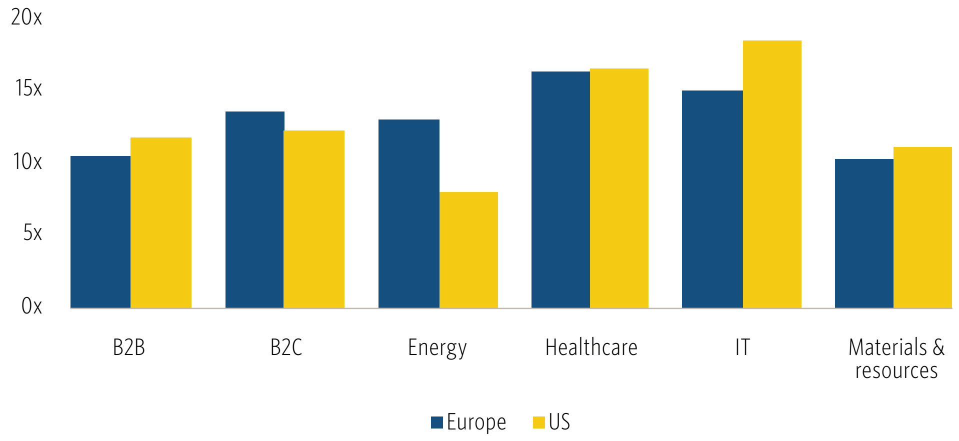
Company name	Close date	EV/EBITDA multiple	Post value (€M/$M)	Country
Theramex	March 30	57.6x	€1,436.5	UK
IntriCon	May 24	56.0x	$228.6	US
Vivalto Home	February 12	42.9x	€200.0	Belgium
SPT Labtech	June 22	40.0x	€760.5	UK
Artel	June 13	28.0x	$131.7	US

Source: PitchBook | Geography: Europe & US
*As of December 31, 2022
Note: Multiples over 100x EV/EBITDA have been excluded

3: "Carlyle, PAI Nearing $1.4 Billion Deal for CVC's Theramex," Bloomberg, Aaron Kirchfeld et al., March 27, 2022.

As can be seen in the below chart, US multiples have been driven higher by both tech and healthcare, which are proportionally more dominant sectors in the US. Europe, on the other hand, tends to have more deals in asset-heavy industries such as industrials, manufacturing, and automotive. In fact, 11 out of the top 20 European PE deals in 2022 were in these categories, which tend to fetch EV/EBITDA multiples in the 5x to 10x bracket, such as Biffa, which sold for 6.2x EV/EBITDA, Atlantia for 9.7x, or even Stagecoach for 4.2x. Biffa, the British waste management company, is a good example of why multiples are lower in Europe, as the company was sold for a lower price after initially refusing a higher offer. Following a weakening macroeconomic environment and a weaker British pound, Biffa accepted a lower takeover bid from Energy Capital Partners, a US PE firm.[4,5]

Median European vs US buyout EV/EBITDA multiples by sector, 2018-2022*



Source: PitchBook | Geography: Europe & US
*As of December 31, 2022
Note: Deal count is below 30 in the US for energy and materials & resources.

Stimulus artificially boosts multiples

We also need to consider the macro picture in both regions over the past two years. The US injected record amounts of fiscal stimulus into its economy following the pandemic, with an unprecedented €5.0 trillion ($6.0 trillion) in funding from US Congress pushing its debt-to-GDP ratio to a record 129%.[6] Europe's stimulus was far less important in magnitude, even though Europe's population is roughly double that of the US. Europe also had stricter and longer lockdowns than in the US, which slowed its re-opening. Furthermore, the Fed now has more assets than the European Central Bank and thus a bigger balance sheet.[7]

Europe was also hit by an energy crisis stemming from the Russia-Ukraine War that decelerated the appetite for dealmaking on a continent already plagued by higher regulatory scrutiny given the nature of the European Union (EU), which counts 27 members with competing priorities. Add to the mix that the US dollar is the world's

4: "Biffa Accepts Lowered £1.3bn US Private Equity Bid," Financial Times, Mark Wembridge and Leke Oso Alabi, September 27, 2022.
5: The reader may have noticed that many of the deals mentioned were take-privates, and, indeed, these account for the bulk of our multiples data and may somewhat skew multiples toward larger deals, as take-privates disclose their multiples while not all private deals have the same transparency. There is also some selection bias as less-favoured or distressed private companies that are not being bought would not appear in the data set.
6: "Country List Government Debt to GDP," Trading Economics, 2023, accessed March 27, 2023.
7: "Central Banks: Fed, ECB & BOJ Weekly Balance Sheets," Yardeni Research, March 23, 2023.

reserve currency and that it strengthened versus the Euro, reaching its highest level in 20 years in 2022 to achieve parity.[8] This all resulted in greater US PE activity and higher multiples being paid relative to Europe which saw multiples contract in 2022.

Outlook

We don't expect the divergence between European and US multiples to persist in the medium term, as we expect US multiples to contract like those in Europe given the similar trajectory imposed by their respective central banks. That said, the US may always trade at a slight premium to Europe given the higher contribution of its tech sector. However, the gap will tighten and move in tandem rather than opposite directions. A contraction in multiples has been looming for years, and this shift in monetary policy seems like the inflection point for lower multiples moving forward.

Public vs private multiples

Financial theory stipulates that public multiples should be higher than private multiples because public markets offer a liquidity and transparency premium to investors. In addition, public markets are accessible to everyone and have greater numbers of market participants willing to offer a higher multiple, thus driving valuations higher. But we have seen that real-world data sometimes diverges from theory. For instance, in Europe, EV/EBITDA multiples for PE buyouts have tracked higher than public multiples in the STOXX 600 benchmark. In fact, they have been on average 1.6x higher than public markets over the last 10 years.

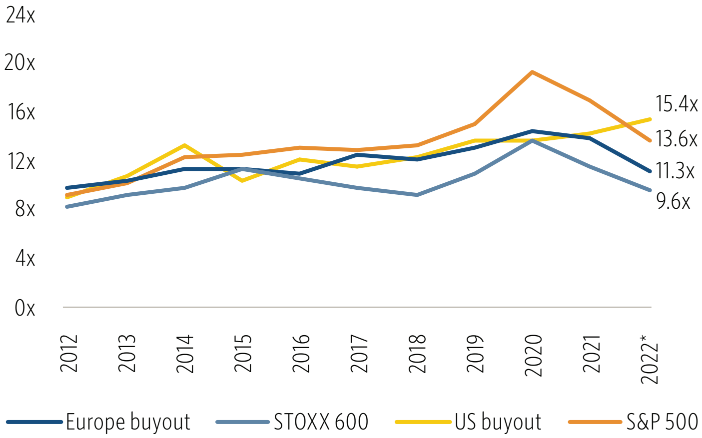
Public multiples no longer command a premium relative to private multiples.

On the other hand, in the US, which lately has commanded higher multiples than Europe, we see that the S&P 500 tends to be higher than median US PE buyout multiples by an average of 1.1x EV/EBITDA over the past 10 years. This could be in part because the US benchmark is heavily dominated by tech companies, which represent 25% of the index,[9] compared to 7% for the European benchmark.[10,11] Tech tends to fetch higher multiples than other industries, which helps explain the divergence. More interestingly, however, we note that 2022 saw PE buyout multiples in the US leap higher than public multiples by 1.8x EV/EBITDA. Historically, such a crossover tends to happen in periods of market downturn such as the global financial crisis (GFC), where we also saw multiples cross over. This can be explained by several factors. Firstly, the PE asset class has boomed over the last decade, leading to record amounts of dry powder chasing similar assets and thus driving private multiples higher. Secondly, as we have commented in our 2022 Annual European PE Breakdown, companies have preferred to stay private in the current downturn environment, avoiding costly IPOs and public market volatility in valuations—as they see less benefit from going public than ever before. Therefore, companies with strong multiples that would have typically publicly listed have remained in private markets. This has gone hand-in-hand with the increase in take-privates, which have been immensely popular in the past year and continue to be so into 2023. Finally, there is the fact that private markets lag public markets, and we would only see PE buyout multiples contract in future quarters if the public markets continue to be sluggish.

8: "Euro Reaches Parity Against the Dollar, Hits Its Lowest Level Against US Currency Since December 2002," CNBC, Sam Meredith et al., July 12, 2022.
9: "iShares S&P 500 Index Fund," iShares by Blackrock, December 31, 2022.
10: "iShares STOXX Europe 600 UCITS ETF: (DE) EUR (Dist)," iShares by Blackrock, March 8, 2023.
11: A year ago, these percentages would have been even higher, as tech sector share prices fell the most relative to the other sectors.

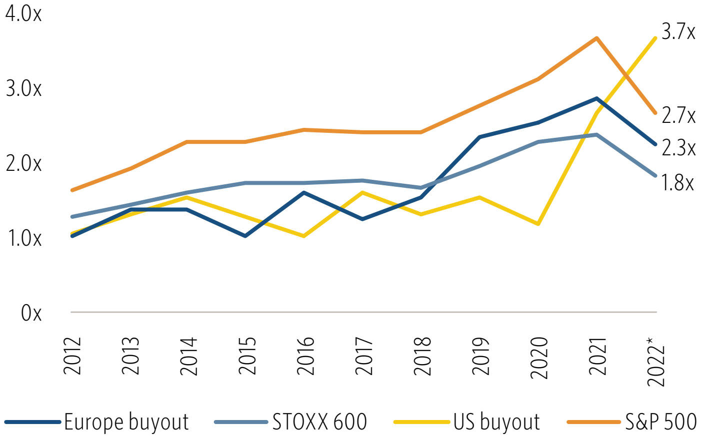
We expect PE as an asset class to continue growing in the medium term as it becomes more accessible to different industry players, from wealth managers looking to diversify their asset allocations, to institutional investors seeking to add private markets to defined contribution plans, to retail investors tapping into the asset class through new platforms such as Moonfare. As a consequence, PE will start dictating buyout multiple levels, and we expect the gap between public and private multiples to converge and the traditional premium associated with public markets to continue to disappear.

Median European and US private vs public EV/EBVITDA



Source: PitchBook; Morningstar; iShares | Geography: Europe & US
*As of December 31, 2022

Median European and US private vs public EV/revenue



Source: PitchBook; Morningstar; iShares | Geography: Europe & US
*As of December 31, 2022

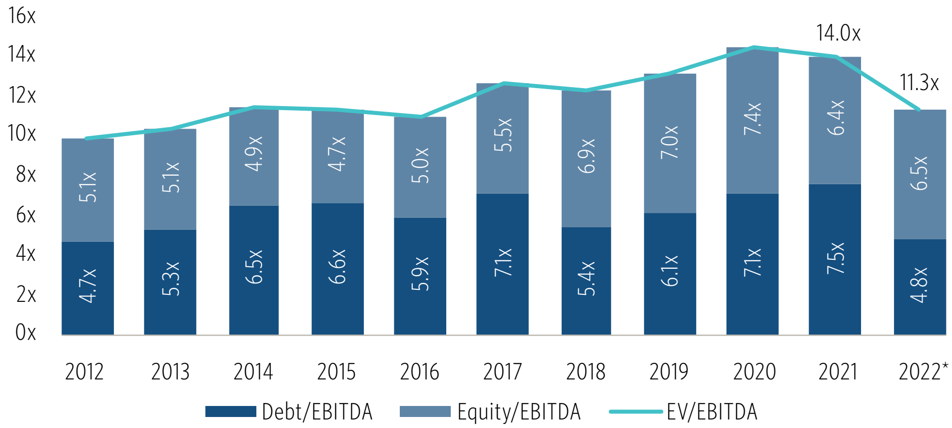
Drivers of buyout multiples are changing

Adding value through EBITDA growth

Historically, PE buyout returns "have come largely from multiple expansion in recent years, rather than from revenue and margin growth," according to a recent Bain & Company analysis.[12] However, as the macroeconomic playing field alters, we will see multiples contract; thus, there will be greater emphasis on driving returns from EBITDA. We seem to be at an inflection point in the PE industry as these shifts of drivers will begin to materialise, which likely will lead to more scrupulous manager selection by LPs that prefer managers that have established track records and have shown they can generate added value from EBITDA growth and not just from multiple expansion and deleveraging. Our data already points to an 11-year low for first-time managers fundraising, as explained in our 2022 Annual European PE Breakdown. In a recent presentation, Partners Group, the Swiss PE giant with $135.0 billion in AUM, noted that only 41% of outperformance in the S&P 500 was attributed to EBITDA growth over the 10-year period from 2011 to 2021, as opposed to the 59% attributed to change in valuation (For example, multiple expansion).[13]

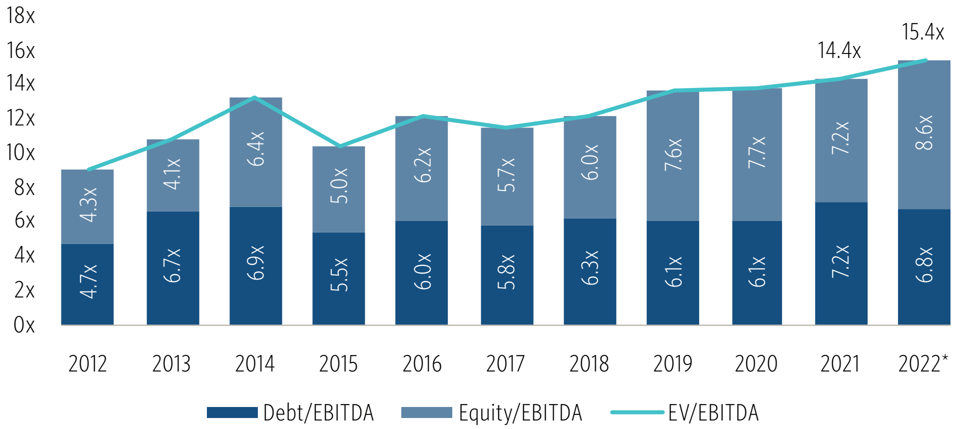
12: "Global Private Equity Report 2023," Bain & Company, Hugh MacArthur et al., 2023, accessed March 27, 2023. https://www.bain.com/globalassets/noindex/2023/bain_report_global-private-equity-report-2023.pdf
13: "Annual Results 2022," Partners Group, March 17, 2023.

Median European PE buyout EV/EBITDA multiples



Source: PitchBook | Geography: Europe
*As of December 31, 2022

Median US PE buyout EV/EBITDA multiples

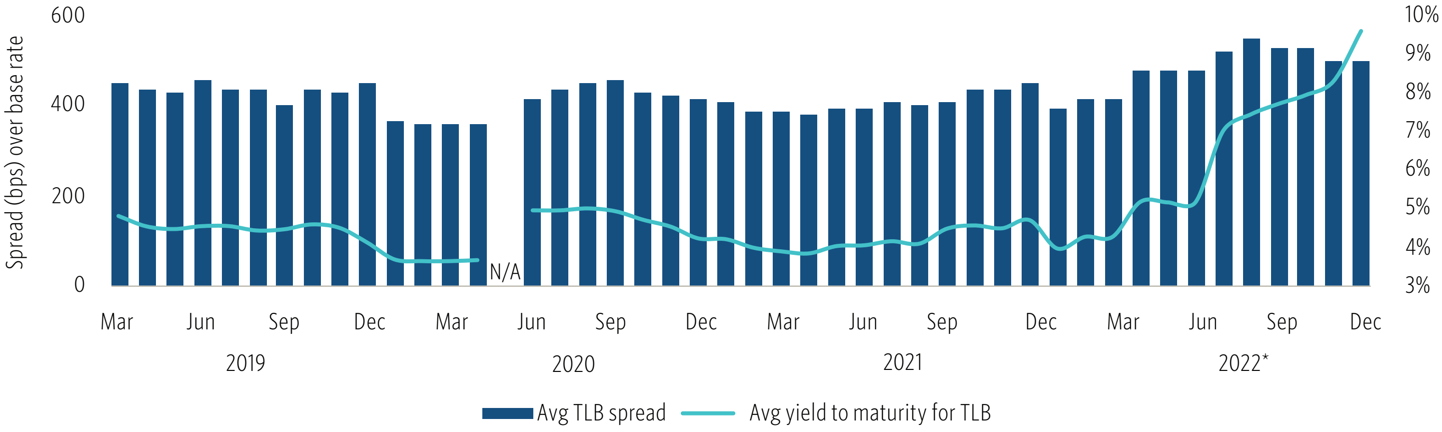


Source: PitchBook | Geography: US
*As of December 31, 2022

Credit conditions and interest rates

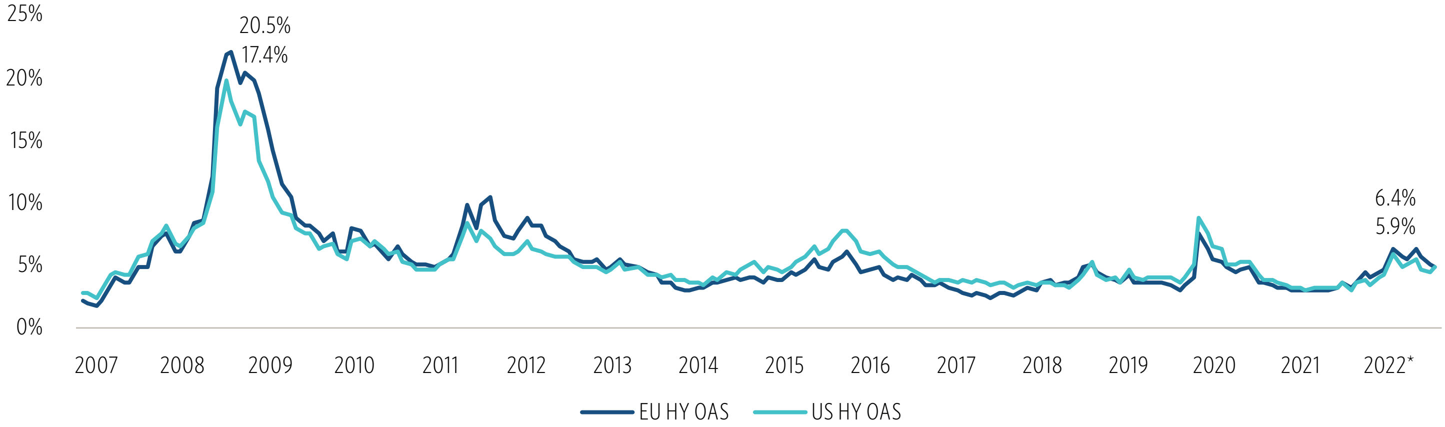
By definition, enterprise value is composed of both equity and debt. To understand what drives buyout multiples, we must understand what drives the debt component. Historically, tight credit spreads, low interest rates, and loose covenants have all contributed to higher buyout multiples because sponsors can borrow at low costs to fuel and leverage their buyouts. However, in periods of market downfall, we see the opposite happen—as we witnessed during the GFC—with high yield spreads ballooning over 20%, leading to a drop in buyout multiples and a general shutdown of deals. Indeed, from 2007 to 2009, European multiples fell almost 40.0%, going from an EV/EBITDA of 14.3x in 2007 to 8.7x in 2009 while US multiples fell even faster, dropping 33.6% between 2008 and 2009. In 2022, we have once again seen an uptick in high-yield spreads, leading to higher borrowing costs and thus lower EV/EBITDA multiples. Speaking of costs, yields have jumped dramatically in H2 2022, going from a 5.2% average yield-to-maturity for term-loan bullet (TLB) loans in June to 9.5% in December in Europe, while average TLB spreads stayed relatively stable around the 500 basis points spread over the base rate.

Average TLB primary spread and YTM: Buyouts



Source: PitchBook | LCD • Geography: Europe
*As of December 31, 2022

European and US high-yield option-adjusted spread



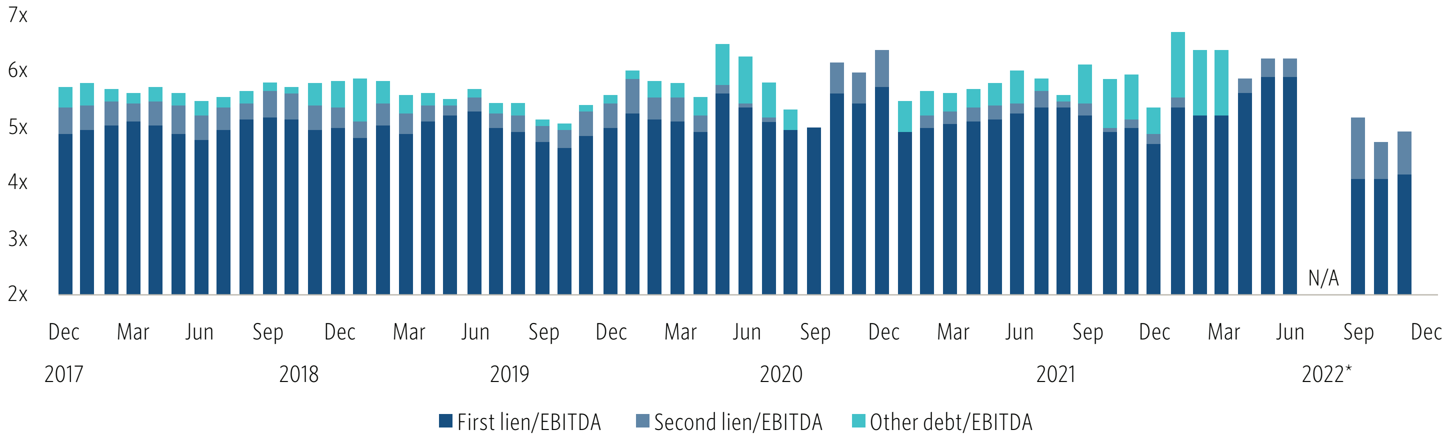
Source: PitchBook | Geography: Europe & US
*As of December 31, 2022

Interest rates are the prime driver of the credit market, and as we know, 2022 saw interest rates rise following tightened monetary policies in most developed economies. This has impacted financial sponsors across different asset classes as their borrowing costs jumped and their valuations dropped because the discount factor increased; suddenly capital became scarcer than in the previous decade. This inverse correlation can be illustrated with the chart, below, titled EU 10-year government bond yields vs buyout EV/EBITDA, using the Euro 10-year as a proxy for interest rates. For PE, this also leads to less leverage used in buyouts and thus lower multiples being paid. According to Partners Group, debt used to account for 80%-95% of private buyout capital structure in 1990 but now accounts for only 40% to 50%.[14] Similarly, LCD data shows that debt/EBITDA for sponsored deals came down in H2 2022 in Europe from 6.2x in June to 4.9x in December.

14: Ibid.

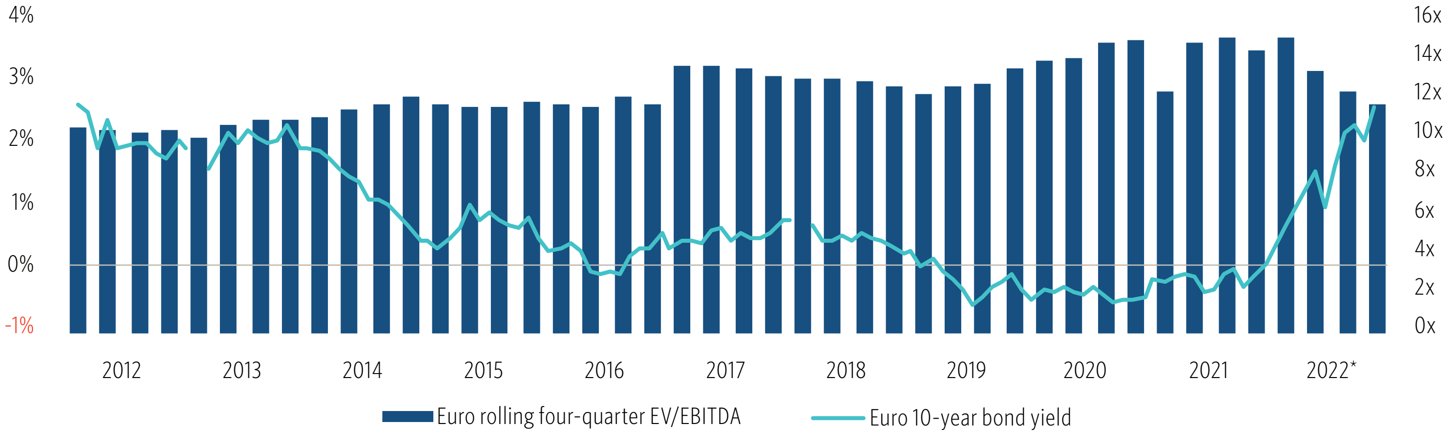
Looking forward, on the one hand PE firms have record amounts of dry powder to deploy in the near future, which may lead to higher multiples; however, the higher interest rates and wider spreads will negatively impact multiples. We believe we will continue to see high multiples being paid at the top of the segment for treasured assets, where competition and auctions will be driving individual price tags higher. However, the bulk of transactions within the smaller deals will fetch lower multiples and ultimately bring the median multiple lower in this tightening monetary cycle.

Pro forma debt/EBITDA ratios for sponsored deals



Source: PitchBook | LCD • Geography: Europe
*As of December 31, 2022

EU 10-year government bond yields vs buyout EV/EBITDA



Source: PitchBook; European Central Bank | Geography: Europe
*As of December 31, 2022