PitchBook

Exploring European Buyout Multiples

Comparing valuation differentials in Europe and the US

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Key takeaways

- For the first time in over a decade, 2020 saw considerable divergence in buyout multiples between Europe and the US. European prices dipped to a seven-year low while US valuations accelerated to a new high, due in part to a steeper flight to pandemic-proof assets in the US that came with a substantial COVID-19 premium.
- The valuation mix is shifting across both the US and Europe, with greater proportions of transactions being priced between 10.0x and 14.9x in Europe, whereas the US saw a record percentage of deals valued between 15.0x and 19.9x. The higher price ceilings and floors in the US are largely a reflection of the wider market exuberance driven by central bank and government stimuli.
- Buyout valuations in the UK, France, and Germany have displayed convergence in the last three years, with UK prices falling while the latter two regions saw increases. Median EV/EBITDA multiples in the UK were the richest at 13.4x, followed by France at 13.1x, then Germany at 12.5x—all still historically high. As a rule, when there's strong liquidity, coupled with low economic growth and cost of capital, the premium for growth vociferously rises, and this has kept prices aloft.
- With continued fiscal-monetary support, an expanded and favourable opportunity set, accessible debt markets, an encouraging economic outlook, and record PE dry powder, we expect European valuations to track higher during the next 12 months—although still being comparatively lower than the US—as investors look through the uneven recovery. That said, Europe's lacklustre vaccination rollout, recently imposed lockdowns, greater risk of developing vaccine-resistant virus mutations, and inflationary pressures could undermine the recovery and price rises.

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Introduction

Lofty PE valuations have long been touted as the prominent headwind to GP returns, due in part to heavy competition and a flood of investment capital chasing the same assets. Multiple expansion, revenue growth, deleveraging, and margin improvement are the typical value drivers in a buyout. A recent Bain analysis of hundreds of funds showed multiple expansion and revenue growth are the biggest drivers of GP returns.[1] When GPs buy companies at heightened valuations it becomes materially harder to generate additional value, especially in volatile and uncertain environments, which consequently hinders returns.

The abrupt and synchronised dislocation caused by the pandemic had many believe buyout valuations would finally fall to more reasonable levels amid scale consolidation and distressed M&A, as seen during the global financial crisis (GFC), where median European multiples plunged 45.0% from 2007-2009. But in the capricious year of 2020, valuations overall remained elevated and varied greatly by region. This analyst note will provide background on the key drivers of buyout multiples, as well as explore differences in valuations across Europe and the US over the past decade. As we dig deeper, future analyst notes may examine valuation differences across Asia, sectors, and company sizes.

EV/EBITDA

Buyout multiples refers to the price of an asset as a function of a financial metric. There are numerous types of multiples that can be used by managers including EV/EBITDA (enterprise value divided by earnings before interest, taxes, depreciation, and amortization), EV/revenue and EV/ARR (annual recurring revenue), among others. The sector of a company and where it stands in its business lifecycle (early stage, growth, mature, declining) help bankers and GPs determine which multiple to employ. For example, prospective investors in a young fast-growing SaaS (software as a service) company will likely use its annual recurring revenue multiple, while buyers of a mature retailer with predictable and stable cash flows will use the target company's earnings-based EBITDA multiple. This note will focus on the most commonly used PE multiple, EV/EBITDA. EV reflects the value of a company including its debt and equity, less any cash, while EBITDA is a widely used proxy for how much pre-tax cash flow a company generates.

Buyout valuation drivers

Precedent transactions and trading comps

Public & private precedent transactions, as well as trading comps, arguably drive the bulk of any buyout valuation. As most buyouts go through an auction process, the valuation range of an asset is typically set by bankers based on precedent transactions. Sponsors have to ultimately decide whether they can meet somewhere within this range. Trading comps, which are current multiples observed in the public markets, are also used and help explain why buyout valuations typically move with public market prices.

1: "Global Private Equity Report 2021," Bain & Company, Hugh MacArthur et al, March 2, 2021.

While public multiples are generally higher than their private counterparts, the particularly hot liquid markets have recently made trading comps a somewhat difficult valuation proxy for sponsors to use. Some comparable public assets currently trade at outsized EBITDA multiples driven by large inflows from exchange traded funds (ETFs), low interest rates, and enormous stimulus injections, among other things, as opposed to changes in company fundamentals. This can distort buyout prices away from their intrinsic value and usually results in bankers and sponsors applying higher discount rates on target company cash flows.

Credit conditions

Understanding the demand and supply dynamics in the high-yield debt, collateralized loan obligation (CLO), and leveraged loan markets heavily influences buyout valuations. Knowing what these non-investment-grade debt markets will bear for a specific asset with respect to pricing and terms is critical in pricing buyouts. Historically, tight high-yield credit spreads,[2] low interest rates, and loose covenants have fuelled elevated buyout valuations, as companies are able to take on more debt at lower costs with few operating restrictions. For example, during market downturns such as the GFC, credit spreads quickly ballooned to more than 20.0%, which explains why buyout valuations fell precipitously and deal volume plummeted: The high financing costs deterred buyers, and everybody but forced sellers tabled exit plans due to material drops in valuations. Conversely, during sanguine credit markets such as Q1 2021, where high-yield credit spreads lie around 3.0%, buyout pricing swells. This is mainly driven by low financing costs, vigorous demand for non-investment-grade debt, and relaxed operating terms (covenant-lite deals), which help support the business plan under consideration. As a rule, when there's strong liquidity coupled with low economic growth and cost of capital, the premium for growth exponentially rises, and this is where we currently lie.

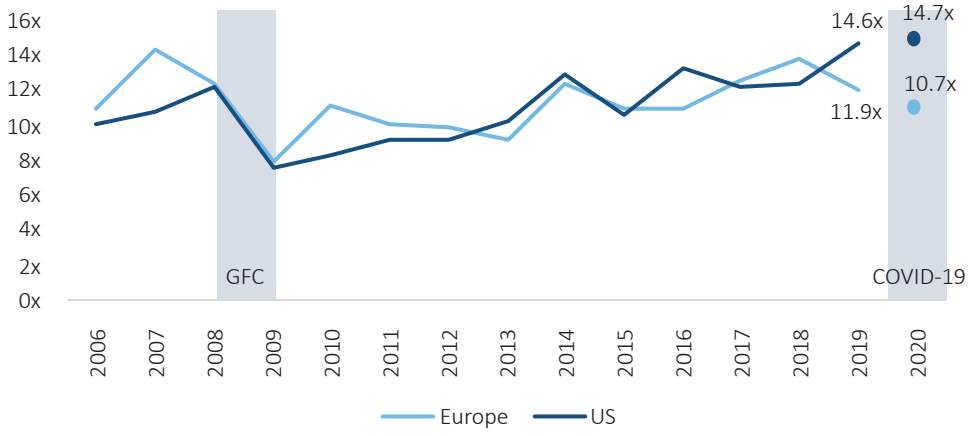
Competition

Competition for a given company also accounts for a great deal in entry prices. Corporates, other buyout shops, and now SPACS are fuelling the unprecedented competition for PE targets, which in turn drives prices higher. PE funds are looking a lot like corporate acquirers now due to their gargantuan amounts of dry powder. The bulk of buyouts go through auctions, which naturally result in higher valuations caused by corporates and other buyers bidding up prices. With so much competition and liquidity in the market, many sponsors are now submitting pre-emptive bids. This can put a binding offer in front of a seller before first-round auction bids are due, which may result in lower valuations as bidding wars are removed. In addition, sponsors building early relationships with prospective founders and management teams well before they contemplate partnering with a PE firm can help remove competition and ultimately reduce entry prices.

2: Credit spread definition: the difference in the yield on high-yield bonds and a benchmark bond measure such as Euribor or treasury bonds.

Comparing European buyout multiples to the US

European and US median EV/EBITDA buyout multiples



Source: PitchBook | **Geography:** Europe and US

For the first time in more than a decade, 2020 saw considerable divergence in the median European and US EV/EBITDA buyout multiples. The European median EV/EBITDA multiple fell to 10.7x in 2020—a seven-year low—while US prices reached a new record of 14.7x. The four-turn gap[3] between median European and US prices has never been wider and can be partly explained through Europe's poor public equity performance, considerably lower fiscal-monetary stimuli, mediocre handling of the COVID-19 pandemic, a weakening US dollar, and a steeper flight to pandemic-proof assets in the US.

A swath of European companies are trading well below their intrinsic value due to investors penalising the region for its low growth, geopolitical tensions, and mediocre pandemic handling, which has led to lower earnings forecasts. For example, in 2020, the US Russell 2000 index returned 20.0%, while the Stoxx Euro 600 lost 4.0%, putting downward pressure on European buyout multiples. Although the US surpassed 500,000 COVID-19 deaths in February, the most of any country globally, the country's unprecedented stimulus of €5.0 trillion ($6.0 trillion), which is more than 25.0% of pre-crisis GDP, is a considerable uptick from its 4.9% economic response during the GFC,[4] and helps outline why prices have reached a new peak. The Federal Reserve also increased its balance sheet by €2.4 trillion ($2.9 trillion) during the pandemic, a 75.0% increase from pre-pandemic levels and significantly higher than the ECBs 36.0% increase.[5] And despite Europe's COVID-19 death count being substantially lower than the death count in the US, the continent did not control the virus as well as Asia nor did it inject astronomical stimulus sums like the US, leaving the continent somewhere in the middle in terms of virus containment and stimulus injections. As a result, the EU's output gap[6] is virtually double the US, with

3: Four-turn gap defined: The difference between the median European and US EV/EBITDA buyout multiples.
4: "The $10 Trillion Rescue: How Governments Can Deliver Impact,", McKinsey & Company, Ziyad Cassim et al, June 5, 2020.
5: Ibid.
6: Output gap defined: The difference between pre-crisis trend growth and currently forecast trend growth.

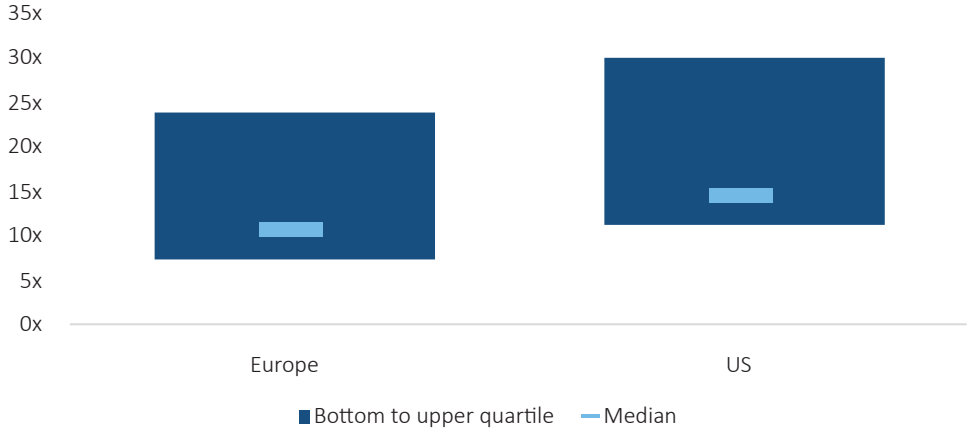
no realistic chance Europe will hit its pre-pandemic forecasted path of growth in 2021, while the US should.

Although many foreign buyers are dollar-denominated investors, the falling strength of the USD in 2020 may have applied upward pressure on US buyout valuations. The USD lost nearly 7.0% in value in 2020,[7] driven by the rally in risk assets. The euro gained around 9.0% on the USD in 2020, while the Japanese Yen gained approximately 5.0%,[8] indicating cheaper US assets for foreign denominated buyers, which perhaps spurred competition.

Lastly, the steeper flight to pandemic-proof assets in faster-growing industries in the US also drove prices to lofty levels, as a significant COVID-19 premium was attached to such businesses. In 2020, 38.0% of US PE deal value came from the IT and healthcare sectors, compared with Europe's 31.0%. These two industries saw valuations either hold steady or increase in 2020 due to the vaccine race and ubiquitous stay-at-home orders, which served as COVID-19 tailwinds. For example, in Q3 2020, Accelmed acquired US-based healthcare company TearLab Corporation for €33.7 million at a whopping 48.0x EV/EBITDA multiple. Sponsors targeted entities that could support more debt, as favourable credit conditions allowed deals to close. In the US, almost 80.0% of deals were leveraged more than 6 times EBITDA[9]—historically, the point of concern for regulators.

Pricing dispersion

2020 EV/EBITDA buyout multiple dispersion



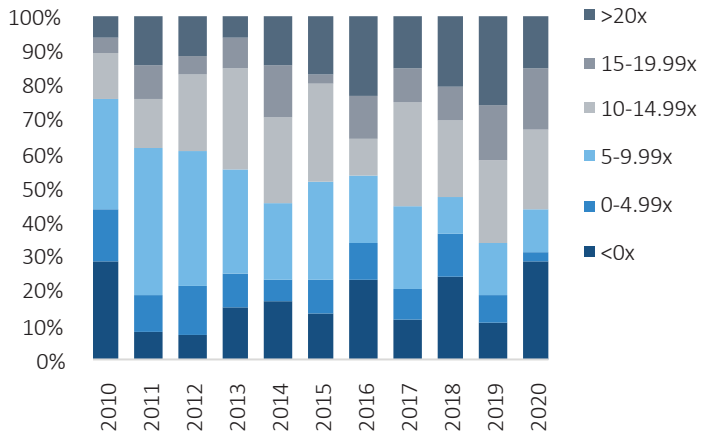
Source: PitchBook

The valuation mix is shifting across both the US and Europe, with more deals migrating towards pricier buckets. For the first time in over a decade, 23.0% of transactions in Europe were priced between 10.0x and 14.9x, while the US recorded a new peak of 17.9% of buyouts valued between 15.0x and 19.9x. The higher price ceilings and floors in the US are largely a reflection of the

7: "''Bets against dollar ratchet up despite rebound'', Financial Times, Eva Szalay, January 18, 2021.
8: ''The dollar Dollar is Is on pace Pace for its Its worst Worst 4th-quarter Quarter performance Performance in 17 Yyears as vaccine Vaccine rollRoll-outs Outs embolden Embolden investors''Investors,'', Markets Insider, Amanda Cooper, December 16, 2020.
9: Ibid.

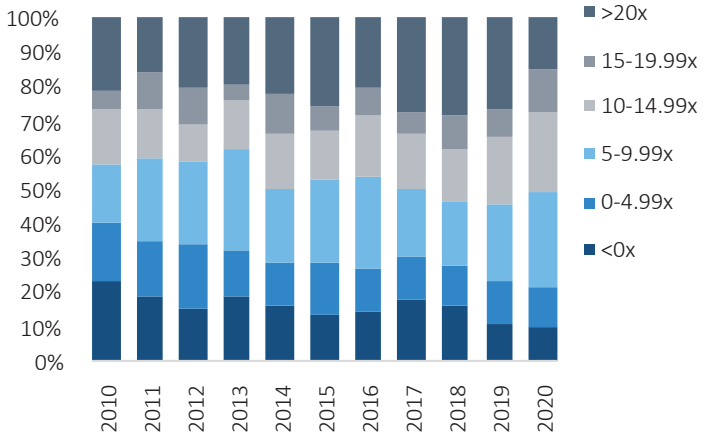
wider market exuberance driven by central bank and government stimuli. The bigger pool of large-cap buyout targets headquartered in the US helps explain the more expensive price environment, even when adjusting for the size of targets. For instance, if we look at the 2020 US median buyout multiple for transactions sized between €500.0 million and €1.0 billion (between $595.0 million and $1.2 billion), it stands at 20.0x, considerably higher than Europe's 13.3x reading. As transaction sizes fall, the difference significantly shrinks, as seen from Europe's 11.7x median multiple for deals sized between €100.0 million and €500.0 million, being only one turn lower than the 12.7x number for the US.

European EV/EBITDA buyout multiples



Source: PitchBook | **Geography:** Europe

US EV/EBITDA buyout multiples



Source: PitchBook | **Geography:** US

Interestingly, in 2020 the proportion of US targets with negative earnings approached levels seen during the GFC, although that was not the case in Europe. These figures likely reflect lower levels of company profitability during the pandemic but also potentially a higher proportion of start-up-like targets that have not yet reached profitability. Similarly, companies that have just reached profitability and are still growing at faster rates may be inflating the aggregate numbers in the US, especially if they are being valued on a multiple of revenue rather than EBITDA.

While some European assets are still fetching high prices, such as the €3.2 billion buyout of UK-based cybersecurity company Sophos, which was sold at an enormous 46.0x EV/EBITDA multiple; Europe's outsized number of SMEs and geopolitical tensions helps explain the regions lower prices. For instance, in Q2 2019, Vinci Airports acquired Gatwick Airport for €3.3 billion at a 16.2x EV/EBITDA multiple. Vinci stated if it weren't for the geopolitical tensions caused by Brexit, they could not have dreamed of being able to purchase Gatwick at less than 20.0x core earnings.

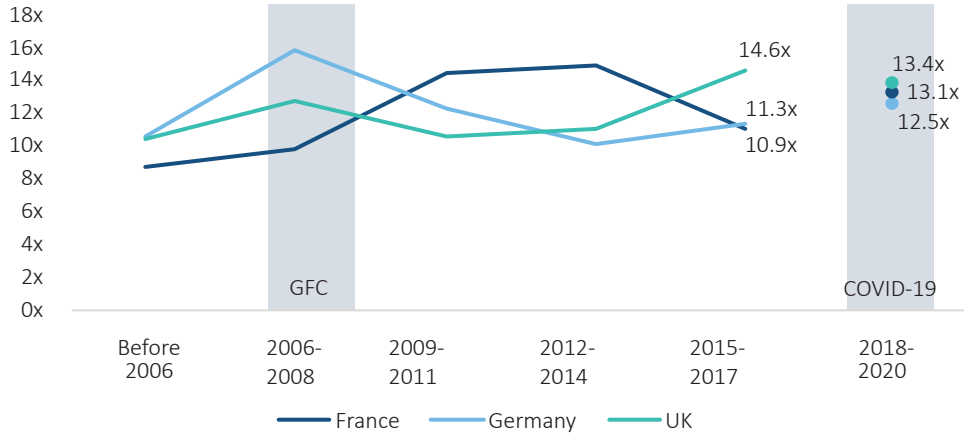
Top 10 global buyouts by EV/EBITDA buyout multiple in 2020

Target company	Notable Investors	Deal size (€M)	EV/EBITDA multiple	Industry sector	Global region	Close date
Cremonesi	Fondo Italiano per l'Efficienza Energetica	€10.0	85.7x	B2B	Europe	April 24, 2020
Webster (Australia)	Public Secot Pension Investment Board	€521.1	48.1x	Materials and Resources	Oceania	February 18, 2020
TearLab Corporation	Accelmed	€33.7	48.0x	Healthcare	North America	July 9, 2020
Sophos	Thoma Bravo	€3,242.9	46.0x	IT	Europe	January 16, 2020
Boldon James	TA Associates Management et al	€33.4	42.5x	IT	Europe	June 25, 2020
Majesco	Thoma Bravo & Ares Capital	€615.7	34.7x	IT	North America	September 21, 2020
Queue-it	GRO Capital	€15.9*	32.8x	IT	Europe	March 26, 2020
Polski Bank Komórek Macierzystych	Active Ownership Capital	€160.0	32.1x	Healthcare	Europe	February 6, 2020
Citadel Group	Pacific Equity Partners	€276.2	29.4x	IT	Oceania	December 8, 2020
Lytx	Government of Singapore Investment Corporation (GIC)	€2,244.7*	25.0x	IT	North America	January 8, 2020

Source: PitchBook
*Small portion of deal size figures are post valuation numbers due to a lack of reporting

Comparing intra-European buyout multiples

Median EV/EBITDA buyout multiples by three-year buckets[10]



Source: PitchBook | **Geography:** Europe

The big three European PE countries have displayed convergence in buyout valuations since 2018. While prices for UK assets have been falling since 2015, due in part to the uncertainty caused by the Brexit vote in 2016, asset valuations in France and Germany have been rising as competition for

10: Three-year bucket definition: Due to smaller sample sizes in the France and Germany region, we went with a three-year bucket format in order to bolster sample sizes to an acceptable level.

European assets less exposed to UK geopolitical headwinds intensified. Whilst UK valuations have been on a downward trend over the past five years, they have also been the richest in Europe, accounting for 40.0% of the continent's top 10 buyouts by EV/EBITDA multiple in 2020. The UK is Europe's most developed PE ecosystem, consistently accounting for the bulk of Europe's deal flow and fundraising over the past decade, which has buoyed prices. For example, the recently announced Silver Lake and Nestle €3.5 billion investment into UK-based IVC Evidensia valued the company at almost 90x EV/EBITDA, which is four times the company's valuation from two years ago.

While French valuations remain lower than the UK's, they have been on an upward trend since 2015. French President Emmanuel Macron's favourable tax breaks for managers relocating to France and reduced corporate income taxes have been positive tailwinds for PE in the region, which has pushed prices higher. For instance, Eurazeo Pme acquired France-based software provider EasyVista for €80.4 million at a lofty 20.1x EV/EBITDA multiple. German buyout valuations have also been on an upward trajectory since 2012, but to a lesser extent than France. Germany is Europe's largest economy, indicating an expanded opportunity set. Substantial opportunities in the region's heavy manufacturing and industrial sectors, as well as GPs driving digitization through its not-so-tech-savvy economy, have heightened competition in the region, which has in turn gradually increased valuations. This very trend was highlighted with KKR's (NYSE: KKR) €600.0 million buyout of Germany-based payments provider Unzer at a 24.8 EV/EBITDA multiple. For KKR, this purchase is the latest in a string of German acquisitions—including a minority stake in Axel Springer—as it seeks to take advantage of the region's fragmented markets.

Median valuations remain historically high in all three European countries, fetching median multiples anywhere from 12.5x–13.4x in 2020. One dealmaker focused on UK financial services assets said he cannot remember the last time he worked on a transaction priced under 10.0x. Because of increasing competition and liquidity, we believe the elevated price environment is the new normal. Sponsors will have to work harder to drive value in assets, as well as being more creative with deal origination activities, in finding hidden gems who want to sell to or partner with GPs.

Top 10 European buyouts by EV/EBITDA multiple in 2020

Target company	Notable Investors	Deal size (€M)	EV/EBITDA multiple	Industry sector	Euro sub-region	Close date
Cremonesi	Fondo Italiano per l'Efficienza Energetica	€10.0	85.7x	B2B	Southern Europe	April 24, 2020
Sophos	Thoma Bravo	€3,242.9	46.0x	IT	UK/Ireland	January 16, 2020
Boldon James	TA Associates Management et al	€33.4	42.5x	IT	UK/Ireland	June 25, 2020
Queue-it	GRO Capital	€15.9*	32.8x	IT	Nordic Region	March 26, 2020
Polski Bank Komórek Macierzystych	Active Ownership Capital	€160.0	32.1x	Healthcare	Central & Eastern Europe	February 6, 2020
Unzer	KKR	€600.0	24.8x	IT	DACH	July 1, 2020
SpaMedica	Nordic Capital et al	€347.2	23.3x	Healthcare	UK/Ireland	March 18, 2020
Gunnebo	Altor Equity Partners	€232.6	23.0x	IT	Nordic Region	November 17, 2020
EasyVista	Eurazeo Pme et al	€80.4	20.1x	IT	France/ Benelux	September 23, 2020
Aspen Pumps	Inflexion Private Equity Partners	€470.8*	19.5x	B2B	UK/Ireland	January 31, 2020

Source: PitchBook
*Small portion of deal size figures are post valuation numbers due to a lack of reporting

European valuation outlook

With continued fiscal-monetary support, an expanded and favourable opportunity set, accessible debt markets, an encouraging economic outlook, and record PE dry powder, we expect European valuations to track higher during the next 12 months—although still being comparatively lower then the US—as investors look through the uneven recovery. The early stages of an economic recovery are generally accompanied by a favourable growth picture, recovering fundamentals, and bullish market sentiment. Although we've seen a small uptick in German bund yields from -0.61% to -0.3% in Q1 2021, the ECB remains extremely dovish and recently pledged to accelerate its bond buying under its Pandemic Emergency Purchase Program (PEPP), set to last until March 2022 and totalling €1.85 trillion.[11] This ample and predictable liquidity is projected to spur economic growth in the Eurozone to 4.0% in 2021,[12] while keeping borrowing costs low. This in turn should keep high-yield credit spreads at favourable levels, meaning valuations should remain elevated.

Second, Europe is the world's largest economy if we aggregate all its economies together, and has several undervalued companies in fragmented markets, implying an expanded opportunity set, with perhaps more compelling risk-rewards than the US. For instance, on a price-to-earnings basis, the US public markets trades around 23 times, while the overall

11: "ECB Could Tweak Its Pandemic Stimulus as Bond Yields Surge, Germany's Weidman Says," CNBC, Silvia Amaro, March 3, 2021.
12: "ECB Pledges to Step Up Pace of Stimulus to Counter Market Sell-Off," Financial Times, Martin Arnold, March 11, 2021.
13: "UK Plc Up for Sale as Overseas Buyers Eye Bargains," Financial Times, Daniel Thomas and Peggy Hollinger, March 1, 2021.

Eurozone is at 17, and the UK is at a two-decade low of 14.[13] Investors will be more receptive to targets whose prices reflect the troubles of the past 12 months rather than the anticipated vast growth of the "roaring 20s," especially with Europe's more stable political environment due to the avoidance of a no-deal Brexit and the rotation into more cyclical assets.

Third, mounting competition with the addition of European and US SPAC acquirers, and a record of €233.3 billion of European dry powder on hand, will likely cause multiples to increase in 2021, buoyed by the anticipated strong European COVID-19 recovery, especially in the UK given its rapid inoculation programme. Additionally, US-headquartered buyout groups, including KKR and Carlyle, have raised European focused mega-funds in the past two years, and CVC Capital Partners closed Europe's largest ever buyout fund in 2020 at €21.3 billion, signalling enormous amounts of capital chasing larger European deals. That said, the Eurozone's lacklustre vaccination programme, recently imposed lockdowns, greater risk of developing vaccine-resistant virus mutations, and inflationary pressures could undermine the recovery and price increases.