PRIVATE EQUITY
STANDING UP WELL IN THE MIDMARKET IN EUROPE AND THE U.S.

In a turbulent macroeconomic and political environment, midcap private equity slumped but did not stall abruptly. What are the main trends observed in the American and European markets in recent months?

TWO PERSON INTERVIEW with **Eva Davis,** managing partner of Winston & Strawn in Los Angeles and **Grine Lahreche,** partner at Winston & Strawn in Paris.

Grine Lahreche

Global private equity has declined sharply over the past 24 months. How have your respective markets changed and what are the main trends?

Eva Davis: Transactions led by private equity funds slowed down on the US market from the end of 2022 and throughout the year 2023. Rising interest rates slowed the momentum of new LBOs, which were hampered by overpriced debt, but financial investors compensated for this drop in activity by stepping up buy-and-build strategies for their holdings. The last two years have been dominated by add-on deals for platforms owned by funds. In the midmarket, we have seen a number of these transactions, in the $10m to $100m valuation range on average. Buyers consider these smaller transactions advantageous, as they are accretive for the platform and do not require any new debt. Despite their scarcity, large company mergers have created carve-out opportunities for funds on the lookout for complementary acquisitions to diversify the vertical markets of their holdings and their geographical exposure. Financial shareholders are no longer reluctant to pursue their buy-and-build strategy long after the initial exit deadline, to maximise the value of their holdings when the environment is more favourable to disposals.

Grine Lahreche: The slowdown in private equity deals has been more limited in France than in other, less mature, European markets. The success of several fund-raising operations has enabled a certain vitality to be maintained in the external market and significant valuations for the best assets.

We have also observed a growing appetite among foreign buyers, particularly American funds, for French targets, which are considered to be more dynamic given the appreciation of the dollar, and more attractive than in other European countries.

This is good news for sellers, as these investors tend to be sector agnostic and have a very business-like focus, with teams of operating partners well-versed in optimising operational processes. Finally, as always in tense times, the polarisation of premium and more standard assets has become more pronounced, boosting the tech and healthcare sectors, which are more sought-after than ever. Reinvestments in tech and healthcare companies have also increased thanks to the growing popularity of continuation funds.

What are the main differences in how operations are structured and in the cultural practices in France compared with the United States?

Grine Lahreche: Practices are increasingly tending to converge between the European and American markets, even though there are still formal and cultural 3differences.

In France, for example, the weight of management in LBO deals is a specifically European (and particularly French) feature, especially in secondary and tertiary LBOs (the alignment of the interests of sponsors and management remains a universal principle, whatever the methods involved).

Eva Davis: In the US, the importance of management is considered on a case-by-case basis, depending on whether involvement is deemed critical to the execution of the buy-and-build strategy, for example, or the in-depth knowledge of the ecosystem in specific sectors.

This is what determines the weight of management in negotiations and the keys to sharing value creation with the investor.

How has the factoring in of ESG criteria changed in your respective markets?

Grine Lahreche: Compliance with ESG criteria has become a decisive aspect of the appeal of European targets in recent years. The place of this extra-financial component has become increasingly significant in the processes as European LPs become more demanding and the regulatory environment more restrictive, particularly with the entry into force of the reporting obligations under the CSRD directive applicable from 1st January 2024.

Eva Davis: In the United States, ESG reporting requirements are basically confined to listed companies. In private equity, there are no real regulatory requirements for funds to disclose ESG information or to act on ESG results. Private equity funds are therefore view the question from a business perspective rather than in terms of regulatory pressure or meeting the requirements of their LPs. In addition, some LPs (particularly the larger and/or more influential ones) may require ESG reporting from the GP, which may, in some cases, encourage ESG compliance. Nevertheless, most investors have integrated extra-financial criteria as a competitive factor for targets, and take them into account in their valuation and potential attractiveness at exit.

In an environment of more complex exits, what were the different strategies adopted by funds to cope with the slowdown in the rate of disposal of their portfolios?

Eva Davis: With the rising cost of debt, buyout packages had to adapt, using seller credit and earn-out mechanisms or preferred equity instruments. We also saw the rise of GP-Led single asset deals, which have become a genuine alternative exit scenario for returning liquidity to investors without selling off the best assets. Years ago, buyout funds were often reserved for portfolio run offs and unsellable companies, but now they are the preserve of the best companies. And investors no longer think twice about carrying out two processes in parallel: a traditional sale and a secondary transaction. If the valuation obtained on the traditional M&A market does not come up to their expectations, they prefer to reinvest in their own target rather than forego the upside of the next growth cycle. This new exit route is expected to settle in for the long term, even after the conventional transfer routes are no longer blocked.

Grine Lahreche: Continuation funds are becoming increasingly popular in the mid-market, but they should be handled with care to avoid conflicts of interest, as only the very best companies that still have a growth potential with their current shareholders are actually eligible. Apart from continuation funds, French private equity players have also used roll overs, which enable them to make partial exits to crystallise capital gains, while reinvesting alongside a new shareholder, thereby generating genuine market value from assets of which they have in-depth knowledge. As a result, the lengthening of the holding period has led to a proliferation of transactions in which the historical sponsors invite new minority shareholders to take part in a partial cash-out pending a full exit.

What are your predictions for your respective markets over the next few months?

Eva Davis: In the United States, the slump in private equity over the last two years seems to have bottomed out. All the signs point to a sustained volume of transactions in the second half of 2024 and the first half of 2025, and we have been witnessing a strong rebound since the start of the year. Under pressure from their LPs, investment funds are working hard on the exit front to return cash to their subscribers, and are also reaching the deployment deadline for their last vehicles raised. Although the context remains marked by persistent inflation, an economic slump, rising interest rates and high geopolitical tensions, the midmarket has been relatively spared compared to the large cap, where transactions require debt in larger amounts.

Grine Lahreche: Before President Macron announced the dissolution of parliament on 9 June 2024, we were witnessing a kind of return to pre-Covid normality, with new dynamics in the processes driven by the need to deploy the funds raised by private equity and the foreign investors' appetite for French targets. The climate of uncertainty and relative political instability risks compromising this new momentum, even if the series of crises since Covid has created a climate where the non-normative is becoming something of a norm.

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