Private Equity International

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**PRIVATE EQUITY DEALS & TRANSACTIONS**

# Cambridge Associates' Auerbach: Why smaller companies are in vogue in PE

Average MOIC and annual revenue and EBITDA growth for US small- and mid-cap deals have outperformed those for businesses at the larger end of the spectrum, says Andrea Auerbach at Cambridge Associates

At the upper end of the private equity market, fund sizes continue to grow, typically resulting in ever larger transactions for their managers. But size can be a 'frenemy' of portfolio company performance, given that it is harder for large companies, in comparison to their smaller counterparts, to repeatedly deliver strong revenue and EBITDA growth.

That said, larger companies are better able to take advantage of economies of scale and, on average, run more profitably. From our perspective, growth has been a key driver of private equity returns, and we believe delivering that requisite growth gets harder as companies get bigger.

Smaller companies typically exhibit better operating characteristics that are critical to earning a compelling private investment return. Based on analyses using information gathered from our database of operating metrics for nearly 5,000 US companies, smaller companies grow faster than their larger counterparts and are acquired at lower prices in transactions that use less leverage, which in today's interest rate environment costs more and can constrain growth.

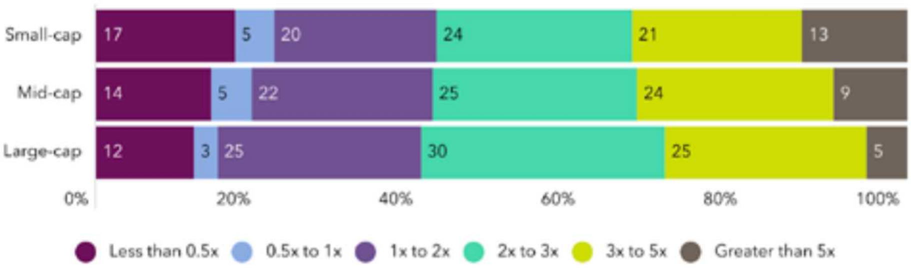
Andrea Auerbach

### À la mode

In this quieter market, occurring at a time when managers may have to work harder to generate returns (and hopefully more liquidity) for investors, it seems that smaller companies are in vogue, with operating characteristics that benefit funds of all sizes.

For example, a large sponsor-backed platform can acquire a smaller company for a new product line, customers, and/or operating capabilities and talent, or multiple small companies can be combined to create a larger platform. Of course, smaller funds can also acquire a small company, improve and professionalise its operations, and, after it grows, simply sell it to a new owner better suited for the next step in its journey. ■

**US private equity returns by company size: multiple on invested capital outcome distribution (%)**




Note: Company size is based on enterprise value at acquisition. Small-cap is defined as enterprise values of less than $250m, mid-cap as enterprise values of $250m to $1bn, and large-cap as enterprise values greater than $1bn. Size as of 31 December 2020; returns as of 31 March 2022

Source: Cambridge Associates

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