Why definition matters in the lower mid-market

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Federated Hermes
Private Markets

www.federatedhermes.com/private-equity
For institutional investors only

As private equity continues to mature – surpassing $5 trillion in assets in 2025[1] – and the returns that investors saw a decade ago become increasingly difficult to replicate today, more investors are moving down the market in search of a better return.

Against this backdrop, the term 'lower mid-market' is being widely used to describe a vast – yet undefined – range of companies at the smaller end of the scale. It is here that many of the industry's most exciting opportunities now reside. However, in the absence of any consensus, investors are approaching this segment with vastly differing views of what the lower mid-market is. Depending on who you ask, the segment can include companies with an enterprise value of up to $500m, although in some cases, companies with a value as high as $2bn are also being described as lower mid-market.

We define the lower mid-market as private equity portfolios with a median enterprise value of up to $500 million. In practice, however, our investment strategy focuses on the smaller end of that range. In the fifth vintage[2] of our flagship co-investment program, the PEC series, the median enterprise value of the 45 companies we backed was approximately $140 million. Although, our approach allows us to also invest opportunistically in larger companies, this reflects the area of the market where our deal team has consistently sourced opportunities for over 10 years – a space that has become our primary area of specialization.

Across this segment, we target healthy, growth-oriented businesses that are well-positioned to benefit from the professionalization and commercialization that institutional investors like us can provide, and that are typically absent from most LP portfolios.

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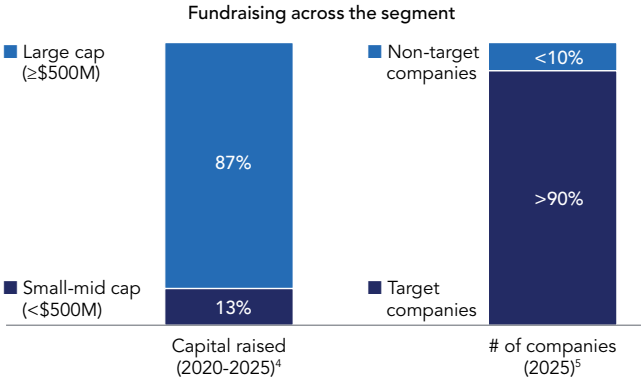
Why the lower mid-market... and why now?

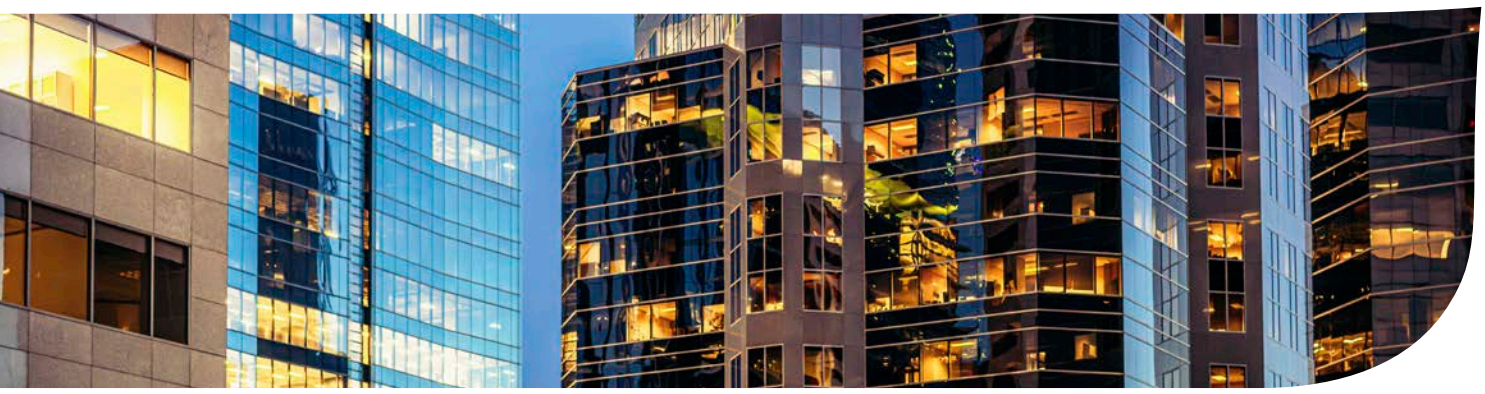
Historically, private equity inflows have aggregated at the mid and upper end of the market where many LPs are now fully invested. However, a sluggish exit environment along with a sharp slowdown in asset growth has left many investors waiting longer than average to realise a return.

This historic focus on larger deals has created an industry imbalance, resulting in less capital chasing highly attractive opportunities in the lower mid-market. As Chart 1 shows, 87% of commitments have gone to companies at the larger end of the market, providing exposure to less than 10% of available private companies. This dearth of capital at the smaller end has increased inefficiency in the space and reduced competition for acquiring these fast-growing companies. This is evidenced by a 2.9x[3] average discount in purchase multiple in the lower mid-market.

Chart 1: Relatively less capital going into the lower mid-market



In the 10 years that our team has specialized in this area, we have witnessed the consistent outperformance potential of lower mid-market companies. It is on the back of these dynamics that we believe investors are increasingly keen to exploit the gap between capital raised and the investment outlook.



[1] Source: Bain & Company — Global Private Equity Report 2025.

[2] The investment period for this fund ended on 30 June 2025 - it is no longer accepting new investors.

[3] Source: PitchBook data for North America and Europe across 2019-2024. EV/EBITDA multiples weighted by deal count per year. Lower mid-market is defined as transactions with enterprise value (EV) below $500m, while Large and mega market refers to transactions with EV of $500m and above.

[4] 2020-2025 US and Europe fundraising data from PitchBook's Annual 2025 European and US Private Equity Breakdown reports. All underlying fundraising figures are reported in USD.

[5] Source: S&P Capital IQ, covering commercially-active US businesses as of 13 February 2025. Target companies are defined as those with revenues between $10m-$250m, which are considered representative of our investment opportunity. Non-target companies are those with revenues greater than $250m.

Maintaining a clear definition of what the lower mid-market is essential to successfully tapping into the forces driving this outperformance. These characteristics are outlined below:

1. A broader, more attractively valued opportunity set

The smaller companies we seek are the backbone of the global economy, representing the vast majority of private companies. This part of the lower mid-market, therefore, encompasses a broad investment universe – spanning more sectors and industries than its larger counterparts – and the potential to offer investors a broader, more diverse opportunity set to select from.

The Private Equity industry average EBITDA multiple for deals under $500m – which measures how much investors pay relative to a company's earnings – has been about 11.6x, versus 14.5x for deals over $500m.[6] These more attractive entry valuations are driven by price inefficiencies, less capital flowing into the market segment and less intermediation, allowing investors to buy in the lower mid-market at a better price point.

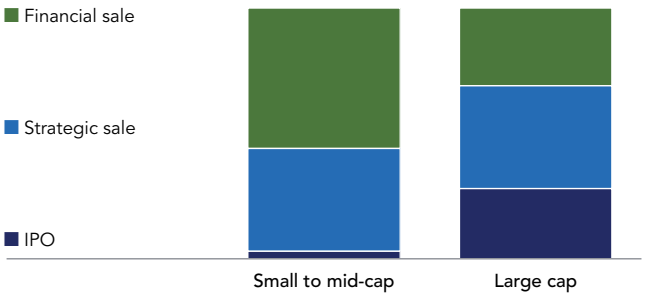
2. Less financial engineering and debt

Larger transactions typically include a degree of financial engineering and debt that is less commonly used in the lower mid-market. In Federated Hermes' last co-investment fund[7], 40% of the deals had zero debt attached to them. This is an outcome of both the nature of the sector and the specificity of our selection process and approach. We specialise in buying into already healthy businesses that can generate strong returns through operational value creation and strategic guidance. This ultimately allows us to build a portfolio of companies that we believe will be attractive to a broad range of buyers.

3. More pathways to exit

Exit strategies in the lower mid-market are less IPO dependent and more attractive to several different types of buyers. A strategic buyer is among the most common type of buyer of lower mid-market companies. These are firms that are looking to acquire other businesses with specific characteristics or technologies that can be beneficial to their own growth. A lower mid-market company may also be a target for financial buyers. Over the five- to seven-year holding period, a portfolio company is likely to have grown, in some cases, beyond the lower mid-market range. As a result, a financial buyer – i.e. another private equity investor – may see the company as an attractive addition to a larger fund.

Chart 2: US PE-backed exit value by type (2021 – 2024)



Source: JP Morgan Private Equity Insights.

With significant dry powder in the mid and upper end of the market, large funds looking for suitable acquisition targets are providing a strong exit pathway for lower mid-market investors. As chart 1 on the previous page shows, 87% of capital in private equity flowed to funds greater than or equal to $500m in size.[8]

4. An opportunity to align with founders

In targeting companies in the lower mid-market, investors are more likely to enter into partnership with a company founder. For more than half the deals our team has participated in, it is the first time that the founder is taking on institutional capital. In a first round of fundraising, an owner/founder is less likely to be driven by price and, instead, is more focused on finding the right partner to help them scale, professionalise the business, with the goal of delivering a positive return on capital. We believe this alignment of interests and the shared desire to generate performance alpha is less likely to be present among companies worth $5bn who are, for example, embarking on their third or fourth fund.

[6] Source: PitchBook data for North America and Europe across 2019-2024. EV/EBITDA multiples weighted by deal count per year. Lower mid-market is defined as transactions with enterprise value (EV) below $500m, while Large and mega market refers to transactions with EV of $500m and above.

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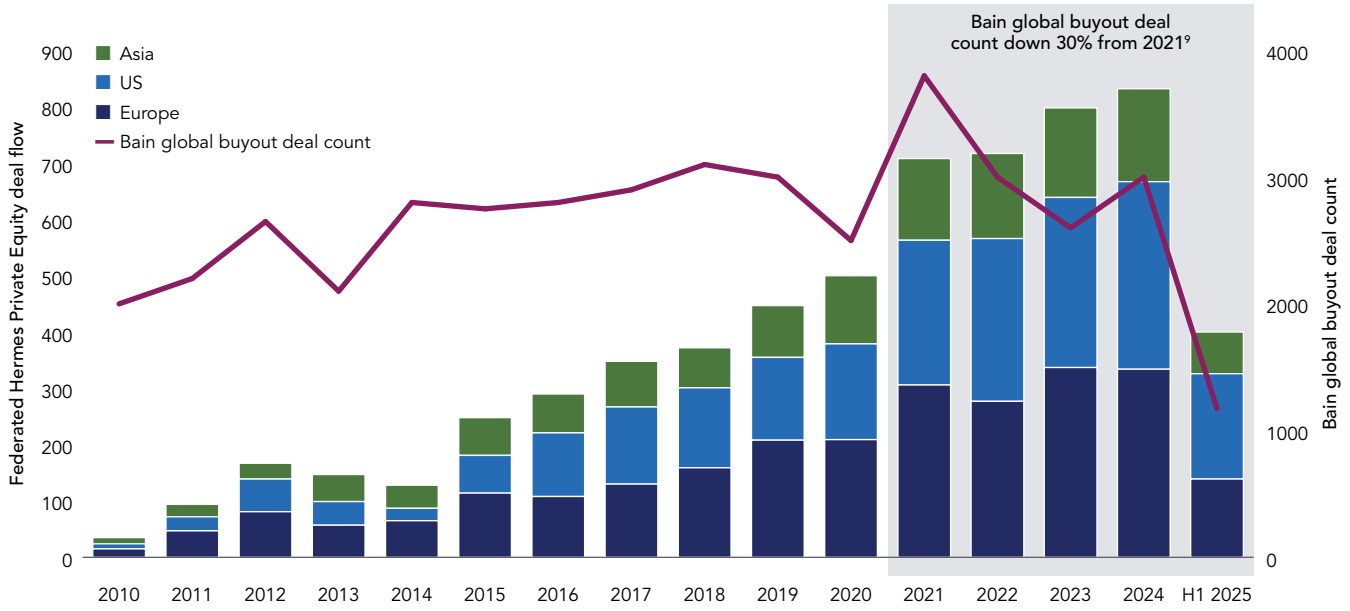
[8] Source: 2020-2025 US and Europe fundraising data from PitchBook's Annual 2025 European and US Private Equity Breakdown reports. All underlying fundraising figures are reported in USD.

Chart 3: Co-investments sourced since 2010



Why Federated Hermes Private Equity?

The lower mid-market, although ripe with investment opportunity, remains one of the hardest parts of the industry to access. Transactions often occur in a less formalised setting relative to larger deals, and many companies are taking on institutional capital for the first time. Due to their size, target companies are likely to have less established due diligence processes, reporting and governance structures. This means that prospective investors must themselves have the time, resource, and specialist skill to evaluate the investment and the company's ability to deliver on its return potential.

At Federated Hermes, we have worked to build a strong reputation and established networks in the lower mid-market. Our team is experienced in sourcing investable opportunities and putting them through a rigorous underwriting process. Historically, of the deals we analyse, less than 1% are ultimately added to the portfolio. In our last co-investment fund[10], the median enterprise value for companies invested in was $140m.

Given the less-formal nature of the market, the task of constructing a lower mid-market portfolio can be challenging, requiring specialised knowledge and an established network. The focused approach that we employ allows us to develop a strong pipeline of high potential deals. The strength of our deal flow and well-established investment process allows us to build differentiated portfolios comprised of companies that we believe we can sell, facilitating our track record of efficiently returning capital to investors.

[9] Source: Bain & Company, Private Equity Midyear Report 2025. As at 30 June 2025.

[10] Source: The investment period for this fund ended on 30 June 2025 – it is no longer accepting new investors.

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Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns and, where possible, to contribute to positive outcomes that benefit the wider world.

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Since our first Private Markets investment in 1983, our close connections, partnership mindset and deep understanding of client needs continue to define our client-focused approach across the asset classes and capabilities.

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