The Public Private Multiple Discrepancy

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REQ regularly collaborates with Master students in Finance on interesting topics related to our investment strategy. The following article is a summary of the Master Thesis on “The Public Private Multiple Discrepancy” written by Emil Kaasa and Adrian Vedum Håland. They dive deep into almost 1000 private acquisitions by listed acquisition-driven compounders in Sweden. The article sheds light on one aspect of our strategy and is written by the students.

Historically, there has been significant M&A activity in the Swedish market compared to other Nordic markets. From 2019-2022, the Swedish M&A deal volume was double the size of both the Norwegian market and the Danish market[1]. Our master’s thesis aimed to investigate the companies that drive a high volume of acquisitions in the Swedish market, known as acquisition-driven compounders, the acquisition multiples they pay in the private market and the stock performance of this group of listed companies.

In our study, we extracted data on acquisitions of privately held firms from the annual reports of listed acquisition-driven compounders. We studied a total of 980 acquisitions within the 10-year period of 2013-2022.

The Public Private Multiple Discrepancy

In our study, we examined a portfolio of 35 companies listed on the OMXS, all of which can be categorized as acquisition-driven compounders. We calculated valuation multiples of private acquisitions over the last 10 years based on the annual reports from our list of acquisition-driven compounders. Each company employed different reporting styles, presenting a diverse range of data availability to the public. We selected three distinct valuation multiples, EV/Sales, EV/EBIT and EV/EBITA, related to various acquisitions made by the portfolio companies from 2013 to 2022. Our analysis of the M&A strategy of these acquisition-driven compounders reveals a significant valuation discount for privately held firms compared to public targets. The findings indicate that companies listed on the OMXS traded at higher multiples than privately held firms, with averages of 2.9 times the EV/Sales multiple, 2.6 times the EV/EBITA multiple, and 2.4 times the EV/EBIT multiple. This substantial multiple discrepancy aligns with the findings of other researchers on the topic[2] [3], confirming a consistent valuation discount for privately held companies across all three multiples. The table below illustrates a comparison in valuation multiples between privately held targets and the OMXS Index from 2013 to 2022.

Public vs Private Valuation Multiples

EV/Sales	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Private	0,9x	1,3x	0,9x	1,0x	0,9x	0,8x	0,9x	1,0x	1,2x	1,2x
OMXS	3,0x	3,1x	3,0x	3,0x	2,9x	2,6x	2,9x	3,0x	3,6x	2,5x
EV/EBITA										
Private	6,2x	5,1x	6,3x	6,5x	6,9x	5,8x	7,1x	7,2x	8,1x	7,1x
OMXS	20,1x	19,4x	17,8x	18,7x	17,1x	16,0x	15,6x	16,9x	18,3x	12,1x
EV/EBIT										
Private	9,2x	11,3x	7,8x	12,0x	7,6x	9,7x	8,6x	7,0x	11,7x	7,8x
OMXS	24,3x	23,8x	24,2x	23,7x	20,5x	20,5x	24,1x	23,0x	19,5x	22,0x

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Long term performance of acquisition-driven compounders

There is limited literature on the long-term performance of acquisition-driven compounders. Acquisitions of privately held companies tend to generate positive returns, while acquisitions of public firm often lead to negative outcomes[4]. Frequent, programmatic acquirers have outperformed market benchmarks and performed better than infrequent acquirers[5].

In our analysis, we utilized the Calendar Time Portfolio (CTP) approach to assess long-term stock performance. Portfolios were constructed monthly by grouping acquisitions within a particular month, and we measured abnormal returns using the Market Adjusted Model, CAPM, and the Fama-French 3 Factor Model. By incorporating several models, we aimed to ensure robustness, emphasizing the Fama-French 3 Factor Model for its comprehensive variable inclusion.

Our study concludes that acquisition-driven compounders generated monthly abnormal returns ranging from 0.33% to 1.08%, depending on the model and timeframe. The CAPM and Fama-French 3 Factor Models showed consistent positive returns, with the latter displaying increasing alpha over time.

The table below summarizes the excess returns across different time frames and models, accounting for the effect of prior acquisitions in determining the statistical significance of the results.

Long-Term Performance: Overview

Expected return: OMXS			
Timeframe (months)	**Abnormal return**	**Std.Error**	**T-stat**
[0,3]	0.64%	0.31%	**2.09**
[0,6]	0.63%	0.27%	**2.31**
[0,12]	0.54%	0.27%	**2.00**
[0,24]	0.33%	0.14%	**2.31**
[0,36]	0.36%	0.18%	**1.98**
Expected return: CAPM			
Timeframe (months)	**Abnormal return**	**Std.Error**	**T-stat**
[0,3]	0.81%	0.25%	**3.28**
[0,6]	0.86%	0.21%	**4.14**
[0,12]	0.68%	0.21%	**3.18**
[0,24]	0.50%	0.15%	**3.24**
[0,36]	0.63%	0.19%	**3.25**
Expected return: Fama French 3 Factor			
Timeframe (months)	**Abnormal return**	**Std.Error**	**T-stat**
[0,3]	0.62%	0.22%	**2.87**
[0,6]	0.78%	0.38%	**2.08**
[0,12]	0.67%	0.32%	**2.09**
[0,24]	0.83%	0.40%	**2.10**
[0,36]	1.08%	0.09%	**12.39**

Our findings align with previous research. We find a significant public private multiple discrepancy and our research confirms that acquisition strategies targeting private firms produce long-term excess returns for shareholders.

[1] Airisto, T. Byrne, D. & Jensen, J. (Feb 06, 2023). M&A holds the line in the Nordics with robust performance. White & Case.

[2] Koeplin, J., Sarin, A. & Shapiro, A. (2000). The Private Company Discount. Journal of Applied Corporate Finance, 12 (4), 2-127.

[3] Block, S. (2007). The Liquidity Discount in Valuing Privately Owned Companies. Journal of Applied Finance, 17(2), 33-40.

[4] Fuller, K., Netter, J. & Stegemoller, M. (2002) What Do Returns to Acquiring Firms Tell Us? Evidence from Firms That Make Many Acquisitions. The Journal of Finance, 57 (4), 1763-1793.

[5] Bradley, M. Sundaram, A. (2006) Acquisitions and Performance: A Re-Assessment of the Evidence. SSRN

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