CAPZA

Part of AXA IM Alts

AXA Investment Managers

For professional clients only

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An introduction to the European Flex Equity market

Flex Equity provides flexible financing solutions tailored to the unique needs of mid-market companies. For investors, it combines the growth potential of equity with the protective benefits of bond structures, offering a flexible solution tailored to the unique needs of companies. This paper explores the rising prominence of Flex Equity, with a focus on the European mid-market. As traditional debt becomes less accessible, both investors and companies are increasingly turning to flexible capital solutions that can bridge funding gaps and support long-term growth.

The European mid-market (companies valued between €50m-€500m) remains especially attractive, underpinned by a deep pool of entrepreneurial businesses, stable corporate governance and comparatively conservative leverage levels. Our longstanding heritage in the region, and strong relationships with management teams, positions us to identify and partner with high-quality businesses seeking bespoke capital solutions.

Flex Equity offers a versatile tool to meet evolving capital needs, deploy capital at favourable entry points and deliver resilient risk-adjusted returns. We believe the outlook for Flex Equity is highly compelling as demand is increasing both from an investor and borrower perspective. In this paper, we will go through the drivers behind this demand and the unique characteristics of the European mid-market.

1. What is Flex Equity

Flex Equity, or Flexible Equity, is a hybrid investment instrument that merges the advantages of pure equity and the more protective benefits of bond instruments. For investors, it offers an attractive blend of income generation through regular payments – plus capital gains through equity stakes.

These solutions have gained traction over the past two decades, as small- and medium-sized enterprises (SMEs) seek funding solutions without excessive loss of control or shareholder dilution.

In practical terms, the equity can be complemented by mezzanine financing, convertible bonds, preferred shares, or a combination (or even a succession) of these elements. The structure is customisable depending on the company's needs, the investor's preferences, and the economic environment.

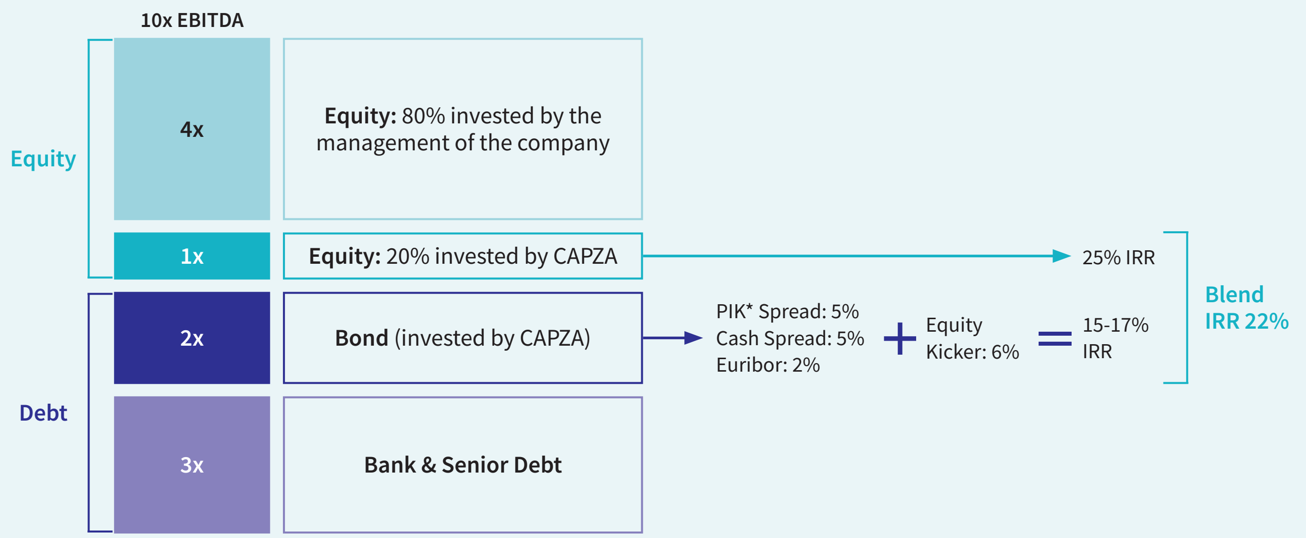
Key features

- **Flexible Terms:** Mix of equity and bond instruments, with customisable repayment schedules and dividend structures tailored to the company's cash flow and growth prospects.
- **Downside Protection:** Seniority in the capital structure compared to pure equity, offering a buffer against losses.
- **Equity Upside:** Participation in the company's growth through warrants, profit-sharing, or conversion rights.

Flex Equity can take various forms:

1. Mezzanine financing
2. Convertible bond
3. Preferred Shares
4. Common Equity

Example of how a Flex Equity deal is structured



Source: CAPZA. For illustrative purposes only. Performance is purely theoretical and does not illustrate future performance. *Payments in Kind.

In the example above, the company wishes to be valued at 10x its annual EBITDA. Of this 10x, 3x comes from traditional funding such as senior debt, 2x from mezzanine bonds, and preferred and common equity making up the remainder.

The split depends on the company's leverage capacity, cash flow profile, and desired dilution, with Flex Equity designed to fill the gap between senior debt limits and equity tolerance (details of different scenarios are given in the case studies at the end of this paper).

Rates and Flex Equity

Rising interest rates make traditional debt more expensive and typically slow economic growth. At the same time, the increased cost of debt makes alternative financing options such as Flex Equity more attractive. By offering equity participation and more flexible repayment terms, Flex Equity provides an appealing alternative to companies that are wary of taking on costly traditional debt.

2. The drivers behind the growth of Flex Equity

A combination of structural market shifts and evolving borrower needs has increased the demand for flexible financing solutions. Traditional bank lending has tightened due to regulatory capital constraints (e.g. Basel III/IV), limiting credit availability to mid-sized and non-listed businesses.

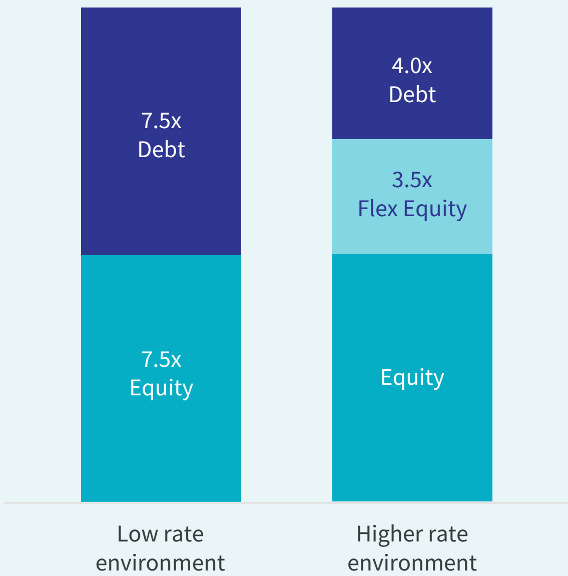
Strategic drivers include a growing preference for capital structures that support growth without immediate cash flow strain or loss of control, and increased private equity activity in mid-market deals.

Equity: Simple private equity stakes can be overly dilutive or misaligned with founder timelines. For example, a founder who sells a majority stake to a private equity firm to obtain liquidity and fund expansion expects a long-term strategic partnership. However, the PE firm's shorter 4-5 year exit timeline can lead to pressure for rapid scaling and a focus on near-term returns, colliding with the founder's longer-term vision. With reduced ownership and limited control, the founder's influence and eventual upside are significantly diminished.

Debt: Higher interest rates have made debt financing more expensive. Higher rates have been a contributing factor to the funding gap created by the withdrawal of traditional lenders from some areas of the lending market. In the example below, a company that was able to get financing of up to 6x its EBITDA during the period of lower rates, today finds itself able to get debt financing of just 3x to 4x its EBITDA.

In other words, there is a 2x to 3x funding gap. But company management don't want to further dilute their equity stake by issuing equity. Instead, they opt for a Flex Equity solution that can take the form of preferred, convertible or mezzanine bonds, or a combination of these.

Refinancing example – impact of higher rates

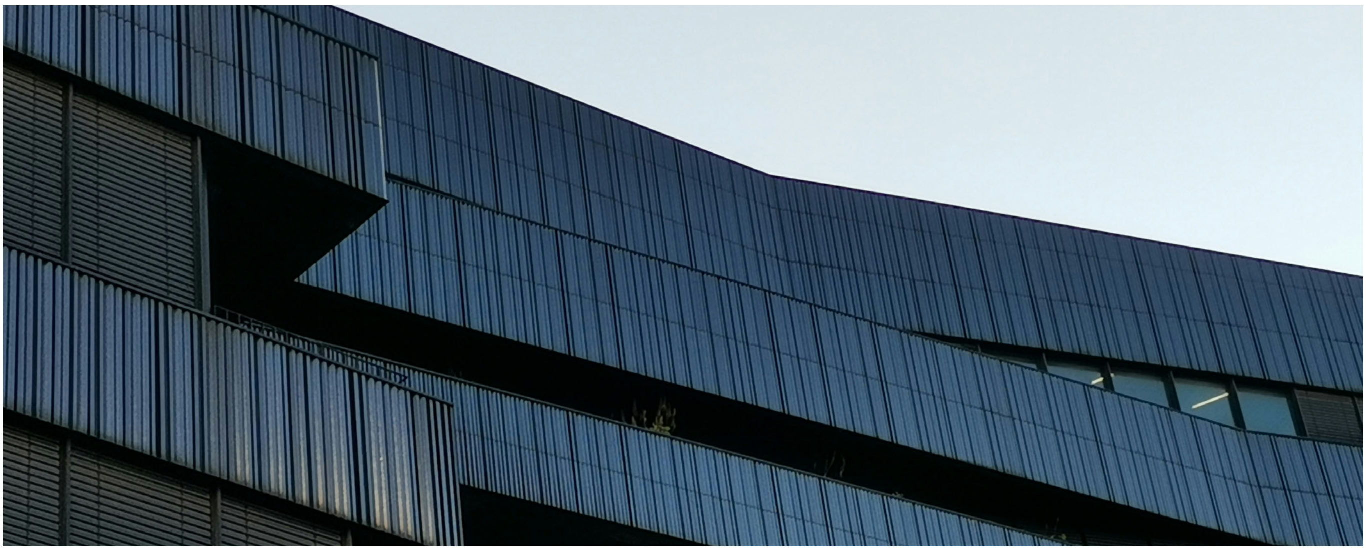


Source: CAPZA. July 2025. For illustrative purposes only.

Flex Equity offers solutions along the debt-to-equity spectrum

Debt and debt-like ← → Equity and equity-like

	Debt	Preferred and warrants	Convertible preferred equity	Minority common equity
Pros	• Non-dilutive (no loss of ownership or control) • Predictable cost (fixed interest) • Maintains existing equity upside for shareholders)	• Flexible repayment (often no cash pay requirements) • Warrants delay dilution and align investor upside with company success • Typically junior to debt, providing balance sheet flexibility	• Deferred dilution until conversion; hybrid of bond and equity • Often has downside protection (e.g., liquidation preference) • Converts into equity on predefined terms (e.g., exit or valuation triggers)	• No repayment obligations; fully equity-based • Attracts long-term partners without majority control
Cons	• Requires regular interest payments and principal repayment • Restrictive covenants can limit operational flexibility • Can strain cash flows, especially during downturns	• More expensive than debt • Warrants create future dilution • May include negotiated governance rights or restrictions	• Can lead to significant dilution of founder's stake upon conversion • Complex structuring can create misalignment or negotiation issues • Mechanism for agreeing valuations can be subjective	• Immediate dilution of ownership • Investors may still require board rights or vetoes • Expectations can be misaligned if growth or exit timeline differs



3. Why focus on European mid-market

Funding gap requires alternative capital

Europe's mid- and small-cap PE market (small-cap are generally firms valued are at less than €50m, mid-cap are firms valued between €50m-€500m) presents a significant and growing opportunity, underpinned by a deep pool of businesses seeking flexible capital solutions amid tightening traditional debt markets.

The 2008 financial crisis triggered major shifts in bank lending, particularly affecting non-listed SMEs in Europe. In the years since, banks have increasingly retreated from lending to SMEs as capital requirements from regulatory reforms such as Basel III have made it punitive. Heightened market volatility and economic uncertainty have further pushed banks toward more stable, predictable borrowers.

As a result, many SMEs have found themselves underserved by traditional lenders, creating a financing gap increasingly filled by alternative capital providers.

Highly diverse opportunities with idiosyncratic drivers

Historically, the small- and mid-parts of the market have offered far more investment opportunities in deals. According to Preqin data, there have been 15 times more small- and mid-deal opportunities than large deals[1] over the past decade.

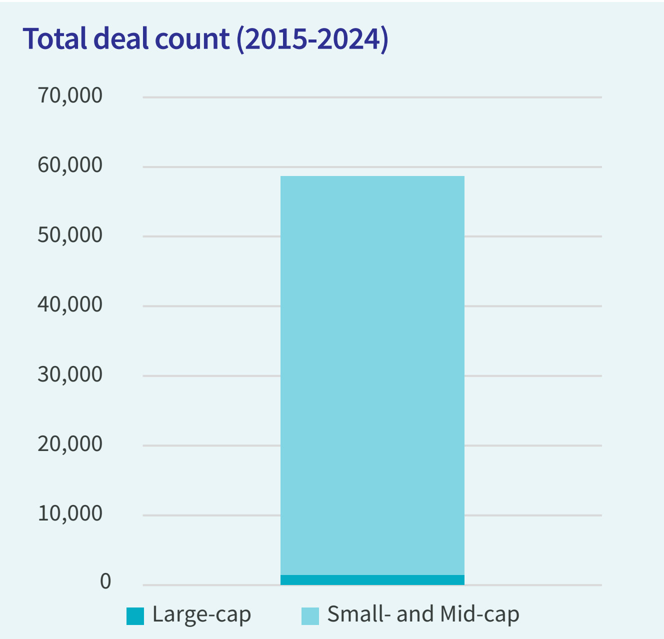
In other words, this segment makes up the bulk of the "long tail" of private equity, accounting for 98% of all funds in the market and 90% of all deals[2].

The small- and mid-market fund universe is diverse, providing various investment strategies and unique opportunities across sectors and regions. This contrasts with the concentration of generalist managers at the larger end of the market. This means that buyers in this space are more specialised and terms for investors can be more favourable.

Larger firms often lack the specialised local knowledge needed to identify return opportunities in the mid-market, which is crucial for understanding regional nuances and industry trends. Consequently, mid-market investors can leverage undervalued assets and negotiate better deals, enhancing their potential for higher returns. This underscores the importance of specialised approaches in the mid-market landscape.

In contrast with large and mega buyouts, which heavily depend on traditional economic tailwinds such as falling interest rates and stable GDP growth, mid-market strategies operate differently. These strategies focus less on macroeconomic conditions and more on driving value through operational improvements, niche market opportunities, and strategic growth initiatives.

The mid-cap market makes up a significant share of the total European PE market



Source: Pitchbook. Dec 2024. Small- and mid-cap: <€500m, Large-cap > €500m.

Note: 1. SPI Research, StepStone analysis. Dec 2024. 2. Preqin. Dec 2024.

Lower entry multiples

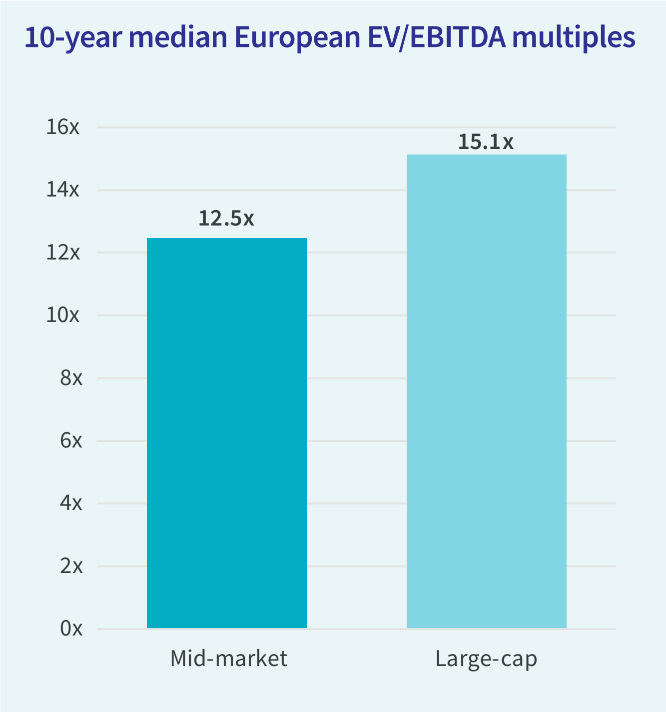
Mid-market firms typically present lower entry multiples and significant value creation potential. Many mid-sized companies are often under-optimised in terms of operations. This creates opportunities for investors to achieve outsized returns by implementing targeted growth initiatives, facilitating digital transformation, and enhancing governance practices – ultimately leading to improved efficiency and profitability.

Valuations and number of deals

The segment also offers a broader and more fragmented opportunity set, including founder-led businesses with succession needs and limited access to capital. In contrast, large-cap deals are heavily intermediated, more efficiently priced, and increasingly reliant on financial engineering in a higher interest rate environment.

The characteristics of the mid-market appeal to a diverse pool of potential buyers, including private equity funds seeking value creation through active ownership, and strategic or industrial buyers aiming to expand their footprint or gain synergies. Existing management teams may also pursue management buy-outs (MBOs), while Buy-In Management Buy-Out allow external managers to join forces with incumbents to take control. In some cases, public markets offer an exit route via IPOs, further enhancing the appeal of well-positioned mid-market companies.

Valuation multiples for European mid-market buyouts lower than large-cap



Source: Pitchbook. May 2025. Middle-market: €50m – €500m. Large-cap: > €500m. From 2015-2024.

Mid-market offers greater influence

The small- and mid-market provides a lot of primary opportunities which generally offer better pricing than secondary or tertiary transactions. Of equal importance, the primary market offers investors greater control and flexibility.

Through primary investments, sponsors can influence operational improvements, geographic expansion, product diversification, and strategic acquisitions. This allows for building scale, strengthening competitive moats and optimising capital structure, including tailored use of leverage.

Unlike secondary investments – where terms and strategy are largely fixed – primary deals allow investors to align capital deployment with their expertise and timing, unlocking greater upside potential through active ownership and bespoke value creation strategies.

The small- and mid-market by definition also typically offers investors greater influence compared to large-cap transactions, as the acquiring investor can play a more hands-on role in driving value creation. These businesses are often at an earlier stage of institutionalisation, which means there's more room to professionalise operations, improve governance and accelerate growth through strategic initiatives.

With fewer layers of management and closer alignment between owners and operators, buyers can implement meaningful changes more quickly - unlocking operational efficiencies, expanding margins, and positioning the company for significant upside.

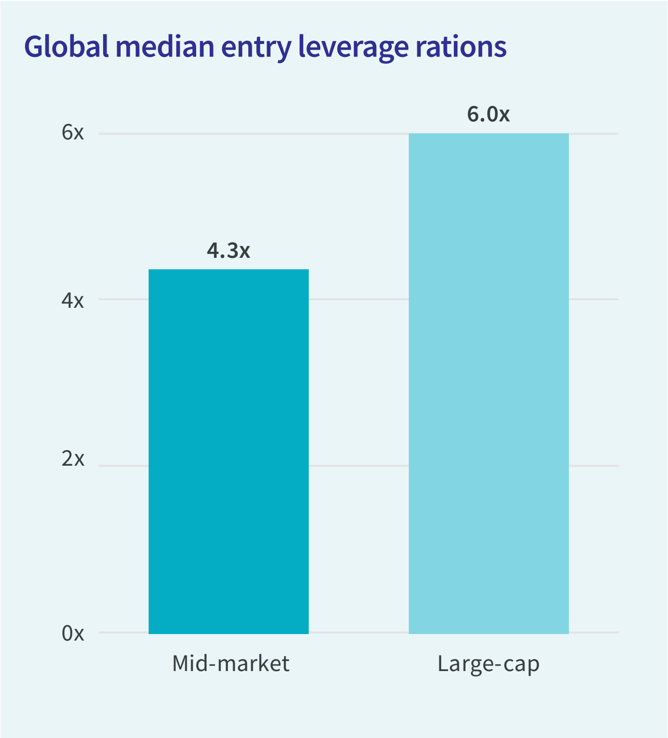
Source: CAPZA. For illustrative purposes only.

Lower leverage

Mid-market firms typically operate with lower leverage ratios than large-cap companies, as can be seen in the graph (albeit depicting global data). Lower leverage means less debt service pressure, providing greater financial flexibility and resilience, especially in volatile or rising interest rate environments.

It also reduces the risk of covenant breaches or distress during downturns, which is critical for preserving capital. For equity investors, this conservative capital structure can allow more room for operational improvements and growth initiatives to drive returns, rather than relying heavily on financial engineering.

Additionally, lower debt levels often make it easier to access follow-on financing or support add-on acquisitions, enabling scalable value creation. This prudent approach to leverage contributes to more sustainable performance and often leads to stronger alignment with management teams focused on long-term outcomes.

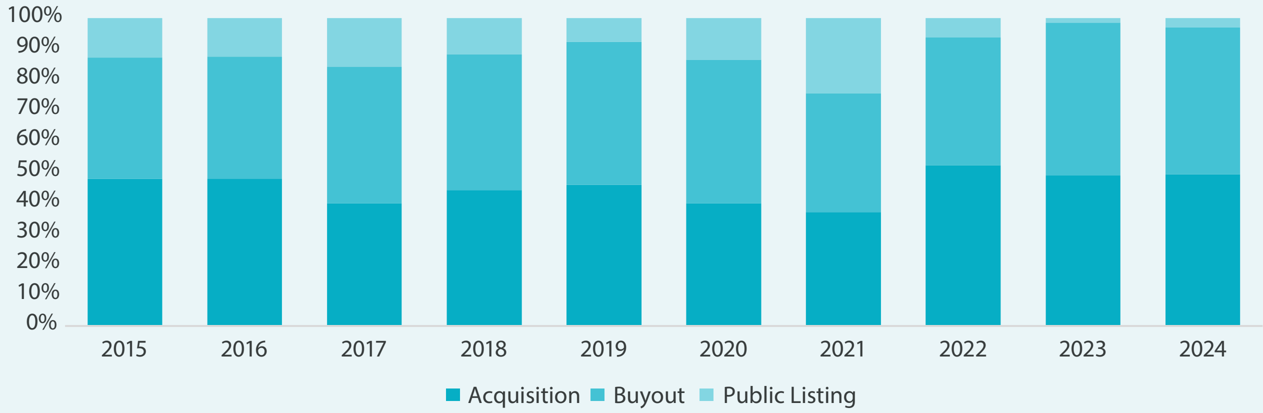


Source: Pantheon, March 31, 2024. Companies invested in from 2000 to 2022.

Broader Exit and Distribution Potential

LPs are increasingly scrutinising a manager's ability to deliver distributions to paid-in capital (DPI) across cycles. For many years, LPs saw little trade-off between ever-growing fund sizes and returns. Today, we see that exit activity has slowed the most at the mega-cap level, prompting some investors to shift their focus to small- and mid-market funds, which have broader exit potential.

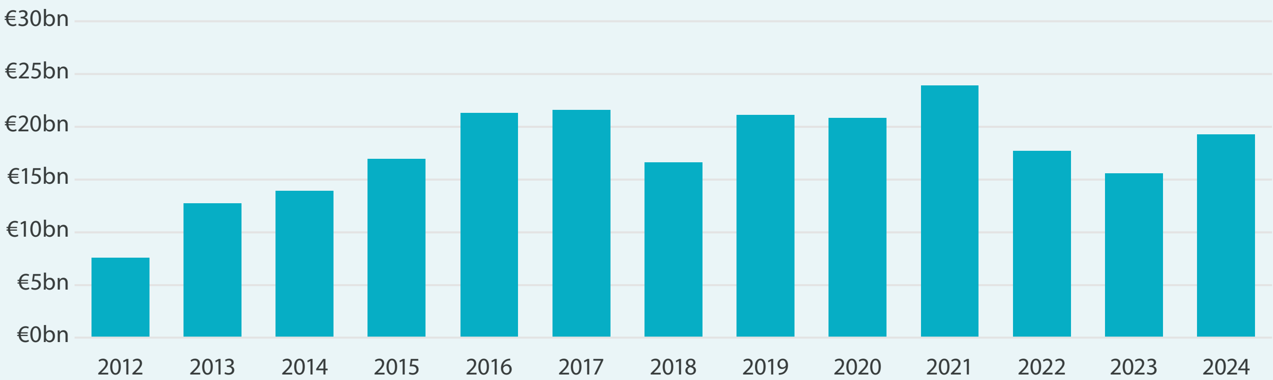
Europe mid-market PE Exits by type



Source: Pitchbook. May 2025. Mid-market: €50m – €500m.

Strategic sales are most common in mid-market private equity, where companies are large enough to be valuable but still digestible for corporate buyers. These exits often command premium valuations due to synergy potential, making them the most lucrative and preferred route for sponsors.

European mid-market fundraising



Source: Pitchbook. May 2025. Mid-market: €50m – €500m.

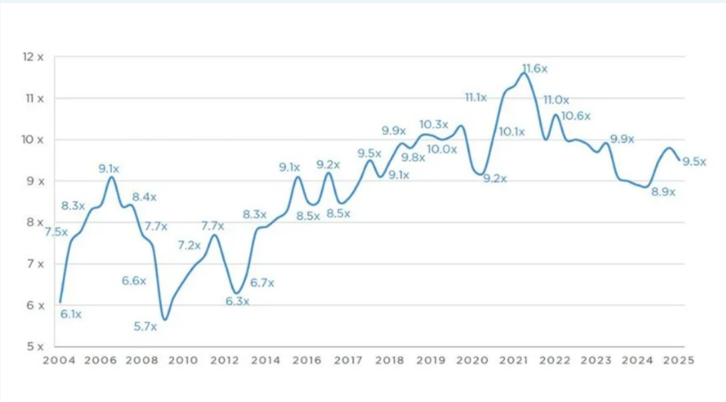
As a result, this market segment attracts more and more interest, with European mid-market fundraising reaching nearly €20bn in 2024. Investors have increasingly recognised the region's potential for consistent returns through hands-on value creation and operational improvements. As large-cap deals became more competitive and expensive, the mid-market has emerged as a fertile ground for differentiated strategies, including buy-and-build, digital transformation and sustainability-led growth. This shift has drawn growing attention from both European and global investors seeking resilient, scalable opportunities with lower entry multiples and meaningful upside.

Buyouts remain cheaper in Europe than in the US

European buyout deals show a persistent discount compared with North America, with entry EV/EBITDA consistently lower between 2018 and 2023. Additionally, Europe's fragmented market and high concentration of founder-led or family-owned businesses present a rich pipeline for buy-and-build strategies.

Preqin Transaction Intelligence data reveals an average 9.8% discount over the period, with discounts rising substantially in the information technology and industrial sectors in recent years[3]. Overall, the median US EV/EBITDA multiple in 2024 was 10.3x compared with 8.3x with Europe[4].

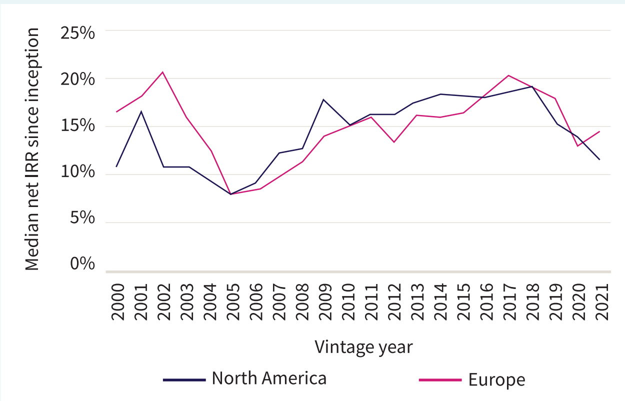
EV/EBITDA for Eurozone M&A transaction, rolling 6 months



Source: Argos Mid-Market Index, June 2025.

This performance is evident in median net IRRs, with Europe's 2021 IRR of 14.5% significantly exceeding North America's IRR of 11.6%[5].

Europe has consistently outperformed the US over recent years



> "Europe's 2021 net IRR of 14.5% significantly exceeded North America's IRR of 11.6%."

Source: Preqin, Dec 2024. Year refers to vintage.

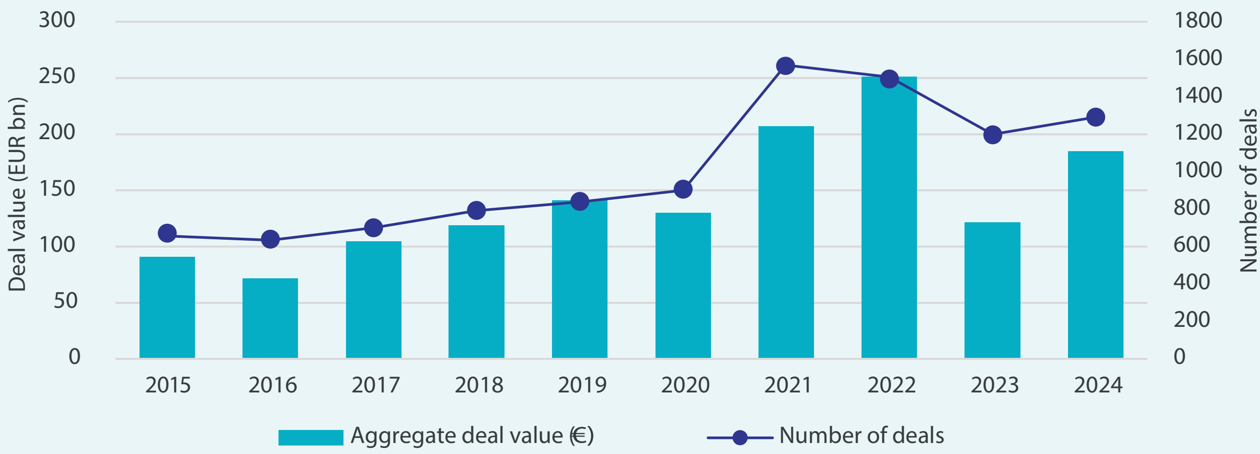
Past performance is not an indicator of future returns.

Note: 3. Preqin, Alternatives in Europe 2024. 4. Source: Pitchbook 2024 Annual Global M&A Report. 5. Preqin 2025 PE Global Report.

US investors are increasingly turning to European PE

US interest in European PE deals continues its long-term growing trend. 2024 had the third-highest number of European PE deals with US investors' participation on record.

PE deal activity with US investor participation



Source: Pitchbook. April 2025.

4. Investors' demand for Flex Equity

Attractive risk-adjusted returns are a key driver of the growing interest in Flex Equity, but there are a few more key benefits:

Customised deal structures

Investors can tailor capital structures to balance control, risk and return by adjusting the exposure to preferred equity, mezzanine or convertibles bonds.

Downside protection

Structured equity terms can include priority on exit proceeds or downside buffers, reducing exposure compared to pure equity.

Alignment with founders and management

Aligning interests between PE funds and management is key to value creation. When founders retain meaningful equity, they're more motivated and aligned for long-term success. Passionate teams often choose less dilution over early cash-outs to maintain control and purpose.

Creating sustainable operational value

For PE funds, there has never been a greater need to focus on value creation to drive returns, given increasing entry prices (as a multiple of EBITDA) and longer holding periods. Companies in private equity ownership (excluding add-ons) for more than four years comprised 61% of all buyout-backed assets, up from 55% in 2023 and the ten-year average of 53%[6].

Access to high-quality, founder-led companies

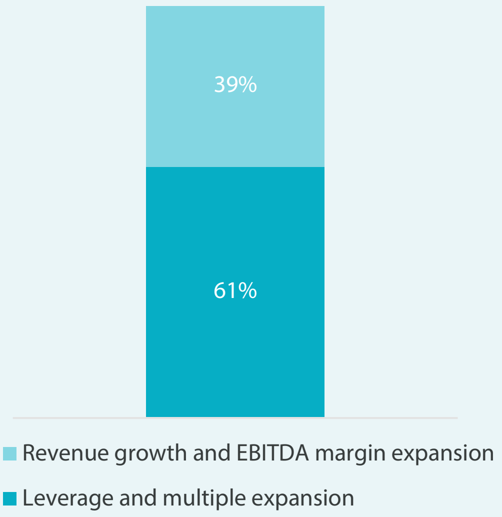
Flex Equity appeals to strong businesses that are reluctant to give up control, opening doors to otherwise inaccessible deal flow.

Diversification within private markets

It adds an uncorrelated return profile to portfolios, complementing both traditional buyouts and credit strategies.

Between 2010 to 2022, the majority of returns for deals - 61% - were attributed to leverage and multiple expansion, with the remaining 39% resulting from revenue growth and EBITDA margin expansion[7]. However, in recent years, leverage and multiple growth has pushed managers to prioritise operational enhancements to achieve their return targets. Consequently, there is now greater focus on boosting top-line growth and driving margin expansion as essential components of value creation.

Source of returns for private equity deals 2010 - 2022



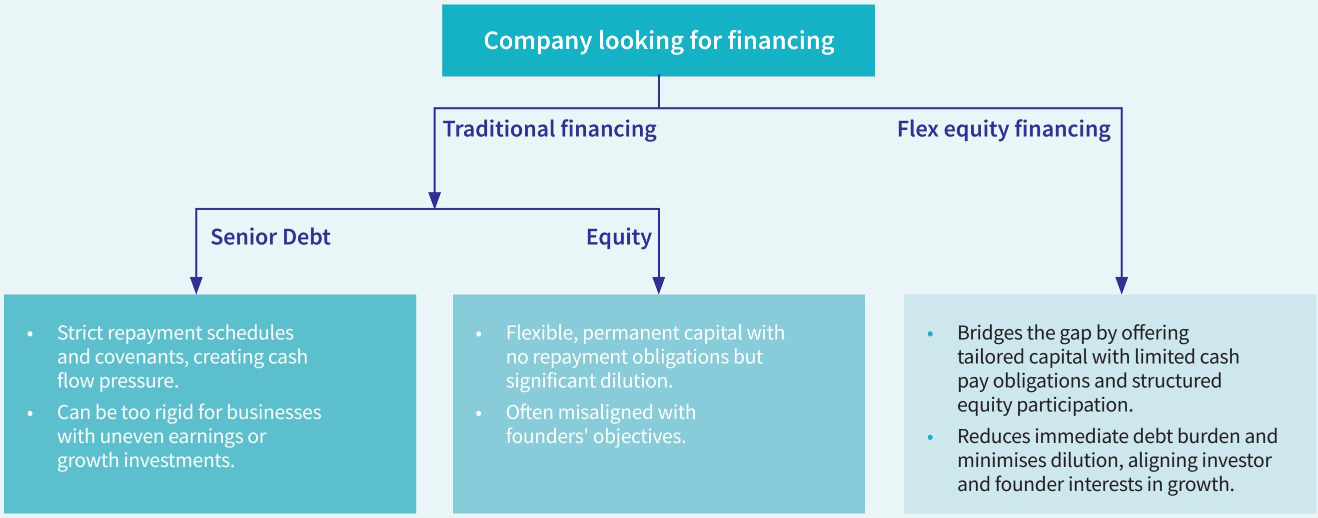
Source: McKinsey, SPI by StepStone. February 2025.

Note: 6. Source: McKinsey 2025 Global Private Markets Report. February 2025. 7. Source: McKinsey, SPI by StepStone. February 2025.

5. Increasing company demand for flexible solutions

Flex Equity is a crucial tool in the arsenal of private equity firms. PE funds able to provide flexible, tailor-made structures have a clear advantage in highly competitive processes and can have better pricing power to win over the most attractive companies in deal flow without overpaying.

Why do companies choose Flex Equity financing



Bespoke deals

The primary advantage of Flex Equity is its flexibility in deal structuring, allowing investors to craft bespoke financing solutions that fit the specific needs of the company and market conditions. Main features include:

	Repayment Terms	Liquidity Solutions	Cost of capital	Rapid Refinancing
What Flex Equity offers	Flex Equity allows for deferred or contingent repayment schedules, giving companies breathing room to manage cash flow during challenging times. For example, repayments can be structured to begin only after achieving profitability or reaching specific milestones.	Flex Equity can replace cash coupons with payment-in-kind (PIK) structures to manage cash interest coverage ratios. Typically, PIK can take the form of additional debt (interest is added to the principal amount, to be repaid later) or equity (additional shares).	Bond instruments are cheaper than equity. Companies who need to fund their development projects may prefer to do so while optimising their overall cost of capital.	Offers the possibility to refinance the mezzanine financing more rapidly, providing greater financial flexibility.

Benefitting from strategic advice

In Flex Equity, capital providers frequently take board or observer seats. Entrepreneurs seek not just funding, but also strategic insights from seasoned managers. The ability to gather benchmarks, learn best practices and share experiences with like-minded entrepreneurs offers invaluable benefits. Flex Equity investors may take a more engaged approach - often including board participation - even when their capital resembles debt in structure.

Lower cost of capital

Flex Equity financing is often more cost-efficient for companies because it typically carries a lower solvency capital requirement compared to pure equity. Flex Equity is structured to reduce immediate dilution and can include features such as deferred returns or capped upside. From a regulatory and balance sheet perspective it improves leverage metrics without triggering the full equity charge, making it an attractive tool for optimising capital structure while preserving control and reducing the overall cost of capital.

Optimising performance and distribution

Increased borrowing costs have strained companies' ability to service debt and fund growth, especially those in highly leveraged buyouts. With tight capital structures and maturing debt, private equity sponsors must choose between selling aging investments (median holding periods rose from 5.2 to 6.1 years in 2024[8]) at lower valuations or extending and recapitalising debt to buy time.

Compressed multiples and limited exit options have made both paths challenging. As a result, companies are increasingly seeking flexible capital to de-lever, grow, or generate liquidity—without heavy dilution or losing control.

Note: 8. Source: Pitchbook 2024 Annual European PE Breakdown Report

6. What role can Flex Equity play in a wider portfolio?

Smooth returns

Within a private market portfolio, Flex Equity can help smooth returns by offering current income through structured payments, while also preserving the potential for capital appreciation. This makes it an attractive tool for balancing risk and return. It can also act as a stabiliser, cushioning the impact of underperformance in other, more cyclical parts of the portfolio.

Improve liquidity

Flex Equity can also improve liquidity in private market portfolios by offering structured returns that don't rely solely on full company exits. Unlike traditional Private Equity, which often ties up capital for years, Flex Equity structures are designed to return capital earlier through features such as preferred dividends, partial redemptions or interest payments. This creates interim liquidity, helping to reduce the typical "J-curve" of private equity.

For investors, these regular cash flows make it easier to meet capital calls, rebalance portfolios, or take advantage of new opportunities without having to exit long-term holdings prematurely. This predictable liquidity stream also reduces reinvestment risk and enhances overall portfolio flexibility – especially valuable in uncertain or slower deal environments.

7. Key factors when choosing a Flex Equity manager

Long-term track-record

With 93 transactions and 68 exits completed since 2004, CAPZA is one of the few asset managers with an extensive track record in the Flex Equity market. It has built a solid reputation for structuring a wide variety of hybrid transactions by way of equity and bonds (mezzanine, convertible bonds), as a minority or majority shareholder. This ability to offer a hybrid solution to business owners is a clear edge compared to specialised private equity houses as it offers a single-entry point and therefore more flexibility and speed of execution, avoiding the conflict of interest that can be encountered between equity and debt providers.

Deal flow sourcing

CAPZA is one of the few players in its segment with a pan-European approach, with regional teams based in Madrid, Milan, Munich, Amsterdam and Paris offices. This is a true value-add for entrepreneurs looking for partners able to accompany them as they expand across Europe.

Dual expertise

Having a team with extensive dual equity and bond experience and an entrepreneurial background, CAPZA is able to adapt to the needs of business owners and management teams while creating value as an equity sponsor and controlling the downside.

Capacity to structure

Structuring Flex Equity investments can be intricate, demanding expertise in legal, tax, and financial matters. Having the right expertise and a robust ecosystem of partner firms ensures that deals are structured to maximize efficiency, mitigate risks and comply with regulatory requirements. Given the bespoke nature of these capital solutions, processes and legal documentation are less standardised. Therefore, thoughtful guidance from deeply experienced investors is crucial.

Outlook and conclusion

As traditional sources of capital tighten and market conditions remain volatile, Flex Equity offers a differentiated approach that balances downside protection with meaningful upside participation. It bridges the gap between debt and equity, enabling companies to access growth capital while preserving control, managing dilution, and maintaining financial flexibility.

The European mid-market, in particular, provides fertile ground for Flex Equity strategies. Characterised by lower entry multiples, fragmented ownership and a broad universe of founder-led or family-owned businesses, this segment offers strong opportunities for value creation through operational improvement, internationalisation, and buy-and-build strategies. It also presents a more favourable competitive landscape, with less crowding and greater pricing discipline than the large-cap space.

For investors, Flex Equity brings several portfolio advantages: smoother return profiles, reduced exposure to the J-curve and improved interim liquidity through structured cash flows. At a time when LPs are placing renewed emphasis on DPI and distribution timing, this characteristic makes Flex Equity particularly compelling. It also plays a stabilising role in portfolios that include more volatile or long-dated assets, offering diversification without sacrificing return potential.

Demand for flexible, tailored capital is expected to grow. Higher interest rates, regulatory constraints on bank lending and shifting exit dynamics are accelerating the need for more adaptable capital structures. Meanwhile, the European buyout market continues to trade at a meaningful discount to the US, offering investors relative value and room for multiple expansion.

With its long-standing track record, pan-European presence, and dual expertise in equity and credit, CAPZA is well-positioned to lead this space.

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