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Lower Middle Market Outlook 2026

Key Findings

1. Middle Market Reset Largely Complete; Cautious 2026 Recovery Expected

Private equity-sponsored middle-market transactions declined 27 percent year over year through the third quarter of 2025, with 211 completed deals compared with 289 in the same period of 2024, according to GF Data (2025). While GF Data does not publish detailed size-band breakdowns, IBBA Market Pulse reported 247 transactions in the $0–50M segment, down from roughly 310 in 2024, confirming that weakness extended into the true lower middle market (IBBA, 2025).

Fourth-quarter 2025 indicators suggest a bottoming process. Churchill Asset Management reported a 52 percent year-over-year increase in institutional deal flow, and platform acquisitions posted five consecutive quarters of positive growth, the first sustained expansion since late 2024 (Churchill, 2025; Capstone Partners, 2025).

Consensus forecasts from eight institutional sources point to 3–5 percent deal volume growth in 2026, weighted toward the second half of the year. Expectations assume additional Federal Reserve rate cuts and greater clarity on tariff policy, reducing financing costs and executive uncertainty (EY-Parthenon, 2026; Capstone Partners, 2026).

This outlook assumes two to three additional rate cuts and relative policy stability. A stagflation scenario driven by tariff-induced inflation would likely result in flat or negative volume.

2. Financial Buyers Dominate Volume; Strategic Buyers Return Without Premiums

On lower-middle-market deal platforms, independent sponsors account for 26.8 percent of completed transactions and traditional private equity funds represent 21.1 percent, together comprising nearly half of deal volume (Axial, 2025). Because Axial skews toward smaller transactions and fundless sponsors, these figures likely overstate independent sponsor share relative to the full market.

Broader surveys show financial buyers represent about 55 percent of deals by count, with strategic acquirers accounting for 40–45 percent (Pepperdine University, 2025). Strategic buyer activity rose 21 percent year over year in 2025 after a multiyear pullback, but valuation behavior changed sharply. More than half of strategic acquisitions closed at parity with private equity bids, and only one-third paid modest premiums of 1–20 percent, a significant compression from the 30–50 percent premium environment seen in 2021 (Pepperdine University, 2025).

By capital deployed, private equity sponsors still represent roughly 65 percent of middle-market dollars because of larger average check sizes, though this overstates their share of transaction count.

Search funds and ETA buyers remain a smaller but growing segment. Stanford Graduate School of Business tracked 29 acquisitions in 2023, equal to roughly 14 percent of comparable-sized private equity volume. Self-funded searchers are not comprehensively tracked, but conservative estimates place ETA market share near 14 percent, with upside toward 20–30 percent requiring further primary research (Stanford GSB, 2024).

3. Valuation Stability Persists Despite Volume Declines

Median middle-market valuation held at approximately 7.5 times trailing twelve-month adjusted EBITDA in the third quarter of 2025, unchanged from recent years despite cumulative rate increases exceeding 400 basis points since 2022 (GF Data, 2025). This resilience reflects quality selection bias, deployment pressure from dry powder, and improved debt availability as spreads compressed from 2023 peaks (Capstone Partners, 2025).

Reported medians skew toward high-quality assets. Businesses that failed to transact or sold through brokered channels at lower multiples are underrepresented. A true market-wide median likely falls closer to 6.5–7.0 times EBITDA. EBITDA normalization practices also vary widely, with aggressive add-backs inflating reported multiples by 15–25 percent in some cases.

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1. CONTEXT AND DEFINITIONS

1.1 Scope and Methodology

This analysis uses total enterprise value as the primary valuation metric, defined as equity purchase price plus total debt minus cash. Enterprise value provides a capital-structure-neutral basis for comparison across transactions. All multiples are calculated on an enterprise-value basis unless stated otherwise.

The geographic focus is primarily the United States, representing more than 95 percent of observed transactions. Canadian data are included only where sources aggregate North American figures.

Historical comparisons rely on 2023 and 2024 data, with primary analysis drawn from 2025 results through the third quarter and preliminary fourth-quarter indicators. Forward-looking commentary reflects 2026 institutional forecasts.

1.2 Key Terminology

Equity value refers to cash paid to shareholders. Total debt includes senior, subordinated, and seller financing. Cash reflects operating cash, subject to working-capital adjustments. Enterprise value equals equity value plus debt minus cash.

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2. MARKET OVERVIEW AND DEAL VOLUME TRENDS

2.1 Transaction Activity, 2023–2025

The lower and middle markets experienced a fourth consecutive year of contraction in 2025. GF Data reported 211 completed transactions through the third quarter, a 27 percent year-over-year decline. IBBA data for the $0–50M segment showed a similar directional decline, confirming the contraction was not a sampling artifact (GF Data, 2025; IBBA, 2025).

Despite reduced activity, valuation strength persisted. Average multiples rose to 7.5 times EBITDA in the third quarter from 6.9 times in the second quarter, reflecting scarcity of quality assets and sustained buyer competition (GF Data, 2025).

2.4 Lower Middle Market vs. Broader Market

Lower-middle-market performance lagged larger deal segments. Financing constraints, higher equity requirements, and fund-size economics pushed institutional capital toward larger transactions. Large-cap deals benefited from improved regulatory posture and strategic buyer activity, driving strong growth at the top end of the market (PwC, 2025; Capstone Partners, 2025).

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3. SECTOR HEAT MAP

Capital continues to concentrate in sectors with recurring revenue, demographic tailwinds, and regulatory barriers.

Healthcare services remain the highest-valued lower-middle-market sector, with median multiples between 10.5 and 12.0 times EBITDA, supported by consolidation strategies and ancillary revenue streams (Focus Bankers, 2025). Software and SaaS valuations range widely, with churn and revenue retention driving premiums or discounts.

Manufacturing and consumer discretionary sectors experienced multiple compression in 2025 due to tariff risk and cyclical exposure, creating selective entry opportunities for disciplined buyers (Lake Country Advisors, 2025).

STRATEGIC IMPLICATIONS

For sell-side advisors, managing seller expectations and timing processes early in 2026 remains critical to preserving value. Buyer diversification is increasingly necessary, with independent sponsors, search funds, and disciplined strategics forming a larger share of the buyer universe.

Private equity funds face platform scarcity and should prioritize add-on strategies and refinancing opportunities as debt markets normalize. Search funds retain an advantage in sub-$10M EBITDA niches where institutional buyers face sourcing and operational friction.

Strategic acquirers must justify any premiums through near-term, realizable synergies, as the market no longer rewards speculative overpayment.

ABOUT THIS RESEARCH

This brief synthesizes 134 institutional sources published between the fourth quarter of 2024 and January 2026. Primary sources include GF Data, the Stanford GSB Search Fund Study, the Pepperdine Private Capital Markets Survey, and multiple Big Four and elite advisory outlooks. Quantitative claims rely on multiple independent sources where available, and limitations related to disclosure gaps, sample bias, and macro uncertainty remain.

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