Deloitte.

Encouraging Confidence

20 years • Private Equity Confidence Survey

Central Europe

Summer 2023

“We are encouraged by the sentiment for the region, though not surprised given our Survey has shown each shock to be followed by a recovery over the last 20 years.
Now more than ever, Central European Private Equity deal doers’ experience makes them well placed to transact across cycles, and we are seeing improving indicators give reason for further optimism.”

Dusan Sevc, Deloitte Partner and Private Equity Leader

Encouraging confidence

Across its 20-year history, the Deloitte Central European (CE) Private Equity (PE) Confidence Survey Index has acted as a barometer of sentiment, with ups and downs captured and often hinting at market activity to come.

The first half of this year has seen a number of strong exits cast a positive light on CE deal doers' ability to deliver returns. This is likely boosting respondents' confidence, with the Index's recovery gaining momentum in our latest Survey.

Respondents expect to continue with divestments, with a tripling from 5% to 15% of deal doers expecting to sell more in the coming months. This may be down to pricing expectations, with increasing numbers looking ahead to sellers demanding more for their assets – a marked shift in the last year.

Looking ahead, we expect trade buyers to be increasingly drawn to strong businesses in CE made even stronger by their private equity partnerships, paving the way for more success stories. Many of the region's experienced private equity houses are adept at helping businesses to expand geographically, enhance digital capabilities, grow through acquisition and establish ESG frameworks.

This growth and the exits that result should help to attract investor interest in the region, with a number of sponsors currently in the market fundraising. Recent data from InvestEurope suggests nearly a quarter of investment into CE funds in 2022 came from family offices and private individuals, a sign of diversifying LP bases, while anecdotal evidence suggests other houses currently raising are attracting sizeable tickets from Asian investors. While it remains the case that LPs remain cautious globally owing to the backdrop and CE has the added risk of proximity to Ukraine, the fact is that there are successes for robust managers with strong track records.

This vintage of fundraises will focus more on ESG issues, with over a quarter of respondents having implemented decarbonization commitments and targets and another third developing them. Further progress in this space may come from global investors increasingly demanding it, and this will impact fundraises. In fact in May, CE's first private equity house became B Corp certified, showing the great strides some houses are making in this important area.

Sourcing and assessing opportunities for experienced deal doers and ambitious leadership teams is a challenge and opportunity for us. We remain ready to work with them on helping to drive sustainable growth for businesses partnering with the right financial backer.

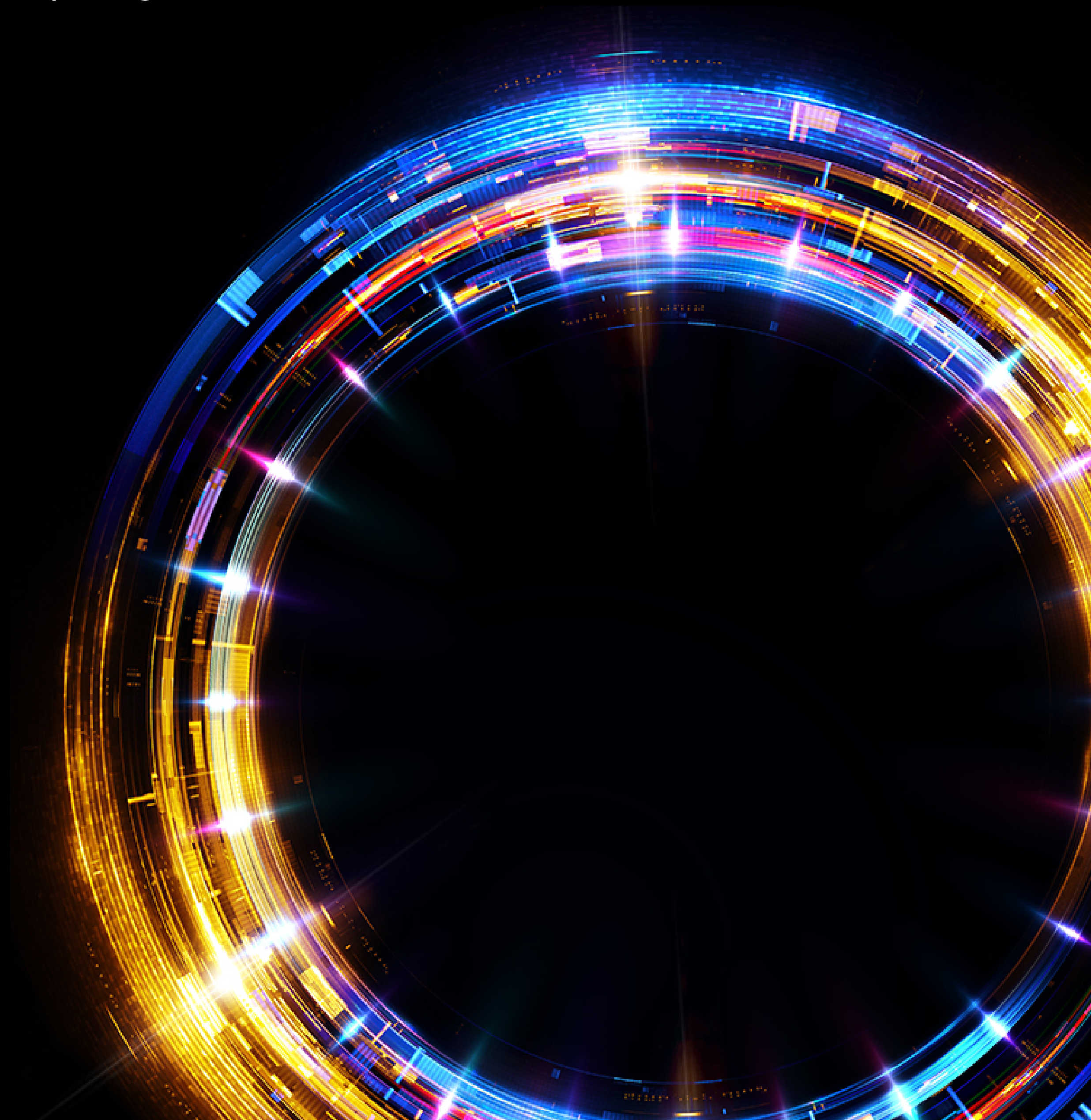
Dusan Sevc
Partner, Private Equity Leader,
Deloitte Central Europe

Central European Private Equity Index: Key findings

Economic prospects may be improving, with glimmers of optimism in our last Survey giving way to more concrete confidence. There has been a near halving of those expecting conditions to deteriorate, from 79% last time to just 43% this time, while the proportion expecting an improvement has shot up from just 3% to 15% this Survey.

Optimism around market activity continues to grow, with over a quarter (26%) expecting a boost in transacting, more than double last survey's 12%. Equally uplifting is that there has been a halving of those expecting a decrease, from over two-thirds last semester (69%) to a third (34%) this Survey.

Credit funds continue to play a bigger role in CE, with 45% of respondents now looking more to non-bank lenders for leverage for new deals and refinancings. 15% report needing more lenders now for a deal, and 13% of respondents claim their transactions are on hold, up from 8% in the last Survey and a clear sign of caution.

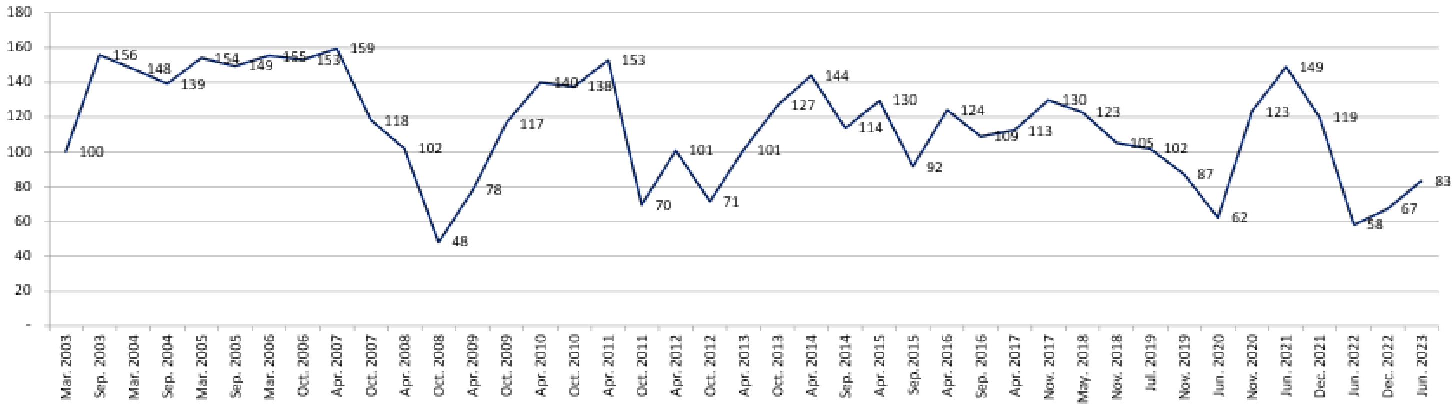


The Index's recovery continues, recording a steepening increase following a 12-month decline following the Ukraine war. While the fall was as dramatic as the post-Global Financial Crisis (GFC) period, the post-dip recovery is gentler. This may be owing to persistent inflation, or it could be that the post-GFC recovery was marred by inexperience-induced exuberance, with that having been the first real downturn for the region's industry.

Experience is the big difference in what is driving confidence now versus after the GFC, and this is crucial. The deal doers operating in today's market have experience in navigating downturns, whereas the 2009 dip was the first in Central Europe following a decade of golden growth. Drawing on that experience, we see confidence across a number of our Survey questions.

The boost in confidence coincides with waning worry around the economic backdrop, with the two usually moving in tandem with our Survey. The optimism is manifesting elsewhere: For the first time in a year, there is optimism around market activity, and more deal doers are looking to fundraise in the months ahead.

Central Europe PE Confidence Index



Survey Results

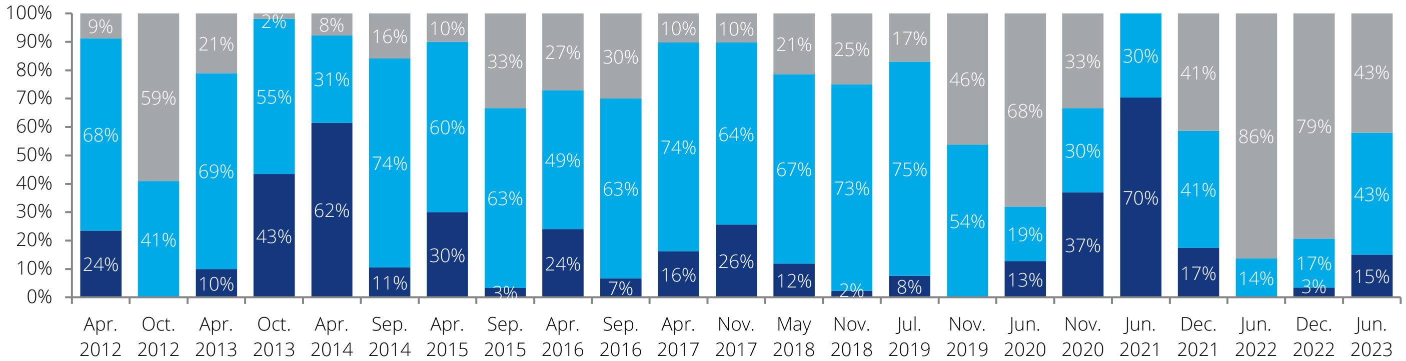
Economic climate

There is markedly less nervousness around the economy, with last Survey's fledgling optimism giving way to more concrete confidence. There has been a near halving of those expecting conditions to deteriorate, from 79% last time to just 43% this time, while the proportion expecting an improvement has shot up markedly from just 3% to 15% this time.

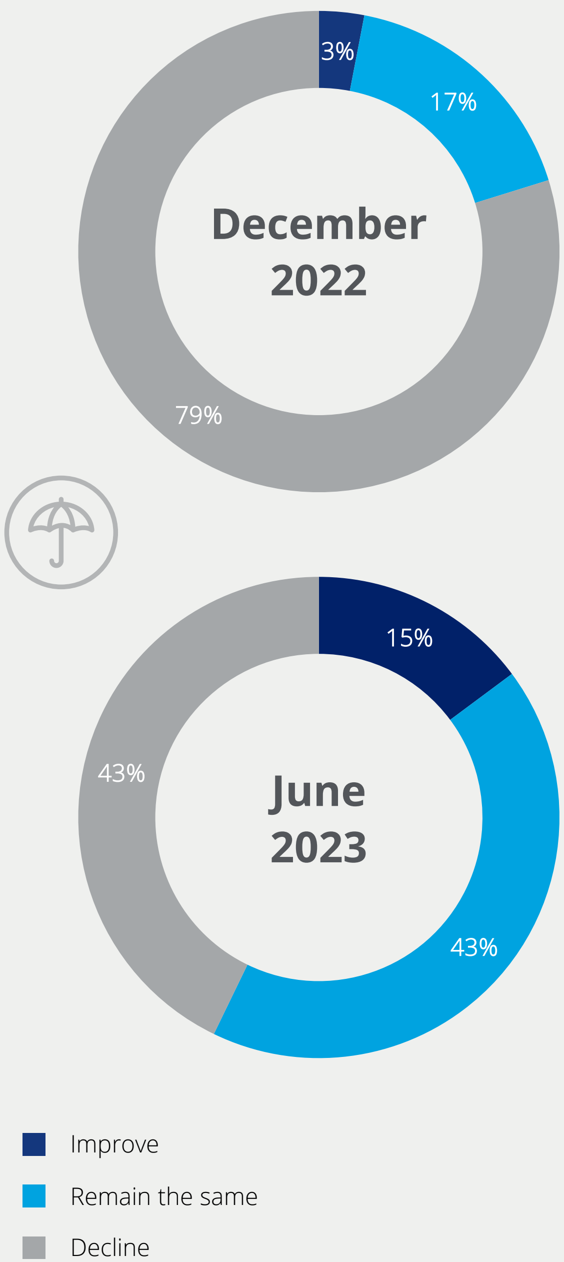
The welcome shift in sentiment around the economy may be down to central banks in CE, still able to influence monetary policy owing to their sovereign currencies, hiking interest rates sharply earlier than the Bank of England or ECB, with a pause in increases possibly inspiring optimism.

Poland, the region's largest economy, recorded GDP growth of 5% in 2022 and is expected to generate GDP growth of 0.7% for 2023 and rise to 2.7% for 2024. This is down to an expansionary fiscal stance, a favorable situation in the labor market and the large inflow of people from Ukraine.

For this period, I expect the overall economic climate to:



Economic climate (December 2022 vs June 2023)



Debt availability

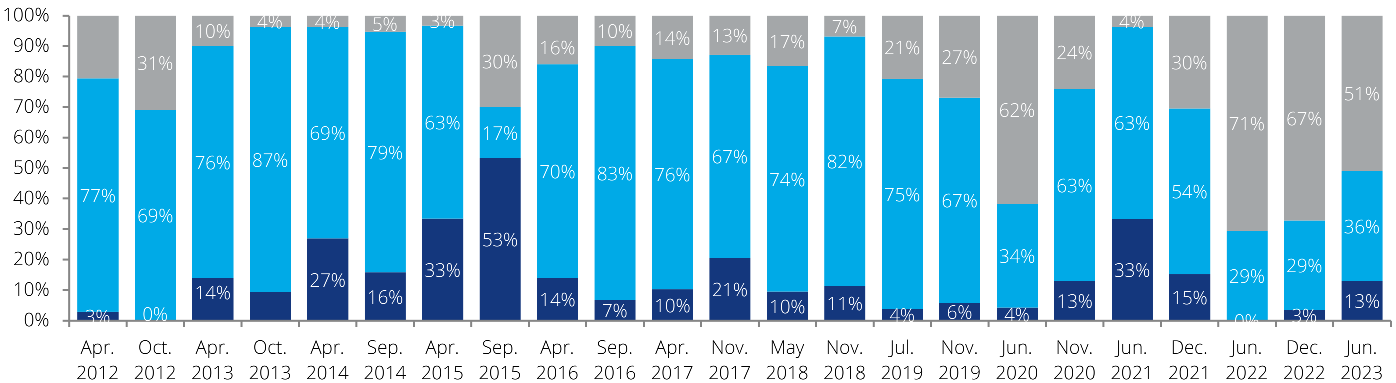
The availability of debt is deemed to be stabilizing, with 51% expecting it to remain the same (36%) or increase (13%), in contrast to just a third last time, when two-thirds expected availability to wane. The optimism is up markedly from our Winter Survey, which itself saw a recovery from when no respondents expected an improvement.

The National Bank of Poland kept its key reference rate at 6.75% in its July meeting, with persistently high inflation levels coming down gently (13% in May down from 14.7% in April). Romania, CE's other sizeable economy, also saw inflation fall gently and so interest rates there were kept at 7.00% in the Romania National Bank's July 2023 meeting after rising from 6.75% in January 2023. Hungary's inflation meanwhile is expected to drop dramatically from a high of 24% to single digits by the end of the year, with interest rates coming down as well. The Czech National Bank also kept its REPO rate at 7%, with expectations that there won't be further rate hikes for some time.

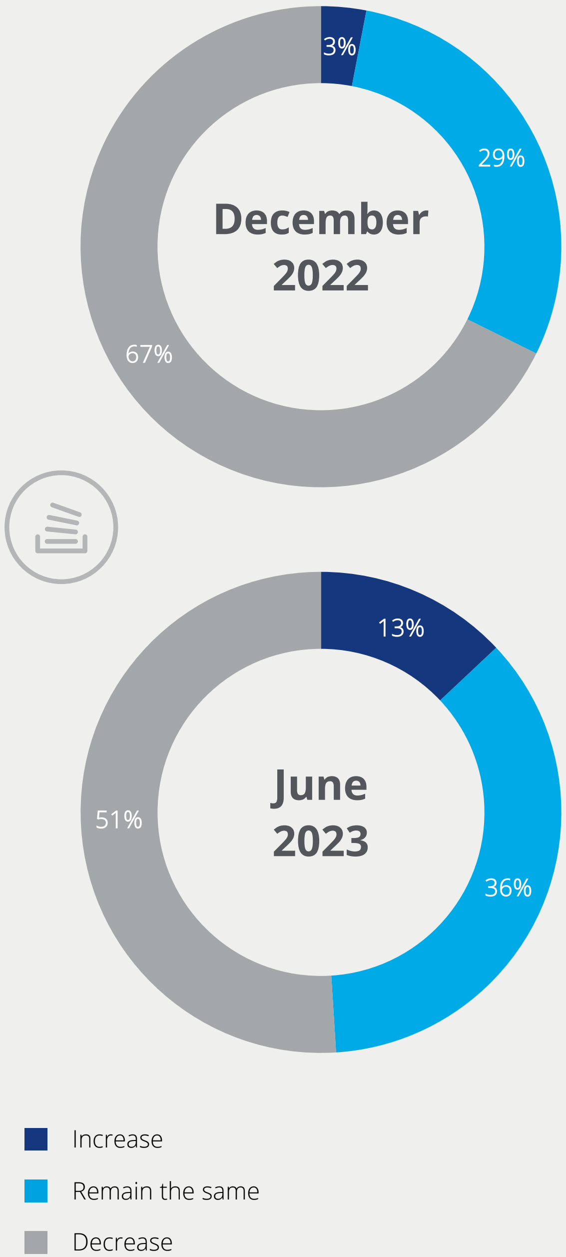
While interest rates impact bank debt, they impact less on non-bank lending, which is becoming more widespread in CE. This source of funding is well established in the US and Western Europe where credit funds invest committed capital alongside sponsors. The last year has seen some positive developments in CE around private credit, with ACP's launch of ACP Credit Fund I holding a €90m first close to provide €5-15m per deal of senior-secured debt solutions, and ACP Fund V holding a first close on over half its €300m target for its Fund V to provide flexible growth capital as a combination of long-term secured debt and equity. The news came around the same time that CVI announced a final close on €132m for its Private Debt Fund.

Another development in the region is for lending to take place in euros, even where the target is based in a country with a sovereign currency. This development may help pave the way for more leverage for growing businesses.

For this period, I expect the availability of debt finance to:



Debt availability (December 2022 vs June 2023)



Investors' focus

Our latest Survey reveals a near doubling of those expecting to focus on fundraising for the rest of this year, with nearly a fifth (19%) anticipating spending most of their time on this exercise. The headwinds will make it a tricky endeavour, but GPs with strong track records are showing signs of success, with Innova reaching over €324m this year and ACP raising two funds simultaneously with successful first closes announced.

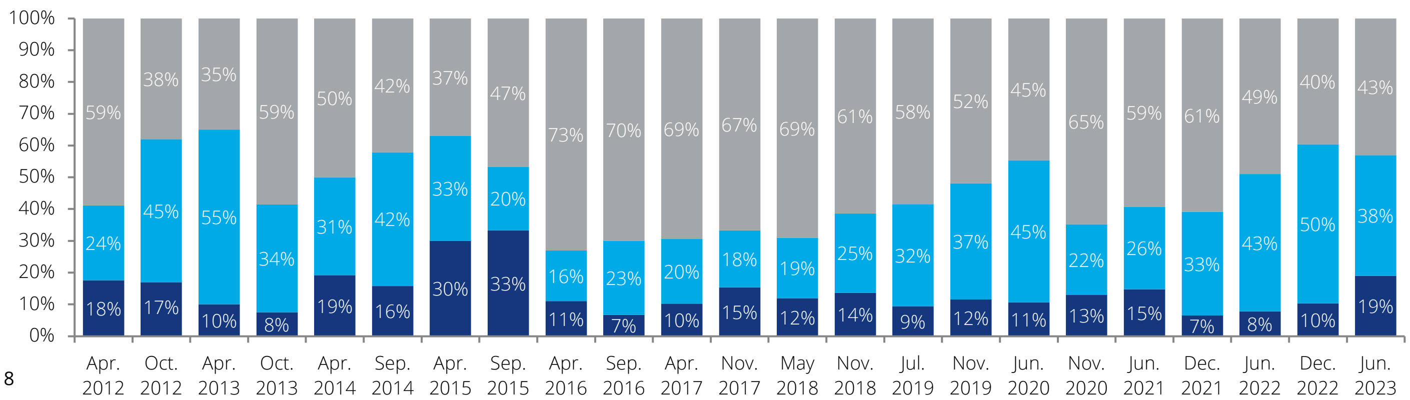
There is a commensurate decrease in those expecting to focus on portfolio management – typically a defensive position taken amidst challenging backdrops and so perhaps a reflection of the renewed confidence exhibited by respondents.

The proportion of respondents expecting to focus on new investments has remained relatively stable at 43%, up only gently from 40% in our last Survey and at around the same level as October 2008 and Winter 2014/2015.

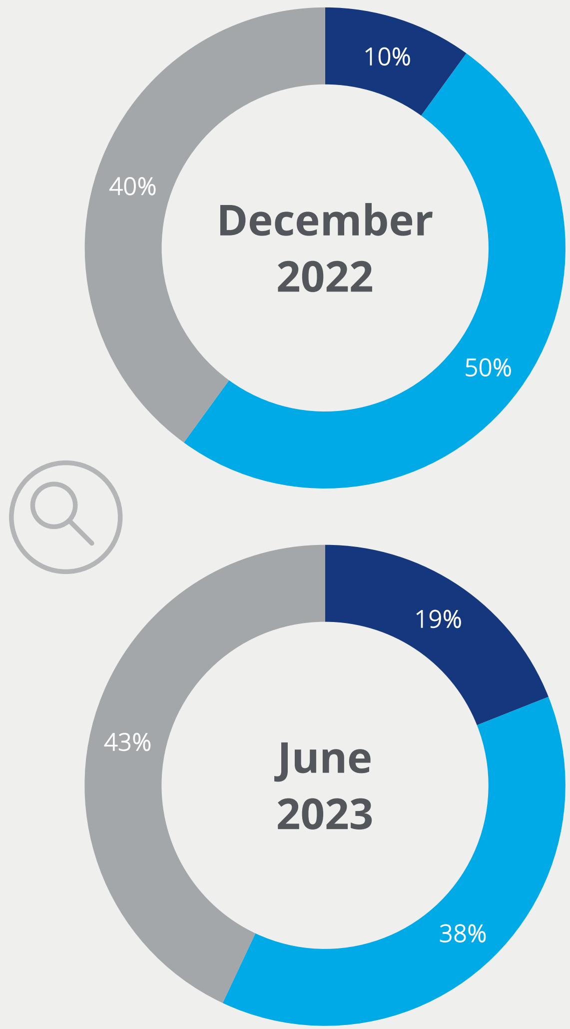
In line with our Survey results, a number of firms are on the fundraising trail:

- Innova Capital held an interim close on €324m for its seventh fund, very near its €350m target.
- ACP is over halfway towards its €300m target for its Fund V after a first close in January.
- Newly-established lower mid-cap Polish GP Spire Capital Partners launched its debut SCP Fund I with a first close in May on €57m towards its €100m target.
Investors include the European Investment Fund, the Polish Development Fund (PFR Ventures), Polish family offices and a group of Polish and international private investors with experience in digital economy and financial markets.
- Czech early-stage venture capital firm Purple Ventures is set to hit the fundraising trail later this year for a new €30m-EUR 40m fund to invest across the region.
- Omorika Ventures, a Southeast Europe-focused venture capital firm, is raising a €50m fund to invest across the region and aims to hold a first close by year-end.

For this period, I expect to spend the majority of my time focusing on:



Investors focus (December 2022 vs June 2023)



- Raising New Funds
- Portfolio Management
- New Investments

Size of transactions

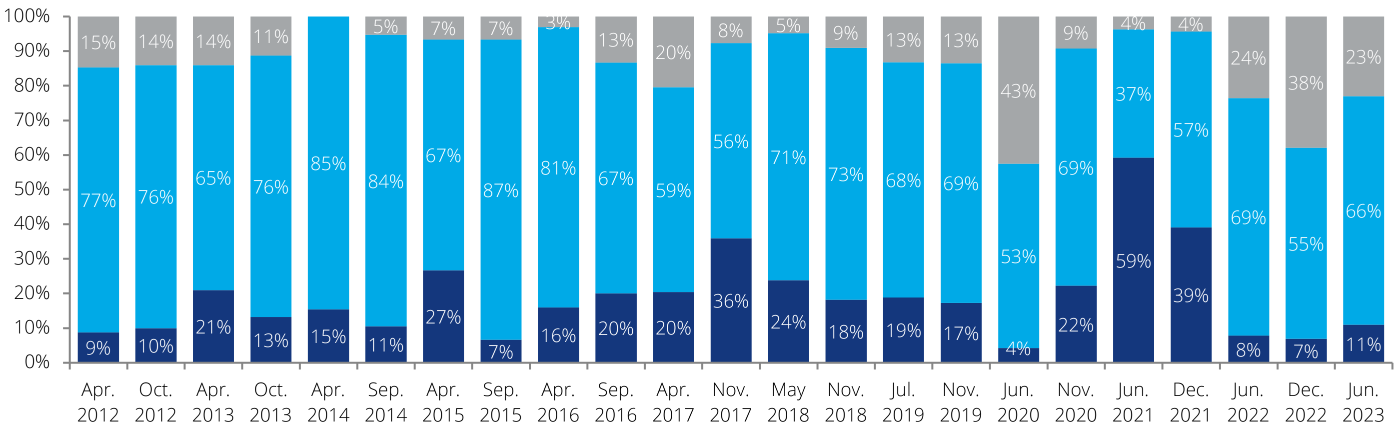
Deal sizes are stabilizing, with over two-thirds (66%) of deal doers expecting them to stay the same, up from just over half in our last Survey. Just under a quarter (23%) expect them to decrease, down from 38% in our Winter Survey, and over a tenth (11%) expect them to increase, up from 7% six months ago.

CE's PE market has long been a mid-market opportunity, with a growing venture ecosystem boosting volume for smaller tickets and large deals only occasionally being reported. A longstanding focus on portfolio management, both owing to CE deal doers appreciating it as a value creation lever and because of possible risk aversion in a challenging backdrop, may also be driving smaller transactions.

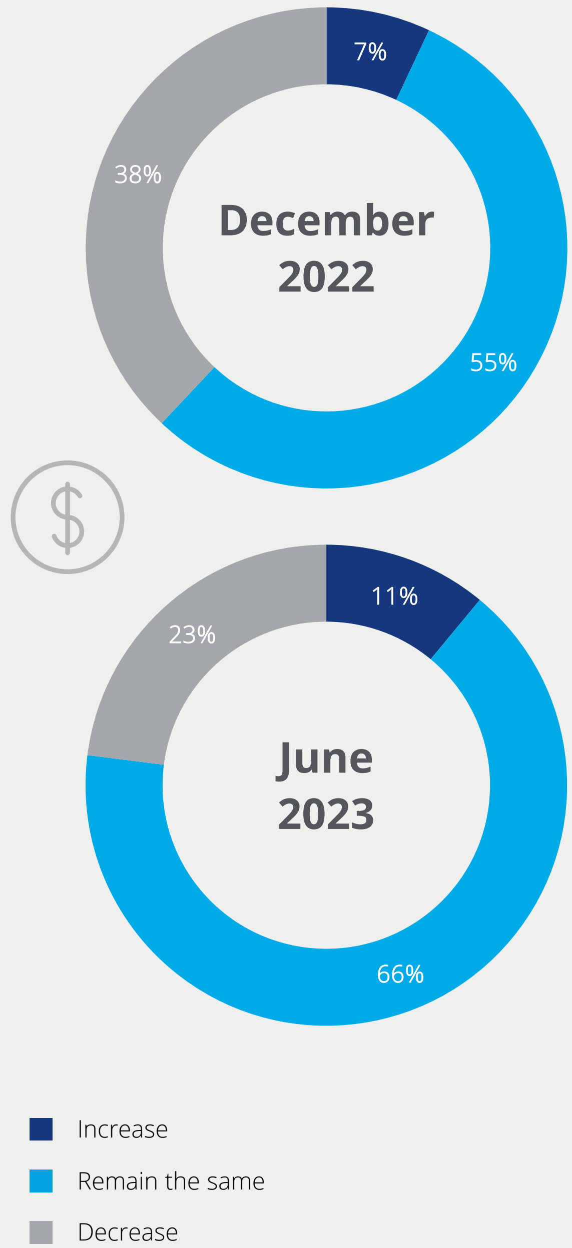
The occasional large deal tends to attract global PE houses, with Carlyle set to acquire a majority stake in Meopta Optika, a Czech manufacturer of optical, opto-mechanical and opto-electronic solutions for a reported €700m. Sometimes sizeable or cross-border transactions attract multiple investors with complementary skills and networks, as was the case in March when Genesis Capital and Value4Capital agreed to acquire XBS Group, a Polish provider of supply chain management solutions operating six warehouses and employing 250 people.

The occasional large deals that do take place can lead to large returns, as the growth story of Inpost shows. Advent International backed the Polish automated parcel machine operator in 2017 before listing it on Euronext Amsterdam in 2021, marking the largest-ever tech IPO in Europe at the time. The hold period saw the business expand across nine European countries, showcasing the positive results that can be achieved with private equity backing in high-potential CE businesses. In May 2023 Advent announced a further partial exit from Inpost to PPF Group.

For this period, I expect the average size of transactions to:



Size of transactions (December 2022 vs June 2023)



Market activity

Optimism around market activity continues to grow, with over a quarter (26%) expecting transacting to increase, more than double last survey's 12%. Equally uplifting is that there has been a halving of those expecting a decrease, from over two-thirds last semester (69%) to a third (34%) this Survey. Two-fifths (40%) expect levels to remain the same, up from 29% last time.

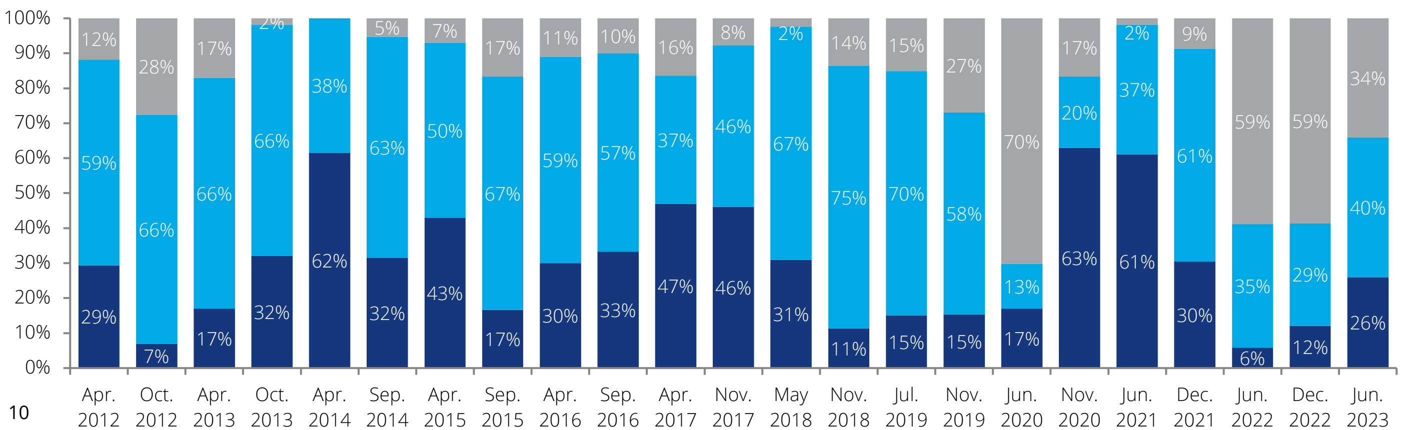
The numbers suggest a calming backdrop, with the post-invasion pause in activity giving way to optimism that this year should prove a good vintage for deals (see slide 16), and recent research from Coller Capital suggests that over 70% of LPs expect 2024 to be strong. It may also be that deal doers are adjusting to a backdrop of uncertainty, increasingly able to support agility in their portfolios as well as with their own deployment.

That inflation comes hot on the heels of the Ukraine war and pandemic may mean that GPs are better placed to assess fresh opportunities and secure financing through new funding sources (credit funds, see slide 16).

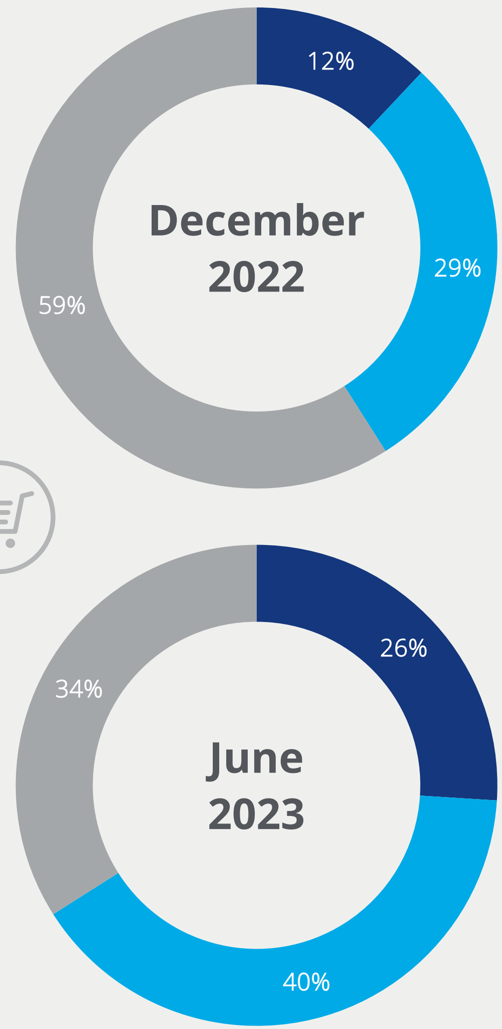
Recent deals to take place in CE include Innova Capital's investment into R-GOL, a Polish provider of specialised football equipment, marking the second investment from its Innova/7 fund, which recently held an interim close. The first was into Romanian fintech Netopia Group in May. The semester also saw Value4Capital acquire Romanian ear, nose and throat equipment retail network Clarfon, with financing provided by new lender ACP Credit. Enterprise Investors acquired a significant minority stake in logistics services business Goodspeed, and BaltCap acquired a 70% stake in Hansab. The semester also saw Accession Capital Partners back Poland's Exact Systems Group.

Bolt-on activity continued this semester, including AnaCap-backed Market Pay's recent acquisition of Polish fintech Novelpay, Innova's Prime Label Group purchasing Pegwan Printing House in Poland and BaltCap's Adoro further building its Latvian social and healthcare chain with the acquisition of Senior Baltic SIA. In May, Abris Capital's Alsendo also bolted on Ecolet.

For this period, I expect the overall market activity to:



Market activity (December 2022 vs June 2023)



Increase

Remain the same

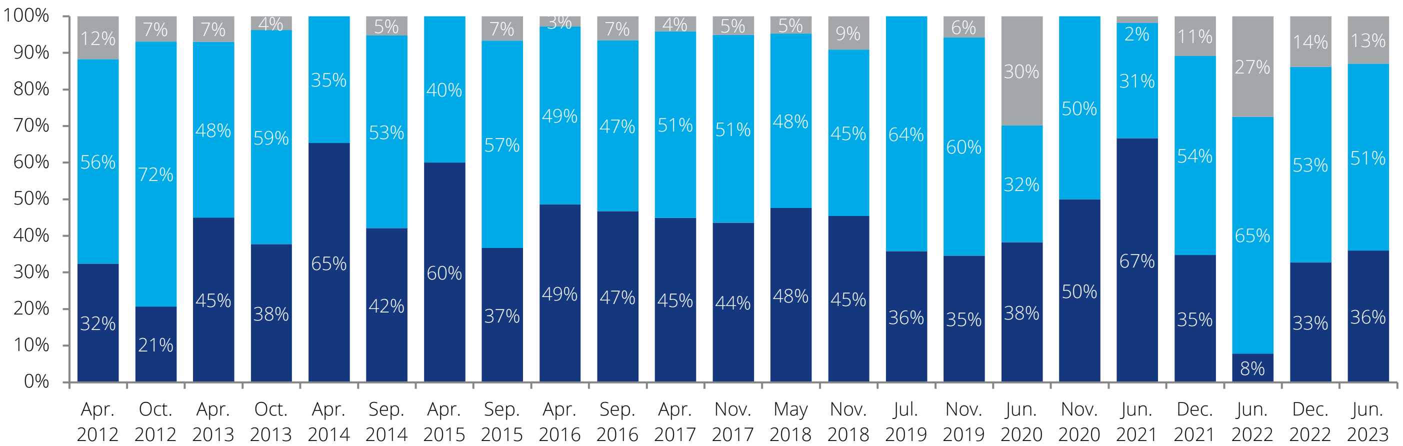
Decrease

Investment return

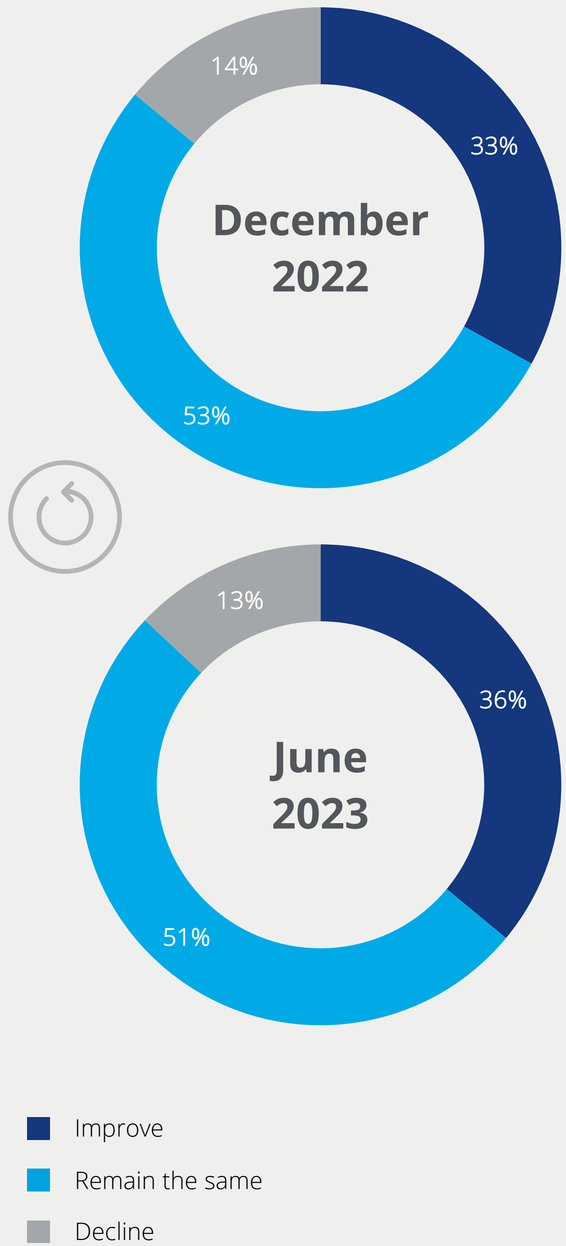
Confidence around financial efficiency of investments has remained steady on last Survey's increased levels, suggesting the Sumer 2022 dip was a short-lived response to the Ukraine war rather than a long-term concern. Over a third (38%) expect efficiency to increase, up gently from just 33% in our last Survey. Over half (51%) expect efficiency to remain the same, and last Survey's reduction in pessimism has held steady at 13%.

The continued optimism suggests both an acceptance that adverse conditions are here but can be managed, and that experience of the last few years puts deal doers in excellent stead to work with portfolios to drive sustainable growth.

For this period, I expect efficiency of my financial investments to:



Investment return (December 2022 vs June 2023)



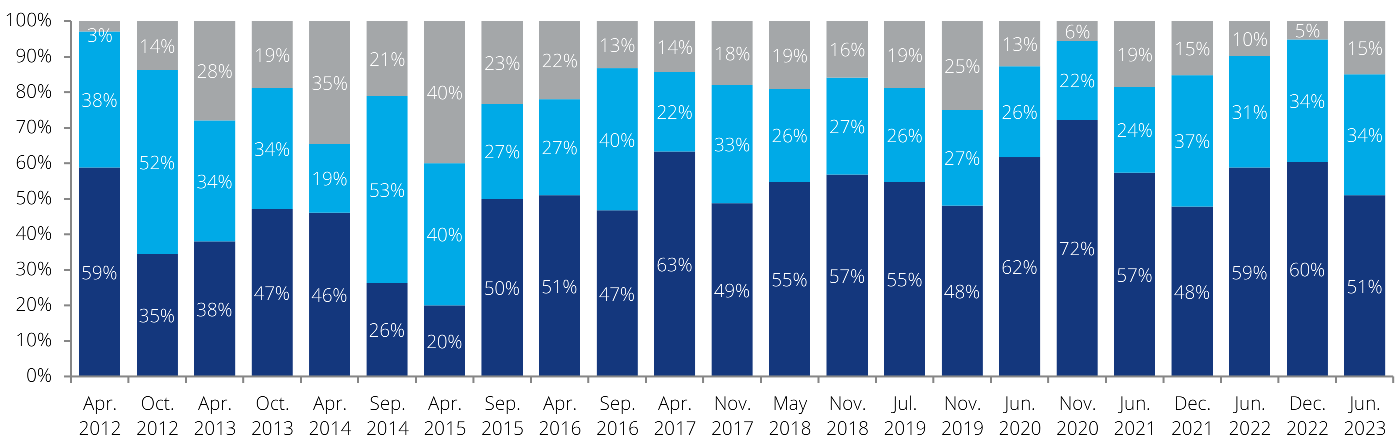
Investors' activities

There has been a gentle shift around buying and selling expectations since our last Survey, with a reduction from 60% to 51% in those expecting to deploy more capital accompanying a commensurate increase in those expecting to sell more, tripling from 5% to 15%.

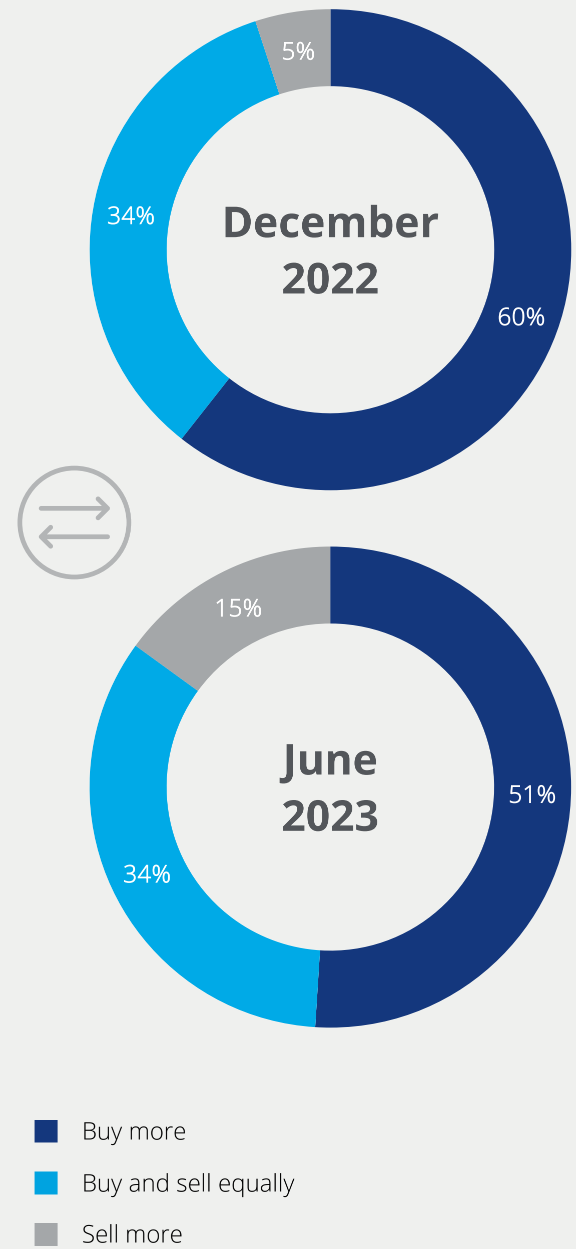
This may suggest an improvement in selling conditions, with valuations typically impacting appetite. With a few countries cutting interest rates and thus putting downward pressure on sovereign currencies, it may make assets in those countries relatively more attractive to foreign buyers from a pricing point of view. It may also be the case that deal doers have held assets for some time owing to adverse conditions and so are now looking to sell businesses they've nurtured. Renewed emphasis on divesting may also be driven by the increase in people expecting to focus more on fundraising, since lining investors' coffers with distributions helps to boost interest in committing to these funds.

During the semester, Abris generated over 3x money on its sale of Graal to trade buyer Lisner Holding (part of Germany's Müller Group), Enteprise Investors made 4x money with the sale of its 38% stake in Unilink in a trade sale to US fintech Acrisure, MidEuropa sold a majority stake in Polish B2B software business Symfonia to Accel-KKR after carving Symfonia out of Sage Group in 2021, and Accession Capital Partners sold Akomex after a three-year hold.

For this period, I expect to:



Investors activities (December 2022 vs June 2023)



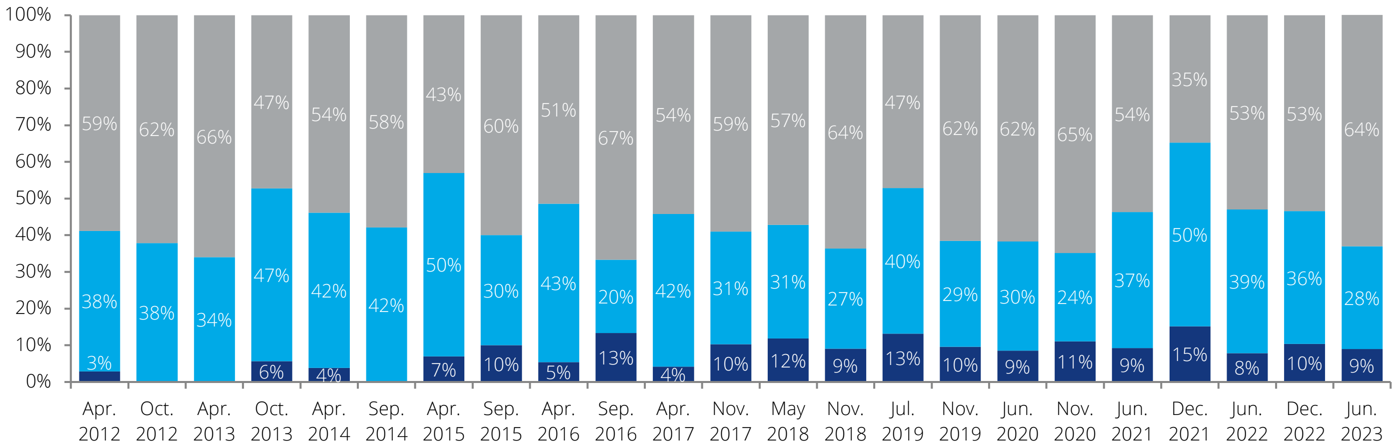
Competition for new investments

As has been the case in nearly all our Surveys, market leaders are expected to be in highest demand in today's market. For the third Survey in a row, the majority of respondents (64%) expect these businesses to be the most competitive, flat on our last Survey but markedly higher than the 35% seen in Winter 2021/2022 just prior to the war in Ukraine. Established businesses offer attractive metrics for lending, namely strong profits and cashflows, helping to offset downside risk in an adverse backdrop.

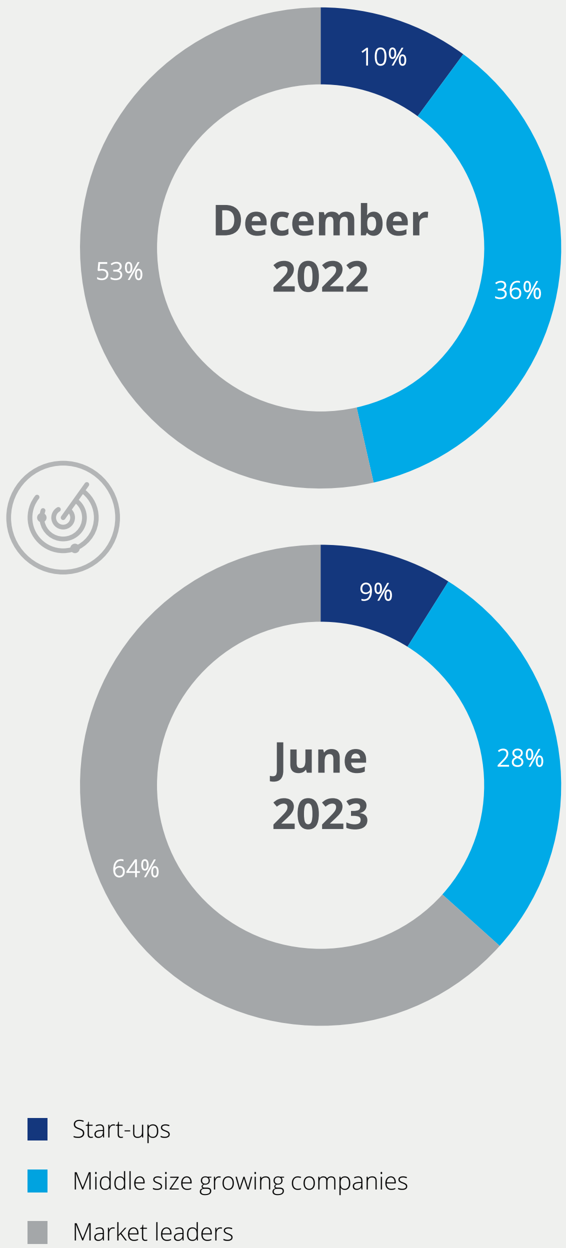
Middle-sized growing companies have lost some popularity, with 28% expecting them to be the most sought-after, down from (36% in the last Survey, down slightly on six months ago (39%).

Start-ups remain the least competitive area, with just a tenth of our respondents expecting them to be the most competitive. This has long been the case, and the recent deflation of the tech valuations backs this up – and is part of the inspiration for newly formed Polish GP Spire Capital Partners. It is interesting to note the nuance in VC deals however – the soft valuations for tech companies is mostly impacting later-stage investing, with seed investments still hotly contested.

For this period, I expect the highest competition for new investment opportunities in:



Competition for new investments (June 2022 vs December 2022)

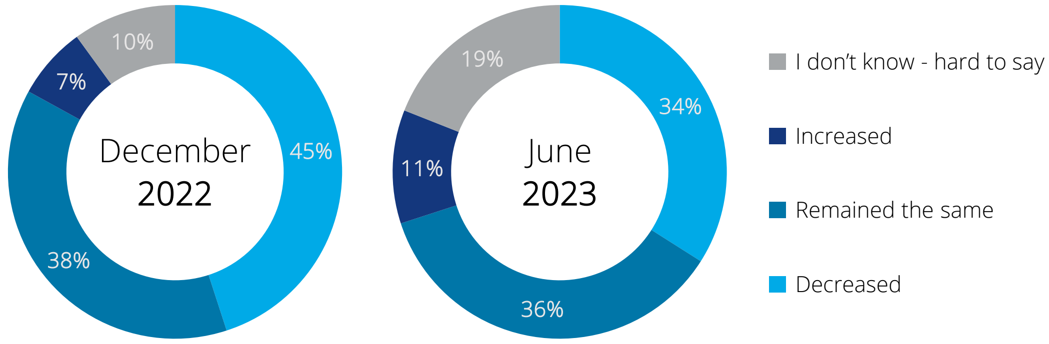


Vendor pricing

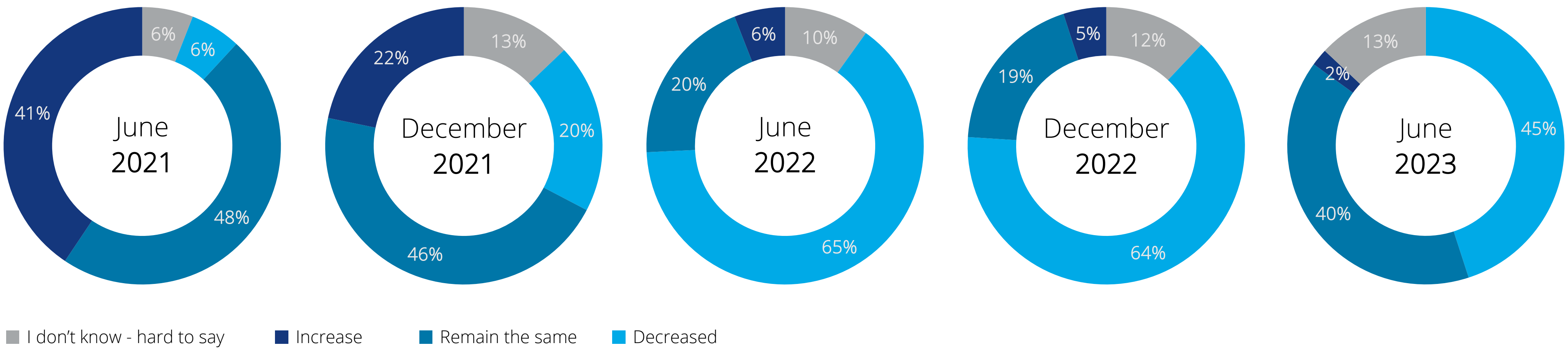
There are mixed messages on vendors' price expectations. Nearly a fifth (19%) aren't sure where they stand now (up from a tenth last Survey), and 13% don't know where they're headed (flat on last Survey). This likely reflects the variations in targets on offer: valuations are based on myriad factors, and while some may have been wishful that pricing would decrease, it will be down to the individual motivations of each seller as well as the businesses' underlying fundamentals, which can shift over time in today's backdrop.

Just a third (34%) feel expectations have reduced in the last semester, down from nearly half (45%) in our last Survey. Likewise, the number expecting a decrease later this year has reduced, from 64% in our last Survey to 45% now, with a commensurate increase in those expecting prices to stay the same – 40% now, double last Survey's 19%. These varying expectations are a reminder of the need to establish relationships with firms well ahead of any process to ensure you understand the specific dynamics of a business, and to ensure you have a strong adviser leading the process.

Relative to 6 months ago, vendor pricing expectations have:



Over the next 12 months, we expect vendor pricing expectations to:



Impact of uncertainty

Impact of uncertainty

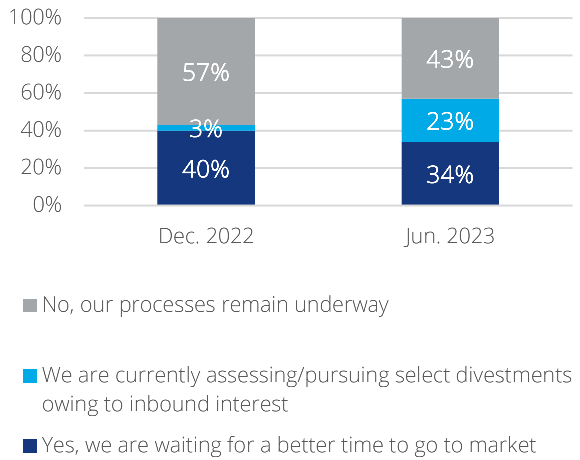
Sale processes continue to suffer the effects of uncertainty. While over two-fifths (43%) say processes remain underway, this is down markedly from last Survey's 57%. A third of respondents (34%) are waiting for a better time to go to market, down from 40% last time.

Credit funds are playing a bigger role in CE, with 45% now looking more to non-bank lenders for their new deal and refinancing leverage. 13% claim their transactions are on hold, up from 8% in the last Survey and a clear sign of caution, while 28% report no change in leverage availability. 15% report needing more lenders now for a deal.

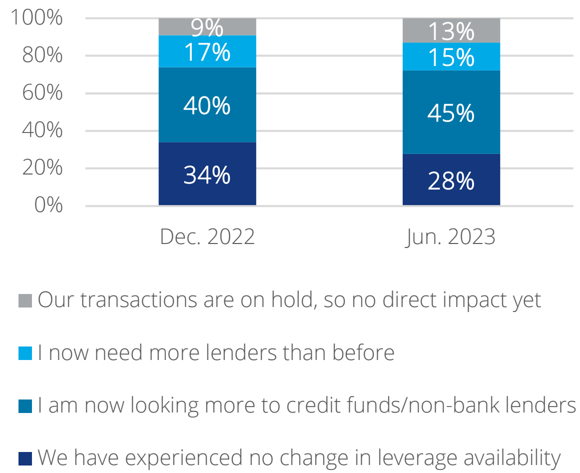
Deal doers remain confident that 2023 will prove be a good one for investments, with 77% of respondents confident the year will prove a good vintage for investments, roughly flat on the last Survey. It is likely a reflection of memories of the post-GFC period 15 years ago, when a number of businesses backed from 2009 onwards proved to be lucrative.

Pipelines continue to improve, with half of respondents seeing more actionable opportunities now than three months ago, marking the third Survey in a row where pipeline optimism is growing. A third feel pipelines are the same, while 17% feel they are deteriorating, an increase on last Survey's 9%.

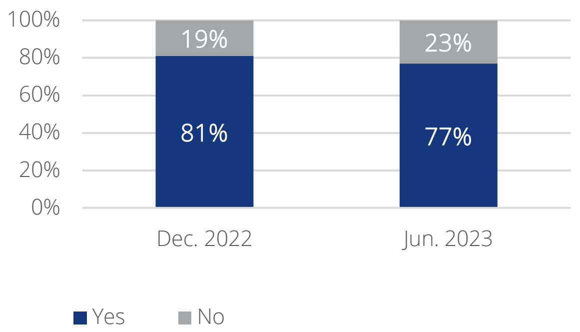
Are you putting off sales as valuations are impacted by the new backdrop of uncertainty and inflation?



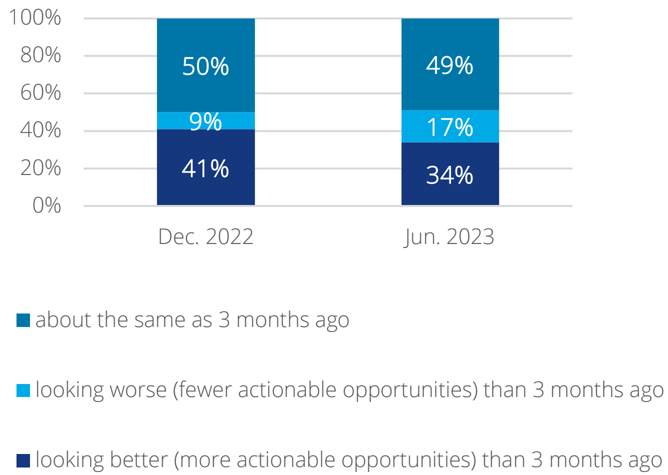
Are you finding leverage more difficult to secure for new deals and refinancings?



Will 2023 be a good vintage for Private Equity fund investments?



Is your deal pipeline:



Sustainability and ESG Agenda

Sustainability and ESG Agenda

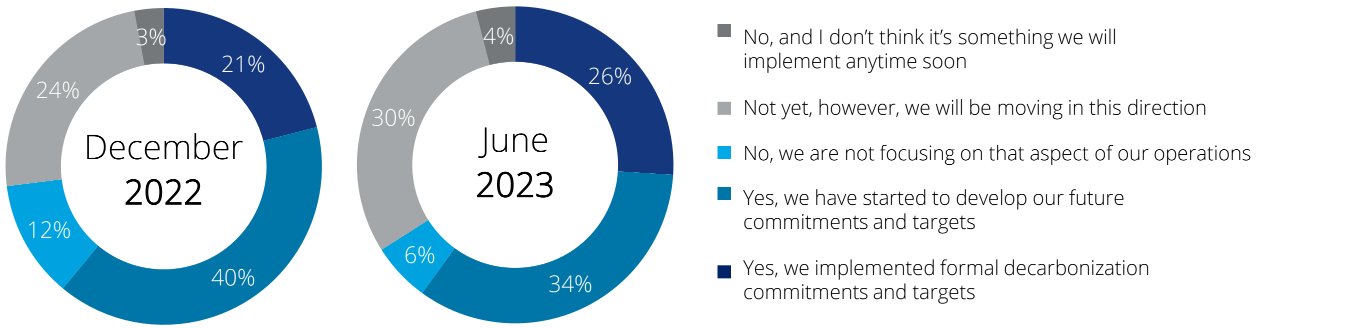
More PE deal doers in CE continue to embrace ESG, with over a quarter having implemented decarbonization commitments and targets, up from a fifth on our Winter Survey. Another third have started to develop these. While a small minority remain unconvinced by the merits of climate neutrality, the percentage is has halved to 6%. Nearly a third (30%) intend to do so, up from a quarter in our last Survey.

Nearly three-quarters of houses in CE have investment policies that include ESG factors, whether investment policies (51%) or ESG improvements post-deal (23%). These figures represent a noticeable uplift on our last two Surveys and may suggest the region's deal doers are heeding LP demand to include key ESG factors in investment decisions and portfolio management.

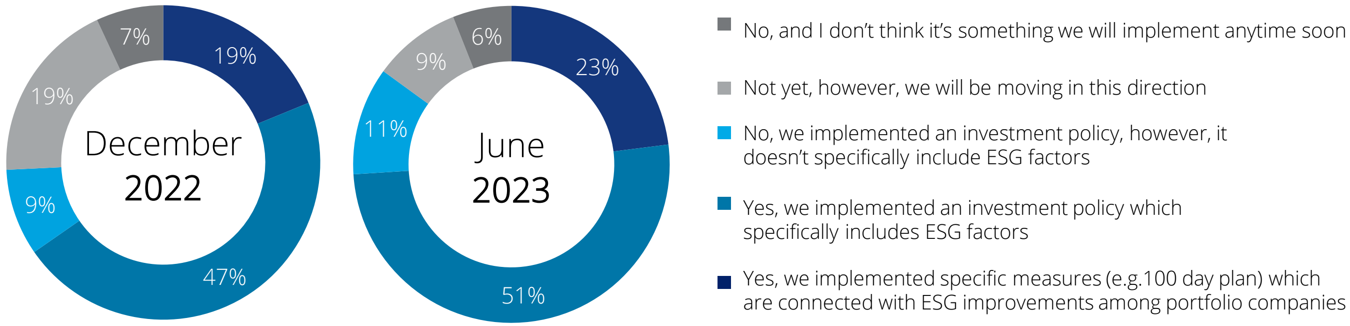
Over half (57%) of surveyed deal doers do not yet incorporate sustainability into valuation methods as they deem the ESG data unsatisfactory. Just 6% include this into DCF modelling and scenario analysis, while 15% include topics into these factors but exclude it from valuation. Another 15% do not focus on it whatsoever.

The enthusiasm for ESG is global and institutional investor demand has sufficiently permeated many deal doers to deem it a genuine way to drive value. Our respondents are integrating ESG into their strategies, deeming it both a value driver (36%) and a risk mitigator (38%). 6% do not have imminent plans to integrate ESG as part of a value creation factor.

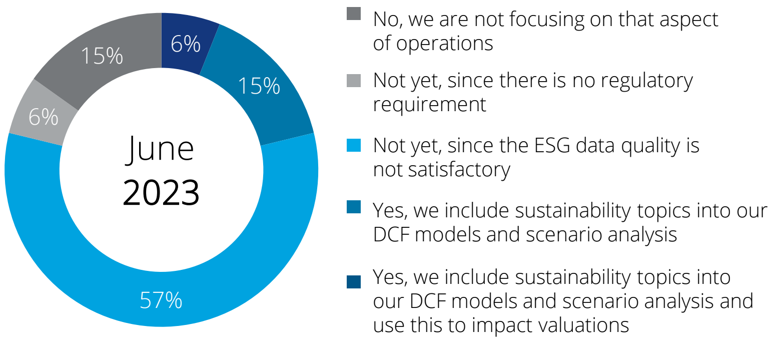
Has your fund made any commitments towards climate neutrality?



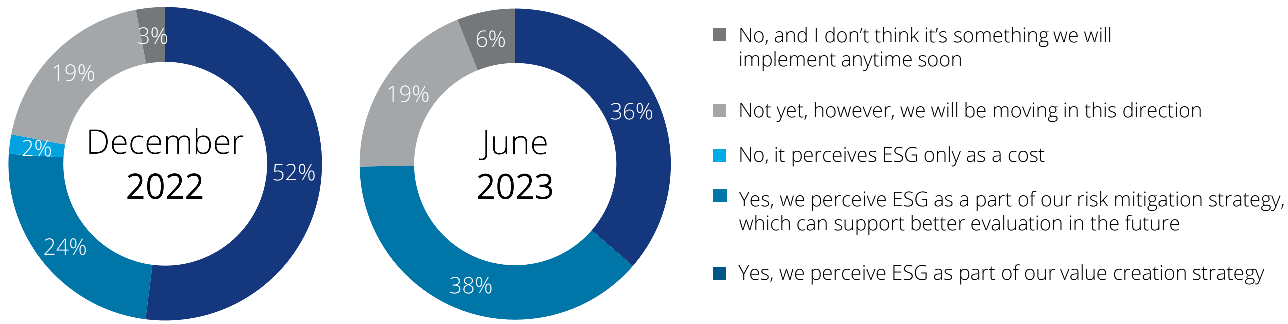
Has your fund implemented a formal investment policy which incorporates ESG and sustainability factors as part of investment decision considerations?



Does your fund integrate sustainability into valuation methods?



Does your fund integrate ESG as a part of value creation factors?



Technology

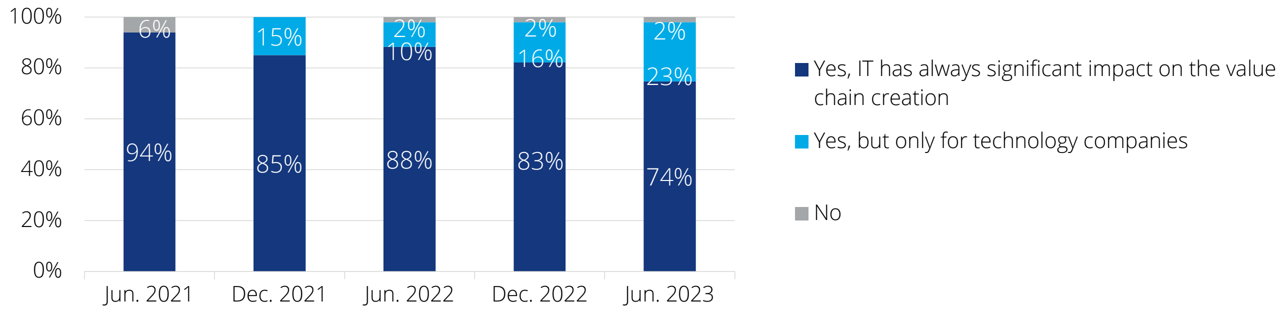
Technology

Three-quarters of our respondents deem IT as capable of creating value, and this enthusiasm is illustrated by private equity firms' increasing focus on this through enhancing their portfolio's digital capacity. An effective digital strategy has myriad benefits depending on the company, from data collection and harnessing to improved user experience.

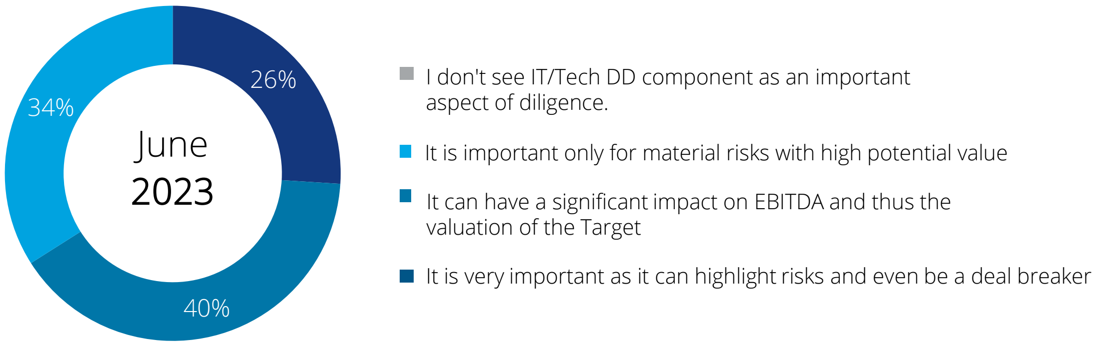
Two-fifths of respondents feel IT plays a crucial role on EBITDA and can impact valuations, while another quarter deem it critical enough to potentially act as a deal breaker. A third feel it is only important for material risks with high potential value, and none deemed IT diligence insignificant.

Only a tenth of respondents (11%) would consider a data breach a deal breaker, down from 19% in our last Survey. Half would continue if the breach were limited, and a third (34%) would adjust the valuation as a result, down from nearly half last time.

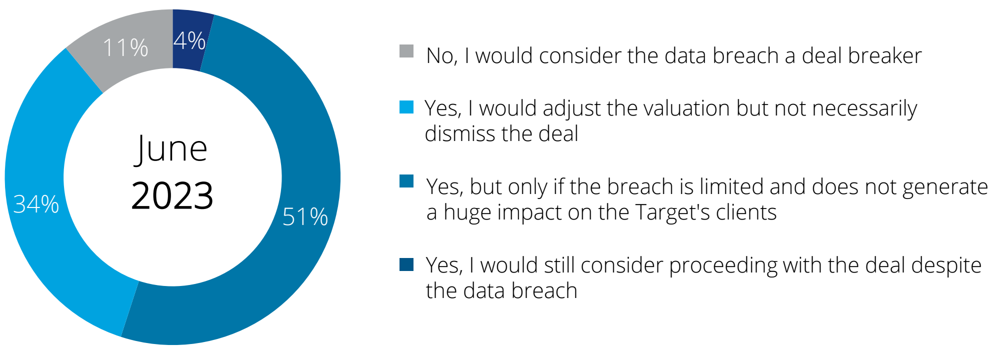
Do you believe that IT capabilities of a portfolio company can be used as a value creation lever?



How critical a role does IT / Technology play in due diligence around M&A processes?



If you discover a data breach involving a Target's customer data during cyber due diligence, would you still consider proceeding with the deal?



Contacts

Deloitte Private Equity Contacts in Central Europe

Czech Republic
Dusan Sevc
Private Equity Leader Deloitte Central Europe
+420 734 797 426
dusevc@deloittece.com

Baltics
Linas Galvelė
+370 52 553 022
lgalvele@deloittece.com

Bulgaria
Tanya Karageorgieva
+35928023456
tkarageorgieva@deloittece.com

Croatia
Lena Habus
+38512351904
lhabus@deloittece.com

Deloitte's South Central Europe Cluster
(Serbia, Montenegro, North Macedonia, Croatia, Slovenia and Bosnia and Herzegovina)
Darko Stanisavić
+381 113 812 134
dstanisavic@deloittece.com

Hungary
Balázs Csűrös
+36 14 286 935
bcsuros@deloittece.com

Poland
Arkadiusz Strasz
+48 510 201 333
astrasz@deloittece.com

Michał Tokarski
+48 608 697 400
mtokarski@deloittece.com

Romania
Radu-Cristian Dumitrescu
+40 212 075 322
rdumitrescu@deloittece.com

Slovakia
Ivana Lorencovičová
+421 258 249 148
ilorencovicova@deloittece.com

Slovenia
Tilen Vahčič
+386 1 307 29 85
tvahcic@deloittece.com