Deloitte.

Growing Confidence

20+ years • Private Equity Confidence Survey

Central Europe

Winter 2023/2024

“It is great to see confidence making a firm comeback after a protracted period of extraordinary difficulty. That the growth in optimism is more measured than in the other periods of the Survey’s sustained growth is a testament to Central Europe experienced deal-doers, who can draw on previous cycles to apply more pragmatism to today’s backdrop.

Cautious confidence is reassuring and suggests that transactions this year will be done thoughtfully with flexible funding suited to maintaining much-needed agility in the region’s fast-growing companies.

The latest Survey marks a third-consecutive semester of increasing confidence, only the third time our Index has recorded such sustained growth.”

Jan Brabec, Deloitte Partner and Private Equity Leader

Growing Confidence

For over 20 years, the Deloitte Central European (CE) Private Equity (PE) Confidence Survey Index has reflected the sentiment of on-the-ground deal-doers around conditions for transactions.

Even if 2023's activity levels remain subdued, fundraises amidst a challenging backdrop as well as a number of lucrative exits have underlined the ability of the region's experienced PE houses to invest and harvest across cycles.

We are confident that 2024 will remain challenging but see stronger activity levels following a subdued 2023. This will be down to a number of factors, namely inflation easing, vendors accepting a new paradigm and working more closely with advisers to prepare businesses for sale, and a loosening of the financial markets – not least as credit funds make firmer inroads into the region. The activity that did take place in 2023 showed a region utilising funding sources akin to those in Western Europe, with private credit funds playing a bigger role in capital structures. This is important because their committed capital is less reliant on interest rates and these non-bank lenders are often more flexible with their offerings and terms than their traditional banking counterparts. We expect them to continue to grow their share of the CE transaction landscape, as has been the case in Western Europe for 15 years.

The exits that were announced over the course of the year highlighted the asset class's ability to drive meaningful value. Expanding companies' geographic footprints and offerings as well as enhancing their digital capabilities are areas we've seen CE PE houses create value during holding periods. We also see more firms helping to steer ESG frameworks within their portfolios, with some achieving the B Corp status during 2023. This is a fantastic sign that regional deal-doers are leading by example as they create sustainable value.

Diligence of new deals has been and will remain challenging owing to turbulent market conditions, with the effects of the pandemic being followed by high inflation and sluggish performance across many global economies. While it's meant many companies have suffered losses and squeezed margins, others have benefitted from the market dislocation. This bifurcation of circumstance makes determining a target company's underlying earnings difficult, as well as managing the gap between buyers' and sellers' expectations – and all these factors highlight the need to engage with an experienced adviser to prepare a business for sale and manage the process.

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.

Jan Brabec
Partner, Private Equity Leader,
Deloitte Central Europe

Central European Private Equity Index: Key findings

There is positive sentiment around the economic backdrop, with a near tripling of those expecting conditions to improve to 42%. Equally encouraging is a halving of those expecting the backdrop to worsen (to 20%, down from 40% in Summer 2023).

In a further sign of confidence, half (49%) of respondents expect transacting to increase in 2024, double last semester's proportion and up from a low of just 6% in Summer 2022. Furthermore, only 14% expect a decrease in activity, down from a third last semester.

Debt markets are more liquid now than in the last few years, with nearly a third (29%) expecting availability to improve. This is more than double our last Survey, while those expecting liquidity to decrease has reduced dramatically to just 22% in this Survey.

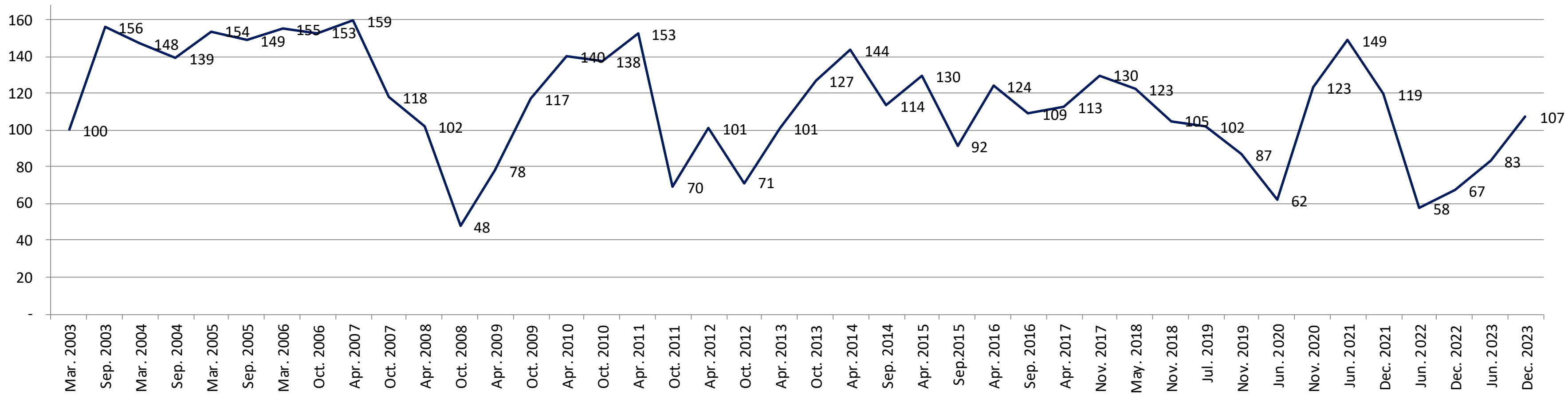
Vendors may have softened their pricing expectations in the last six months, with nearly two-fifths of respondents (38%) feeling pricing had come down in the second half of 2023, slightly more than felt that way in the first half of the year (34%).

Continued Index rise matches record for sustained confidence growth

The Index has continued its rise for a third consecutive semester, landing on a respectable 107. This is important as it marks only the third time in the Survey's 20+ year history that it has climbed for so long, with the other periods of sustained growth commencing in late 2008 and late 2012. All three recoveries followed a sharp decline. Notably the decline preceding the latest recovery was as steep as the dips in 2008 and 2012, but the current recovery is more gradual.

This steadier climb may suggest a more cautious optimism among deal-doers, many of which now have over two decades of experience in navigating economic cycles and challenging backdrops. It may mean they apply more pragmatism to improving conditions, and are better placed than ever to steer portfolios and drive new investment decisions to accelerate growth in Central Europe's most promising businesses.

Central Europe PE Confidence Index



Survey Results

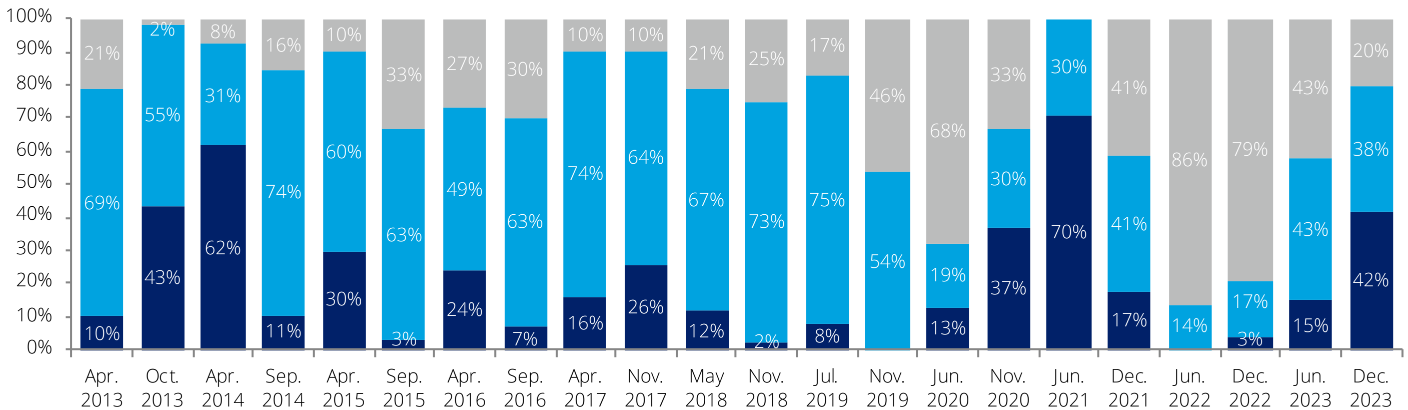
Economic climate

Positive sentiment around the economy is growing, with 42% expecting conditions to improve, nearly triple the previous Survey. There has been a halving of those expecting the backdrop to worsen (to 20%, down from 43% in Summer 2023).

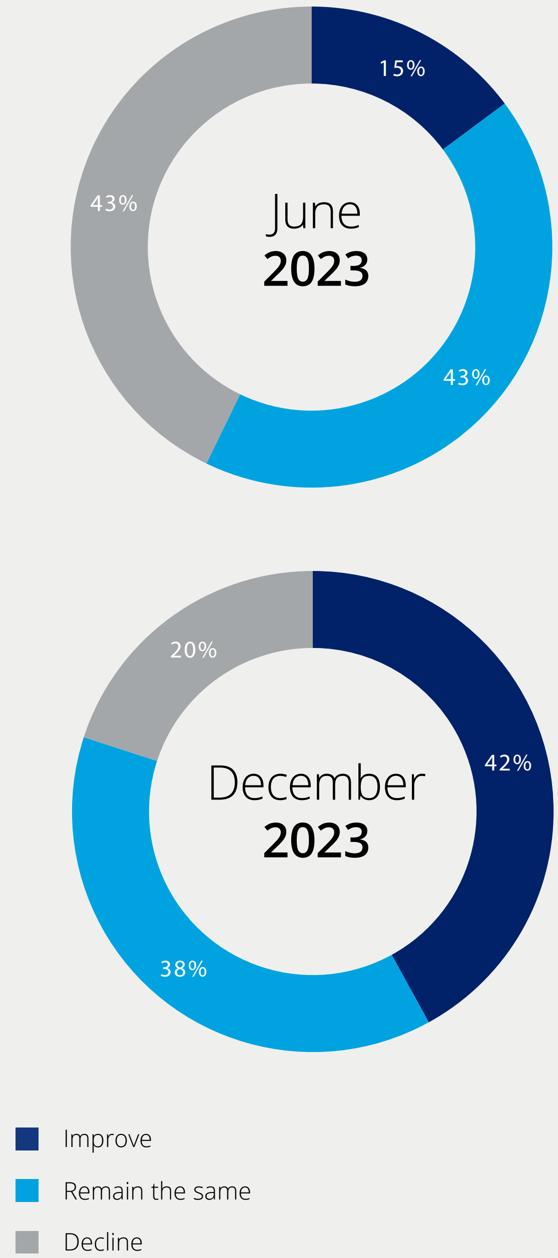
An improvement in the economy has been a long-time coming, with a confluence of macro shocks catalysing double-digit inflation across many countries and blocs globally. The resultant interest rate hikes and their impact on lending and disposable income created challenges for businesses and households alike, making more recent data on easing inflation very welcome. Expectations of reductions in rates will be boosting sentiment, with central banks' sovereignty in much of CE enabling it to influence monetary policy more sharply than in eurozone countries, with the European Central Bank and Bank of England slower to react. This may impact recoveries in 2024.

The region's largest economy of Poland saw a year of two halves, with a sluggish H1 giving way to a recovery in H2 as inflation eased and growth picked up. 2024 is forecast to be more positive on both fronts: 2023's GDP growth of 0.4% (outperforming many more developed economies) is forecast to rise to 2.7% for 2024 and 3.2% for 2025, as inflation halves and unemployment continues to erode . Similar figures for the EU as a whole are 1.3% GDP growth forecast for 2024 and 1.7% in 2025. Poland's comparatively strong forecasts are based on an expansionary fiscal stance, a favorable situation in the labor market and the large inflow of people from Ukraine. Romania, CE's other large market, saw growth halve between 2022 and 2023 to 2.2%, with expectations of a return to growth for 2024 and beyond and inflation comes down.

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



Economic climate (June 2023 vs December 2023))



Debt availability

Debt markets are more liquid now than in the last few years, with the latest figures marking the fourth Survey in a row of steady improvement.

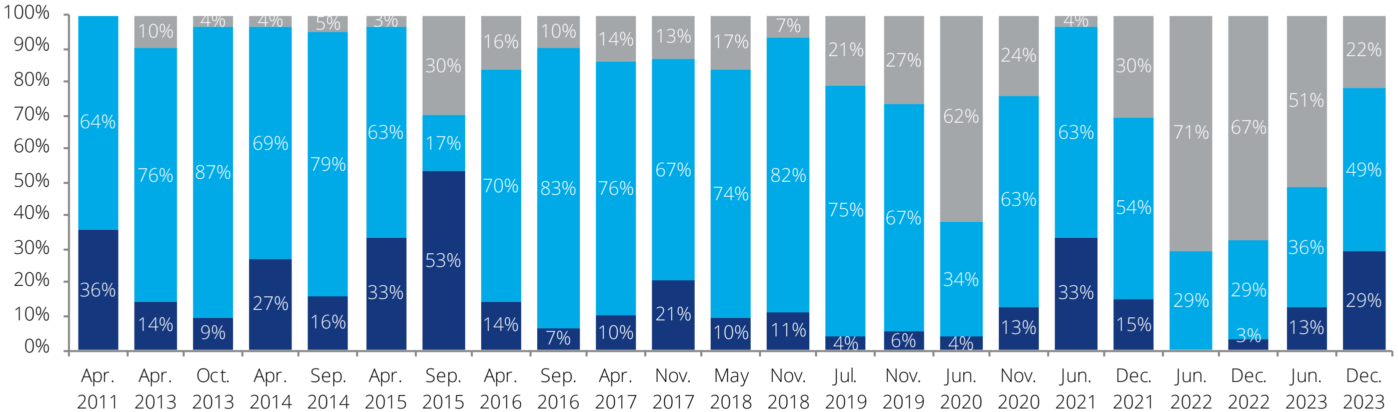
Nearly a third (29%) expected availability to improve, more than double our last Survey, while those expecting liquidity to decrease has reduced dramatically to just 22%. Nearly half (49%) expect conditions to remain the same, in contrast to just a third last time, when over half expected availability to wane.

High interest rates had been impacting on lending, both in terms of availability and terms. A welcome softening may be underway as The National Bank of Poland reduced its key reference rate multiple times since Autumn 2023, and held at the end of 2023 and early 2024. The cuts followed a period of sharp rises in 2022 and 2023, helping to curb persistently high inflation levels which fell sharply in 2023 from over 14% in April to under 7% in December. Romania also saw inflation come down 2023 though interest rates there were held at 7.00% in the Romania National Bank's January 2024 meeting, where they've been since January 2023.

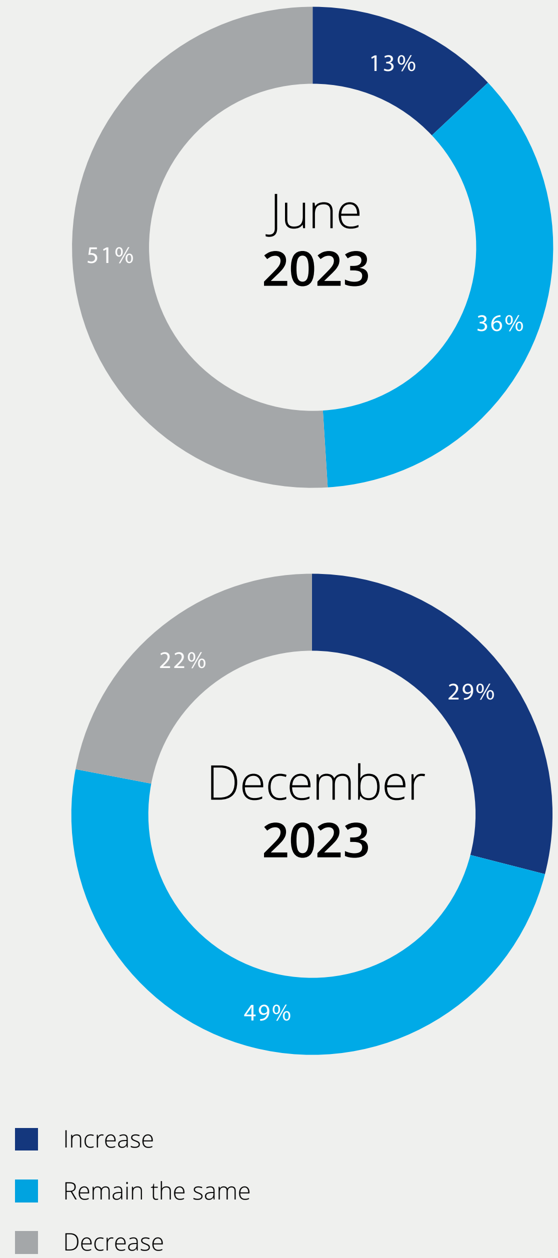
The advent of non-bank lending in CE, which has been growing in Europe for over a decade and in the US for longer, provides an alternative to bank debt. With credit funds investing long-term committed capital, their ability and appetite to transact is largely unaffected by interest rate changes, helping to give sponsors certainty in funding. 2023 saw news in the private credit space, with Accession Capital Partners' (ACP) 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 CEE Private Debt Fund to provide senior debt, junior and unitranche loans to SMEs in CE, with a focus on Poland .

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 (June 2023 vs December 2023))

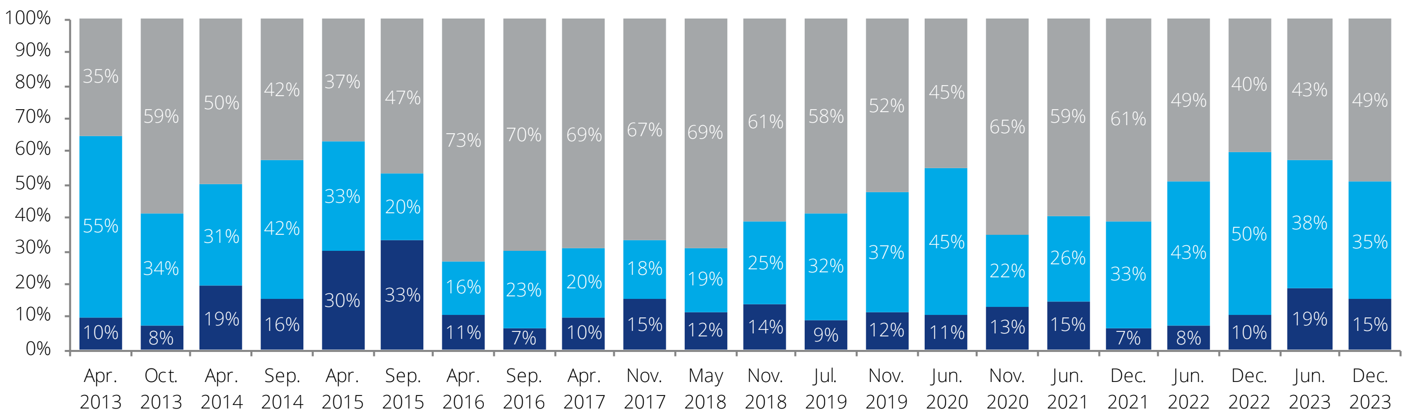


Investors' focus

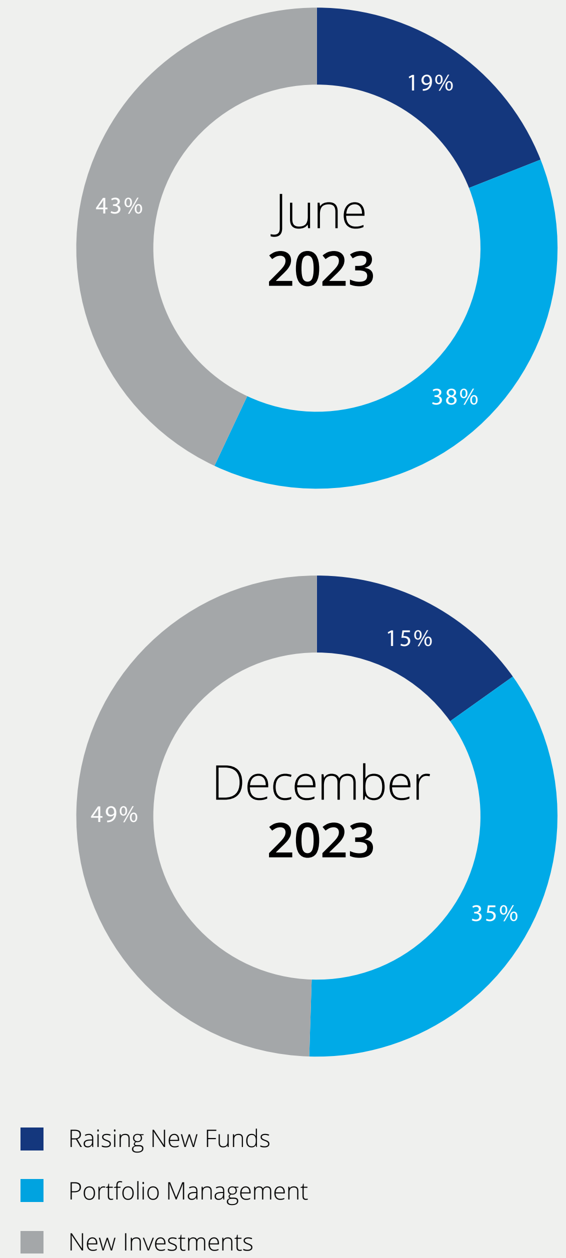
A more favorable backdrop is reflected in deal-doers' expectations for 2024, with a stabilisation of focus on origination, fundraising and portfolio management. Nearly half expect to focus on new investments, up a quarter from the last Survey and a sure sign that there are rich opportunities for investment and pent-up demand to transact following a sluggish 2023. Just over a third (35%) expect to focus on portfolio management, flat on last semester, while 15% will spend most of their time on fundraising.

Fundraising is never easy, and the difficult economic backdrop combined with the proximity of the Ukraine war have made it even more challenging. Despite this, Innova Capital closed its seventh fund on €324m in 2023, while structured growth capital provider Accession Capital Partners (ACP) is raising Fund V and already exceeded the size of its predecessor through a number of interim closes in 2023. 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. Baltic investment firm INVL is raising for its second fund which has a €300m targets and aims for a first close in Q1 2024 and final in 2025. The VC scene is also busy, with Czech early-stage venture capital firm Purple Ventures seeking €30-40m for a new fund to invest seed money into mainly CE-based software-enabled businesses , and Southeast Europe-focused VC Omorika 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 (June 2023 vs December 2023))

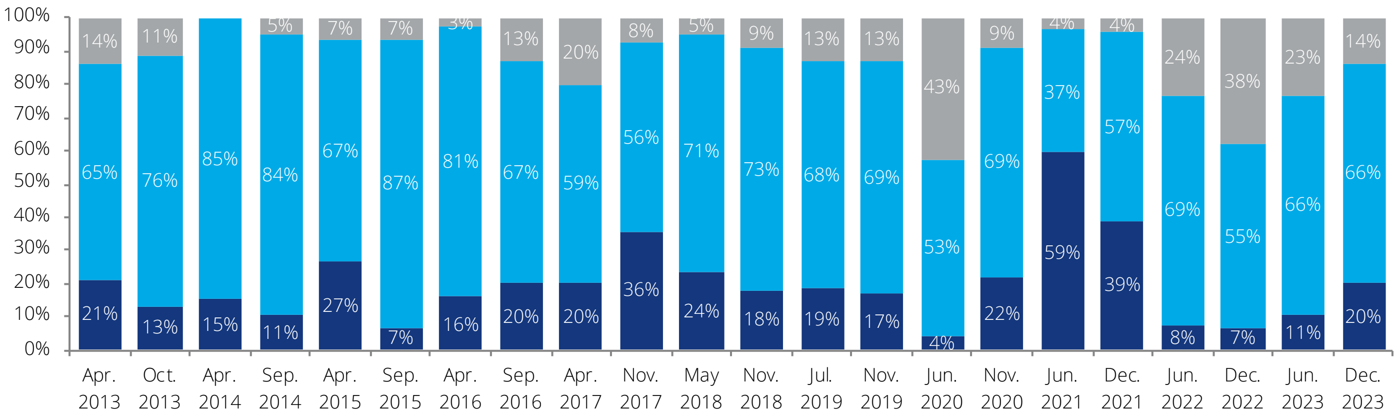


Size of transactions

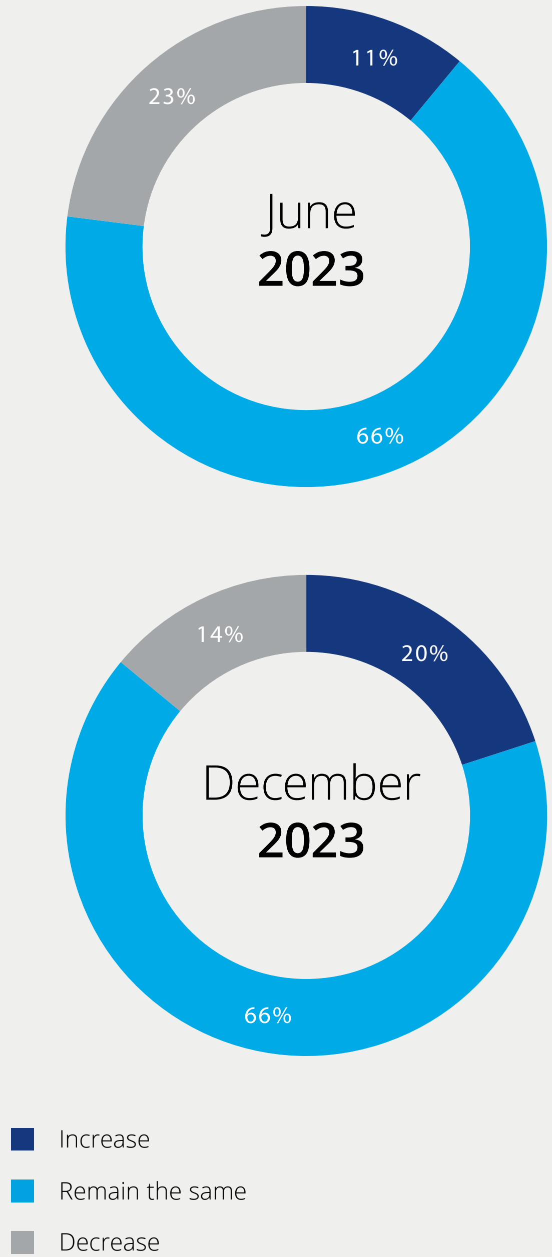
Expectations around deal sizes began stabilizing in our last Survey, and that has continued with a sprinkle of optimism for larger deals. Two-thirds (66%) still expect average sizes to remain the same over the coming months, in line with our Summer Survey. The slight change in sentiment since then is a shift in anticipation of larger deals, with a fifth expecting sizes to increase, nearly double the Summer Survey's 11%, and a commensurate reduction in those expecting averages to come down, from 23% in the Summer to 14% in our latest Survey. This suggests confidence around transaction ability, likely a reflection of the belief in more liquid leverage markets for 2024.

CE's PE market has long been a mid-market opportunity, with occasional large deals typically attracting global PE houses. An example is Carlyle Group's 2023 acquisition of Meopta Optika, a Czech manufacturer of optical, opto-mechanical and opto-electronic solutions for nearly €700m in 2023. There is a growing venture ecosystem in the region however the small ticket sizes boost volume rather than average size.

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



Size of transactions (June 2023 vs December 2023))



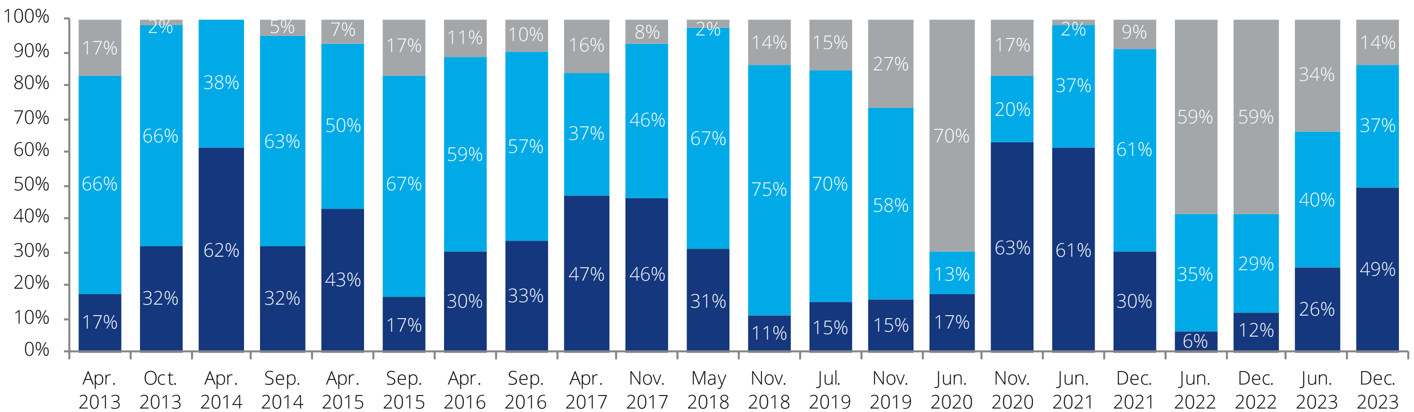
Market activity

The market may have turned a corner at long last, with a noteworthy boost in optimism for activity in 2024. For the third Survey in a row, there has been a doubling in expectations of boosting market activity, and now half (49%) expect transacting to increase this year. This is a fantastic sign of confidence from a low of just 6% in Summer 2022 when the pandemic had given way to the war in Ukraine. Equally positive is the vast reduction in those expecting a decrease, from a third last semester to just 14% now.

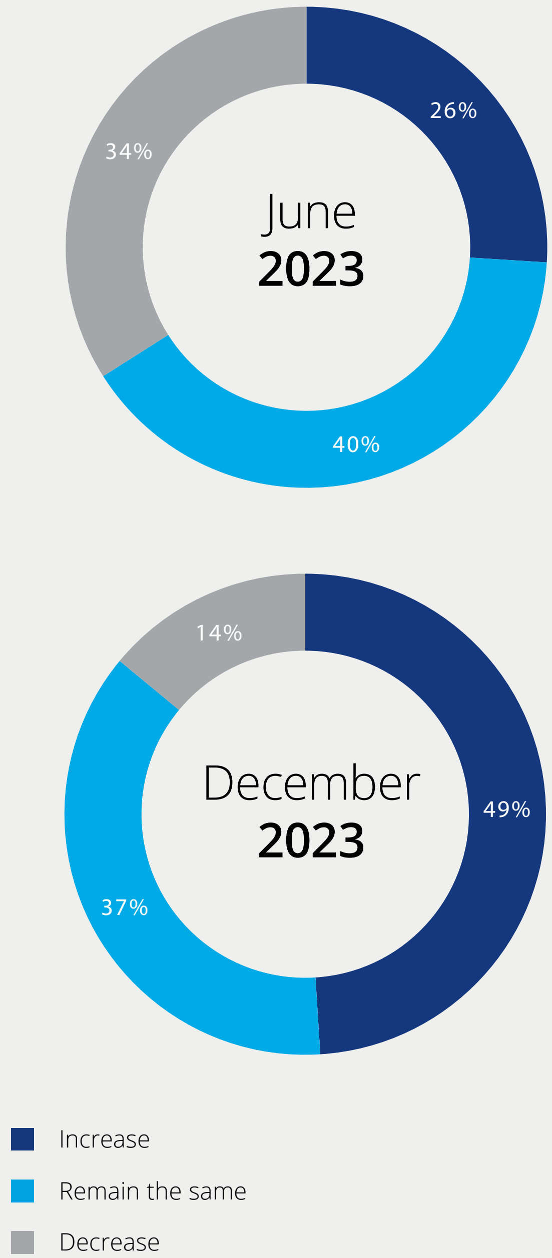
The numbers are among the strongest in our Survey to suggest an improving backdrop. And it won't just be a case of more deals but also strong deals, with expectations that it will be a good vintage (see slide 16).

A number of players were very active in 2023, with Innova Capital announcing a new fund, an exit and four investments, most recently the corporate carve-out of Pfleiderer Polska. Enterprise Investors announced three new investments and two exits, including the sale of its minority stake in FinGo after just two years. Accession Capital Partners (ACP) announced five investments, two liquidity events, a new fund and a new office, while MidEuropa had five liquidity events, including the landmark sale of Romanian supermarket chain Profi. Genesis Capital's private equity fund had a busy year with five new investments and an exit. The autumn was particularly busy, purchasing two media businesses (post-production company PFX and AV Media Group, an audiovisual and events business) as well as STT Servis, a Czech exporter of precision machined parts and assemblies.

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



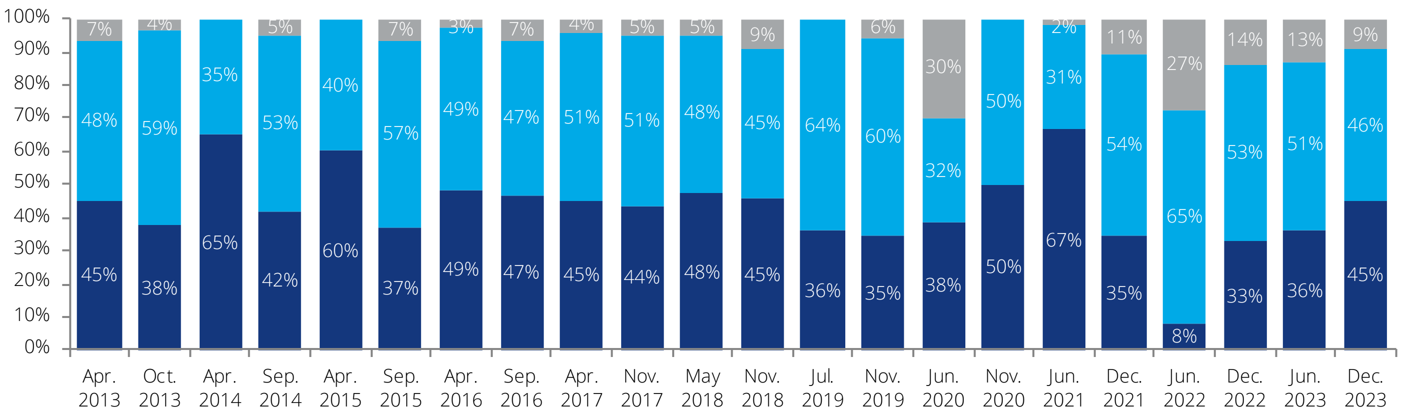
Market activity (June 2023 vs December 2023)



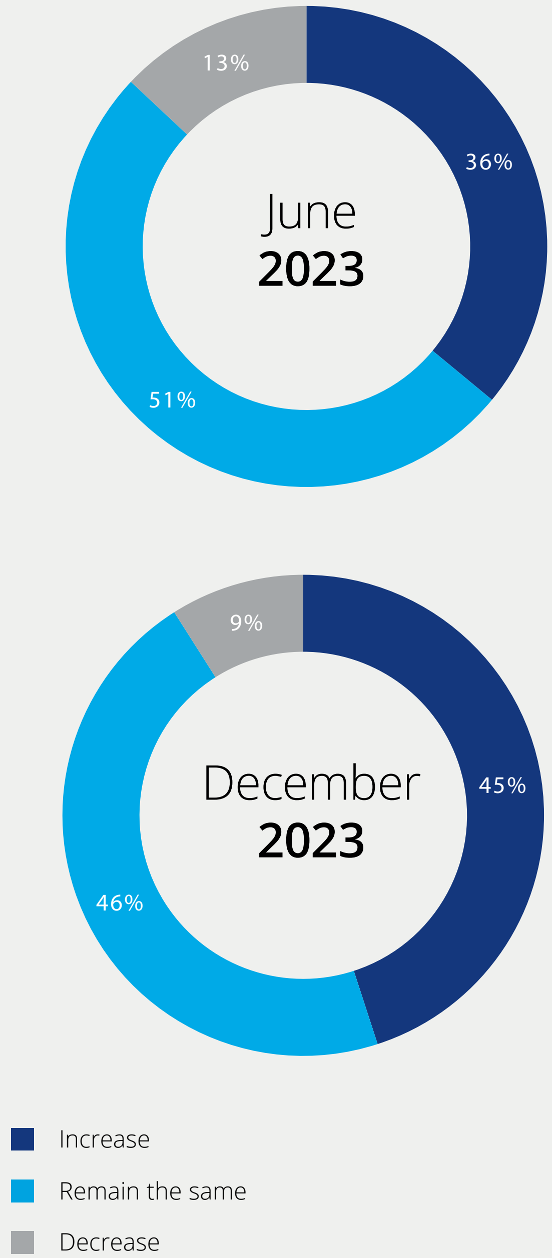
Investment return

Confidence around financial efficiency of investments has improved since the last Survey, which itself was up on the previous, suggesting the Sumer 2022 dip was a short-lived response to the Ukraine war rather than a long-term concern. Nearly half (45%) expect efficiency to increase, up from 36% in our last Survey. Nearly half (48%) expect efficiency to remain the same, while there has been a reduction in pessimism, with just 9% expecting efficiency to decline.

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



Investment return (June 2023 vs December 2023)



Investors' activities

Expectations around buying and selling have shifted gently yet again, with a small decrease in those expecting to sell more in H1 (11%, down from 15%) accompanied by a slightly more marked increase in expectations to buy more (to 57% from 51%). Those expecting to buy and sell equally has remained steady at a third.

Both appetites for buying and selling will have been impacted by relatively low activity levels of the last few years, creating pent-up demand to deploy committed capital as well as a need to harvest returns for investors. Longer hold periods may have created opportunity to grow businesses for longer, while corporations will have spent the time reassessing strategic priorities – and the confluence of these factors may create strong conditions for sales to trade buyers. Likewise the strong focus of PE firms to create sustainable value within portfolios can make some companies ripe to move onto a new financial backer which either has experience better suited to a company's next chapter of growth, or simply be bigger and thus better equipped to nurture a more substantial business. Either way, bulging portfolios may have fresh opportunities for new homes, making way for new entrants as portfolio managers originate fresh opportunities and keep the ecosystem of buying and selling going.

A number of GPs were busy divesting assets to harness distributions for investors during the year, with MidEuropa announcing five liquidity events including the landmark sale of Romanian supermarket chain Profi Rom Food to Ahold Delhaize for an enterprise value of approximately €1.3 billion. The hold period saw the number of site and sales both more than triple following an ambitious expansion programme.

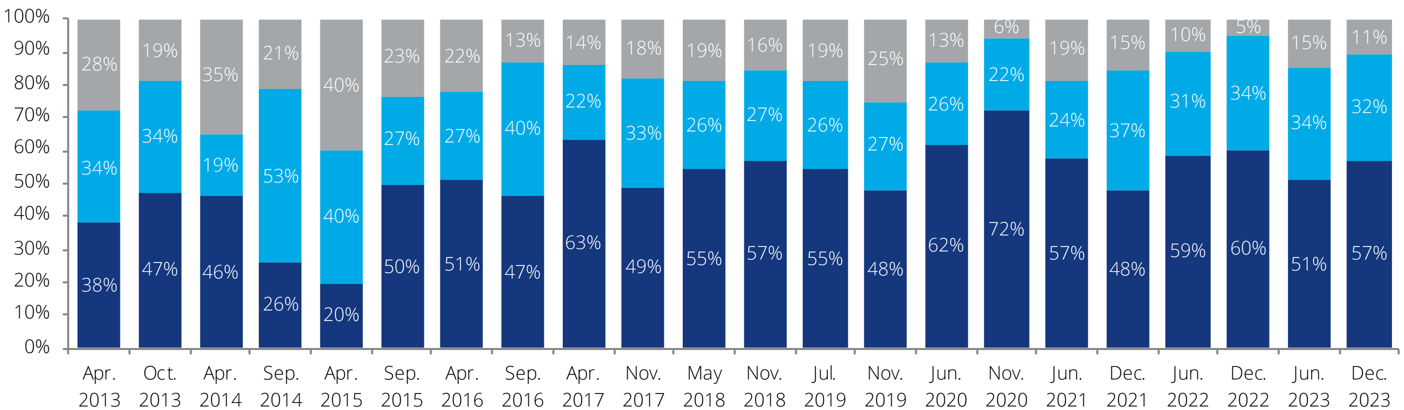
Enterprise Investors announced two sales, most recently that of its minority stake in FinGo, a financial services intermediary, to the founder in following a two-year partnership.

Abris Capital Partners sold two businesses in 2023, Graal in H1 and Velvet CARE in December to Partners Group. The five-year partnership saw sales grow 2.5x and EBITDA by over 5x as the company received B Corp certification. Abris had bought Velvet CARE from Avallon in 2018.

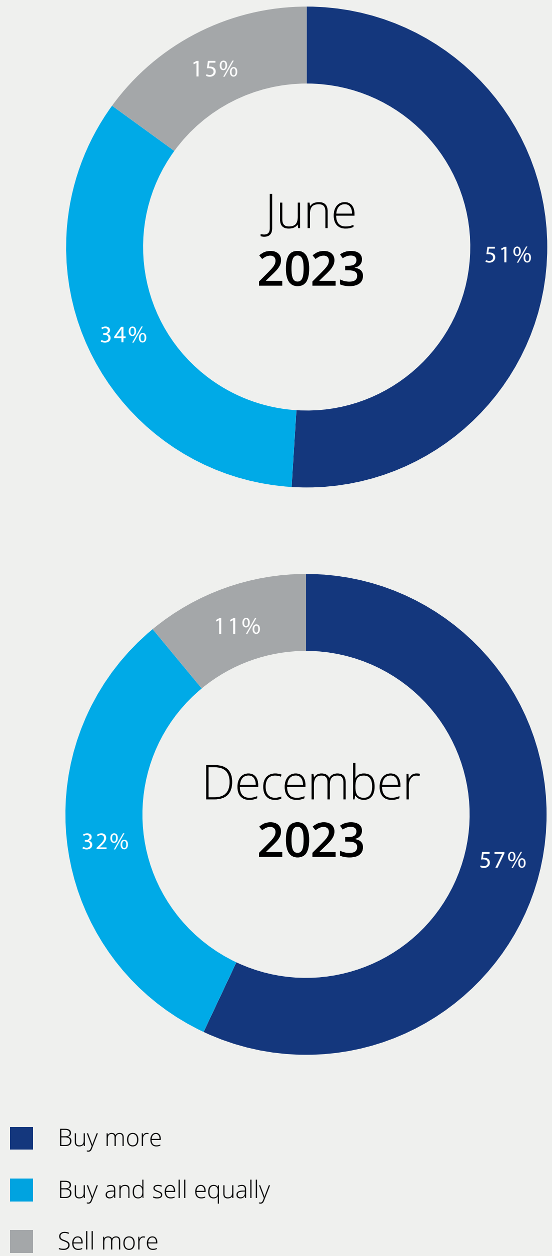
Genesis Capital sold its majority stake in Sanborn to industrial holding company Oriens in December. The six-year hold period saw turnover and EBITDA both double for the component manufacturer.

Tar Heel Capital generated a six-fold return when it exited Transsystem to industrial holding company Oriens after a nine-year hold.

For this period, I expect to:



Investors activities (June 2023 vs December 2023)



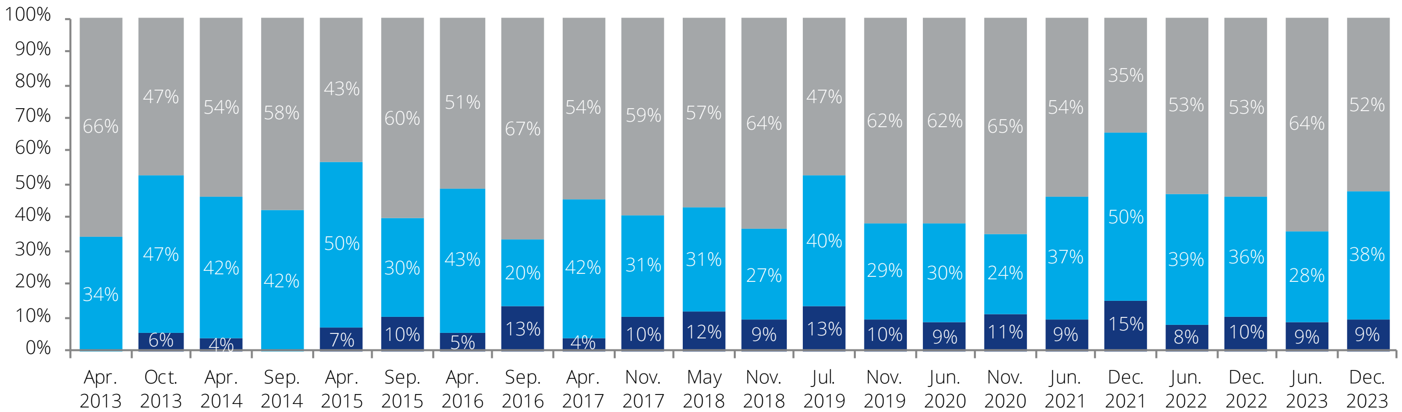
Competition for new investments

Market leaders may be losing popularity in 2024. While the majority of deal-doers (52%) still expect competition to be highest for them, this is down from 64% in our previous Survey. A spotlight is now being cast on middle-size growing companies, with 38% expecting them to be most in demand, up from 28% over the Summer.

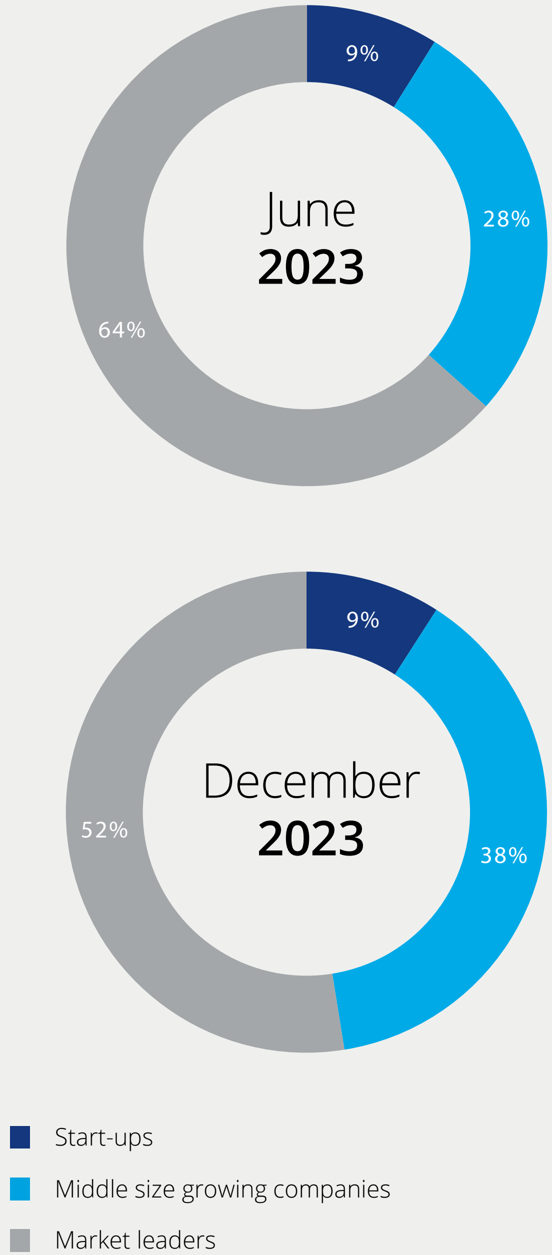
The shift may be a sign that investors are more interested in creating value in smaller businesses rather than paying a premium for a perceived leader. It may also be a sign that credit lenders are creating a greater opportunity for investors in today's market, with the bespoke offering they typically tout better able to understand prospects of a growing business than their institutional counterparts, which may rely more on profits and cashflows to determine lending terms.

Start-ups remain the least competitive area, with just a tenth of our respondents (9%) expecting them to be the most competitive, steady on the last two years. While this has long been the case, there is a thriving venture ecosystem in CE, ranging from seed to later-stage funding and leading to some very big European success stories. Many of them ultimately move their headquarters from the CE roots to larger markets with the help of their VC backers.

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



Competition for new investments (June 2023 vs December 2023)

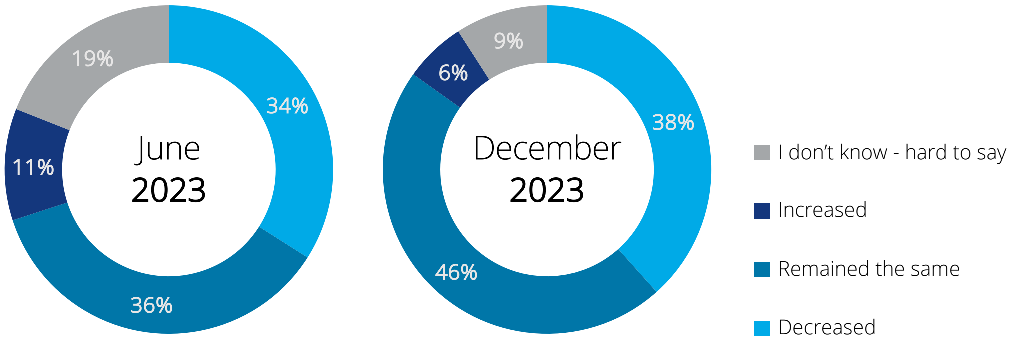


Vendor pricing

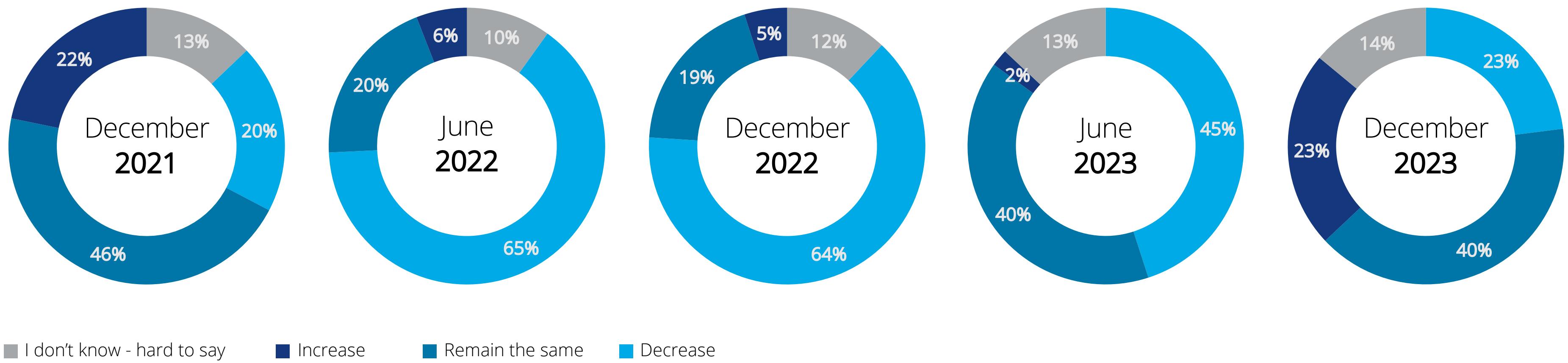
Vendors may have softened their pricing expectations in the last year, with the toll of the challenging backdrop becoming apparent and forcing sellers to accept the current pricing paradigm. Nearly two-fifths of respondents (38%) felt pricing had come down in the second half of 2023, slightly more than felt that way in the first half of the year (34%). Only 6% felt they'd increased, a near halving of the prior semester, and nearly half (46%) felt they'd stayed the same.

Looking ahead the picture is more mixed, with two-fifths feeling they will remain flat (same as last Survey) – but 23% feeling they'll increase, and another 23% feeling they'll decrease. It may be the respondents are looking at different market opportunities, whether sizes or sectors, where the dynamics are different. It is also very much dependent on vendors' motivations: some may have succession issues to address, while the underlying fundamentals of each business will dictate its valuation – and these have been changing rapidly in today's ever-evolving backdrop.

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

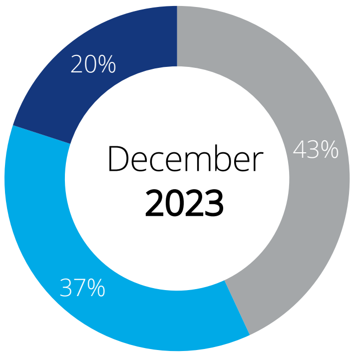
Sale processes are getting back on track after suffering the effects of last year's uncertainty. Now just a fifth of respondents are waiting for a better backdrop, a stark contrast to last Summer when over two-fifths of respondents (43%) pulled processes already in place. Also positive is the finding that 43% of respondents in our latest Survey state processes remain underway. Over a third (37%) are assessing divestments owing to inbound interest.

Deal doers are overwhelmingly confident that 2024 will be a good vintage for investments, with 86% stating it will be a strong time to invest, up from three-quarters in the last two Surveys. While only time will tell whether this proves true, it is believed that vendors' price expectations are stabilizing (see slide 14) and this may mean more transactions are able to get over the line this year.

Growing confidence in pipelines reflects the wider optimism seen in our latest Survey, with nearly half of respondents (45%) feeling there are more actionable opportunities now than six months ago. This continues the growth in pipeline optimism seen over the last three Surveys. Over a third (36%) feel pipelines are the same, while 18% feel they are deteriorating – roughly flat on last Survey.

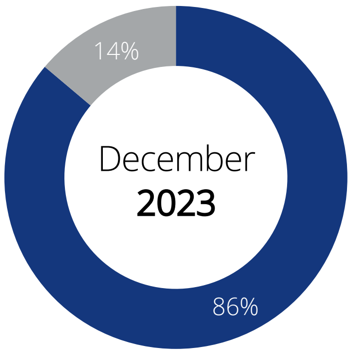
In a sign of the ability of experienced private equity sponsors to help pursue growth by navigating economic with agility, less than a tenth (9%) of transactions closed in the last two years are underperforming. The lion's share (62%) are performing in line with expectations – themselves likely based on events since 2020 – and under a third (29%) are performing in line with revised growth plans as the evolving backdrop meant reassessing and recalibrating priorities. While the market of the last few years has been challenging for all, PE firms have diverse portfolios which can share learnings, as well as experience across previous downturns to draw on – and this can be invaluable for management teams encountering their first downturn and make a meaningful difference to success.

Are you putting off sales processes as valuations are impacted by the ongoing backdrop of uncertainty?



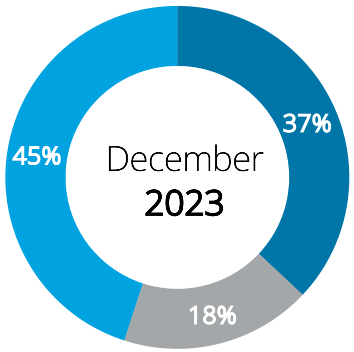
- Our processes remain underway
- We are currently assessing/pursuing select divestments owing to inbound interest
- Yes, we are waiting for a better time to go to market

Will 2024 be a good vintage for Private Equity fund investments?



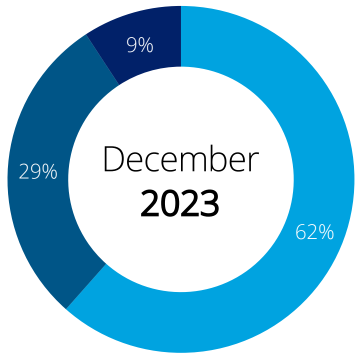
- Yes
- No

Is your deal pipeline:



- about the same as 6 months ago
- looking worse (fewer actionable opportunities) than 6 months ago
- looking better (more actionable opportunities) than 6 months ago

Are transactions you closed in the last 24 months:



- performing in line with expectations
- performing in line with revised growth plans as the backdrop necessitated reassessing priorities
- underperforming and considering options to refocus the strategy or finances

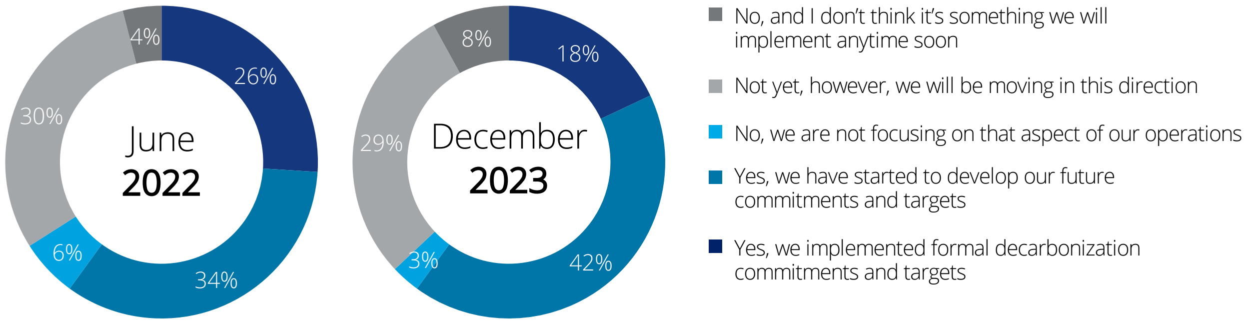
Sustainability and ESG

Sustainability and ESG

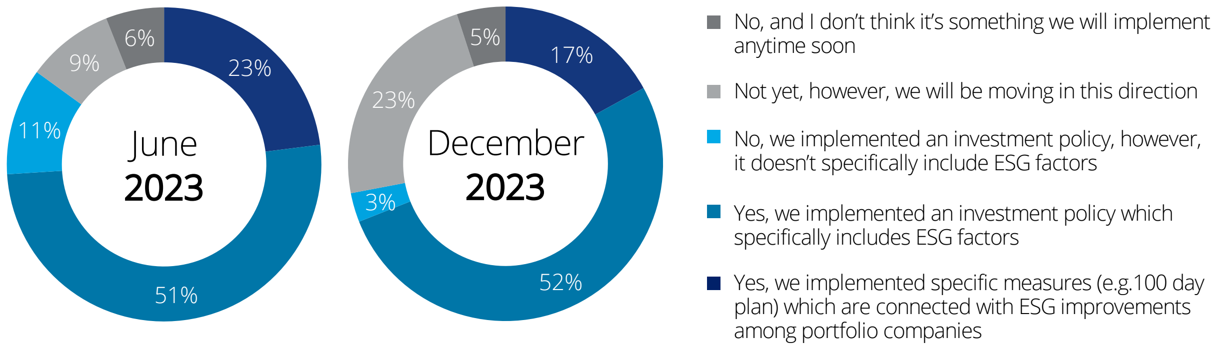
More PE deal doers in CE continue to embrace ESG, with over two-fifths (42%) starting to develop future commitments and targets, up from a third on our Summer Survey. Another fifth (18%) have already implemented formal decarbonization commitments and targets. While a small minority remain unconvinced by the merits of climate neutrality, the percentage has halved for the second Survey in a row and now stands at only 3%. Nearly a third (29%) intend to do so, the same as our last Survey. In 2023, Abris Capital Partners achieved B Corp status, showing how seriously the firm takes ESG matters. Its portfolio company Velvet CARE did as well prior to its sale to Partners Group in December

Over two-thirds of houses in CE have investment policies that include ESG factors, whether investment policies (52%) or ESG improvements post-deal (17%). Nearly a quarter (23%) intend to do so, up from just 9% in our last Survey. That regional deal-doers are embracing ESG matters is a clear sign it is deemed a value driver by the majority of funds, whether in terms of boosting valuations within the portfolio or helping to secure investor interest. However, the data also highlights a persistent minority of nearly a third a third which haven't yet done so. While most of these (23% in our latest Survey – up from just 9% in the last) are moving in that direction, a small proportion (5%) don't feel they will ESG factors anytime soon.

Has your fund made any commitments towards climate neutrality?



Has your fund implemented a formal investment policy which incorporates ESG (E-environmental, S-social, G-governance) and sustainability factors as part of investment decision considerations?



Technology

Why technology, IT, and cyber security are critical factors in M&A deals

Technology capabilities matter in M&A

As the previous editions of the report have shown, the technology capabilities of the target company have a significant impact on the value creation chain in M&A deals. According to our Survey, over 26% of respondents consider technology, IT, and cyber security aspects as critical, while another 31% see them as highly important. Only 8% see them as having limited impact on the transaction.

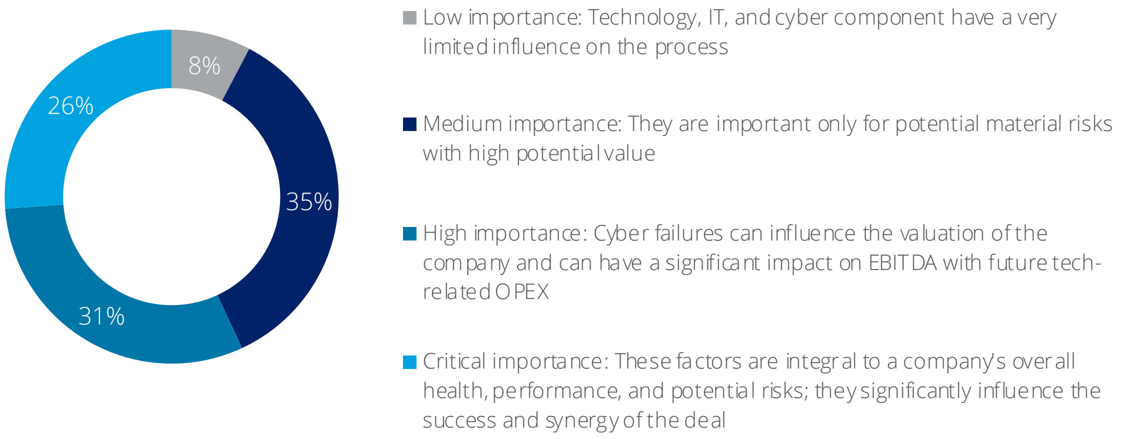
Cyber security is a key challenge

Technology is not only an opportunity, but also a risk. Cyber security is a major concern for dealmakers, as the regulatory landscape grows and cyber-threats continue to increase. Both traditional IT and operational technology (OT/IoT) are subject to regulatory scrutiny, especially in areas such as AI. Cyber-attacks can come in various forms, such as ransomware, data breaches, or targeted infiltration and they can damage the reputation, operations, and finances of the target company.

Technology debt can hamper growth

Another challenge is the technology debt that many companies face. This is the gap between the current and the desired state of technology. It can result from legacy systems, outdated processes, or lack of innovation. As our TechTrends report for 2024 shows, technology debt can become a burden that affects both CAPEX and OPEX in the near future, limiting the growth potential of the targets, thus impacting the transaction.

How important do you deem Technology, IT, and Cyber aspects during the due diligence process in M&A transactions?



Contacts

Deloitte Private Equity Contacts in Central Europe

Czech Republic
Jan Brabec
Private Equity Leader Deloitte Central Europe
+420 246 043 200
jbrabec@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

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