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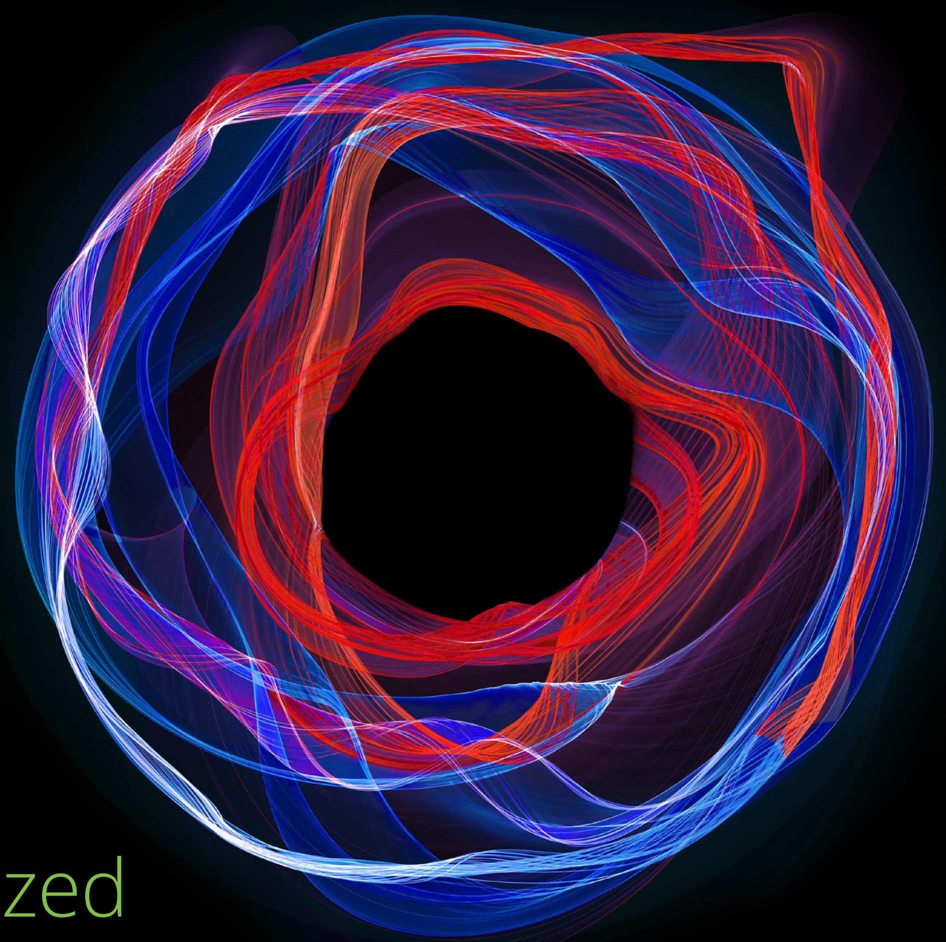


Experienced and well capitalized

Private Equity Confidence Survey Central Europe

Summer 2022

“Following a sharp bounce-back in confidence post-pandemic, the world is now dealing with inflation and the war in Ukraine, with both having profound impacts on people’s lives and global economies. Our Survey’s nearly 20 years have shown us that each shock has been followed by a strong period for transacting followed by a rise in confidence and economic conditions, and we expect this to follow suit. What is different now is the region’s deal-doers’ cumulative experience in steering businesses through adversity and helping them on paths back to growth, with the pandemic a recent lesson in this.”

Dusan Sevc, Deloitte Partner and Private Equity Leader

Experienced and well capitalized

The private equity (PE) market in Central Europe (CE) is feeling the effects of global events, with an ongoing pandemic and now the war in Ukraine catalysing high levels of inflation. Inflation is impacting consumer behaviour and some companies' ability to do business, while monetary policy aimed at curbing the inflation is causing banks to retrench. Overall, it's a market where the only certainty is headwinds for the rest of this year. This has impacted confidence, which has dipped to the second-lowest on record and marginally below early-pandemic levels.

Despite this, our Survey, now in its 19th year, offers reasons for optimism. Firstly, this is the fourth major dip in confidence, and each time the dip was followed by a sharp increase in macro conditions and thus confidence.
The tragic war in Ukraine is geographically close to CE, and this impacts international sentiment, however the major issues facing the CE PE market are inflation and cost of finance – both economic issues, and both affecting markets globally. In fact nearly half of respondents (45%) have said the war has not severely impacted portfolios at all, with another 47% saying less than a quarter of their portfolio is adversely affected.

The last downturn was just two years ago, and what we saw was that private equity was elegantly able to provide businesses with capital and expertise to support plans back to growth. This was similar in the aftermath of the Global Financial Crisis (GFC), and sufficient time has elapsed to know that the post-crash vintage was a very good one for investors.

For these reasons and more, private equity will again be able to invest across cycles, providing its committed capital to businesses less able to rely on banks – thereby potentially increasing the pool of investable opportunities. Now more than post-GFC, the PE houses have ample experience to draw on to help add value beyond pure capital to these companies.
Our survey and in-house experience both suggest multiples are coming down, and this makes it a good time to buy. While banks are lending less or at very high costs, we are seeing in CE the emergence of debt funds.
These have long been popular in the US and began to emerge in Europe in around 2010; now CE has just announced ACP's first close of its debut direct lending fund. It may be good timing indeed.

The growing experience of CE PE – many with 20 and even 30 years of experience – is further enhanced by 'new' tools for creating value within portfolios. Enhancing businesses digitally is a great driver of growth and one that has been undertaken by savvy investors for the last few years; now ESG frameworks are increasingly embraced by the CE PE market.

The last year has seen sustainability go from voluntary to enshrined in regulation, and simultaneously businesses are realising that such a focus makes very good business sense. This will be a strong source of growth for companies in CE, with PE at the vanguard of leading this positive change, with over three-quarters seeing this as part of their risk mitigation and value creation strategies (see slide 18).

As we said in our Survey two years ago, experience will be crucial not just for firms to survive but even thrive in today's adverse backdrop. For most deal-doers in the region, 2008 marked their first downturn following a period of unprecedented growth and surging popularity. Returns were largely predicated on beta as the region's economic growth lifted companies and countries converged with Western Europe to join the EU. Following that period, it has been about driving value through alpha and this will count for a lot in today's market.

Entry prices had been rising before covid, then paused before rising steeply again. This latest pause may have broken an unsustainable uptick, and our Survey suggests vendors will reduce expectations further. While it is a good time to buy and the best businesses will be highly contested, it also means existing portfolios will be nurtured for longer.

Private equity is touted as patient capital and the surge in continuation funds since the pandemic means the industry is well placed to hold assets for longer where they see merit in doing so.

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 in the region.

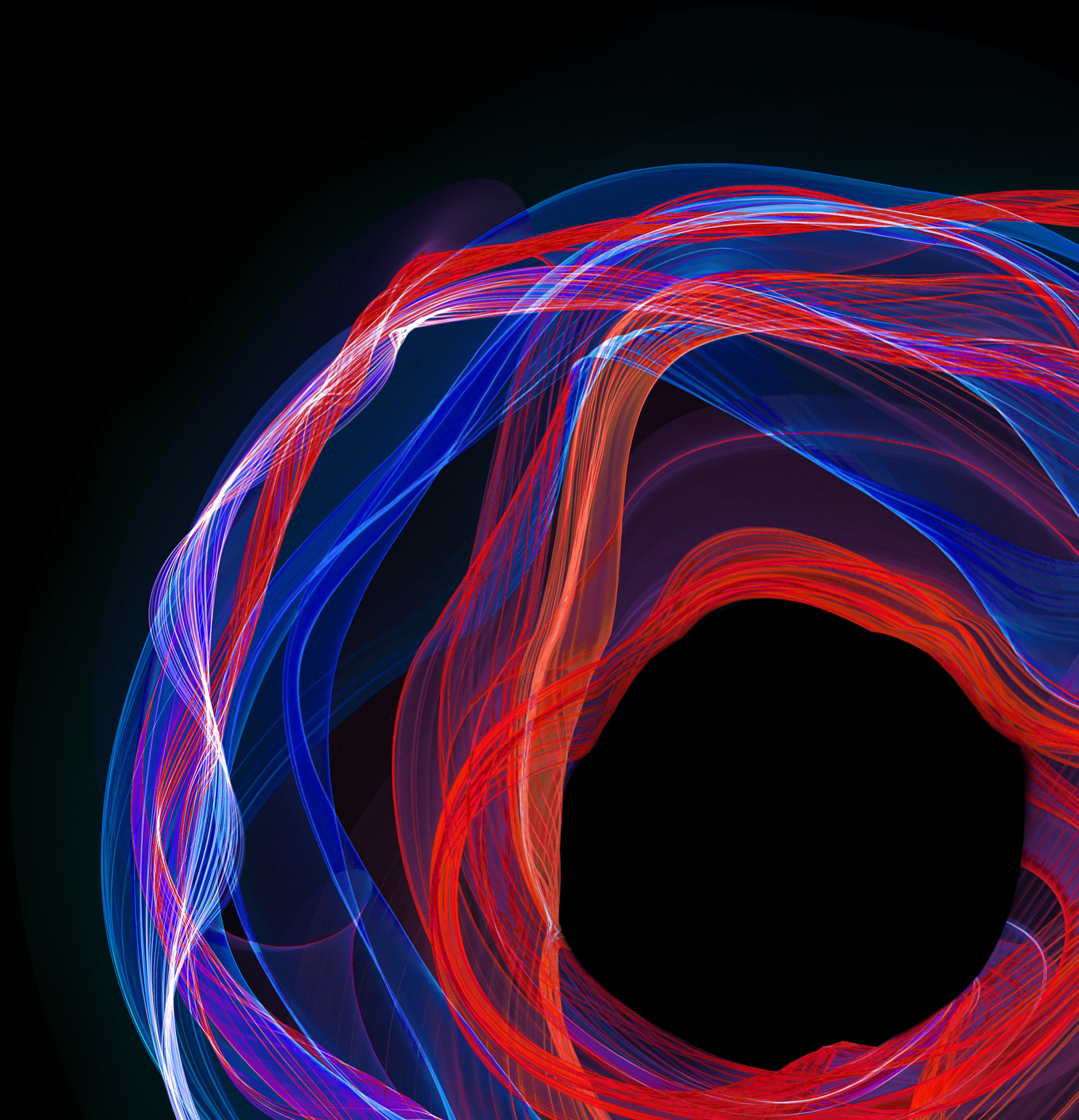
Dusan Sevc
Partner, Private Equity Leader,
Deloitte Central Europe

Central European Private Equity Index: Key findings

GPs want to invest, and it is a buyers' market, with roughly half of deal-doers expecting to focus on new investments, down on the winter figure but still a healthy level given the uncertain backdrop. The continued appetite for transacting may be due to an expectation that valuations are coming down, with 14% of respondents feeling vendors have decreased their price expectations over the last six months, double last Survey's response of 7%, and 65% believe they will continue to do so. Pipelines are robust, with over two-thirds (70.6%) feeling the work-in-progress is roughly the same as four months ago and nearly a fifth (17.6%) feeling pipelines have actually improved.

It will be tricky to leverage deals, with respondents expecting the availability of leverage to decrease over the coming months, with over two-thirds (71%) anticipating a reduction in the availability of debt, up markedly from 30% in the last Survey. The last time the level was this low was in Autumn 2011, when confidence was also down. A nascent non-bank lending market in CE may cater to demand.

Economic expectations and confidence are very low. Economic expectations are pessimistic for the coming months, with a more than doubling of respondents expecting conditions to worsen (from 41% to 86%). This is even higher than when the pandemic first hit, and no respondents expect an improvement. Economic sentiment and our Index typically move in tandem, and the confidence fall to 58 is one of the Survey's steepest declines.



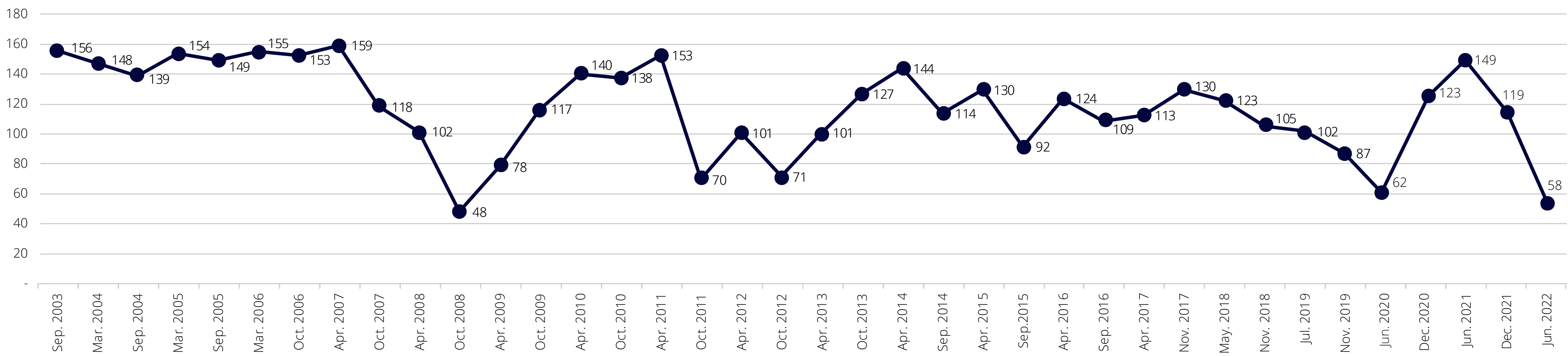
Sentiment has been very adversely affected by a confluence of factors, namely inflation and the restrictive monetary policy it is catalysing. The long-term impact of the pandemic and the ongoing war in Ukraine cast downside risk in CE as well as economies across the globe. These factors have seen our Index dip to 58, one of the Survey's lowest levels in its 19-year history and continuing the steep decline that initially began at the end of 2021.

Our Index has always mirrored sentiment around economic expectations, and swiftly soaring interest rates to tame runaway inflation are causing many to expect headwinds for the rest of 2022 and into 2023.

The dramatic dip is the fourth in the Index's history and is as steep as the 12 month drop following the Global Financial Crisis (GFC), which saw it plummet from 118 to just 48.

A crucial difference versus 2008 is that the region's PE market is now very experienced, with many senior deal team members as well as institutions having two decades or more of deal doing experience. This expertise spans navigating the GFC in 2008, a downturn in 2011 and the recent pandemic – during which time a number of lucrative exits and successful fund closes were announced.

Central Europe PE Confidence Index



Survey Results

Economic climate

Economic expectations are unsurprisingly pessimistic for the coming months. The sizeable increase in respondents expecting conditions to worsen (from 41% to 86%) is even higher than when the pandemic first hit. No respondents expect an improvement and just 14% expect the current backdrop to persist.

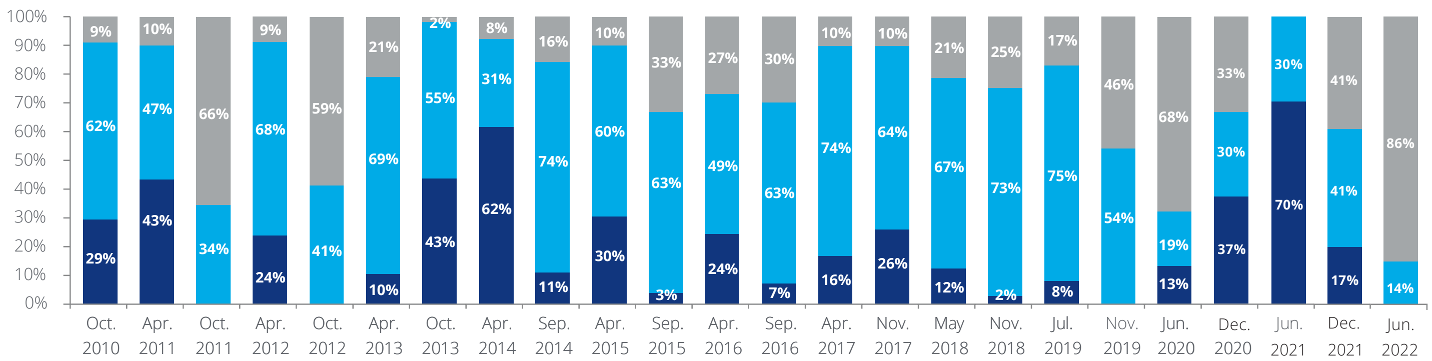
Global financial press indicates this sentiment is global rather than a regional issue, since the sharp uptick following the pandemic slowdown has created a fading base effect, while global inflation and the war in Ukraine are impacting purchasing, supply chains and interest rates. In CE, geographic proximity makes the countries extremely dependent on Russian gas and oil, making the impact more pressing.

Poland, the region's largest economy, enjoyed a strong Q1 on the back of private consumption, a healthy labour market, and minimal supply chain disruptions given previous stock accumulation. That strong quarter created a difficult base for Q2 to start from and so overall the country is set to see growth of 4.3% in 2022 and 3.1% in 2023. Increasing interest rates pose a downside risk, reaching a 14-year high of 6% at the time of going to press.

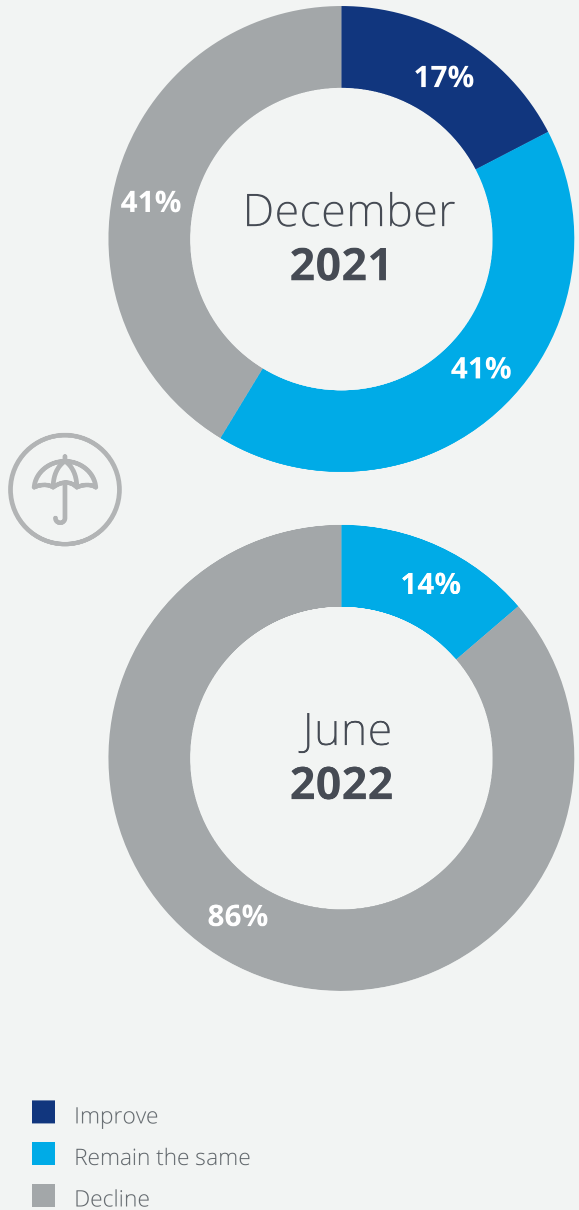
Romania, CE's second largest economy, is expected to grow at 3.5% in 2022 and 3.7% in 2023. The gentle drop on 2021 figures is down to tightening monetary policy, a fading base effect and a slowdown in the boost from easing lockdown restrictions. The country's long-term growth prospects should benefit from the European Commission's announcement in May for Romania to join the Schengen zone.

The Czech Republic is also experiencing cooling growth and for similar reasons: a strong Q1 as pandemic restrictions eased and drove consumer demand gave way to a reversal in Q2 as inflation bit. Inflation is heavily impacted by high house prices, which affect rents and thus official CPI. Additionally, the country's sizeable automotive industry is very prone to current supply chain disruptions. GDP growth is forecast at 2% for 2022 and 2.9% in 2023.

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



Economic climate (December 2021 vs June 2022)



Debt availability

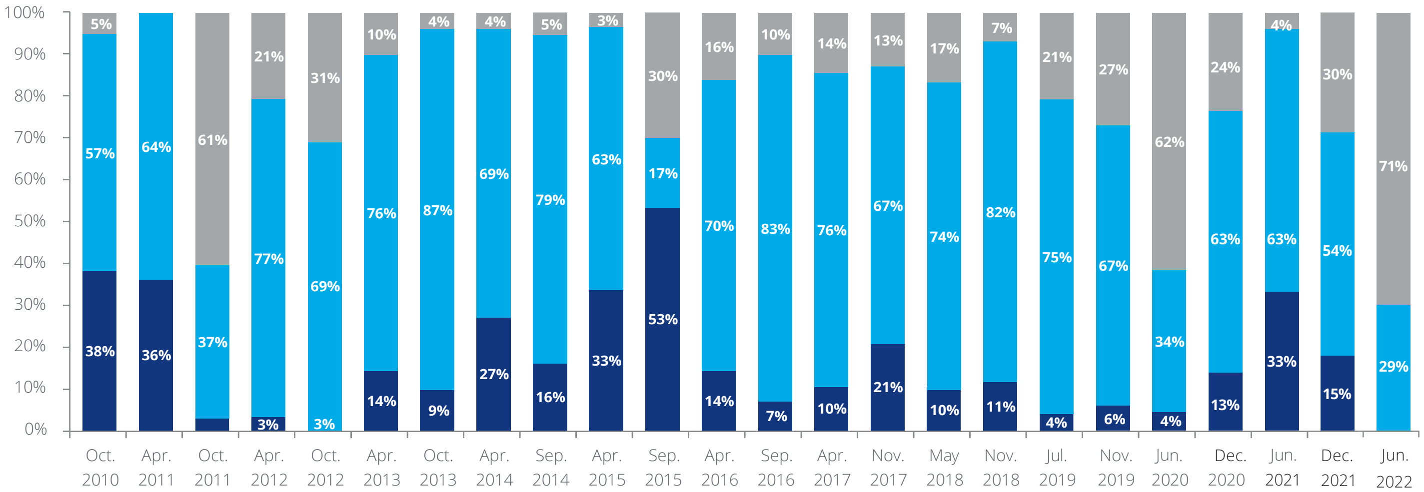
Respondents overwhelmingly expect the availability of leverage to decrease over the coming months, with over two-thirds (71%) anticipating a reduction in the availability of debt, up markedly from 30% in the last Survey. The last time the level was this low was in Autumn 2011, when confidence was also down.

Just under a third of respondents expect liquidity to stay the same (29%), in stark contrast to most of our Surveys since 2003 which have seen the majority of respondents expecting leverage to maintain current levels.

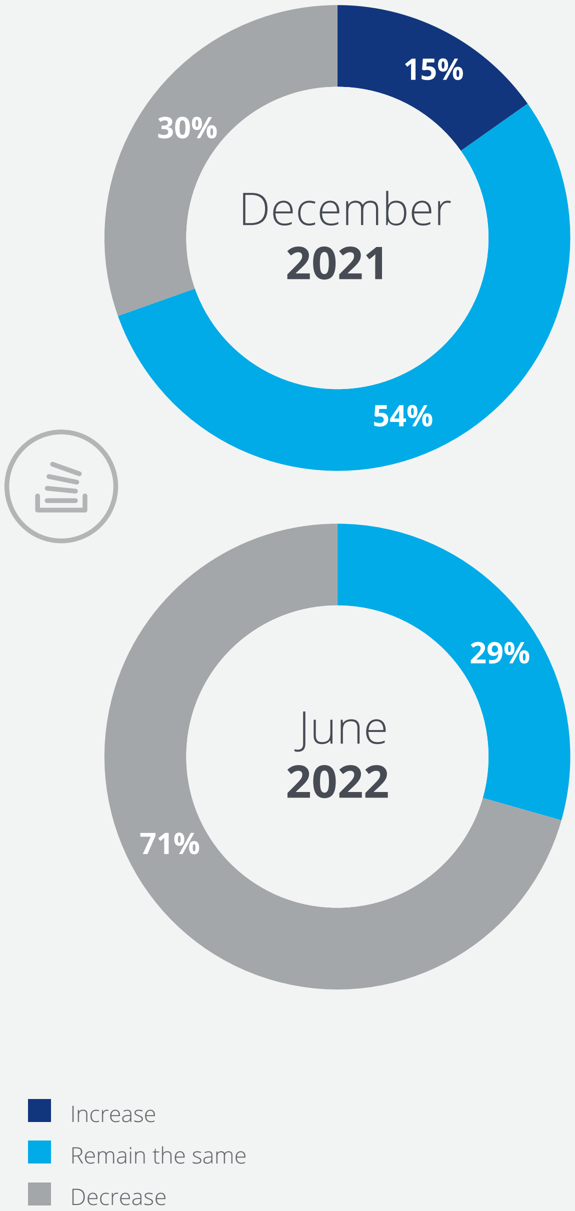
This is down to a tight monetary policy in the region's economies not in the eurozone and so able to control interest rates. In June, Poland's rate rose to 6% to tame the country's highest level of inflation in 24 years (13.9%). In Hungary, the base rate rose to 7.75% from 5.90%, marking the 13th consecutive increase. Czech interest rates reached 7%, the highest rate since 1999, following an unexpectedly high 125bps rate rise in June.

The inflation and resultant interest rate hikes mean banks are retrenching from lending or, when they do offer terms, they are relatively expensive. This is unsurprising and what we saw after the GFC, though the 14 years that have elapsed provide cautious hope this downturn will be different: The GFC aftermath saw the emergence of a generation of credit funds, particularly in Europe, which had lagged the US landscape for non-bank lending. Many of these non-bank lenders have raised a number of funds since then and so have committed capital available to deploy, meaning the universe for lending is wider than it was 12 years ago. While this remains underdeveloped in Central Europe, there is evidence that this may be changing. Accession Capital Partners (ACP), which pioneered mezzanine in the region in 2000, has recently announced the successful first close of its debut direct lending fund to back growing businesses in its core market of CE. The firm held a first close on €90m for ACP Credit Fund I in July 2022 towards its target of up to €200m, and will provide €5-15m per deal of senior-secured debt solutions.

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



Debt availability (December 2021 vs June 2022)



Investors' focus

Roughly half of deal-doers expect to focus on new investments, down from 61% in the winter but suggesting, enduring appetite for transacting from the region's deal doers as well as a belief the backdrop remains conducive to do so. This may be partly down to an expectation that valuations are coming down (see slide 14). While this is likely unwelcome news for would-be vendors, it marks a break from the high-pricing environment across Europe and indeed globally. Multiple data sources have shown that many GPs globally found the post-GFC period of 2009 to be a strong vintage year – and the years preceding it less lucrative for many deals which may have been over-levered in a backdrop which commanded eye-watering prices.

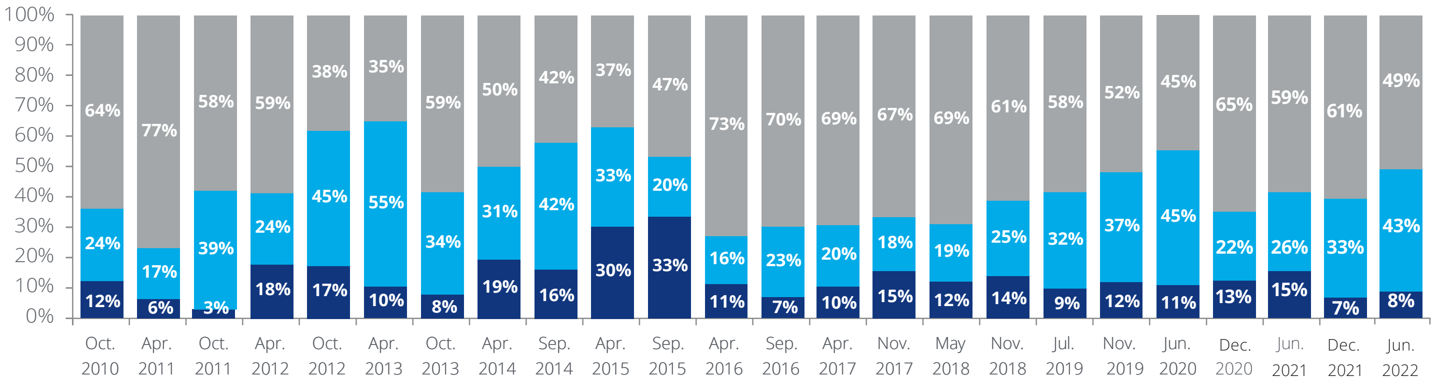
A rise in those expecting to focus on portfolio management (43%) suggests an increase in defensiveness as sponsors look to shore up balance sheets of portfolios to weather upcoming headwinds.

An example of value-accretive portfolio management is add-on acquisition opportunities, with MidEuropa's portfolio company Symfonia acquiring HR cloud specialist HRtec in May. MidEuropa had carved out the Polish ERP and payroll software solutions provider from Sage in 2021. In June, Enterprise Investors-backed Croatian grocery chain Studenac acquired Lonia, one of a number of add-ons since Enterprise backed Studenac in 2018.

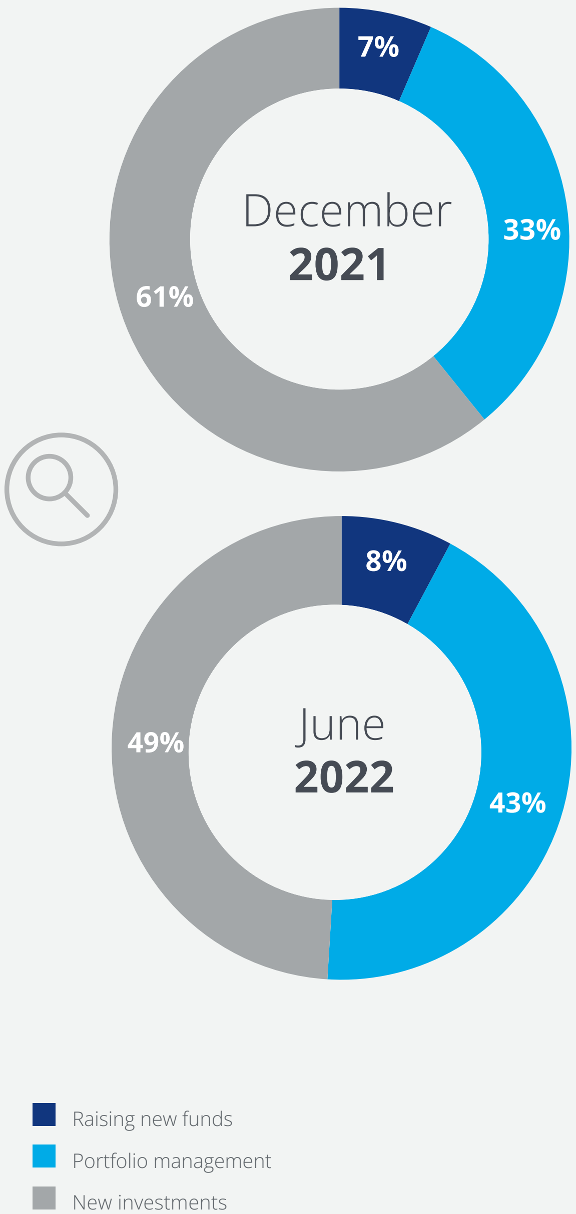
Just under a tenth (8%) of respondents expect to focus on fundraising, roughly flat on our last survey. Recent announcements include a first close for Resource Eastern European Partners III, which is targeting €200m. The announcement comes after the firm announced the successful exits of World Class Romania and Maced. Genesis Capital held a final close for Fund IV on its €150m hard cap in June, with a €15m commitment from the EBRD and a first close in summer 2021.

Another close was that of Provectus Capital Partners whose Adriatic Structured Equity Fund reached a close on €94m in April to make it the largest Adria fund. Spire Capital is looking to reach a first close for its debut institutional fund, seeking €110m. INVL is looking to launch its Growth Fund II and Serbia-headquartered Western Balkans Private Equity Fund is gearing up for a first close of its €80m Southeast European SMEs-focused debut fund.

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



Investors' focus (December 2021 vs June 2022)



Size of transactions

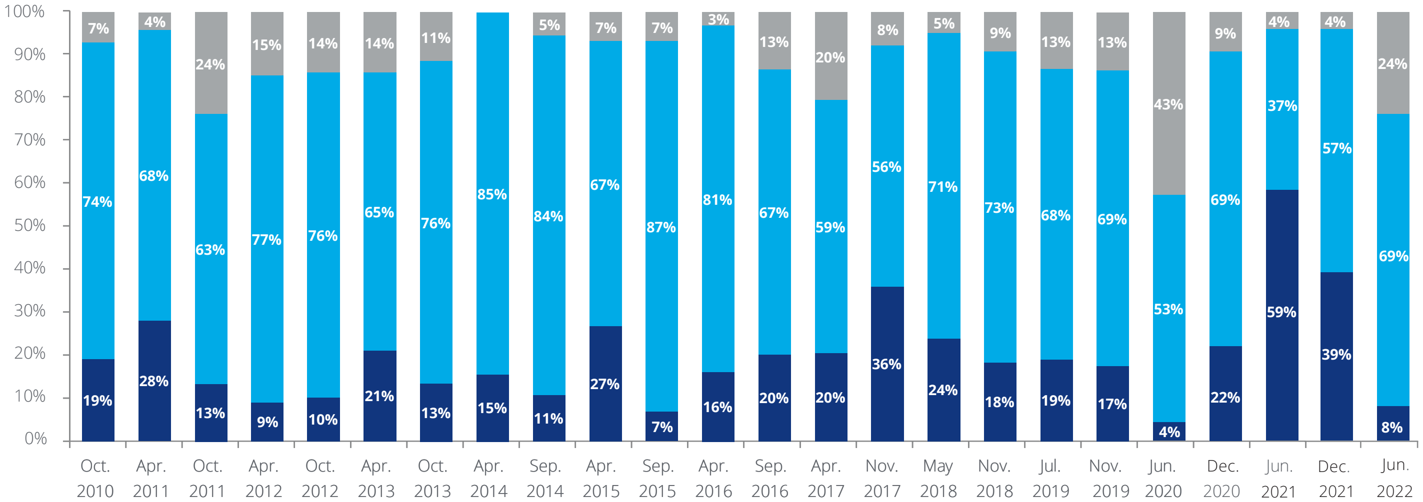
Over two-thirds of deal-doers (69%) expect deal sizes to stay the same over the coming months, despite the worsening backdrop. Nearly a quarter expect sizes to come down (24%), up markedly and likely a result of tightening leverage markets as banks restrict loans to back transactions. Just 8% expect average deal sizes to increase.

CE is typically a mid-market opportunity and most deals this semester reflect hits. January saw Enterprise Investors invest €45m for a significant minority stake in Ekoenergetyka-Polska, a tech business focused on power charging solutions for electromobility.

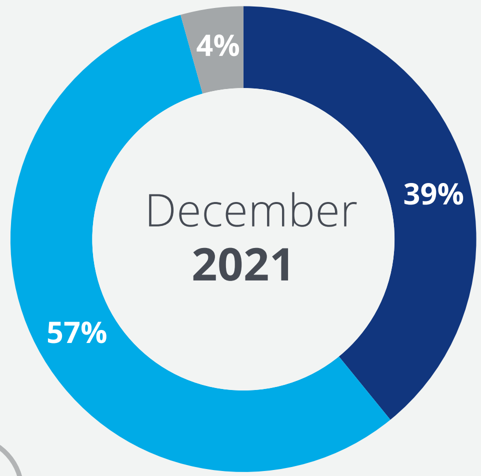
Dental deals were popular at the beginning of 2022: Innova brought together three dental businesses (DPC in Lithuania and Dentaurus and Medicadent in Poland) to create a platform for a regional dental group. That same month, local buyout house Abris made its third investment in the dental sector when it bought Romanian dental distribution platform Dentstore.

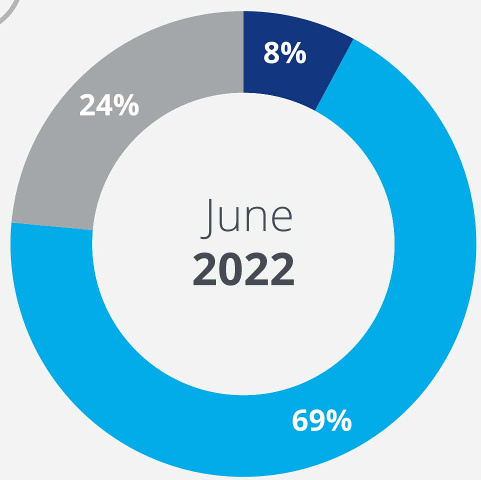
The region occasionally hosts large transactions and in January global VCs Sequoia Capital and Fidelity Investments led a €628m round for Bolt, valuing the Estonia-based ride-hailing business at €7.4bn.

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



Size of transactions (December 2021 vs June 2022)





Increase
Remain the same
Decrease

Market activity

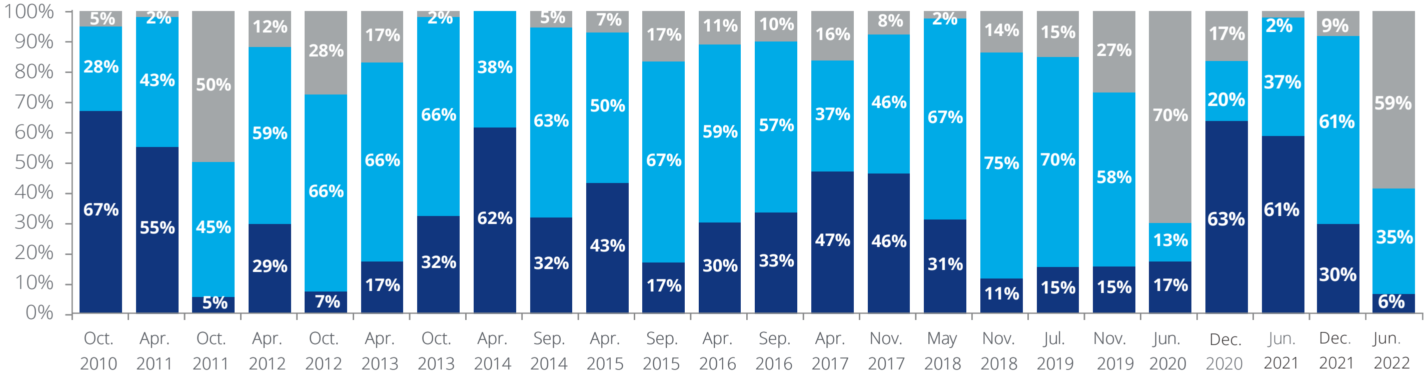
Expectations for market activity are split, with 59% expecting a decrease – a sizeable increase since our last survey (9%), though 35% expect activity to be maintained. Those expecting activity to pick up have reduced dramatically from 30% over the winter to just 6% now.

These expectations broadly reflect the mood in wider Europe, where an uncertain global backdrop from inflation and its impact on valuations and lending is overlaid with downside risk from Covid variants and the war in Ukraine.

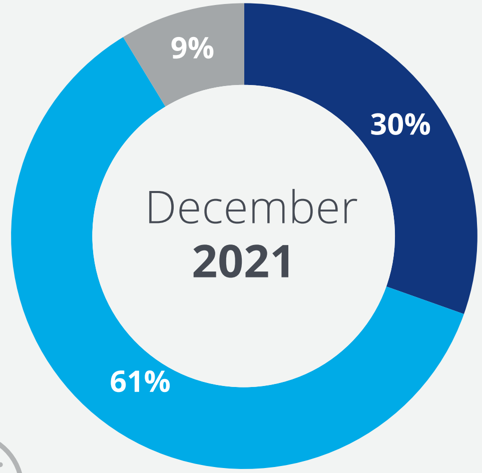
There are signs this period is less precarious than the peak of the GFC in autumn 2008, when the proportion expecting a decrease more than quadrupled from 19% to 80%. Indeed many of the deals that did go on to transact in 2009 went on to become strong exits.

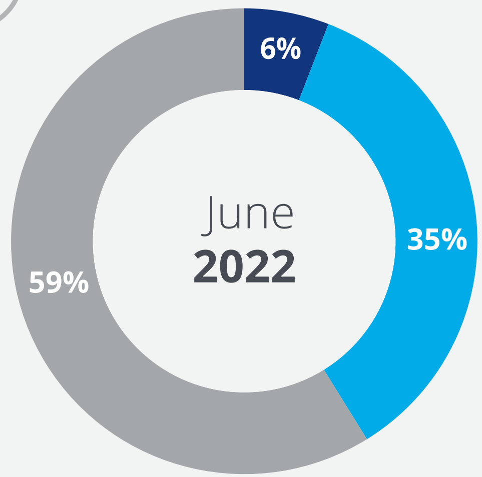
What is likely is a 'flight to quality' to back businesses with robust financials and ambitious management teams seek out a sponsor to help accelerate its growth. Competition will be high for these precious deals and so valuations for them will be high.

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



Market activity (December 2021 vs June 2022)





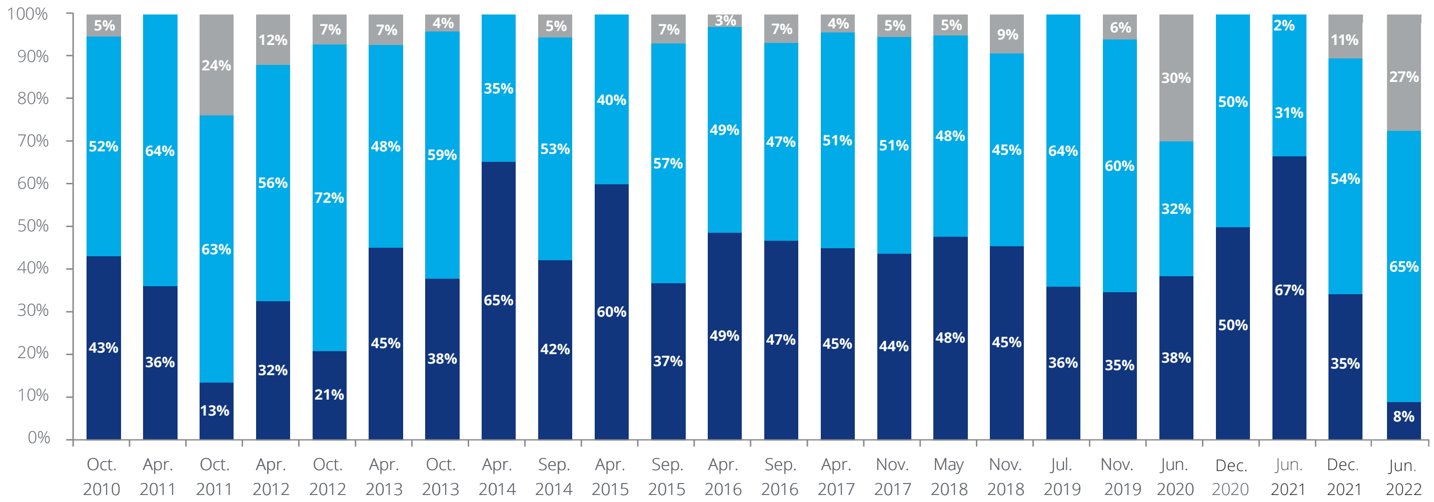
- Increase
- Remain the same
- Decrease

Investment return

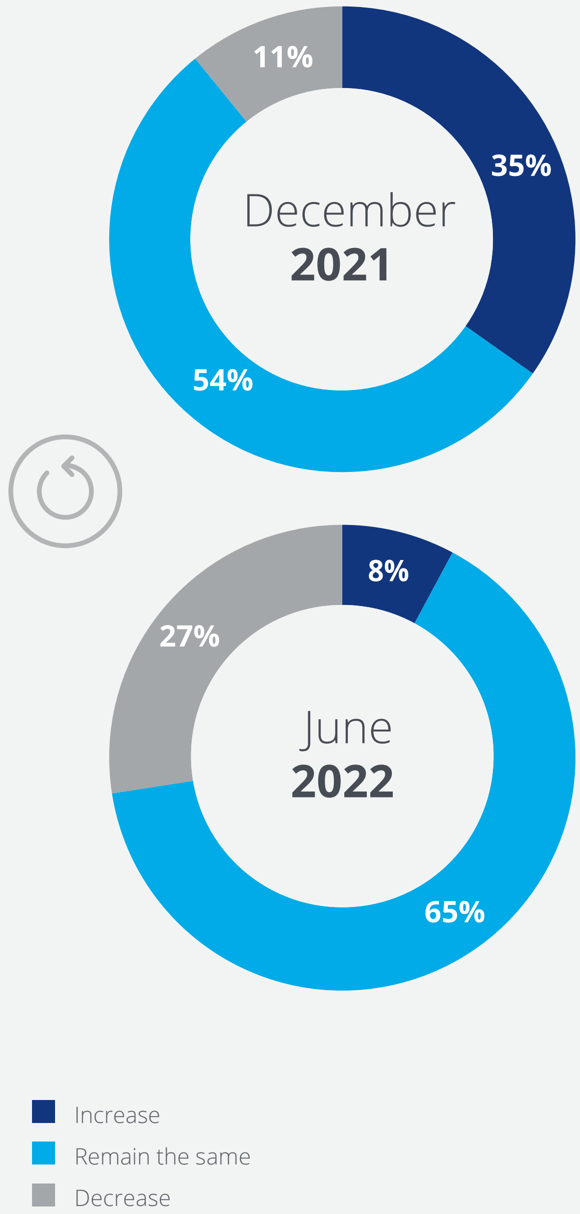
There has been an increase in the proportion of respondents who feel the efficiency of CE financial investments will remain the same (from 54% to 65%), though this is tempered by pessimism: over a quarter expect it to decline (27%) and just 8% expect it improve.

Interestingly, the proportion expecting efficiency to wane is lower than at the start of the pandemic (30%). The figures reveal a reversal of the optimism seen since summer 2021 the world began to 'learn to live with Covid' and vaccines helped governments to ease lockdowns; this began to reverse in winter 2021/22.

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



Investment return (December 2021 vs June 2022)



Investors' activities

This question in our Survey shows the least amount of change in the last six months, with a gentle decrease in those expecting to sell more (10% from 15%), a small reduction in those expecting to buy and sell equally (31% from 37%) and a modest increase in those expecting to buy more (59% from 48%).

The results reflect expectations of valuations, with a buyers' market expected for the rest of this year. The reduction in selling appetite is less stark than after the onset of the pandemic (6%) and much lower than the wake of the GFC. These are encouraging signs of deal-doers' expertise in growing businesses and finding suitable divestment routes. There are more widely used growth levers for businesses now than in the early 2010s, namely digital enhancement and, increasingly lately, adopting ESG frameworks, which can boost a company's valuation greatly for international buyers (see slides 18, 19).

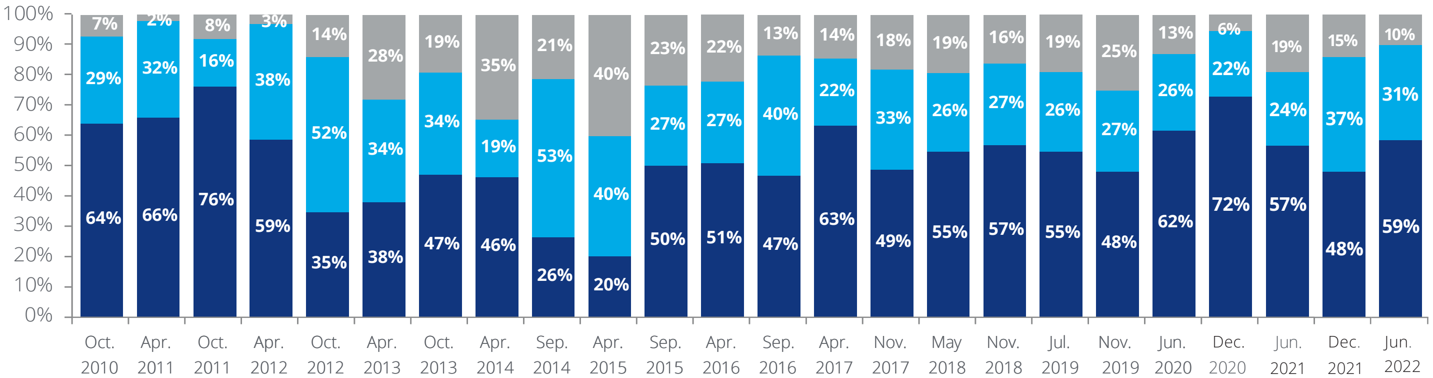
Abris Capital Partners bought and sold during the analysis period. In January Abris made its third investment in the dental sector when it bought Romanian dental distribution platform Dentstore.
That same month, the investor sold Serbia-headquartered animal feed and feed supplements producer Patent in a trade sale to Raiffeisen Ware Austria following a 6.5-year hold.

Resource Partners sold World Class Romania in April after supporting seven acquisitions for the fitness chain it had acquired in 2014, and in February Resource generated an 80% IRR and 2.8x MoC when it sold Maced to Assisi Pet Care.
The two-year hold saw EBITDA nearly triple as Resource supported a push on exports and consolidation strategy for Maced.

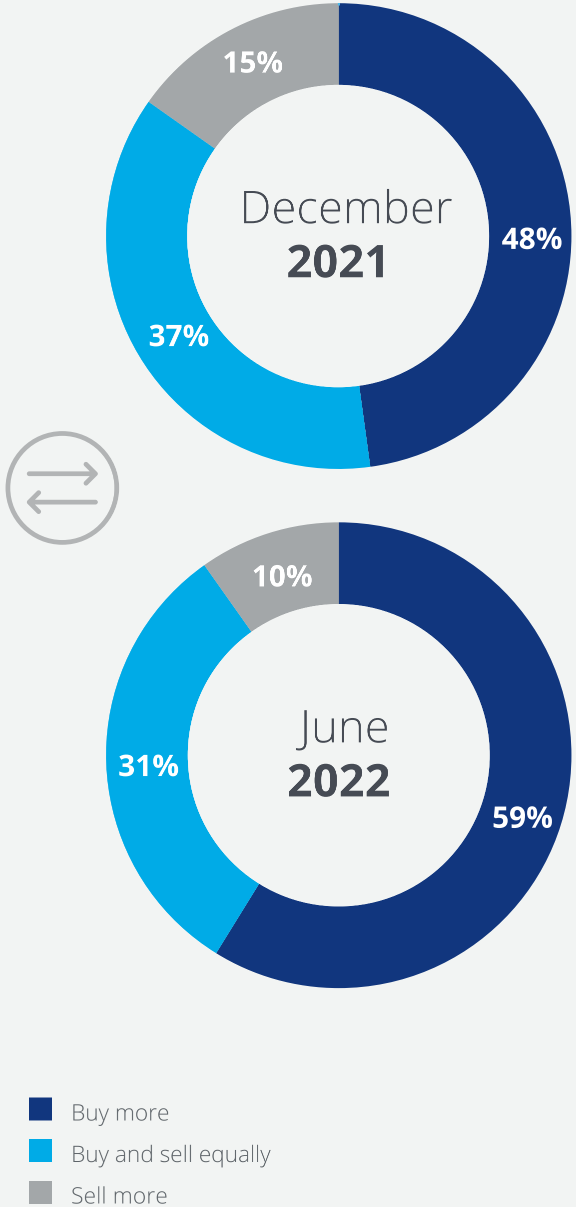
In March Innova sold Slovenian buildings supplier Trimo for 4.5x money in a deal that valued the company at 9.5x 2021 EBITDA after an attempted sale in 2020 collapsed.

Pan-European GP Bridgepoint is reported to be seeking sales of a couple of its Polish investments: In March it was reported that it had appointed an adviser to sell Dr Gerard, a Polish biscuit maker, and in May it was reported that Smyk, a Polish childrenswear and toy chain it acquired in early 2016 for the equivalent of EUR 247m, was on the block.

For this period, I expect to:



Investors' activities (December 2021 vs June 2022)



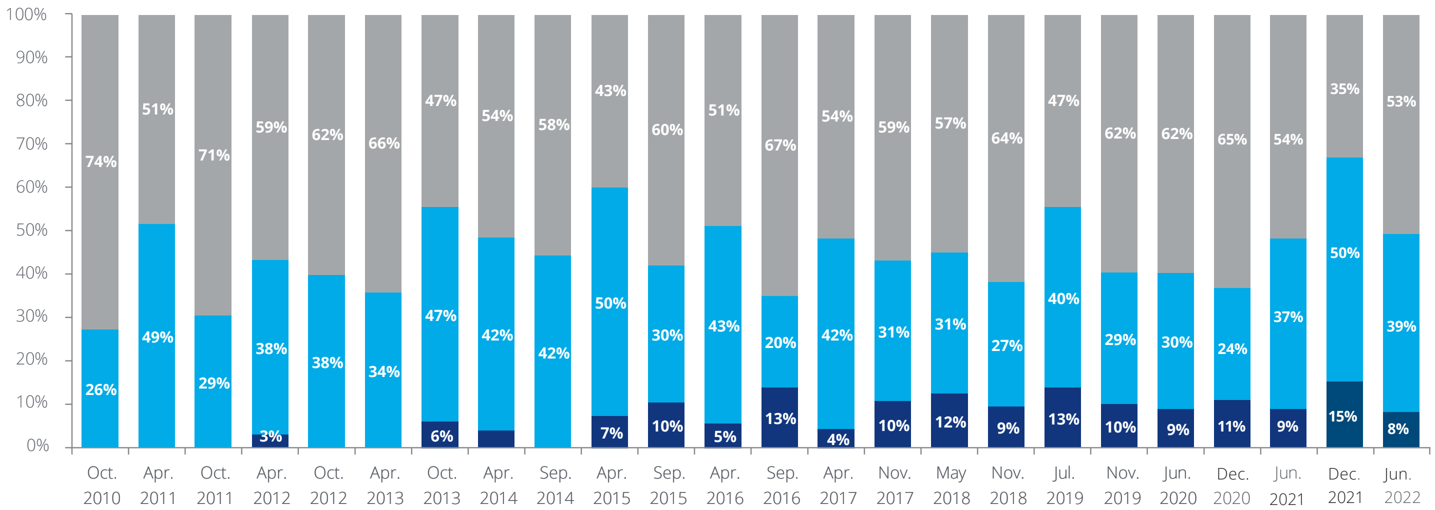
Competition for new investments

Our latest Survey reveals a reversion to typical competition expectations: most (53%) expect market leaders to be the most in-demand from deal-doers. Though market leaders have been the most sought-after in all except four of our 37 Surveys which posed this question, the results denote a marked shift from our last Survey, when mid-sized growing companies were more popular and start-ups were increasingly competitive.

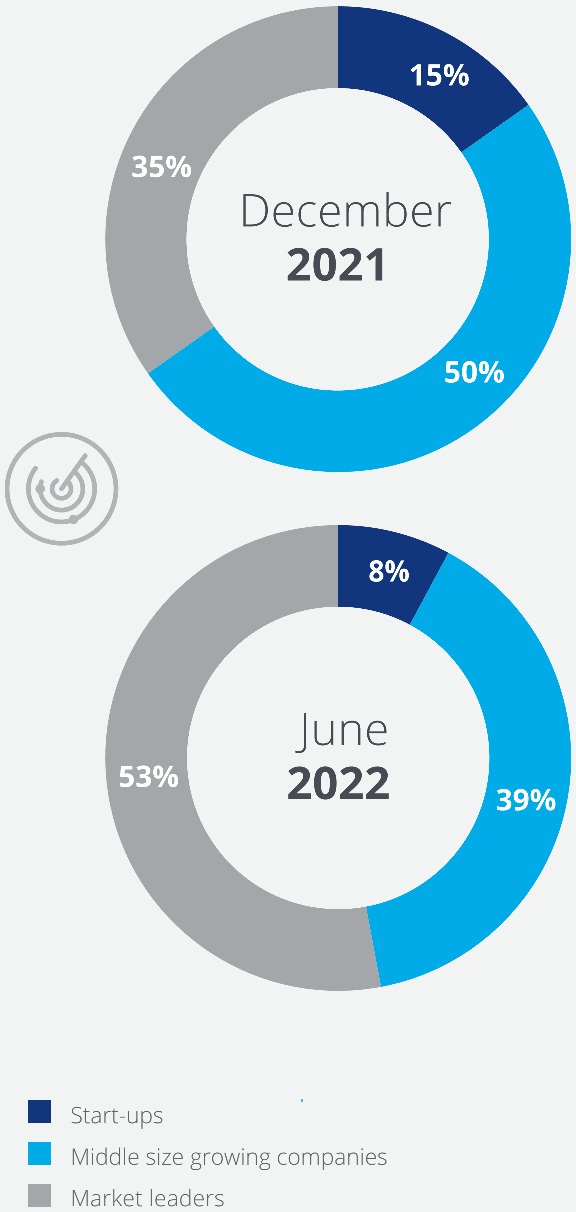
It may be that the sky-high valuations of start-ups globally with a growing number of unicorns was driving interest in less established companies, though the reversing of those valuations combined with an uncertain backdrop are catalysing more defensive investing preferences.

Though start-ups aren't currently expected to be hugely competitive, it is the case that a number from CE go on to become unicorns. In January VC heavyweights Sequoia Capital and Fidelity Investments led a €628m round for Estonia-based ride-hailing business Bolt. The deal valued the business at €7.4bn.

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



Competition for new investments (December 2021 vs June 2022)



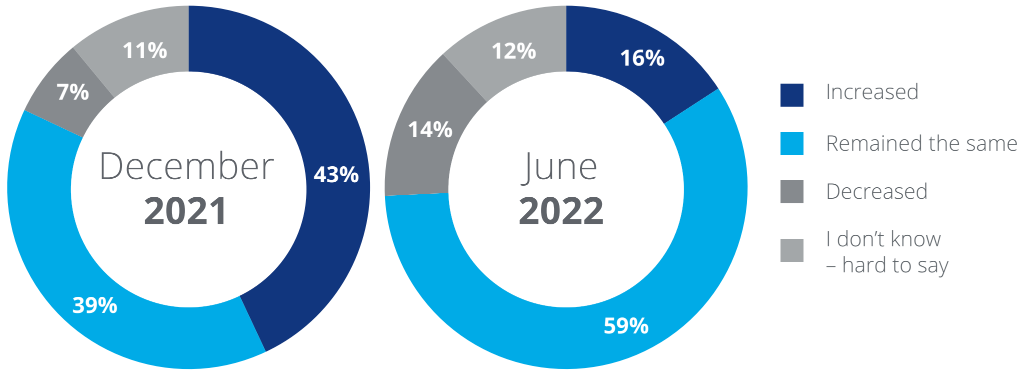
Vendor pricing

Valuations have been cooling and are set to cool further, with 14% of respondents feeling vendors have decreased their price expectations over the last six months, double last Survey's response of 7%, and a staggering 65% believe they will continue to do so. Only a fifth (20%) feel they will remain the same.

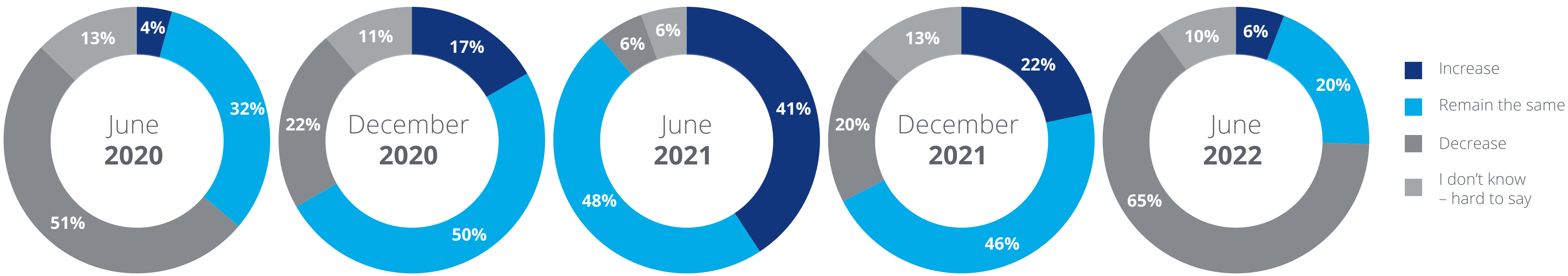
The figures indicate an acceleration of trends already hinted at in our last Survey, despite the fact the war in Ukraine had not yet begun.

There is a small proportion (6%) who feel prices will rise; this may be the fact that a defensive investment strategy favoring established market leaders (see slide 13) may lead to steep competition for the best deals and so intermediated processes may see those assets go for full prices.

Relative to 6 months ago, vendor pricing expectations have:



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



Ukraine War Sentiment

Ukraine war sentiment

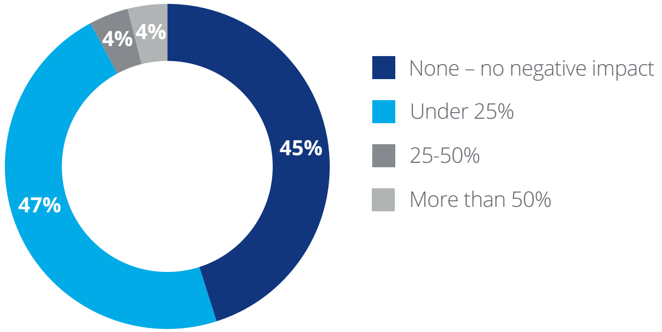
In light of recent events, we asked the CE PE community about its thoughts on the impact of the war in Ukraine on the industry. While it is clear it will affect deal-doing and exits, nearly half of respondents (45%) said there was no negative impact on their existing portfolios, and 47% felt that less than a quarter of their portfolios were severely impacted. Only 4% report over half their portfolio is severely impacted.

Perhaps unsurprisingly, sponsors will work with companies for longer in light of the current situation, with nearly three quarters (73%) expecting hold periods to increase.

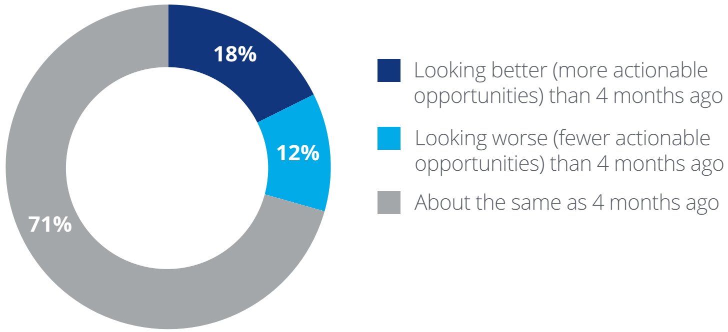
Pipelines are robust, with over two-thirds (71%) feeling the work-in-progress is roughly the same as four months ago and nearly a fifth (18%) feeling it has actually improved. Only 12% feel there are fewer actionable opportunities since the war commenced.

Half of respondents expect the best opportunities to come from family business they're already building relationships with casting a bright light on the importance of origination. Over a quarter expect to find fresh opportunities as they look to cast their sourcing nets wider over the coming months.

What percent of your existing portfolio is severely impacted by the war?

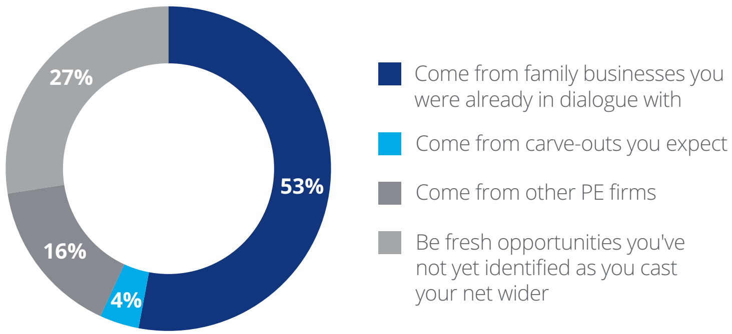


Is your deal pipeline:

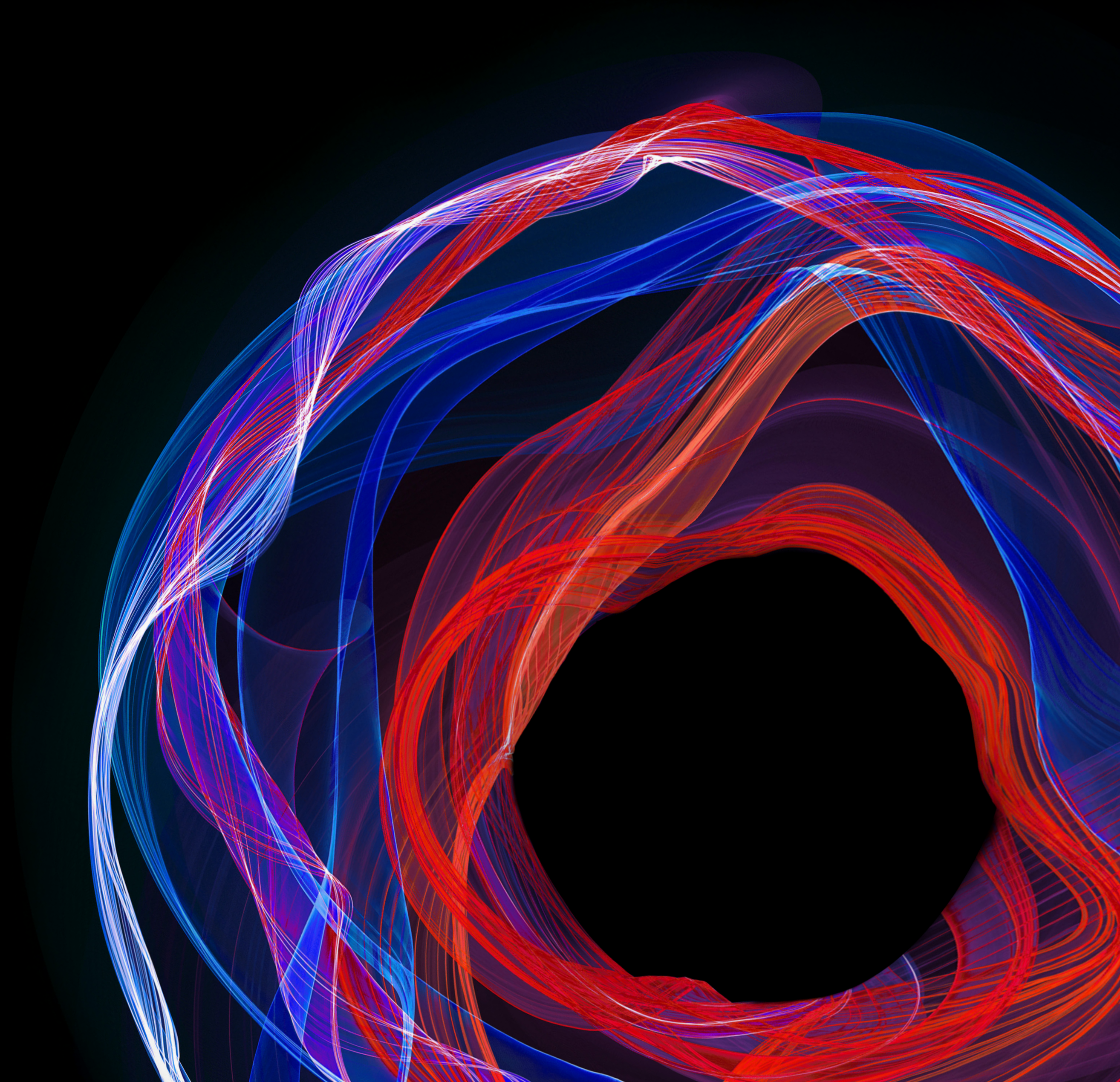


On average, do you expect hold periods for portfolio companies to increase due to the impact of the war in Ukraine?

Will the best opportunities now:



Sustainability and Technology



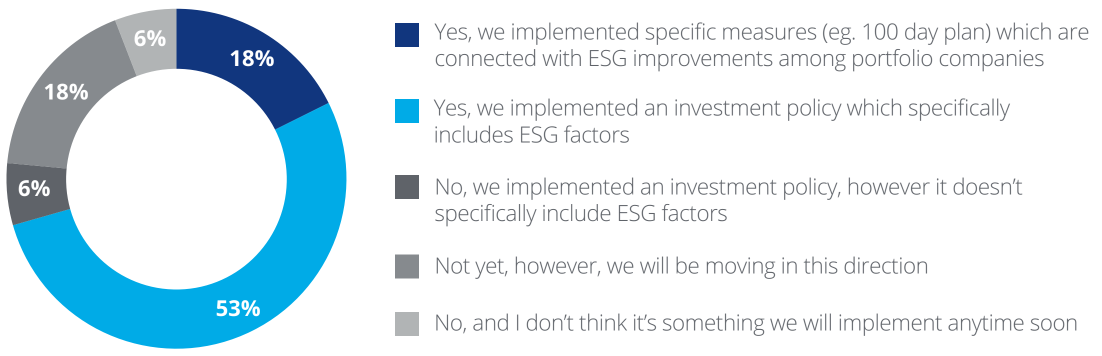
Sustainability & ESG agenda

ESG has gone from a nice-to-have to a must-have for nearly all LPs according to a recent survey. Over half of our respondents (53%) have implemented an investment policy which specifically includes ESG factors, compared to 30% in the previous survey. This is a positive step and we expect to see the percentage grow further as much of the erstwhile advisory guidance around sustainability becomes regulation at the EU and national levels.

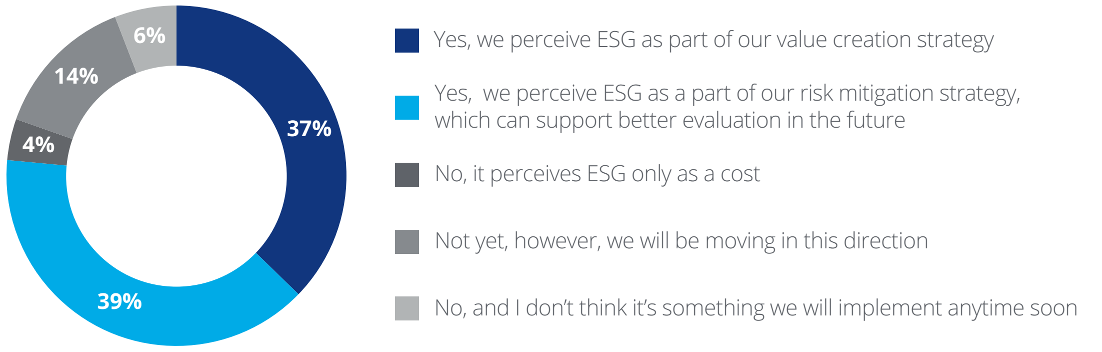
Our respondents are split on considering ESG risk mitigation or value creation, with 37% actively deeming it a value driver, and 39% regarding it as risk mitigation and evaluation. We expect more GPs to embrace ESG as a value creation driver in the coming years as we see sponsors embrace this in the UK and Western Europe. We are surprised that a tenth of respondents still deem ESG as insignificant.

While it is encouraging to see a growing number of PE deal doers in CE embracing ESG, only 13.7% have formally implemented decarbonization targets. With carbon-neutral giving way to net-zero and now science-based targets the gold standard for ESG, we expect more in the CE space to look towards these goals – they make business sense and are now being enshrined in regulation. These targets will be fore PE firms themselves as well as their portfolio companies.

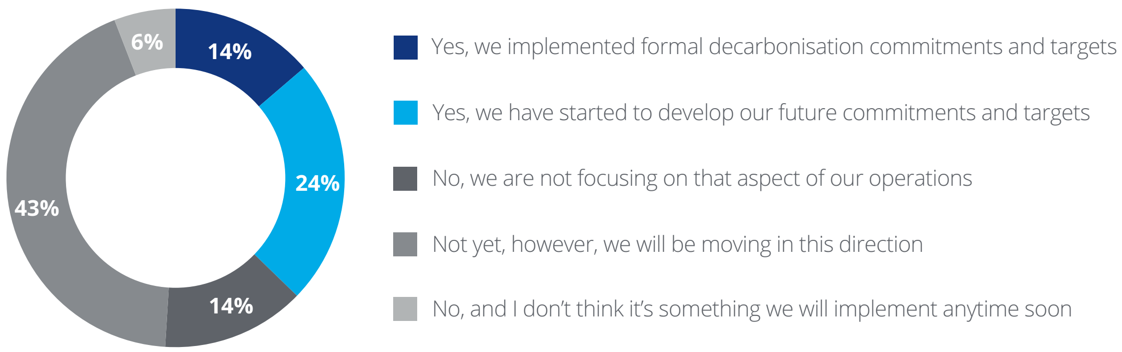
Has your fund implemented a formal investment policy which incorporates ESG (E-environmental, S-social, G-governance) and sustainability factors as part of investment decision considerations?



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



Has your fund made any commitments towards climate neutrality?



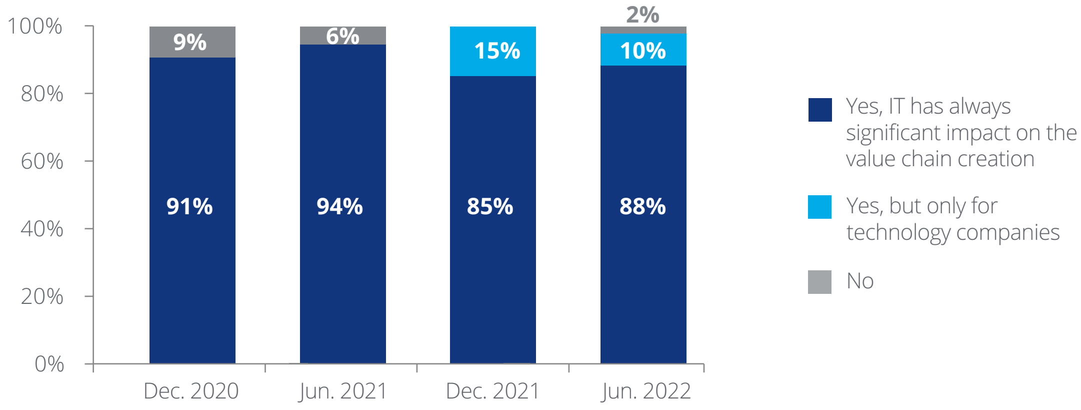
Technology

Most of Deloitte's Central Europe Private Equity Confidence Survey responders have no doubts that technology can be used as a value creation lever, and only 10% think that this statement concerns only technology companies.

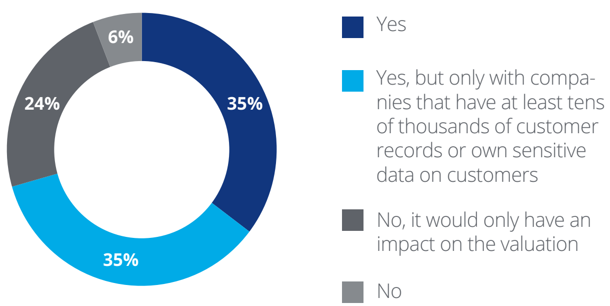
IT, being a subset of Technology assets in the organization, is even more important. Only 2% of respondents believe that their business is able to function with only limited IT back-office support. Investments in the IT area (resulting in savings and increasing reliability) should have a positive impact on the financial results and operations of portfolio companies.

A data breach is widely regarded as a very serious matter, with a significant majority (70%) regarding it as a deal breaker (35% outright and 35% depending on the volume or sensitivity of data breached). A quarter (24%) suggest it would only impact on valuation and not kill negotiations. With ever-more diligence in this area and cyber security a big concern, it is clear businesses must embrace this area with real seriousness.

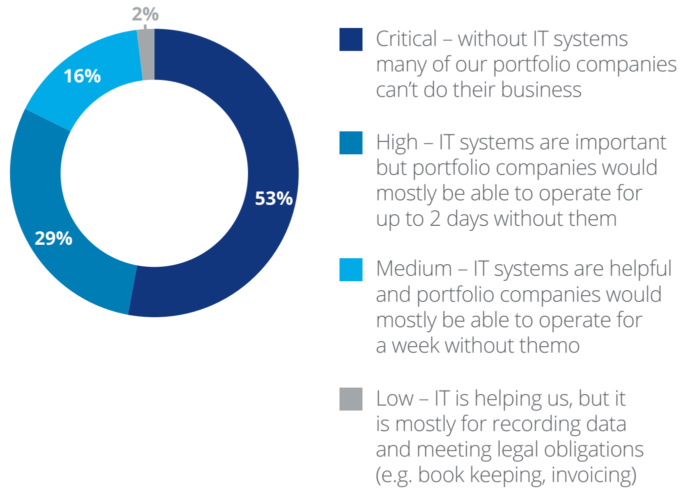
Do you believe that IT capabilities of a portfolio company can be used as a value creation lever?



Would a data breach involving customer information (e.g. hackers getting into a client's database) that you discovered during cyber due diligence be something that you would consider a deal breaker?



What is the current impact of the reliability of IT systems on the business of portfolio companies?



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