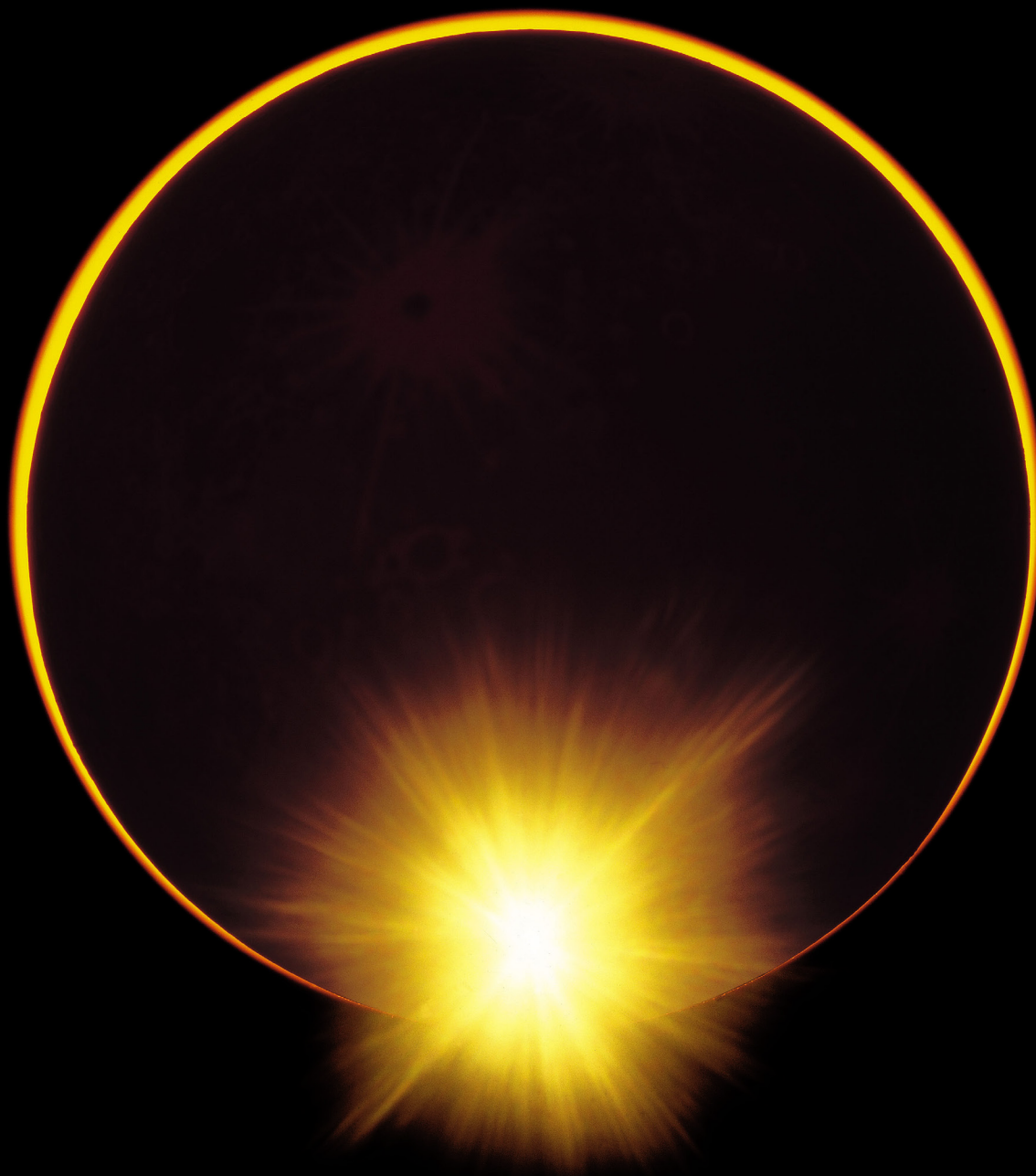


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Great Expectations

Private Equity Confidence Survey

Central Europe

May 2017

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Introduction



Mark Jung

Partner, Private Equity Leader
Deloitte Central Europe

The Central European (CE) private equity (PE) market is set for a resurgence, according to our 29th survey on confidence in the region's PE markets. The Index itself reflects this, with a gentle increase to 113 in this latest survey.

The mood has shifted among CE PE deal-doers, from stability and resilience in the midst of uncertainty last autumn, to more optimistic and deal-hungry now. Nearly half of respondents expect an activity uptick, up from just a third on the last survey. Perhaps unsurprisingly then, more than two-thirds of respondents (70%) intend to focus mostly on new deals over the coming semester.

This enthusiasm is mirrored in economic expectations, with more optimists and fewer pessimists than in the last survey. Indeed GDP growth in the region accelerated between Q3 and Q4 2016, and is expected to continue to improve this year, so the sentiment may be well founded.

These results are particularly inspiring given the timing of this survey: we canvassed opinions just days before British prime minister Theresa May triggered Article 50 to formally begin the withdrawal process from the EU. It now seems that last June's surprise Referendum result caused a pause rather than long-term paralysis from investors. Indeed PE deal activity recovered between Q4 2016 and Q1 2017 in wider Europe¹, from €9.3bn to €17.2bn, with Britain (surprisingly) leading the recovery. In fact the deals in CE since then have been a mixture of the mid-market – long the driver of activity in CE PE – as well as some large deals, such as the \$3.25bn buyout of Allegro by Mid Europa, Cinven and Permira, as well as Mid Europa's €533m buyout of Profi in November.

This healthy appetite for new deals may be caused by GPs looking to deploy freshly filling coffers. A number of the region's deal-doers are on the fundraising trail right now, with closes expected later this year. Arx, Abris, Equitin and Resource Partners are all investing from new vehicles which held first closes in the last nine months, while a number should announce first closes later this year, namely CEE Equity, Mezzanine Management and Value4Capital. MCI has launched its debut fund, seeking \$500m for debt investments; Genesis held a final close last year.

Another reason expectations for dealflow are up may be down to a gentle uplift since the beginning of the year in the value of the zloty. A stronger currency in CE's largest market can make foreign acquisitions less expensive, such as Arx Equity's deal with Danone to carve-out its Czech asset Nutricia Deva at the end of January.

Some high-profile exits could convince investors to take another look at CE, namely two supermarket chains in recent months. The sale of Zabka by Mid Europa is one of Poland's largest-ever PE exits, while Enterprise floated Dino on the Warsaw exchange valuing the business at PLN 1.65bn – and the stock saw its share price increase by 8.5% on the first day of trading.

We are encouraged by the healthy mix of deals and exits over the last few months, and look forward to continuing to work with CE deal doers to identify opportunities and build local businesses.

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¹ CMBOR Q1 2017 preliminary data, supported by Equistone Partners Europe and Investec Specialist Bank

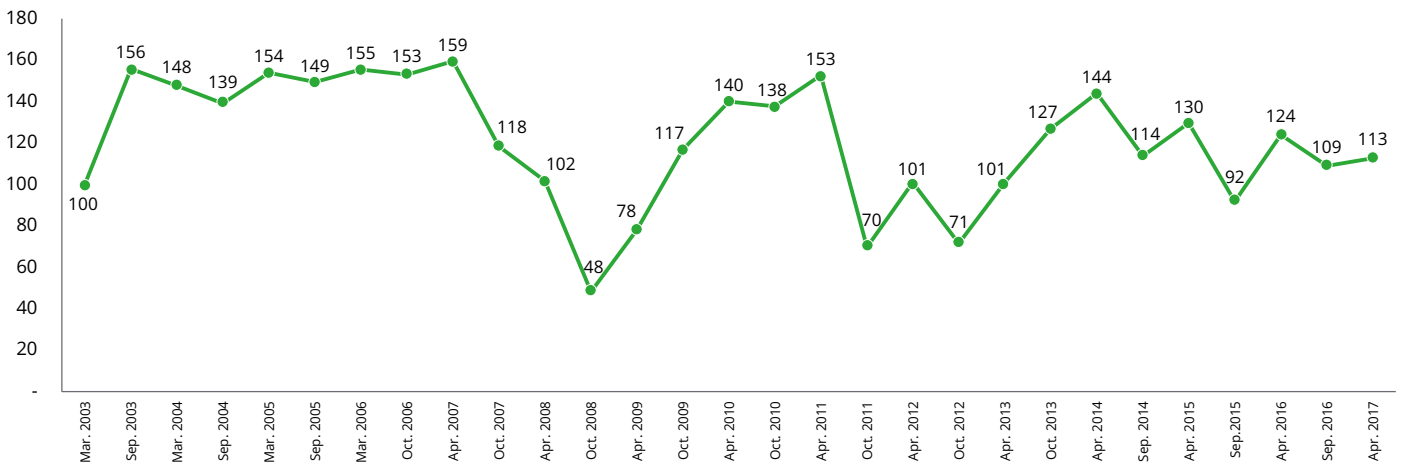
Central European Private Equity Index: Key findings

There are great expectations of increased activity in CE's PE landscape, with the Index gaining some momentum lost during the last survey. This is backed up by a number of factors. Nearly half of respondents (47%) expect an uptick, up from a third six months ago and the highest level recorded since 2011. This optimism may be mirroring recent activity, with a higher-than-usual number of €100m+ EV deals in the last year; Poland's largest-ever PE deal (Allegro); a large number of fund announcements, and liquid debt markets. The dealflow should continue apace: 63% of respondents expect to buy more than they sell in the coming months, the strongest appetite for buying since 2011, and 70% expect to focus mostly on buying in the coming months.

This activity is on the back of stable economies, with a doubling of those expecting an improvement (16%) and a shrinkage by two-thirds of those expecting a deterioration (10%) in the region's economic backdrop. Three quarters (74%) expect the climate to remain the same, up from less than two thirds (63%) last time.

Mindsets continue to shift as regards which segments are most competitive. Market leaders, long deemed the most competitive, continue to rank highly, but are losing ground to middle-sized growing companies, with 42% expecting this segment to attract the highest competition for investment. This is more than double last survey's 20%.

Central Europe PE Confidence Index

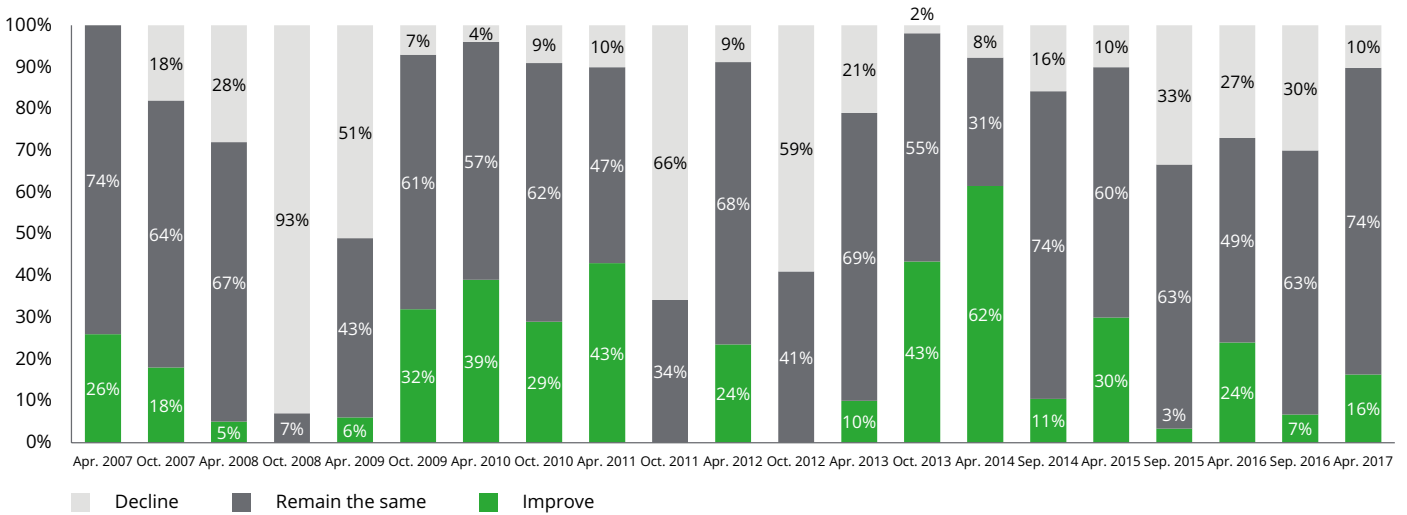


The Index has regained some of its fall witnessed in the last survey to end on 113, up gently over the last six months. A confluence of factors has led to the increase in confidence.

Survey Results

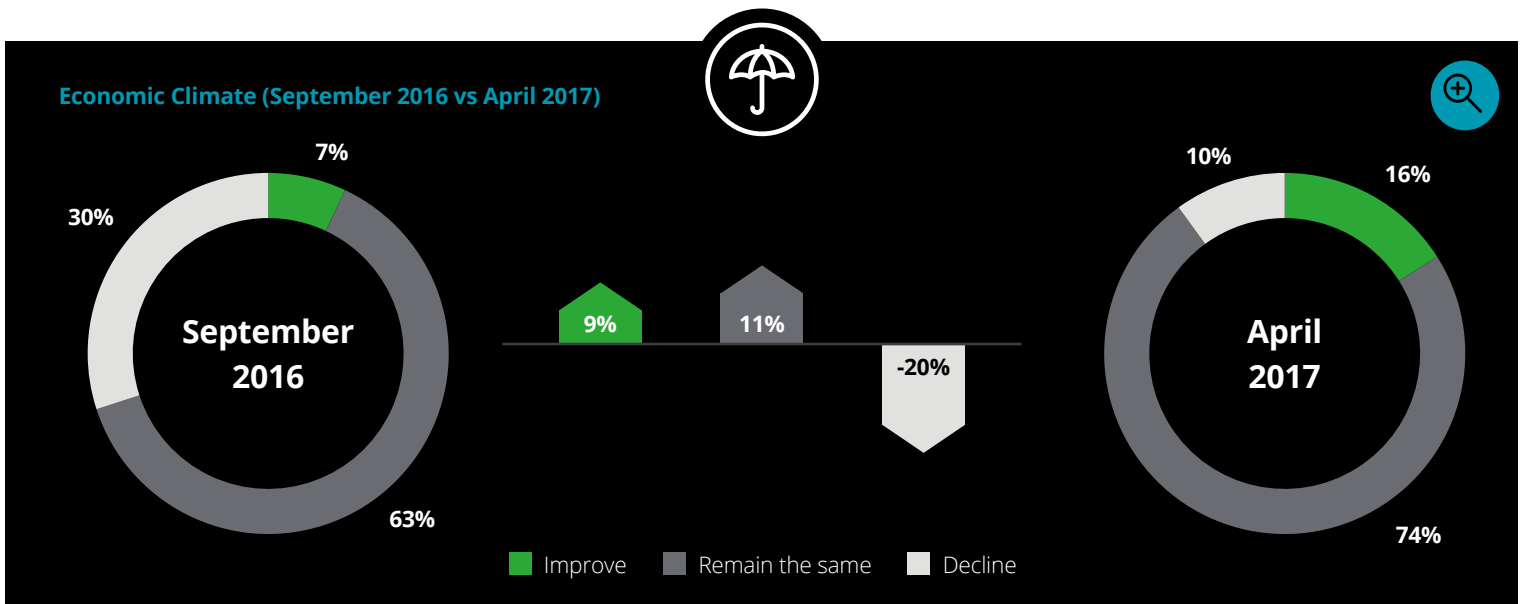
Economic Climate

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



Economic performance begets confidence, and CE's recent improvement in GDP growth is reflected in optimism, with a doubling of those expecting an improvement (16%) and a shrinkage by two-thirds of those expecting a deterioration (10%) in the region's economic backdrop. Three quarters (74%) expect the climate to remain the same, up from less than two thirds (63%) last time.

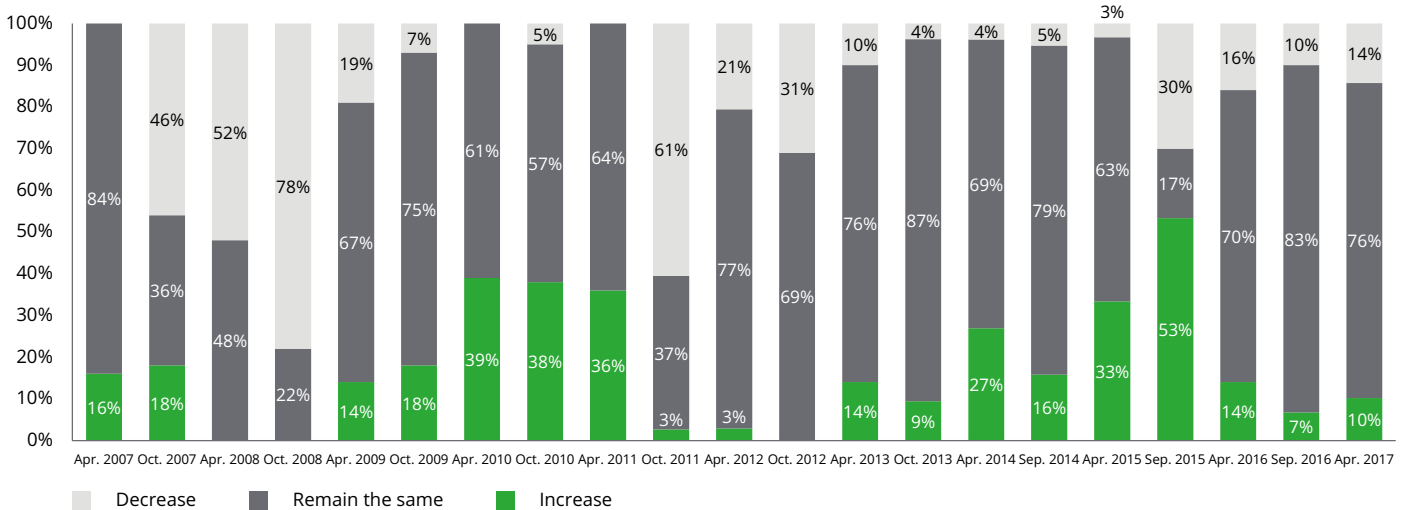
Tight labour markets and easy monetary policies have helped boost momentum, with the acceleration of GDP growth evident in Q4, from 2.6% to 2.8% annually. This is expected to continue and to reach 3.0% for Q1². A recovery from a 'Brexit bump' cannot entirely explain things – this survey was conducted just days before British prime minister Theresa May triggered Article 50 – so a number of the region's macro policies may be bearing fruit.



² <http://www.focus-economics.com/regions/central-and-eastern-europe>

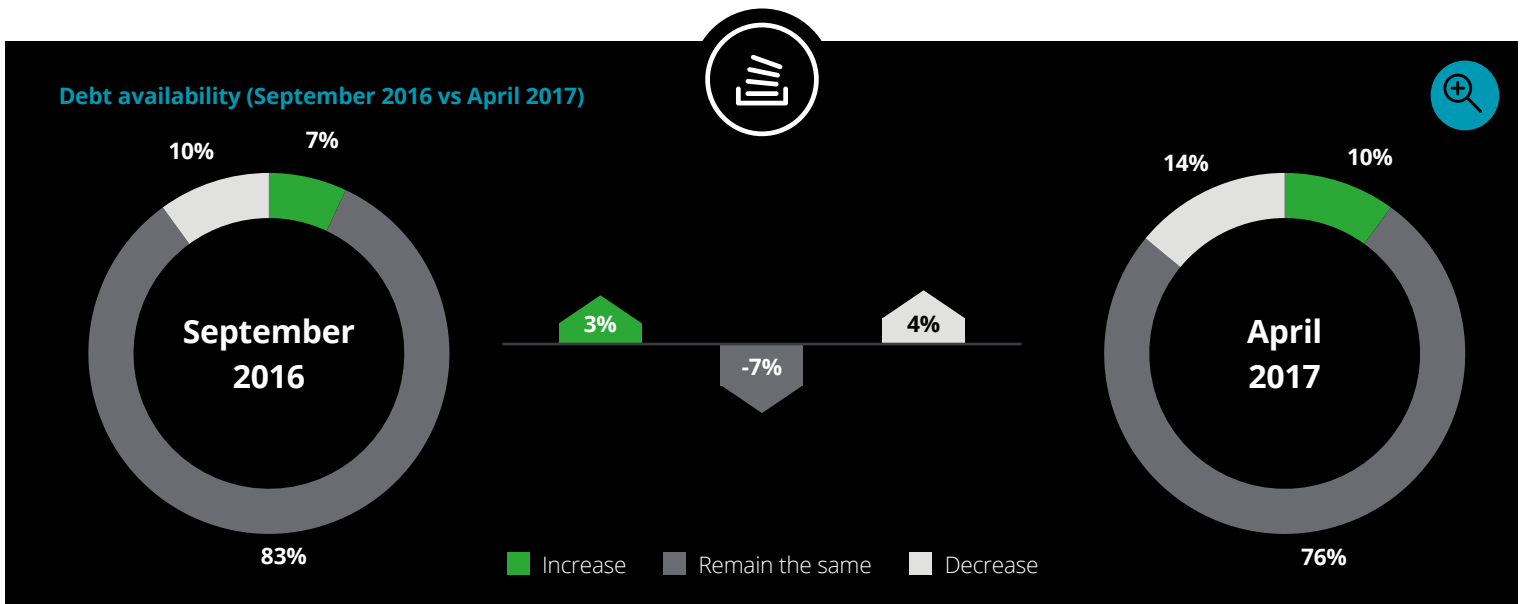
Debt availability

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



Perceptions of liquidity remain high for CE PE, with a tenth expecting debt availability to increase over the coming six months, up from 7% last survey. Three-quarters expect the backdrop to be maintained, roughly in line with sentiment over the last five years.

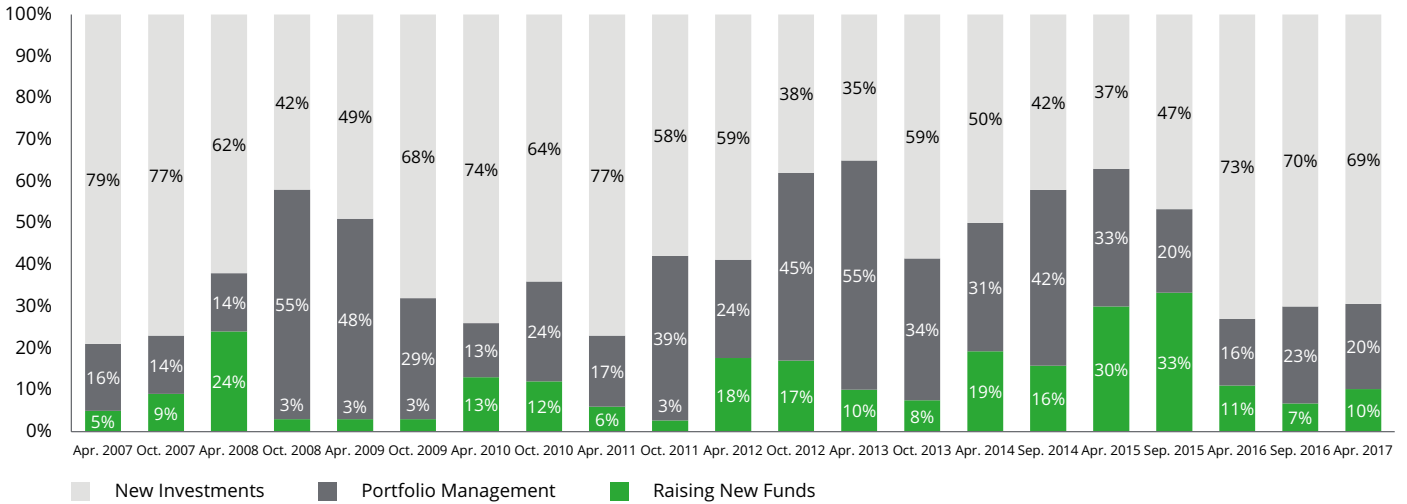
Statistics on European leverage suggest conditions are as liquid as the heyday, with lighter documentation and reverse flex (downward pricing so that lenders can compete) very much the norm now, driving European loan issuance to be the highest since 2008 with a total of €71bn recorded for 2016 – a 15% uptick on 2015, despite Brexit³.



³ Marlborough Partners Quarterly Snapshot 2017.

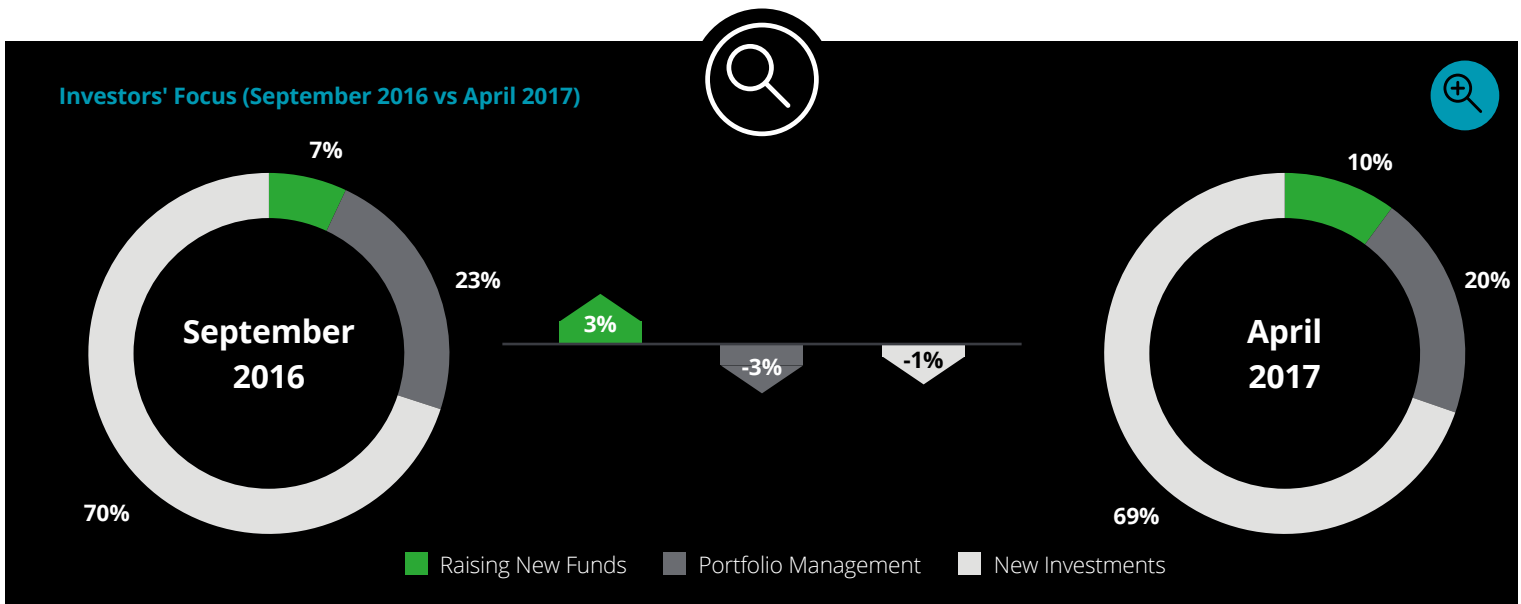
Investors' Focus

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



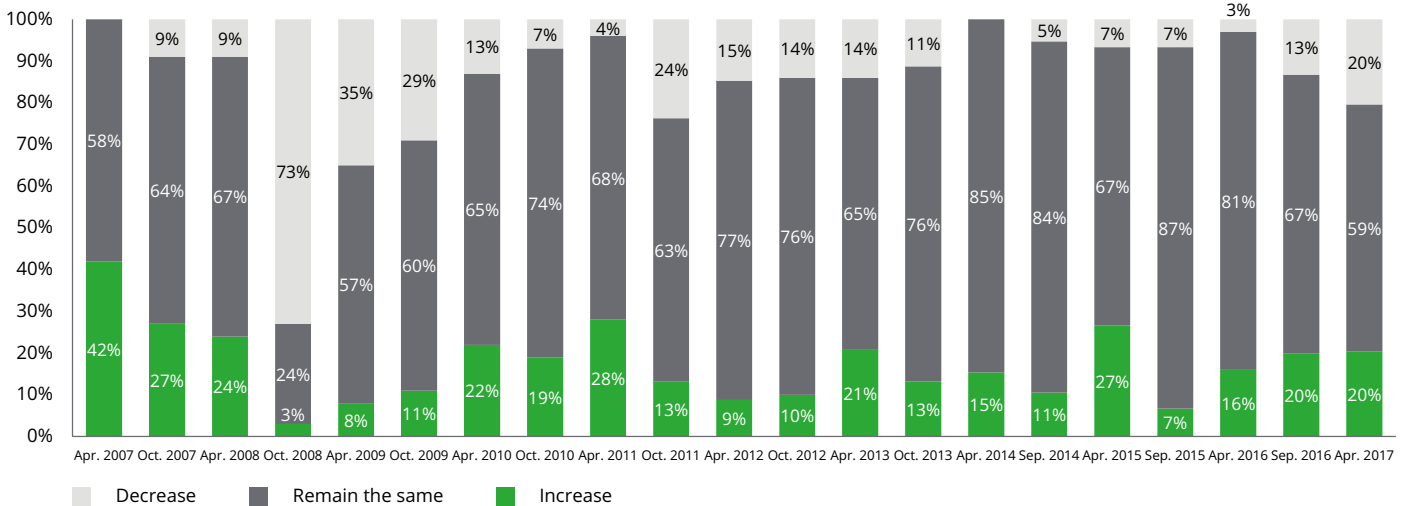
Deal hunger persists, with 70% intending to focus mostly on this over the coming semester. This marks an 18-month-long spell of strong appetite for deploying capital, underlining respondents' belief in the region's prospects for this vintage.

A fifth expect to focus on portfolio management and a tenth on fundraising; both roughly in line with last autumn's survey. Indeed a number of local GPs are on the fundraising trail now. Fundraising is oft-cited as the region's largest challenge, though some recent headline exits – namely Zabka, Profi and Dino may convince institutional investors to take another look at CE PE.

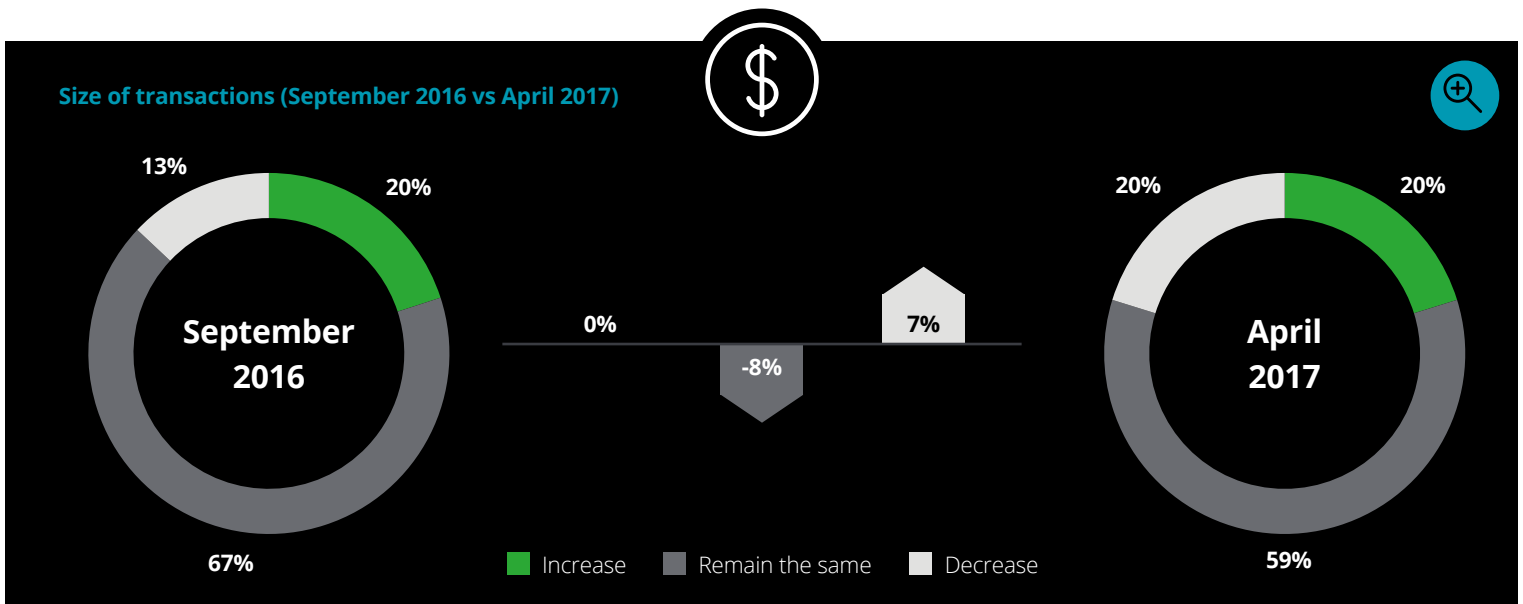


Size of transactions

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

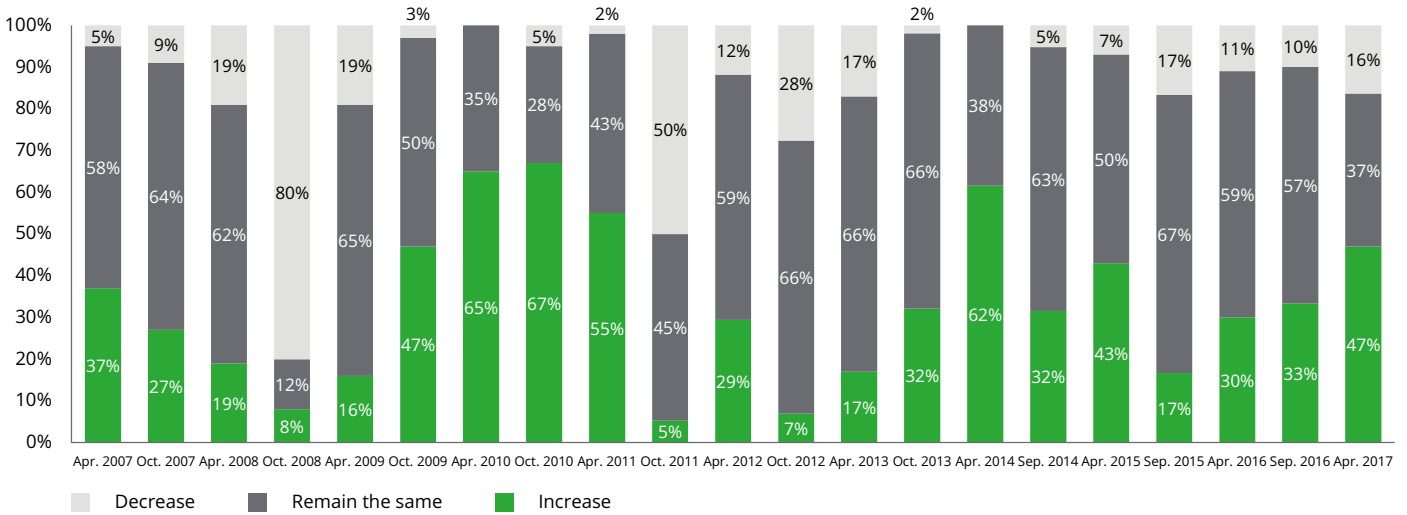


Average deal sizes may be changing, according to two-fifths of respondents (40%), although they are split evenly as to whether this will be upwards or downwards. Though the majority (approx. 60%) still expect averages to remain steady, this proportion is in line with the 2009 survey results, and the lowest levels recorded by the survey since the financial crisis.



Market Activity

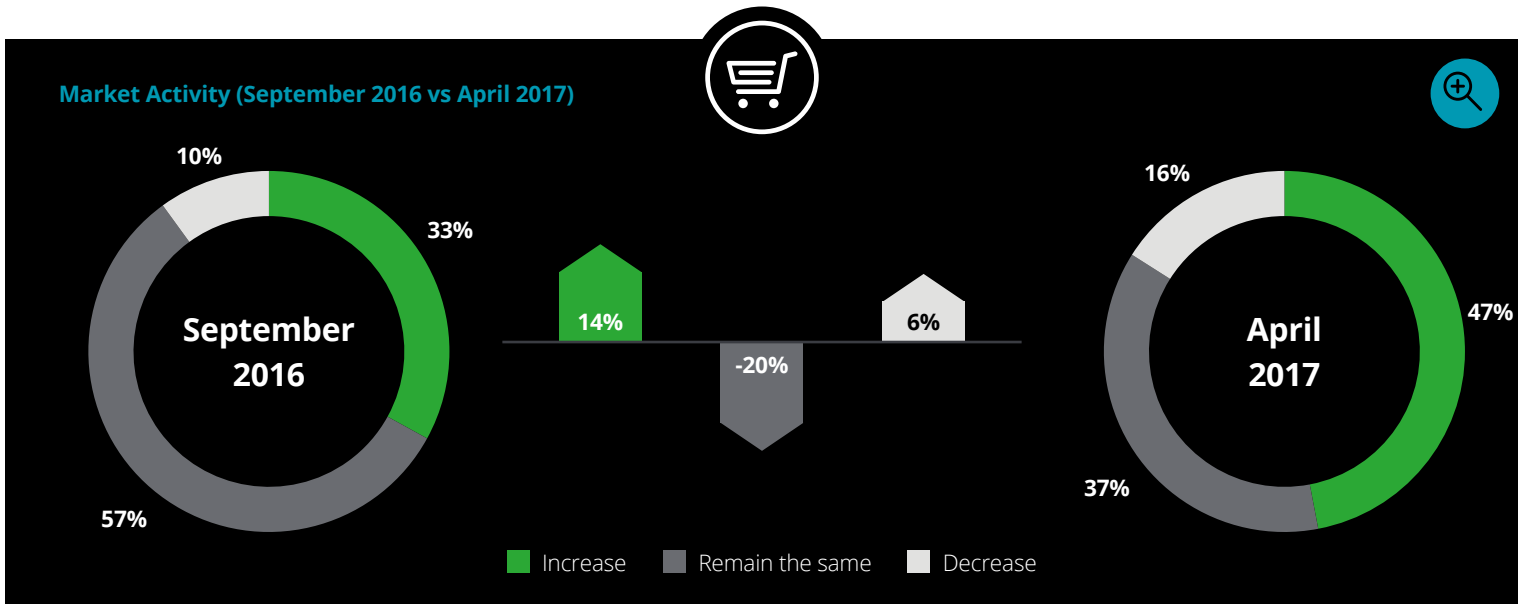
For this period, I expect the overall market activity to:



Activity may be about to increase, with nearly half of respondents (47%) expecting an uptick, up from just a third last survey.

This may be connected to the current high levels of liquidity in the market, enabling buyout houses to finance deals efficiently and thus present more compelling bids in processes.

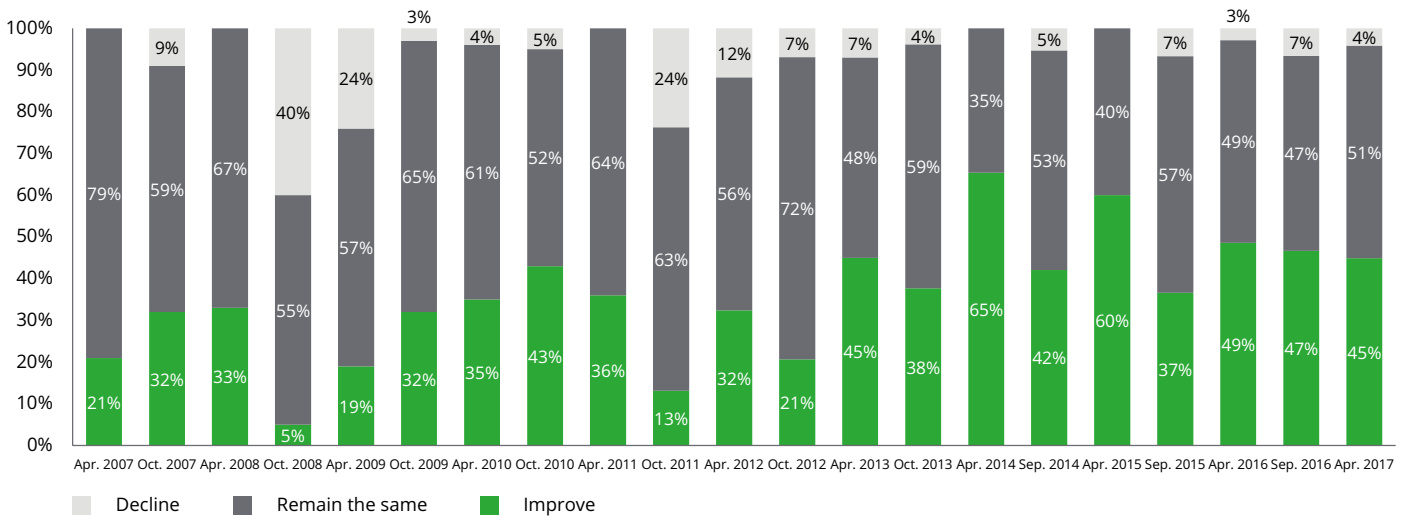
The CE region did experience a renaissance of deals in 2016, with a handful of large deals cause a spike in Q4 2016 values. This led the region to record a healthy 2016 overall, even as European deal value (including the UK) plummeted, with year-on-year activity down 38% from €89.7bn in 2015 to €55.7bn in 2016⁴.



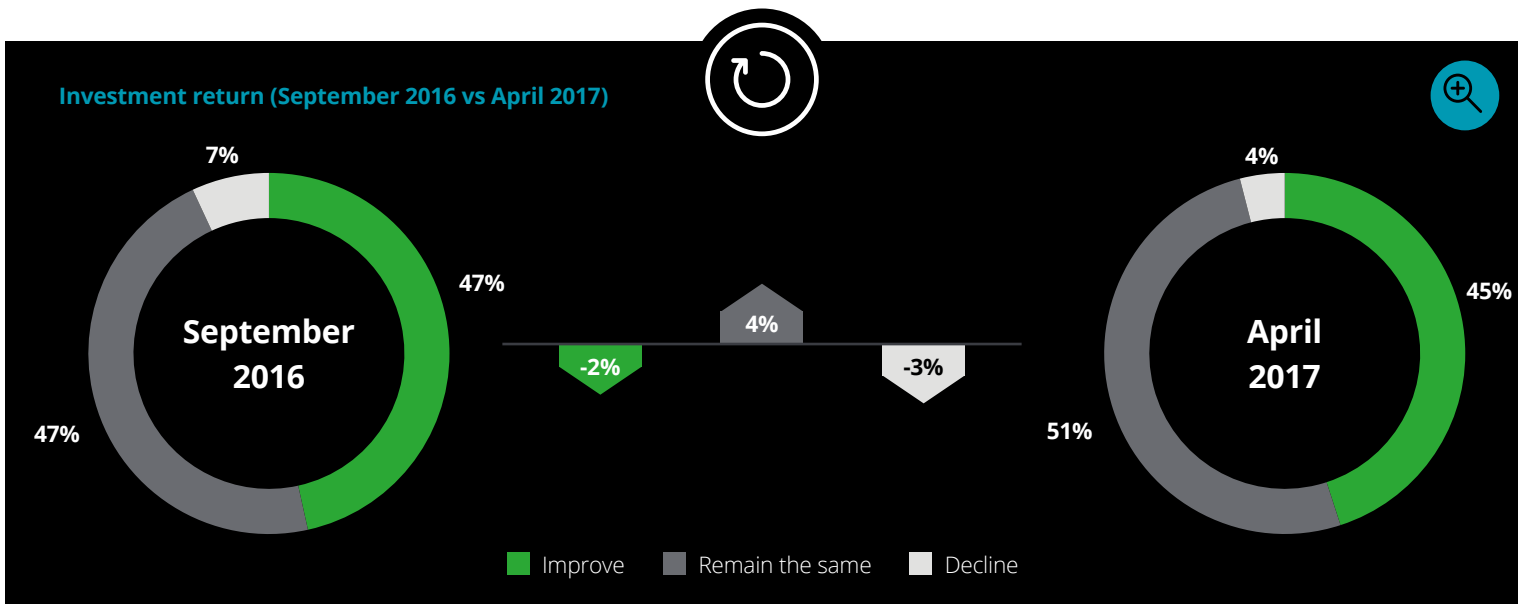
⁴ CMBOR data, supported by Equistone Partners Europe and Investec Specialist Bank

Investment return

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

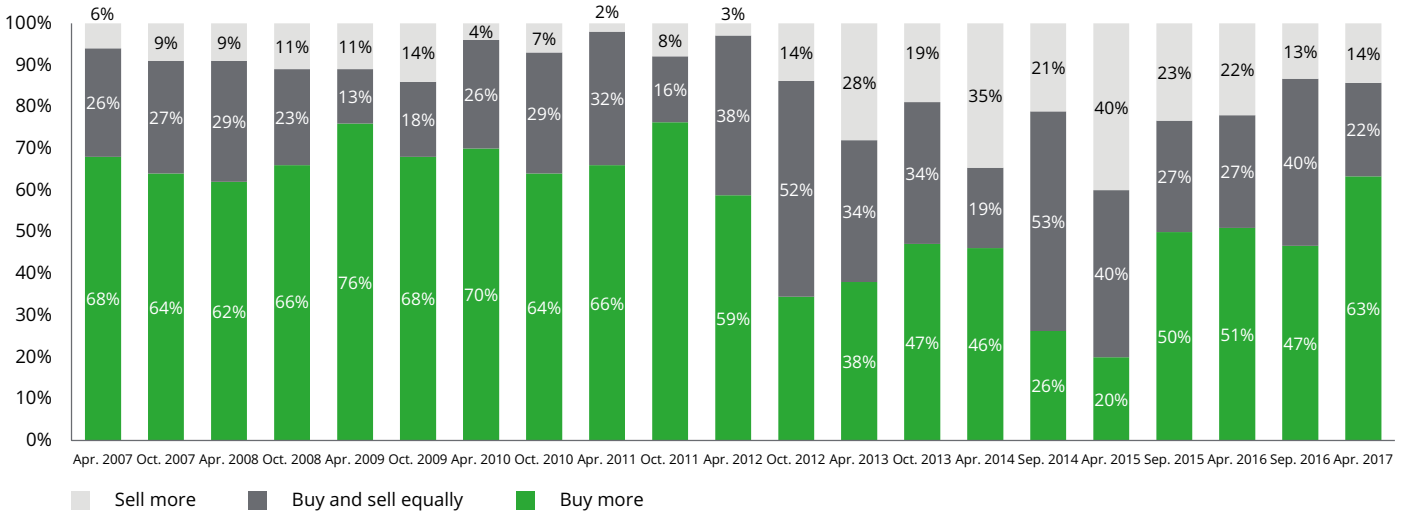


Financial efficiency of investments is expected to remain the same, as has been the case for the last year, with half of respondents (50%) expecting no change. 45% expect an improvement, flat on last survey's 47%, while the small remainder expect a decline.



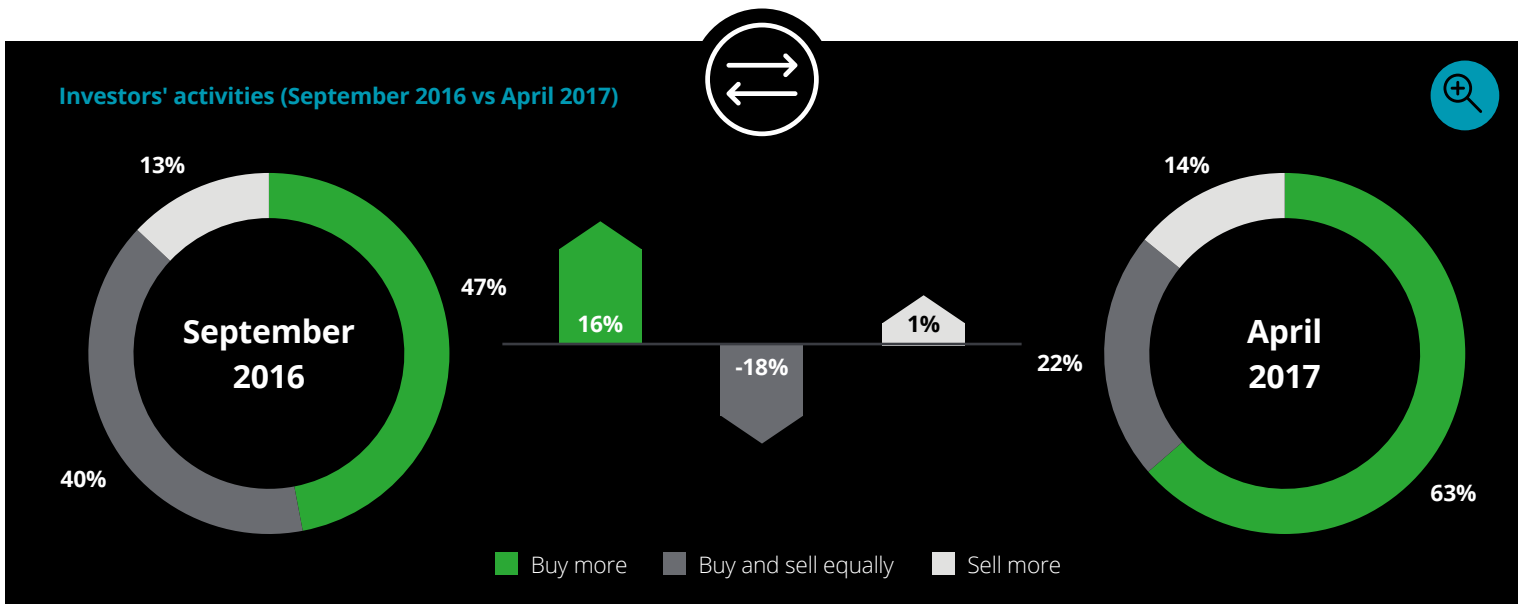
Investors' activities

For this period, I expect to:



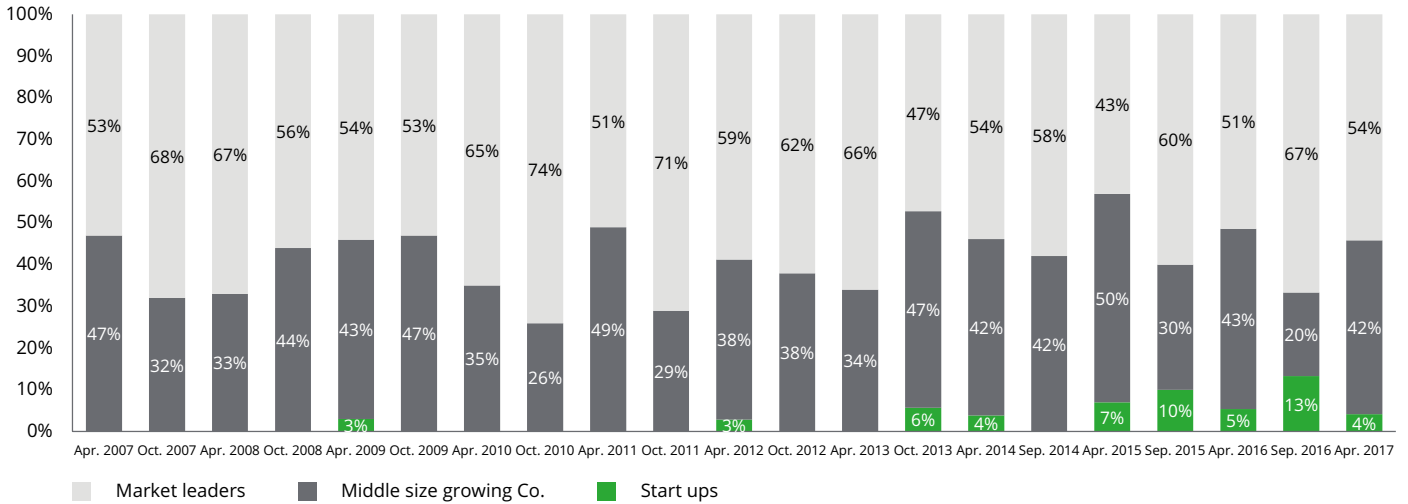
There is a firm focus on deploying capital in the coming months, with 63% of respondents expecting to buy more than they sell, the strongest appetite for buying since 2011. This may be down to a perceived opportunity in the liquidity window, as well as confidence the economic backdrop is conducive to supporting a buyer's market.

There could also be an adjustment of pricing: this survey, just a fifth (22%) expect to buy and sell equally, half last survey's result (40%).



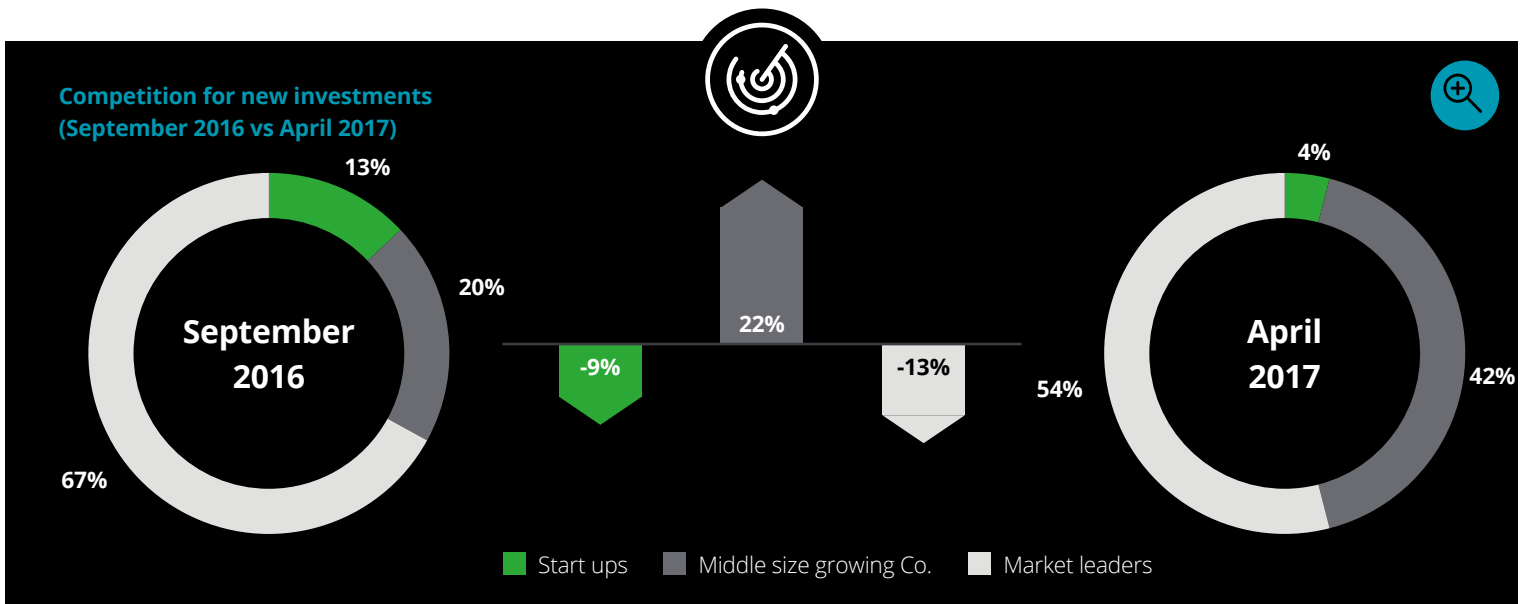
Competition for new investments

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



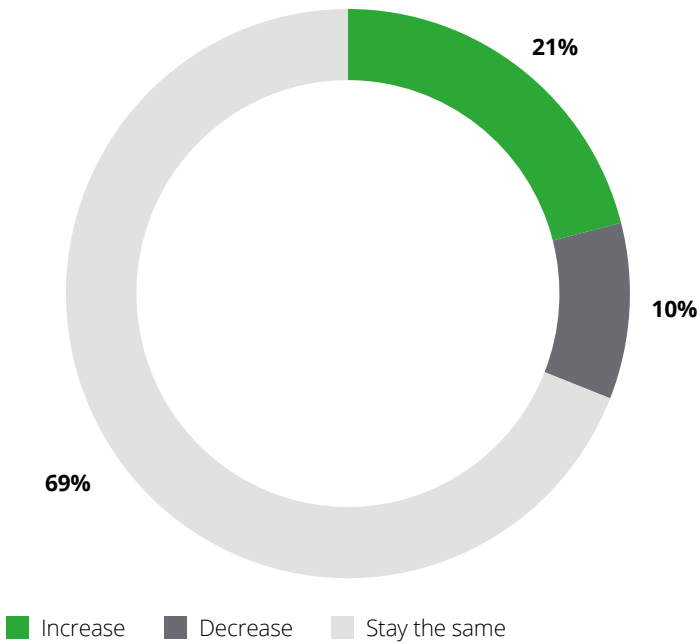
The mid-market is hotting up in CE, with 42% of respondents expecting middle-sized growing companies to attract the highest competition for investment. This is more than double last survey's 20%, with market leaders accounting for much of the drop. They still account for the lion's share, with 54%, and have only ever twice not been the firm favourite.

Following a small and brief surge over the last couple of years, start-ups remain the least competitive, with just 4% believing competition for these assets would be highest.



Entry Multiples

Over the next 12 months, we expect entry multiples on transactions to:

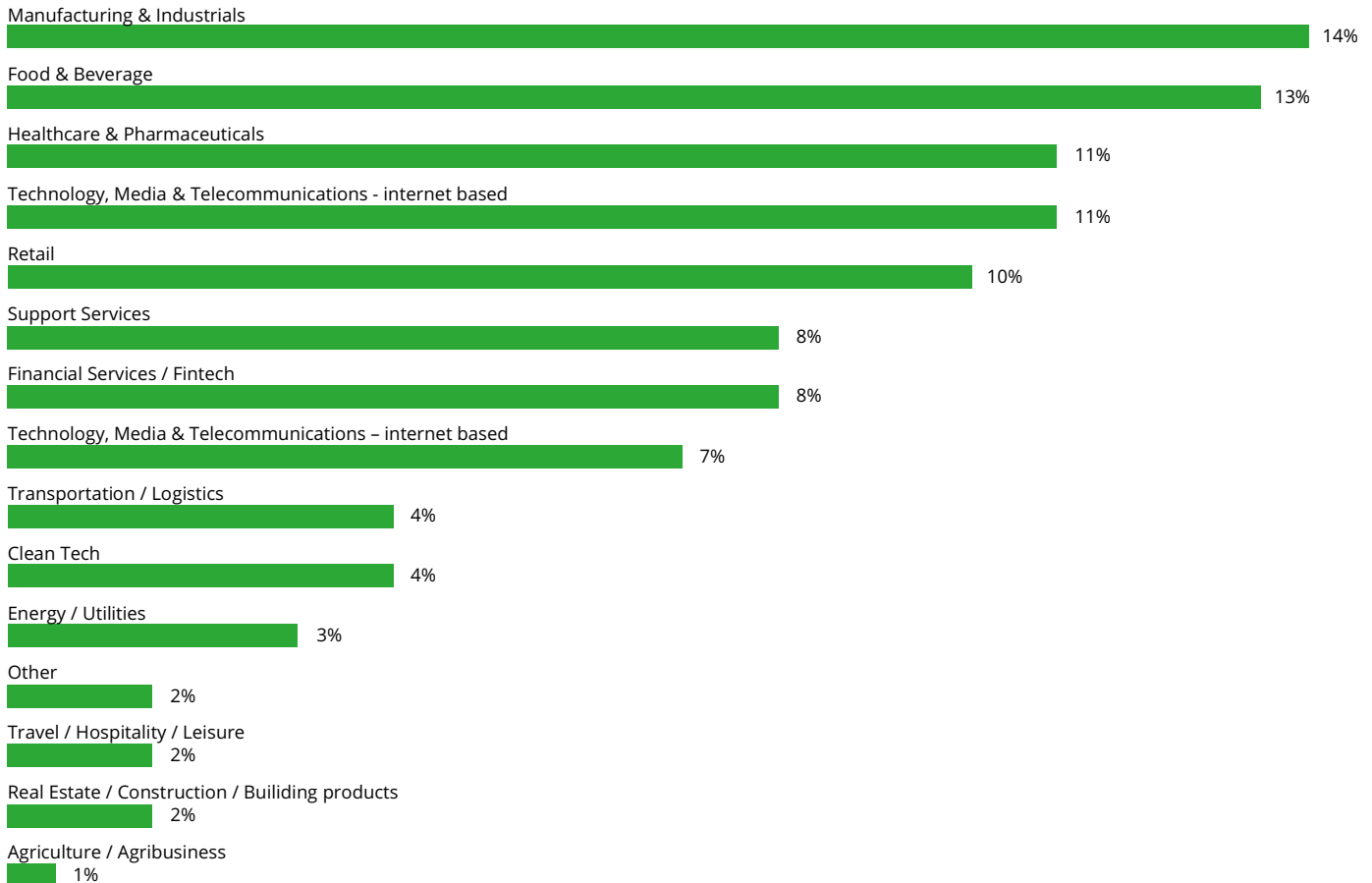


Private equity firms overwhelmingly expect entry multiples on transactions to remain the same. A fifth expect them to increase – which could transpire should liquidity continue to offer inexpensive finance for deals. This may be why there is a clear appetite to do more deals in the coming months too – to try and secure assets before the market sees prices creep up.

Just ten percent expect multiples to decrease.

Sector Focus

In the next 12 months, we expect to focus on opportunities in the following sector(s):



Deal doers are hungry for deals, and they're hungry for food, it would seem, with Food & Beverage one of the most popular sectors for respondents. This may be down to rising disposable incomes and the recent boom in CE consumption levels⁵.

The segment is second only to Manufacturing & Industrials, long a darling of the PE industry globally owing to the (usually) strong heritage and asset-base, which can be handsomely borrowed against. Energy and Utilities, once a big area for investors, is one of the lowest-ranking, likely a sign that these opportunities – largely done during the mass-privatisations – are long gone.

⁵ <http://www.focus-economics.com/regions/central-and-eastern-europe>

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