Deloitte.

From adversity to **Agility**

20 years • Private Equity Confidence Survey

Central Europe

Winter 2022/23

“The market has seen an unusually high number of shocks in just three years, with the post-pandemic recovery giving way to inflation and interest rate rises causing investors to pause and reflect.
In our Survey’s 20 years we have seen that each shock is followed by a rise in confidence, economic conditions, and transacting, so we trust the region’s investors to draw on their experience to help businesses remain resilient and embrace opportunities for sustainable growth in today’s backdrop.”

Dusan Sevc, Deloitte Partner and Private Equity Leader

From adversity to Agility

As our Survey marks its 20-year milestone, we can look back at the decades and see the sentiment peaks and troughs that reflect market conditions. From the 'golden years' of the noughties leading up to the Global Financial Crisis (GFC) and then the recovery that followed, through to the coronavirus pandemic and its aftermath, it's clear the Deloitte Central European (CE) Private Equity (PE) Confidence Index has acted as a strong barometer not only of sentiment, but ultimately of market activity.

We can thus be hopeful that the latest increase, however small, may mark the start of an upturn as we've seen following each drop. Launched in 2003, our Survey missed the dotcom bust, but captured the heady days that followed and ultimately led to strong vintages. The last three years have brought unprecedented uncertainty, with a pandemic giving way to the war in Ukraine, however over 80% of our respondents now feel 2023 will prove a strong vintage.

The CE PE market is now very experienced in building businesses and creating resilience amidst difficult times. Unlike the GFC, the region is now populated by investors adept at amending plans to navigate change, and businesses are now leaner and more agile, having pivoted to survive in the last three years. It may mean they are better placed to weather the current storm, and PE backers are in a strong position to help them grow. Eurosystem projects that a recession in Europe would be relatively short-lived and shallow.

Indeed the Index's shift is accompanied by a belief that pipelines are improving, with two-fifths of respondents seeing more actionable opportunities now than in our Summer 2022 Survey. It may be that softening prices are enticing prospective buyers, with nearly half of respondents feeling prices have softened in H2 2022 and two-thirds (64%) expecting them to come down in H1 2023. While our experience suggests the strongest assets will always command a premium, we do feel we are entering a buyers' market.

It is encouraging to see a growing number of PE deal doers in CE embracing ESG, with over a fifth having implemented decarbonization commitments and targets, and another two-fifths starting to develop them. Additionally, the majority of deal doers now see ESG as a value creation tool for portfolios, a big shift from our last Survey. Initially much of the ESG agenda was driven by institutional investors globally using their sway to influence decisions. We see evidence that many GPs in CE are embracing this more organically now, with a number employing ESG professionals and consultancies in 2022 as yesterday's guidance becomes today's legislation. A swathe of fund launches in 2022 will have helped push the envelope in this important space, even as inflationary pressures and the energy crisis can put pressure on certain aspects of ESG decision making.

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

2023 should be a good vintage for private equity investment in Central Europe. Over 80% of respondents are confident the year will prove a good vintage for investments, and pipelines are improving, with a more than doubling of respondents seeing more actionable opportunities now (41%) than in our Summer Survey (18%). While 40% of respondents will await a more favorable backdrop to launch sales processes, the majority of processes underway (57%) remain so in today's market.

Vendors' price expectations may be coming down, with nearly half of respondents (45%) feeling they've decreased in H2 2022 and nearly two-thirds (64%) expecting them to decrease in H1 2023. The expectations for the first half of this year are the same as our Summer Survey, pointing to consistency in sentiment on how valuations may play out this year.

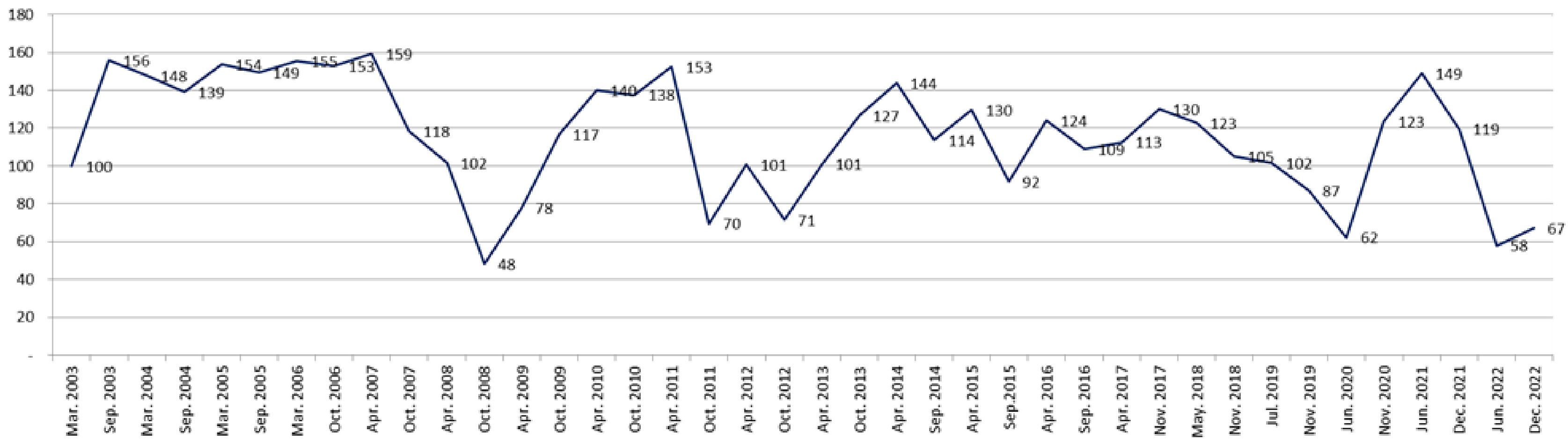
Two-fifths of deal doers are looking more to credit funds and non-bank lenders as they find leverage more difficult to secure for deals, while just over a third (35%) have experienced no change in leverage availability. Nearly a fifth (17%) report needing more lenders now for a deal.

The Index's steep decline has been arrested, recording a gentle but crucial increase following 12 months of freefall as dramatic as the post-Global Financial Crisis (GFC) period. Many of the region's deal doers are drawing on experience gleaned across numerous cycles and so recognize the conditions necessary for successful transacting. This may be why we are seeing optimism despite ongoing adversity in the global economy. Landing at 67, the Index reflects an improvement in sentiment which is borne out in some of our other Survey questions.

Confidence around financial efficiency of investments is growing in optimism, with a third expecting it to increase, up from just 8% in our last Survey. Equally positive is a near halving of those expecting a decline, from 27% in the Summer to just 14% now.

With vendor pricing expectations reported to be coming down, GPs may consider putting money to work in what they deem a strong vintage as elapsed time gives them comfort to transact on assets they've been tracking, and now potentially at more favourable prices. The flip side of this is that fewer may look sell, and we see just 5% intending to focus on divestments, down from 10% in the Summer.

Central Europe PE Confidence Index



Survey Results

Economic climate

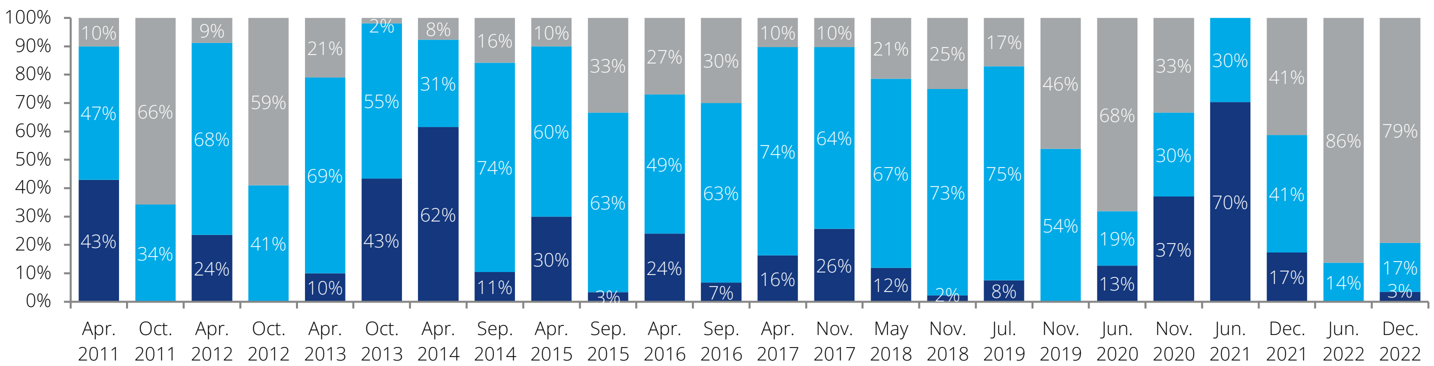
Confidence around the economy is showing nascent signs of improvement, with a gentle reduction in those expecting conditions to worsen (79%, down from 86% in the summer). Expectations of improvement have barely registered (3%), however it is marginally better than the last Survey, which was only the fifth time in our poll's history where no respondents expected an improvement.

The challenging backdrop catalyzing these expectations is afflicting the global economy and is by no means exclusive to Central Europe. Inflation fears continue to plague the entire world, with ongoing supply chain issues impacting businesses and the cost of energy, materials and labor all rising rapidly. At the beginning of 2022, the IMF suggested these issues could continue throughout that year – and that was before Russia's invasion of Ukraine.

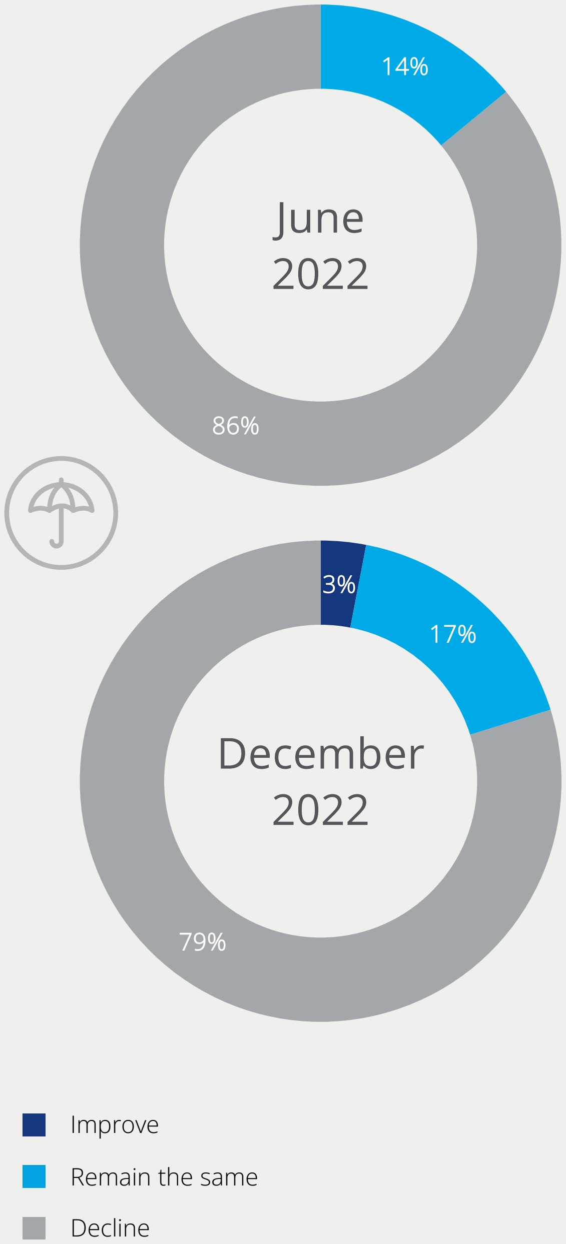
CE is well placed to navigate these challenges, owing both to its own growth rates and proven historical resilience in the midst of economic headwinds. As regards the former, CE continues to lead the developed world. Its nearest neighbours in the eurozone are estimated to have grown at 3.4% in 2022 and are forecast to expand by just 0.5% in 2023. This is largely on the back of inflation projections, which averaged 8.4% in 2022 and are forecast at 6.3% in 2023, with inflation expected to decline markedly over the course of the year. On the other hand, Poland, CE's largest economy, is forecast to record growth for 2022 of 4.8% and 1.5% for 2023. The downside risks are likely a catalyst for the Central Bank's pausing of rate hikes.

As regards resilience, a report published by consultancy Bain and Polish industry association PSIK in November 2022 showed that in addition to CE's strong and consistent GDP growth, the region proved more resilient than Western Europe in the immediate aftermath of the Global Financial Crisis (growth outperformed by 1.5 percentage points) and Covid (2 percentage points). This may be at least partially on the back of low indebtedness, with its public debt to GDP ratio estimated at 58% for 2022, against 95% for the euro area (European Commission).

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



Economic climate (June 2022 vs December 2022)



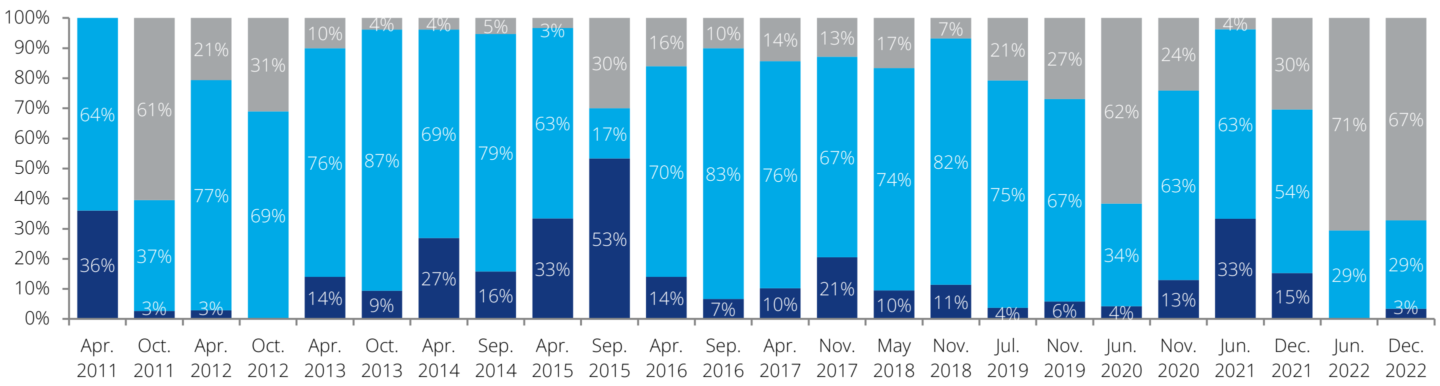
Debt availability

Leverage markets are expected to continue their contraction, with two-thirds of respondents expecting a reduction in liquidity for H1 2023, down gently on last Survey's 71%. While no respondents expected an improvement in our Summer Survey, we do see an optimistic 3% in our Winter edition, revealing a glimmer of hope.

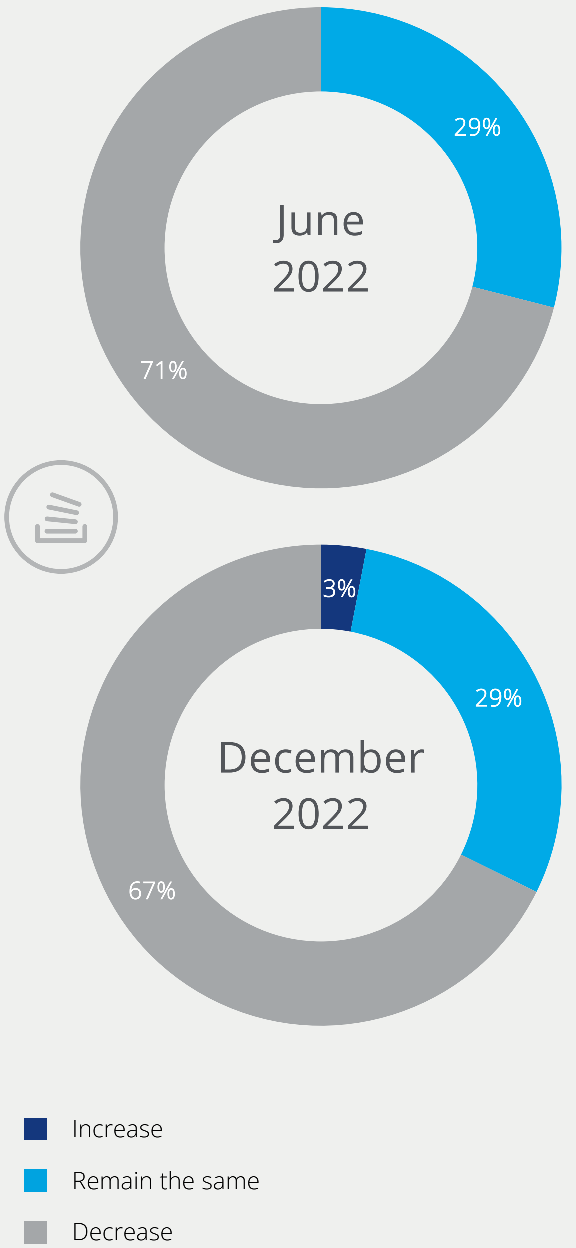
Interest rate hikes in Central Europe – still able to exercise monetary policy through retaining sovereign currencies – have been swifter and steeper than in the eurozone, the UK and even the US. These will have impacted liquidity: Czech rates stood at 7% at the time of writing this report, having risen steadily until Summer 2022 since when it's remained constant. Poland saw its last hike in September and the country's rate stands at 6.75%. The timing of rises stands in contrast to the eurozone, which raised its rates mid-December to 2.5%, the US, which saw seven hikes throughout the year to end 2022 at 4.5% after a December Fed announcement, and the UK, which made its ninth consecutive increase in December to 3.5%.

While rising interest rates have made erstwhile cheap finance considerably dearer and banks have reined in their lending, a nascent non-bank lending market is taking shape in the region. Long established in the US and with over a decade of growth in Western Europe, credit funds may step in where banks step out. Last year saw some positive developments in the space, with ACP's launch of ACP Credit Fund I with a €90m first close which can provide €5-15m per deal of senior-secured debt solutions and made its first investment in the autumn. In January 2023, CVI held a final close on €132m for its Private Debt Fund and ACP announced the launch of AMC Fund V with c€150m of commitments against its €300m target.

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



Debt availability (June 2022 vs December 2022)



Investors' focus

Challenging backdrops typically see investors take a more cautionary approach towards investment, and this Survey reflects a more defensive outlook. Just 40% of respondents expect to focus on new investments, down from 49% in our last Survey and on a level with October 2008 and Winter 2014/2015. The current drop in appetite for deployment is accompanied by a commensurate increase in portfolio management focus, with half now expecting to nurture existing investments, a similar percentage to the onset of the pandemic.

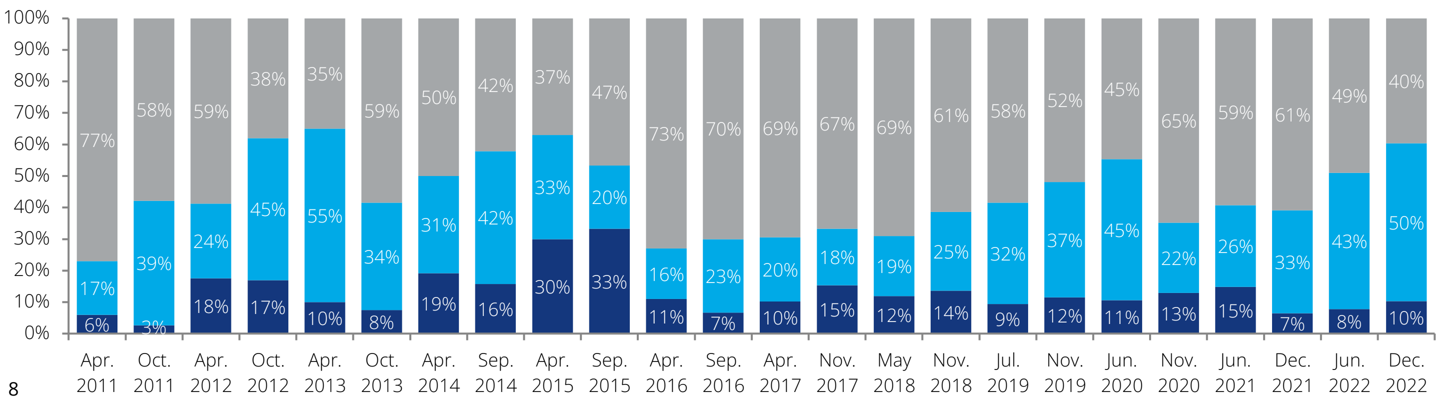
While few purport to focus on fundraising in the coming months, it is less of a sign of sentiment given the infrequent nature of fundraising (as houses only tend to raise every few years as investment periods come to an end).

Despite this, it is a busy time for fundraising in CE, with a mixture of established houses and new vehicles raising money despite headwinds making it more challenging than in previous years:

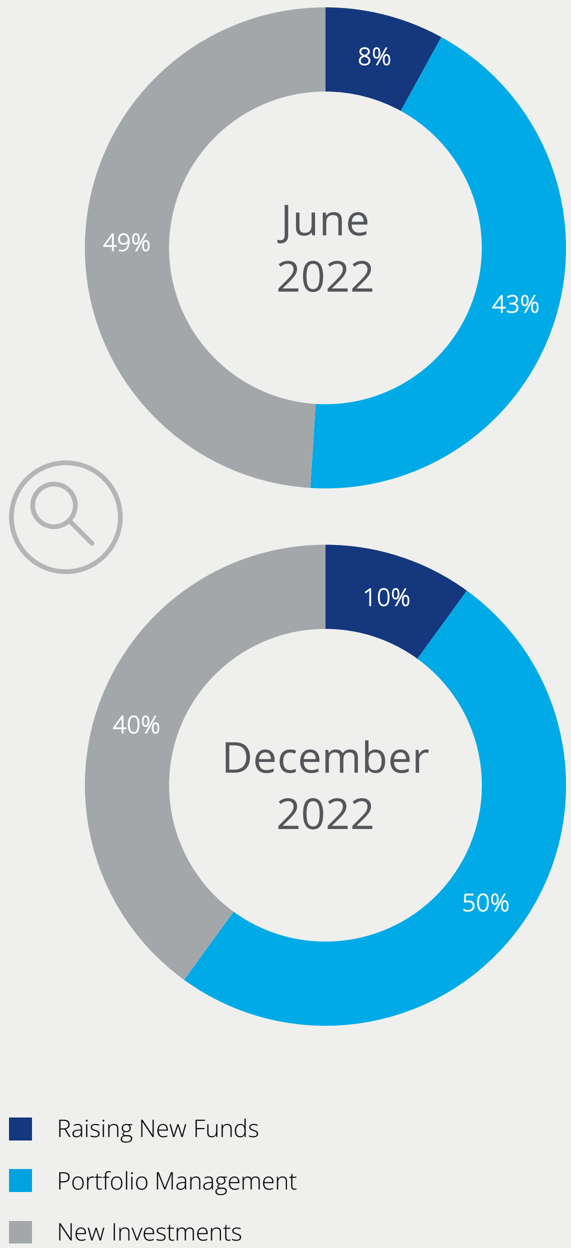
- Innova Capital held a €220m first close for its seventh fund, well on its way to its €350m target
- ACP launched Fund V in January 2023 with €150m towards its €300m target
- Inventure closed its fourth fund on €150m in November 2022 for opportunities in the Nordics and Baltics, with limited angel investing newly included in its remit
- Lithuanian VC Practica Capital is seeking €70m for its third fund for providing pre-seed to Series A capital, with €32m already secured in a first close and a final close expected in June 2023
- Estonian VC and accelerator Startup Wise Guys is targeting family offices and HNWs for its second €20m Challenger Fund, with a €7m second close held in October 2022.

A number of new GPs have emerged: Orbit Capital has a €200m target for its new scale up fund Orbit Growth, with a first close of €42m in early 2022. Polish tech-focused GP Spire Capital is seeking €110m; Czech VC Tilia Impact is a looking to raise €32m, Czech DEPO Ventures is targeting €20m, Lithuanian VC Contrarian Ventures is targeting €100m for a new climate tech fund, and BADideas.fund is seeking €15m.

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



Investors focus (June 2022 vs December 2022)



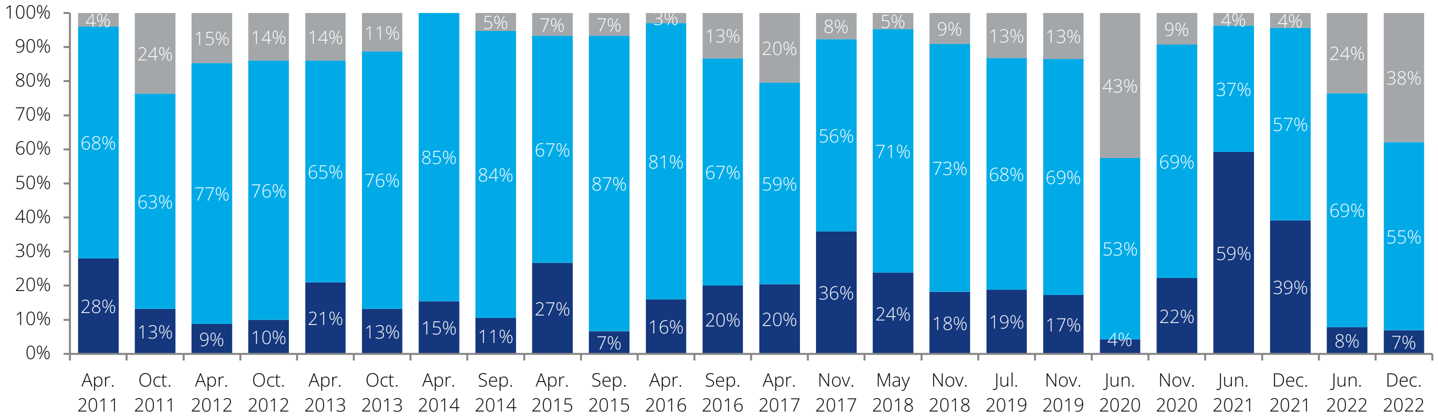
Size of transactions

Deal sizes may reduce, with 38% of deal doers expecting averages to decrease, up from under a fifth in our last Survey. Additionally, just over half (55%) expect transaction sizes to remain the same, a marked decrease from 69% in our last Survey.

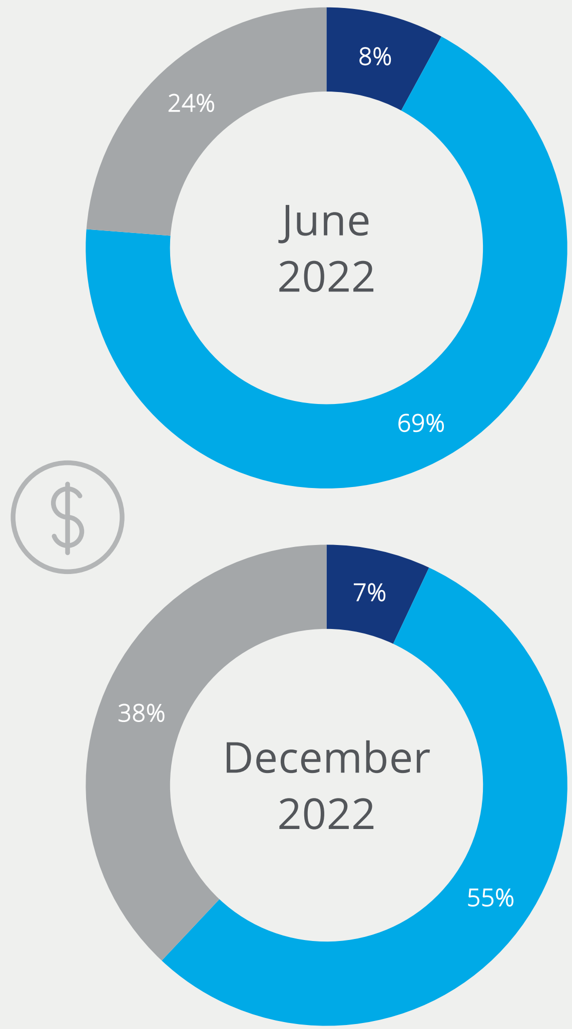
The CE market is typically a mid-market opportunity, with large deals the exception rather than the norm, and it may be that GPs are more cautious about deploying larger cheque sizes in the current backdrop and may focus more on nurturing existing portfolios and seeking growth through buy-and-build (typically smaller transactions once a platform is secured).

A handful of sizeable transactions took place in our analysis period. In August, MVV Energie sold its Czech subsidiary of district heating networks to Cube Infrastructure Managers. Carlyle Europe Technology Partners acquired a majority stake in Tescan Orsay in December. The business was formed in 2013 when Tescan (itself founded in 1991) and Orsay Physics merged. Today the Brno, Czechia-based business is a developer and supplier of scanning electron microscopes and other high-tech scientific instruments and employs 750 people across 14 sites globally.

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



Size of transactions (June 2022 vs December 2022)



Increase

Remain the same

Decrease

Market activity

Expectations for market activity remain unchanged on our last Survey, with 59% of respondents expecting activity levels to decrease. While this is consistent with the Summer results, there is a small increase in those expecting it to increase (12%, double last Survey's 6%). It may be a sign that investors are acclimatizing to a backdrop of ongoing uncertainty, and learnings from the recent pandemic have helped them to reassess opportunities now the war in Ukraine approaches the one-year mark: the initial pause in activity may be giving way to cautious deployment as investors have watched businesses' reactions to evolving conditions and gained comfort in transacting.

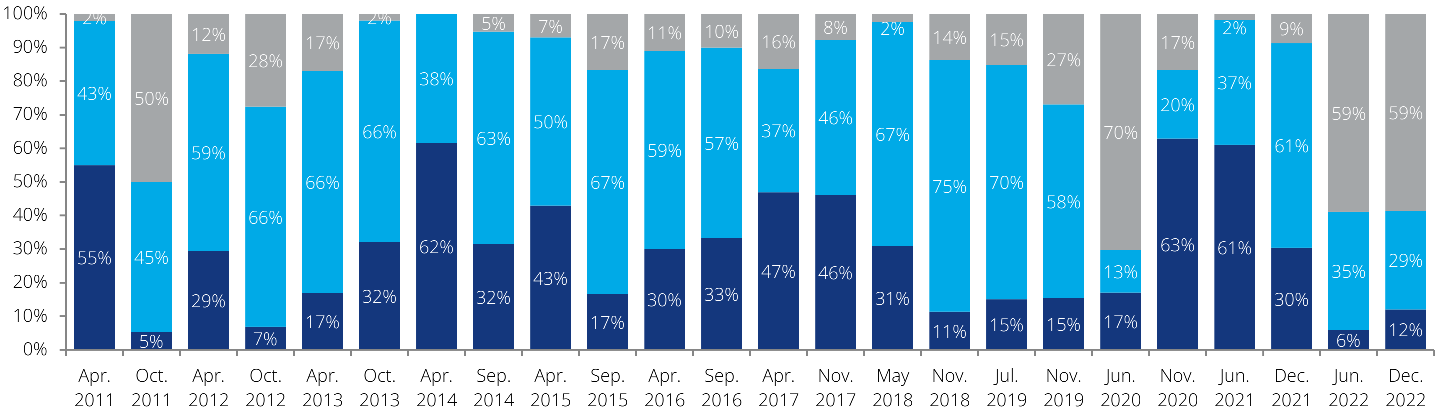
Much of the activity in H2 2022 focused on building up portfolios through M&A. This has long been a value driver for experienced PE houses, since add-on acquisitions are typically procured at lower entry multiples than the platforms, helping to drive down average purchase prices. Additionally, some PE houses can draw on rich experience in this complex exercise and can create valuable synergies by integrating businesses successfully.

Abris Capital was busy supporting its portfolio with M&A during H2 2022, announcing five bolt-ons across three of its businesses. The firm's Scanmed purchased Ars, Alsendo purchased Innoslip and Zaslat, and Green Group bought UAB Ecso and SIGAD.

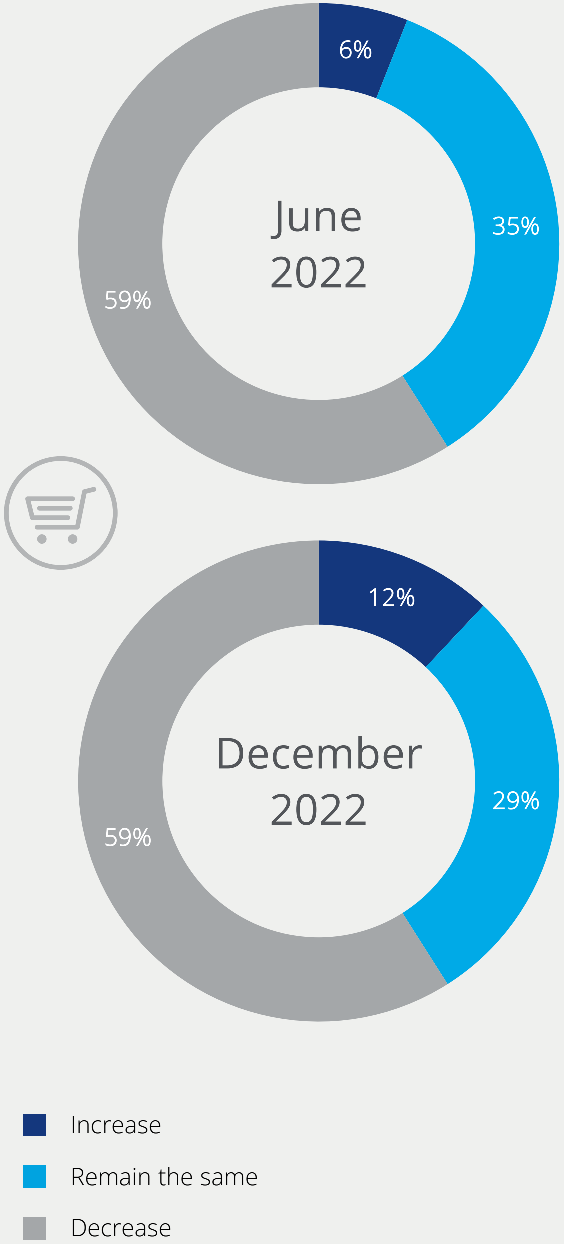
Innova was also busy on the portfolio M&A front, continuing to build up its dental platform United Clinics with the acquisitions of Pro Ortodont and iDentical during the second half of 2022.

Enterprise Investors supported its investment in Croatian retailer Studenac to acquire Toni Marketi (Princeza Korina), a toy retailer on Croatia's Adriatic Coast. It is the latest in a number of acquisitions by Studenac, with Enterprise investing over €260m since its 2018 investment to support its growth, including €120m on acquisitions including Pemo and Lonia.

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



Market activity (June 2022 vs December 2022)

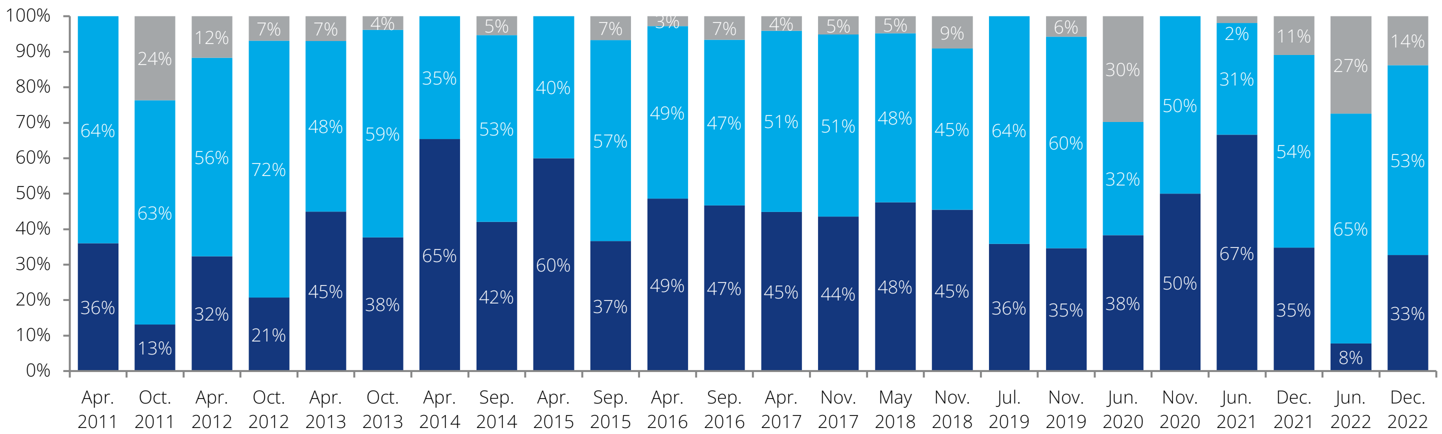


Investment return

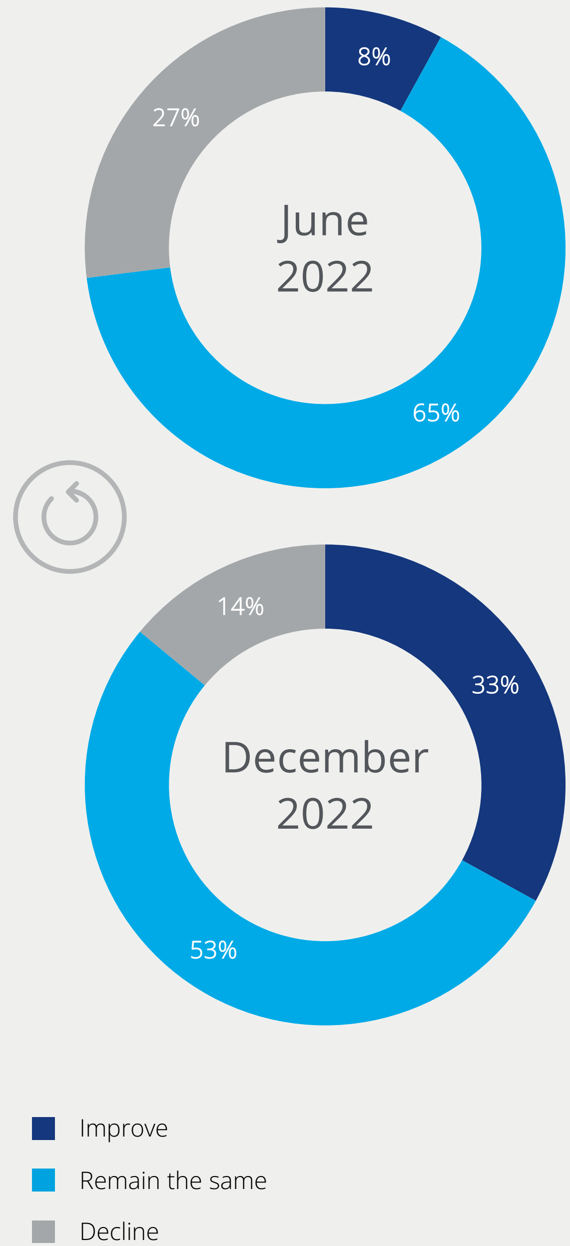
Confidence around financial efficiency of investments has shown unexpected optimism, with a third expecting it to increase, up from just 8% in our last Survey. Equally positive is a near halving of those expecting a decline, from 27% in the Summer to just 14% now.

It may be that the passing of time has seen the initial shock of Russia's invasion wane, and businesses, many already lean and efficient since the challenge of Covid, have proven resilient and flexible in the face of yet more uncertainty. The experience of management teams in navigating change and adversity may be paying off, while CE's deal doers are drawing on increasing experience in helping support and steer portfolios through such periods.

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



Investment return (June 2022 vs December 2022)



Investors' activities

Expectations around deployment and selling have remained steady since our last Survey, with a gentle shift in favour of buying more in the coming semester (60%, steady on 59% in our last Survey). A slide in pricing may be encouraging GPs to consider putting money to work in what they deem a strong vintage as elapsed time gives them comfort to transact on assets they've been tracking, and now potentially at more favourable prices. The flip side of this is that fewer may look sell, and we see just 5% intending to focus on divestments, down from 10% in the Summer.

BaltCap was busy selling, buying and supporting portfolio M&A in H2 2022 : the firm sold its investments in Vendon and Blue Bridge Technologies, both in trade sales; it made four new deals and supported its investment Tradehouse to acquire Scandinavian Brands.

Enterprise Investors bought and sold during the semester. The firm sold Romanian toy retailer Noriel to a Turkish trade buyer following a six-year hold. Enterprise had invested €2m to help the business grow in 2016 when it was a family-owned business operating 47 shops. At the time of the 2022 sale, it was an omnichannel retailer with 88 stores and with revenues of RON 312m, its highest result to date. At the end of 2022, Enterprise acquired a 40% stake in Polish process outsourcing specialist BISAR, investing up to €27m to support the company's further growth and international expansion.

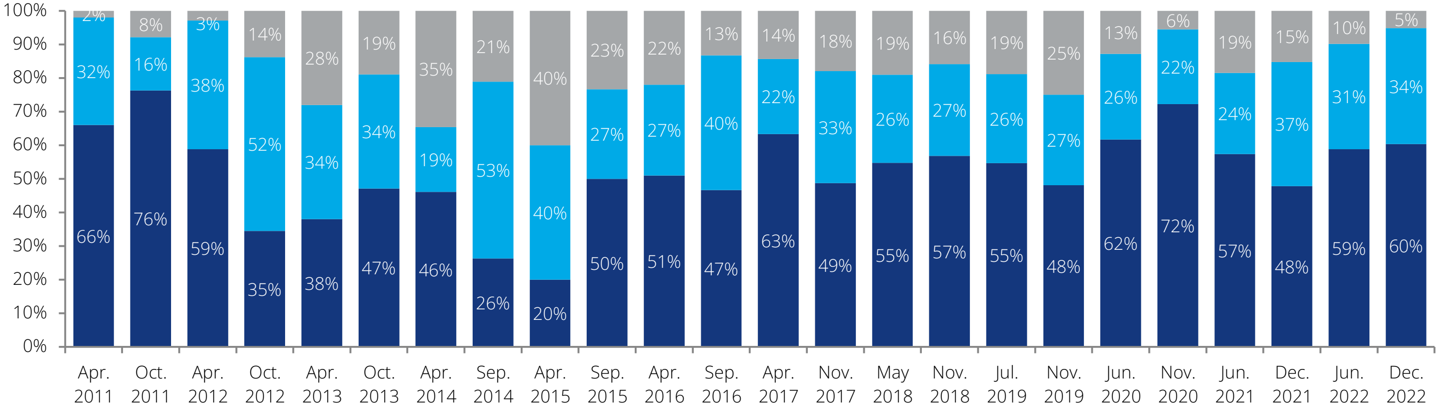
Value4Capital (V4C) sold its investment in Polish waste management firm Kom-Eko in November 2022 in a secondary buyout to CEE Equity Partners. V4C had purchased the business in 2018 and since then it more than doubled its revenues and almost tripled its EBITDA, creating over 250 new jobs.

MidEuropa announced its acquisition of a majority stake in Optegra Eye Health Care in November 2022. The Polish platform is an investment alongside management and incumbent private equity backer H2 Equity Partners.

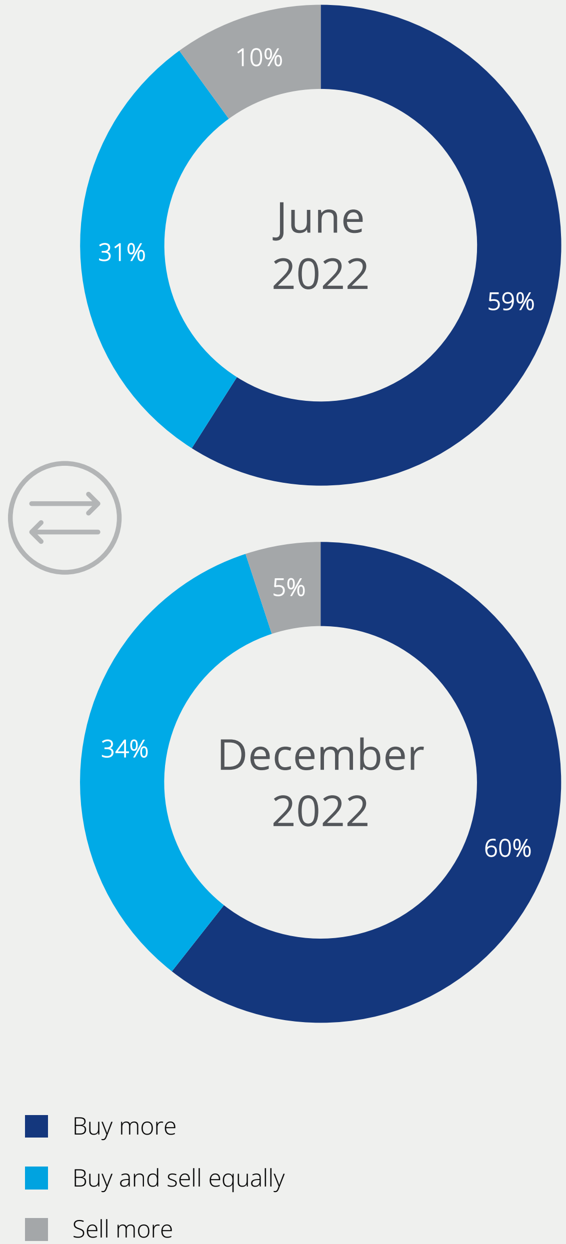
Innova Capital sold transport IT solutions provider Inelo Group to trade buyer Eurowag for over €300m in October 2022 following a nearly five-year partnership that saw four acquisitions and geographical expansion supported by Innova.

In December, Carlyle Europe Technology Partners acquired a majority stake in Tescan, a Brno, Czechia-based global developer and supplier of scanning electron microscopes.

For this period, I expect to:



Investors activities (June 2022 vs December 2022)



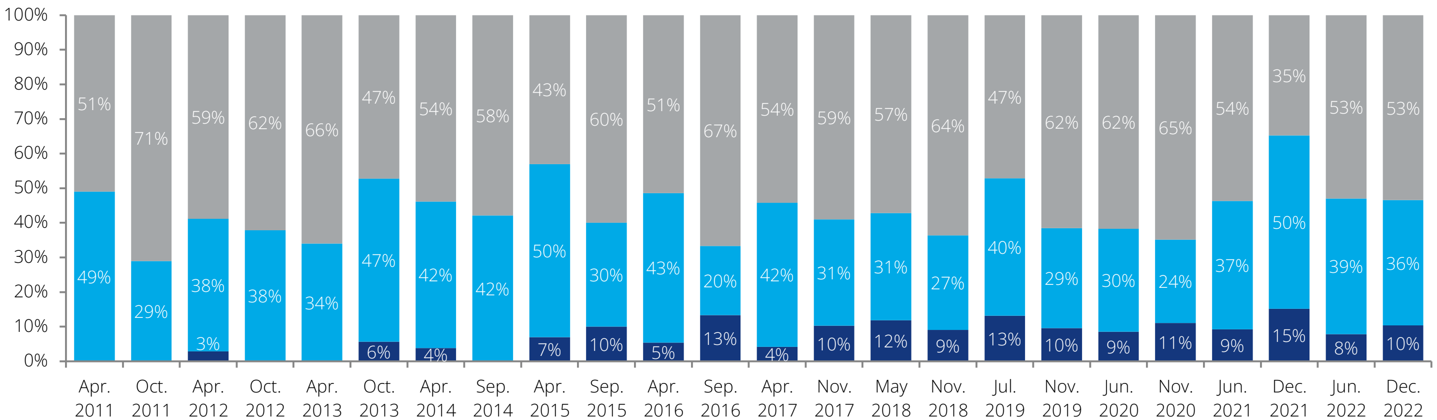
Competition for new investments

Market leaders will continue to be in highest demand as uncertainty persists: for the second Survey in a row, over half of respondents (53%) expect these businesses to be the most competitive. This number is tied with the last Survey, which itself was a large increase on the previous of 35% seen in Winter 2021 and just prior to the war in Ukraine. This is unsurprising since buyers typically seek stability when adverse conditions prevail, and established companies often offer robust cashflows which not only mitigate downside risk but also enable lending against cashflows.

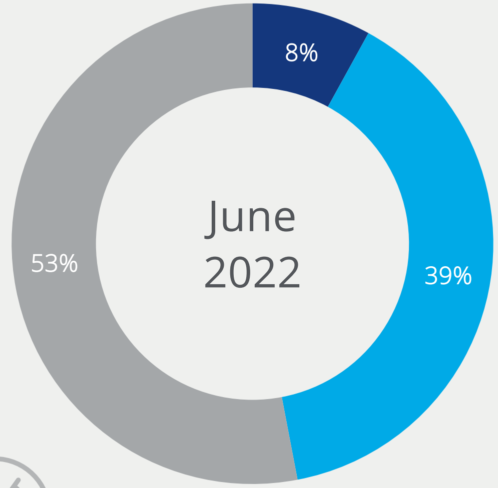
Middle-sized growing companies are expected to be most competitive in over a third of opportunities (36%), down slightly on six months ago (39%), while start-ups regained some of their lost ground to land at 10%.

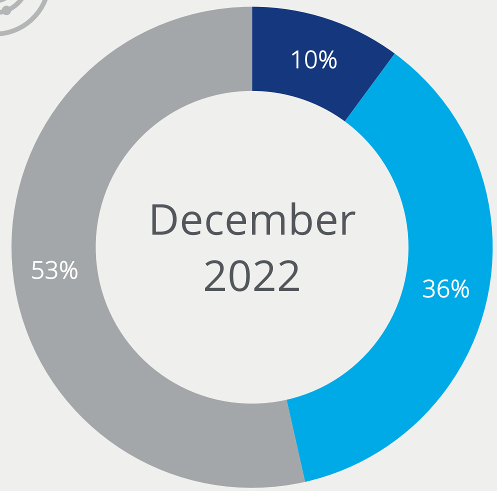
Start-ups had been increasing in popularity for around five years and peaked at 15% in Winter 2021-22, but the fall from grace for tech valuations in 2022 has seen many erstwhile unicorns lose their wings and so all but the most experienced sector experts – best placed to spot and nurture fledgling businesses – have cooled on the prospects of less established companies.

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



Competition for new investments (June 2022 vs December 2022)





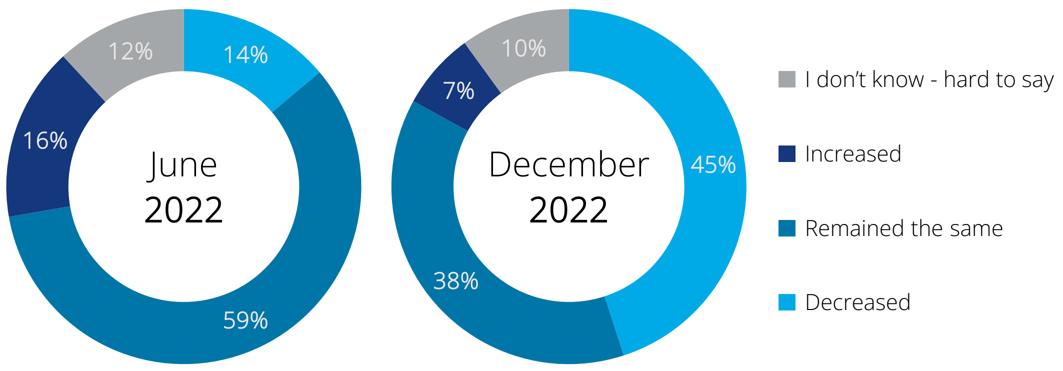
- Start-ups
- Middle size growing companies
- Market leaders

Vendor pricing

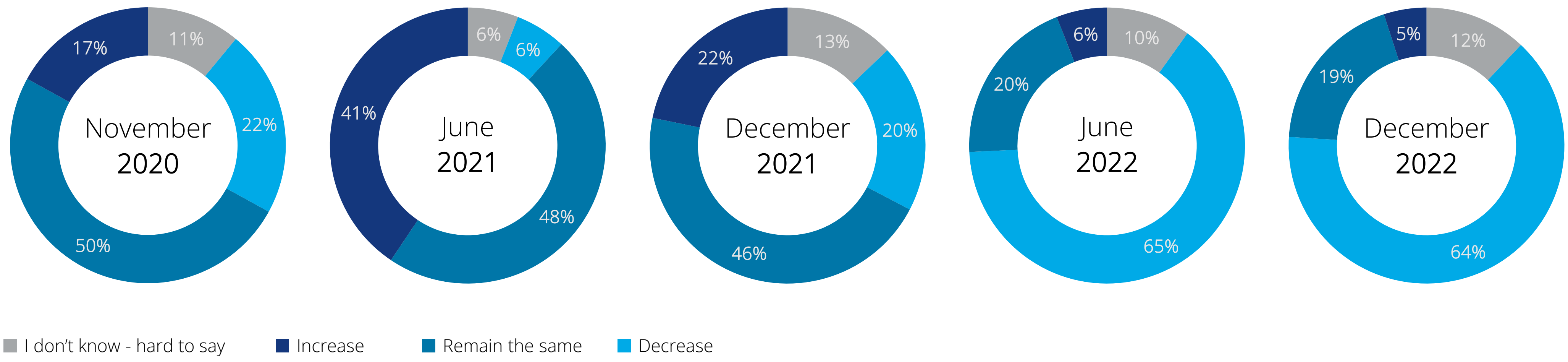
Vendors' price expectations may be coming down, with nearly half of respondents (45%) feeling they've decreased in H2 2022 and nearly two-thirds (64%) expecting them to decrease in H1 2023. The expectations for the first half of this year are the same as our Summer Survey, pointing to consistency in sentiment on how valuations may play out this year.

Pricing has long been a big driver of deals, with entry multiples very high in recent years as an increasing quantum of private equity vied for the most in-demand assets. The slowdown in transactions in 2022 as inflation and energy prices conflated with other headwinds has seen average entry pricing come down.

Relative to 6 months ago, vendor pricing expectations have:



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



Economic backdrop

Economic backdrop

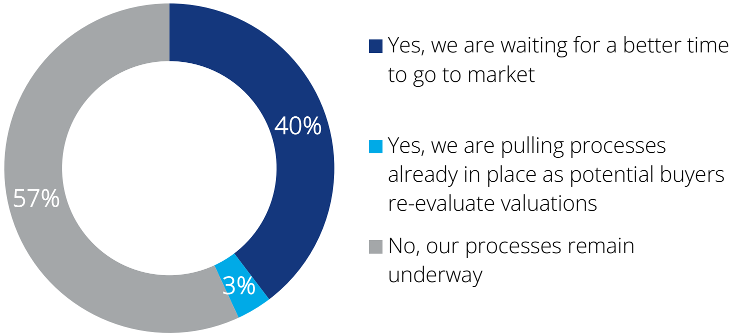
Despite an adverse backdrop, the majority of sales processes (57%) remain underway in today's market. This is likely the result of experienced intermediaries expertly conveying the value in assets they've been tasked with divesting – and, just as importantly – of the value CE's deal doers have added during their stewardship of businesses. The handful of exits mentioned in this report reveal businesses with expanded geographic footprints, increased headcounts and improved earnings – meaning the assets they've nurtured have become very valuable to prospective buyers. For businesses not already in processes, 40% are waiting for a better time to go to market. Under 4% are pulling processes already underway.

The changing backdrop has drawn mixed experiences from respondents. Two-fifths are looking more to credit funds and non-bank lenders as they find leverage more difficult to secure for deals, while just over a third (35%) have experienced no change in leverage availability. Nearly a fifth (17%) report needing more lenders now for a deal.

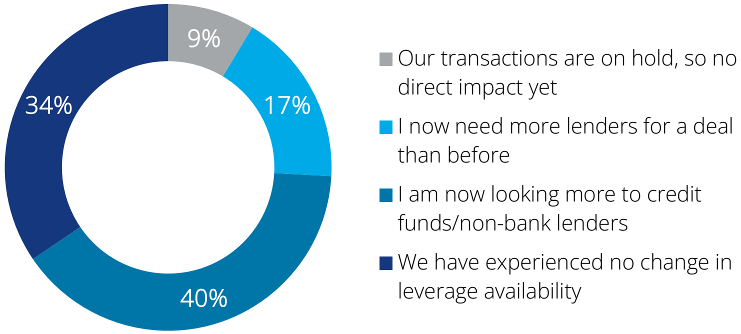
The slowdown in transactions in 2022 may give way to strong investments in 2023, with over 80% of respondents confident the year will prove a good vintage for investments. Most of the region's deal doers will recall the post-GFC period, with a number of strong assets harvested from the 2009 vintage and may feel similar prospects are on the horizon.

Pipelines are improving, with two-fifths of respondents seeing more actionable opportunities now than in our Summer Survey. This is more than twice the percentage that saw an improvement six months ago. Half of our respondents feel pipelines are the same, down from 70% last time.

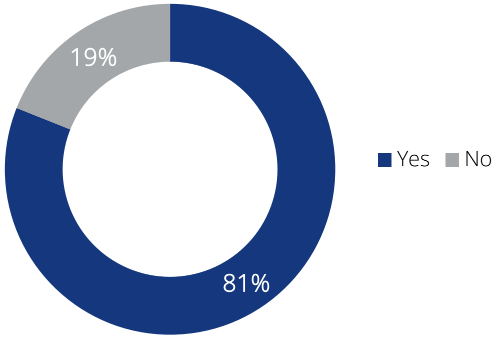
Are you putting off sales as valuations are impacted by the new backdrop of uncertainty and inflation?



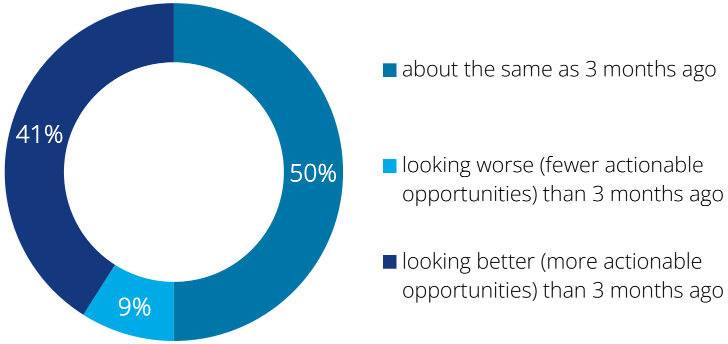
Are you finding leverage more difficult to secure for deals?



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



Is your deal pipeline:



Sustainability

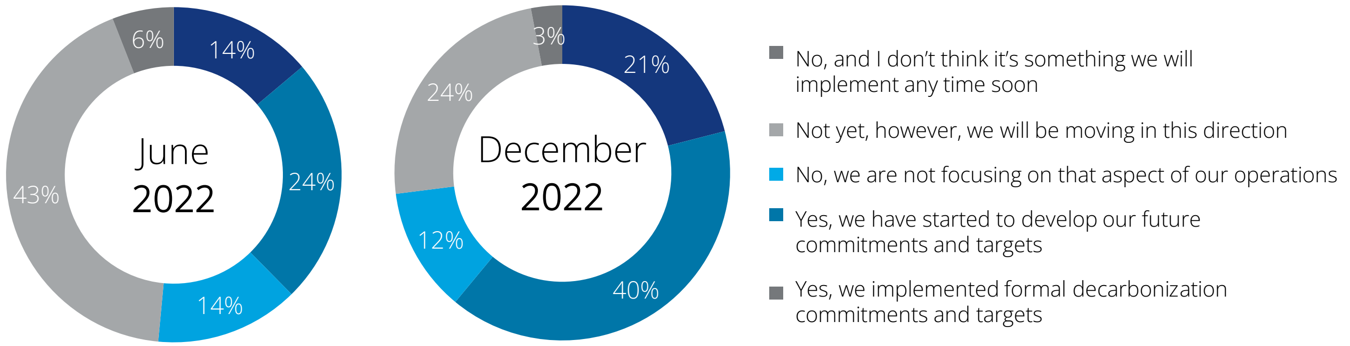
Sustainability & ESG agenda

It is very encouraging to see a growing number of PE deal doers in CE embracing ESG, with over a fifth having implemented decarbonization commitments and targets, up 50% on our Summer Survey. Another two-fifths of respondents are starting to develop these, nearly double our last Survey. There has been a commensurate reduction in those intending to do so, suggesting last Survey's respondents in this category have been progressing their ESG journeys. Such progress is key with ESG: it's not merely a future commitment, nor a goal to reach and be done with, but rather an ongoing effort to continue to meet near- and medium-term objectives through a robust ESG framework. Expectations from consumers and regulators continue to climb, meaning companies must rise to the challenge.

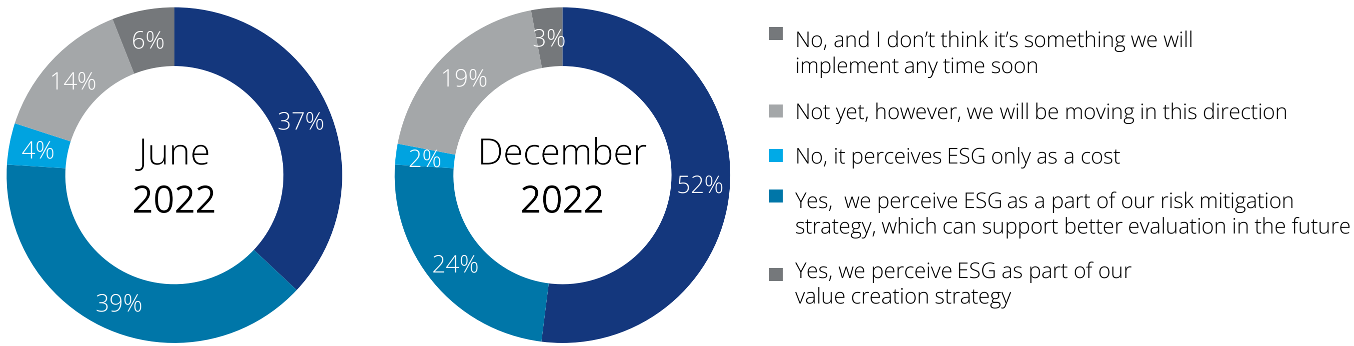
There is a visible shift in deal doers accepting ESG as a value creation tool for portfolios, with the majority (52%) now deeming it part of a value creation strategy. This is up markedly from our last Survey, and another quarter (24%) see ESG as a risk mitigation strategy. The proportions seeing ESG as something they won't implement soon (3%) or as merely a cost (2%) have halved in just six months. This is encouraging on multiple levels: it's clear ESG is becoming firmly entrenched as a value enhancer, and this is leading to a focus on more sustainable business models driven by concrete targets and thus innovation to meet them.

Over two-thirds of houses in CE have investment policies that include ESG factors, whether investment policies (47%) or ESG improvements post-deal (19%). These numbers are steady on our last Survey, suggesting the region's deal doers have heeded LPs' demands for ESG factors in investment decisions and portfolio management. It is surprising that the remainder haven't yet followed suit.

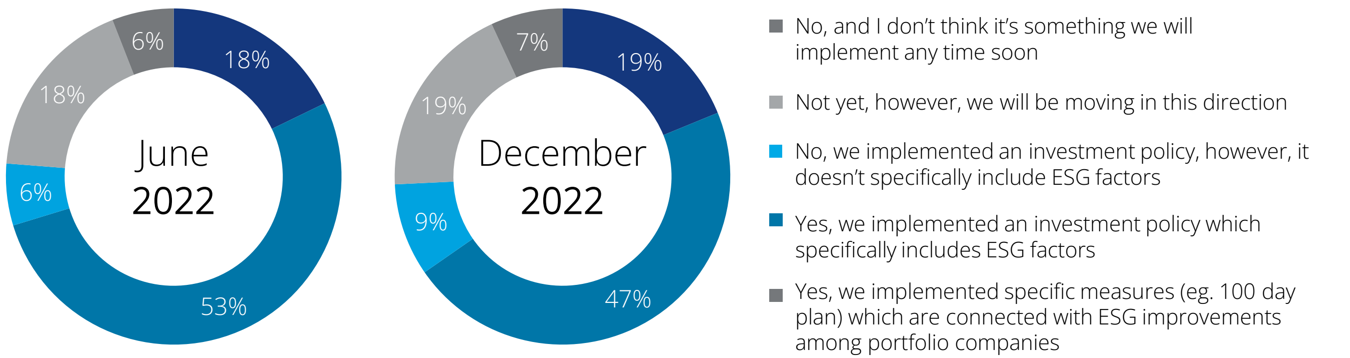
Has your fund made any commitments towards climate neutrality?



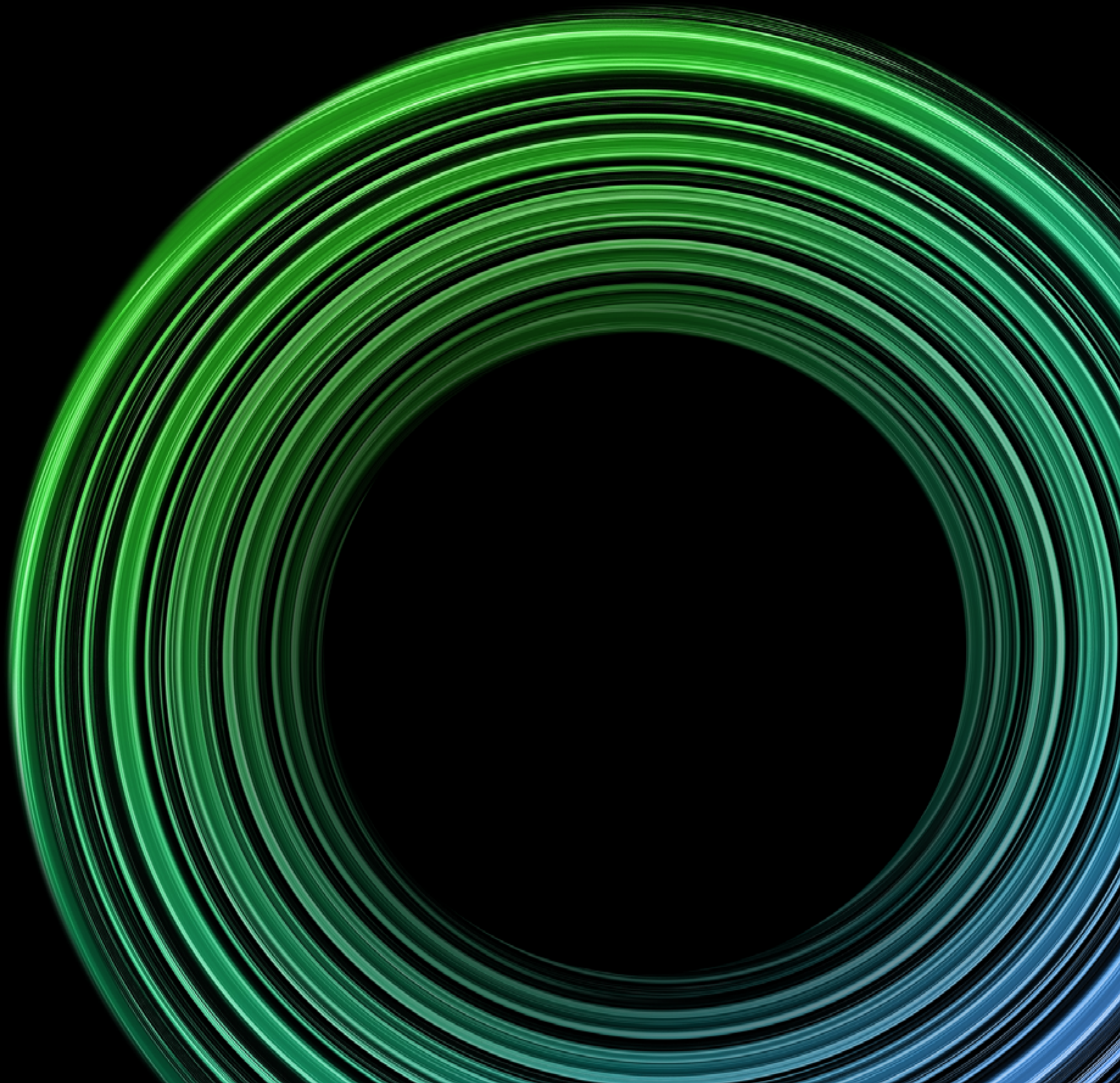
Does your fund integrate ESG as a part of a value creation factors?



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



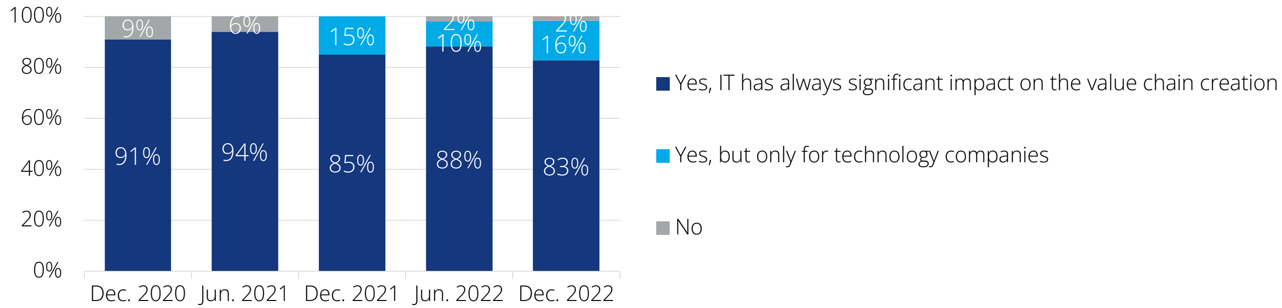
Technology

IT is still recognized as one a value driver, with less than 2% of respondents not seeing its potential in their current portfolio. Increasing numbers of businesses seem to embrace digitalization and reap the benefits, ranging from better user experience of their digital platforms, through cost-to-profit optimized technology, to enhanced values coming out of customer data. Private equity firms globally appear to be well equipped to help portfolios on this journey, even though technology investments may be costly.

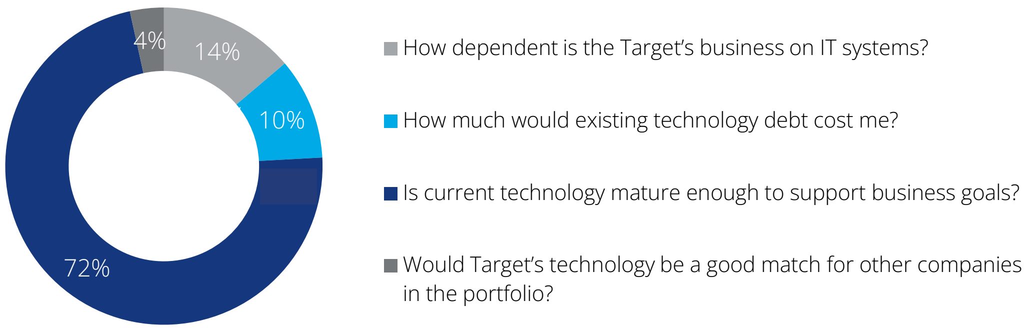
As technology becomes increasingly intertwined in business operations, investors pay heed to the maturity of the technology. Properly developed tools supporting the growth strategy are critical for 72% of the respondents. Over a tenth (11%) see underinvested tech as a risk requiring spend to align underinvested technology with strategic goals. Despite the potential for it to drive further cost optimizations in the future, only 3% see a Target's technology as a possible match for other investments.

Data breaches are evolving from deal breaker to a valuation influencer, with nearly half of respondents (47%) feeling it'd impact valuation, nearly double last Survey's response (24%). Additionally, less than a fifth (19%) feel it'd only be a deal breaker if the data involved were significant, either impacting tens of thousands of records or containing sensitive information, halving from 35% in the last Survey. This suggests investors are willing to offset the risk of acquiring a potentially vulnerable Target with growth potential, addressing cyber security risks during the post-acquisition process.

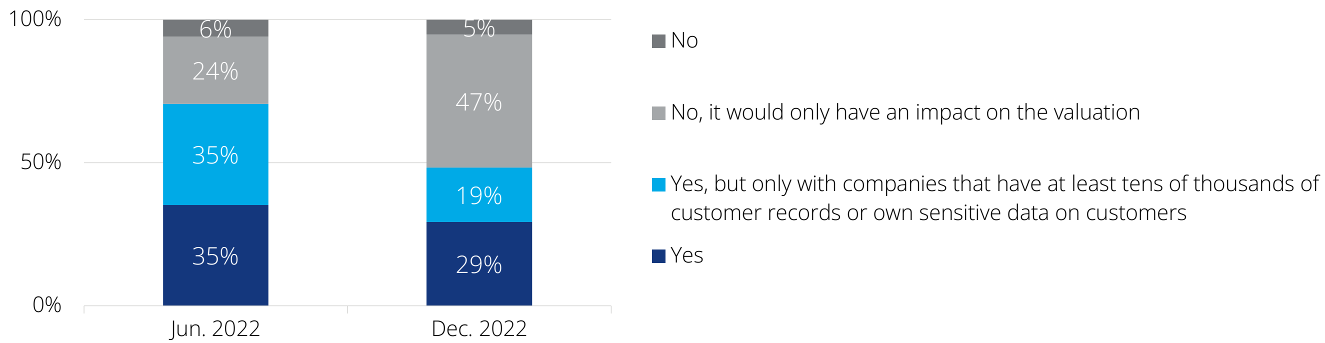
Do you believe that IT capabilities of a portfolio company can be used as a value creation lever?



In your investment thesis, what is the most critical, technology-related factor?



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?



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