

VC Baltic  
Summit 2017

August 24<sup>th</sup>

# PRIVATE EQUITY EXITS: THE CENTRAL EUROPEAN EXPERIENCE

LES NEMETHY



EURO-PHOENIX  
FINANCIAL ADVISORS LIMITED

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# I. INTRODUCTION



# About

## Euro-Phoenix

Financial Advisors Ltd.



EURO-PHOENIX  
FINANCIAL ADVISORS LIMITED



**Financial advisory**  
company (M&A, Capital  
raising, Corporate  
Restructuring, Valuations)  
operating **worldwide** and  
focusing on **Central  
Europe** & emerging  
countries

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**Cross-sector** expertise

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We typically advise mid-cap  
companies  
(\$ or € **10-100 million**)

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**Our strength : running  
competitive sell-side  
processes**



“

Don't congratulate us when we  
buy a company.

Any fool can buy a company...

Euro-Phoenix Financial Advisors Ltd. ©

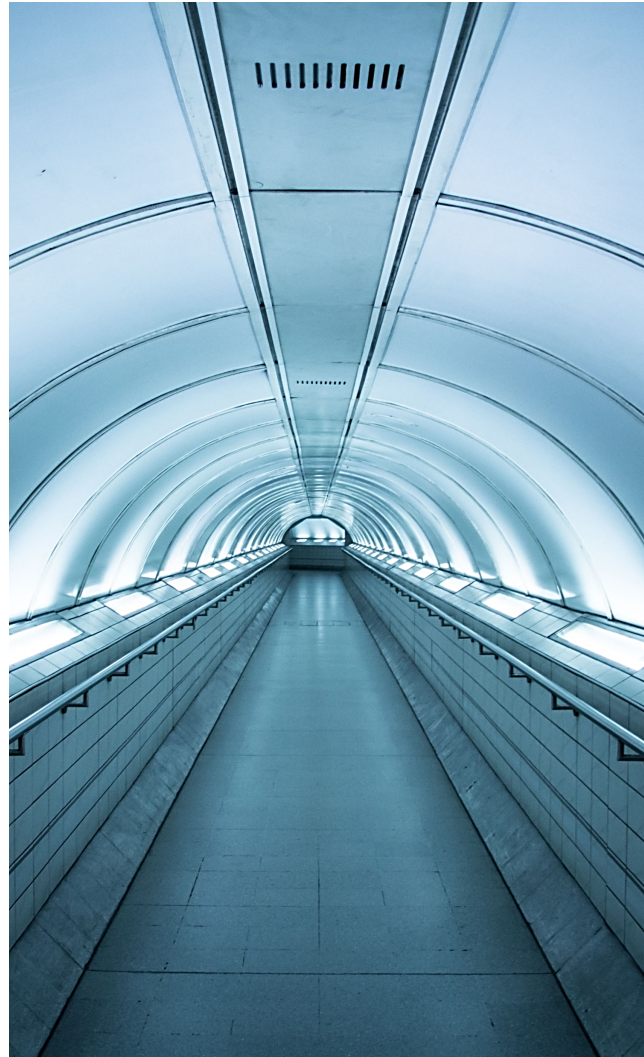
... Congratulate us when we  
sell it and when we've done  
something with it and created  
real value.

”

HENRY R. KRAVIS

FOUNDER OF KOHLBERG KRAVIS ROBERTS

# PE firms typically prepare **inadequately** for exit



## 55%

**of Private Equity firms**

deem that “PE needs to be focused on investing rather than preparing a business for sale”.

## 86%

**of Private Equity firms**

“do not have a systematic exit process and playbook to maximize value on all exits”.

## 47%

**of Private Equity firms**

exit “too early or too late, and value was sacrificed as a result”.

# II.

## THE CENTRAL EUROPEAN PE MARKET An Overview



# Central European PE market : Confidence Index



**2017**  
Overview

**113**

Is the most recent **PE Confidence Index** in the the CE region\*

“CE Investors have long-standing concerns because of:  
**low exit volumes** & **long hold periods\*\***”

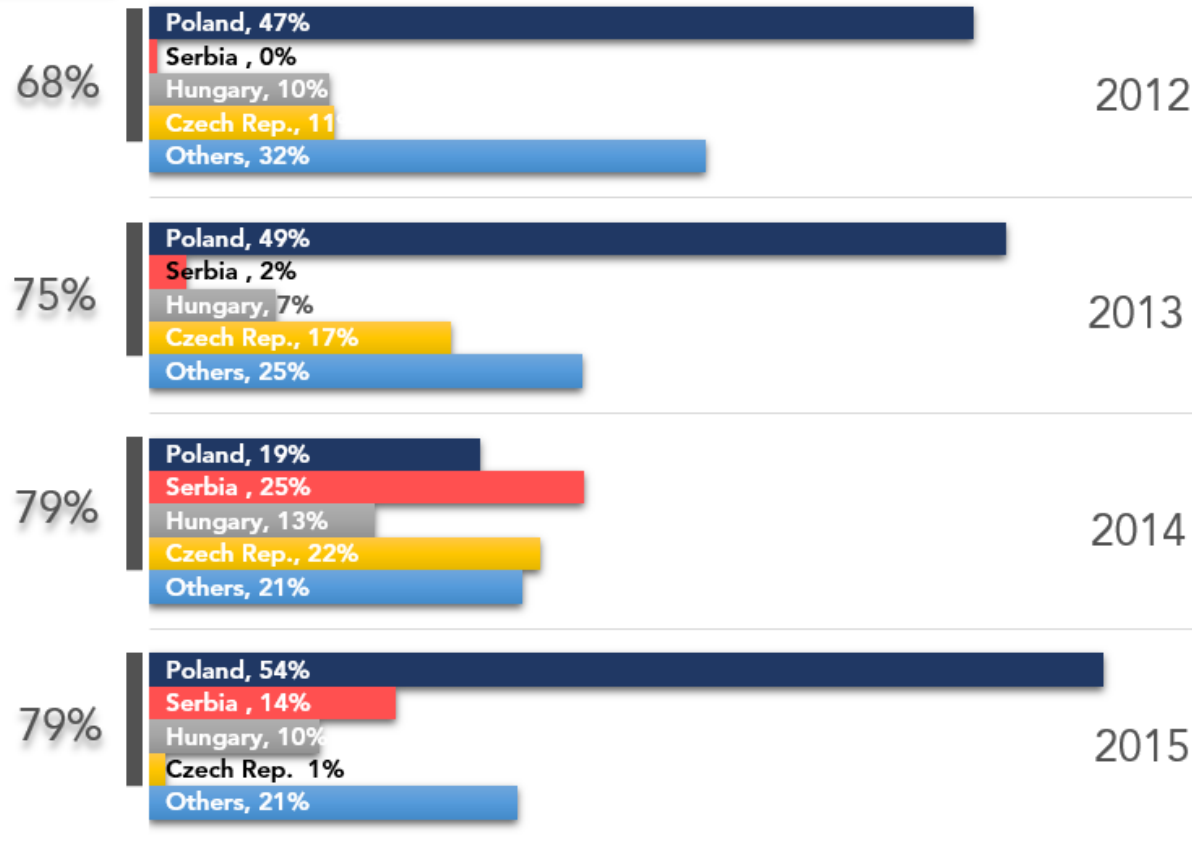
\* Deloitte's "confidence index" The PE Confidence Index is based upon answers received from PE professionals focused on Central Europe. It is composed from answers to the first seven questions of the survey. For each period the average of positive answer ratios over the sum of positive and negative answers is computed. This average is compared to the base period, which in our case is spring 2003 (spring 2003 is considered as a base 100 for Deloitte). The questions asked are about: Economic Climate, Debt availability, Investors focus, Transaction size expectations, Investment return, Investors activity. For more information, please consult the full report mentioned above.

\*\* Source: Private Equity Confidence Survey – Central Europe – Deloitte - May 2017, 2015, 2014, 2011 / CVCA Private Equity Report - Deloitte - June 2017, May 2014

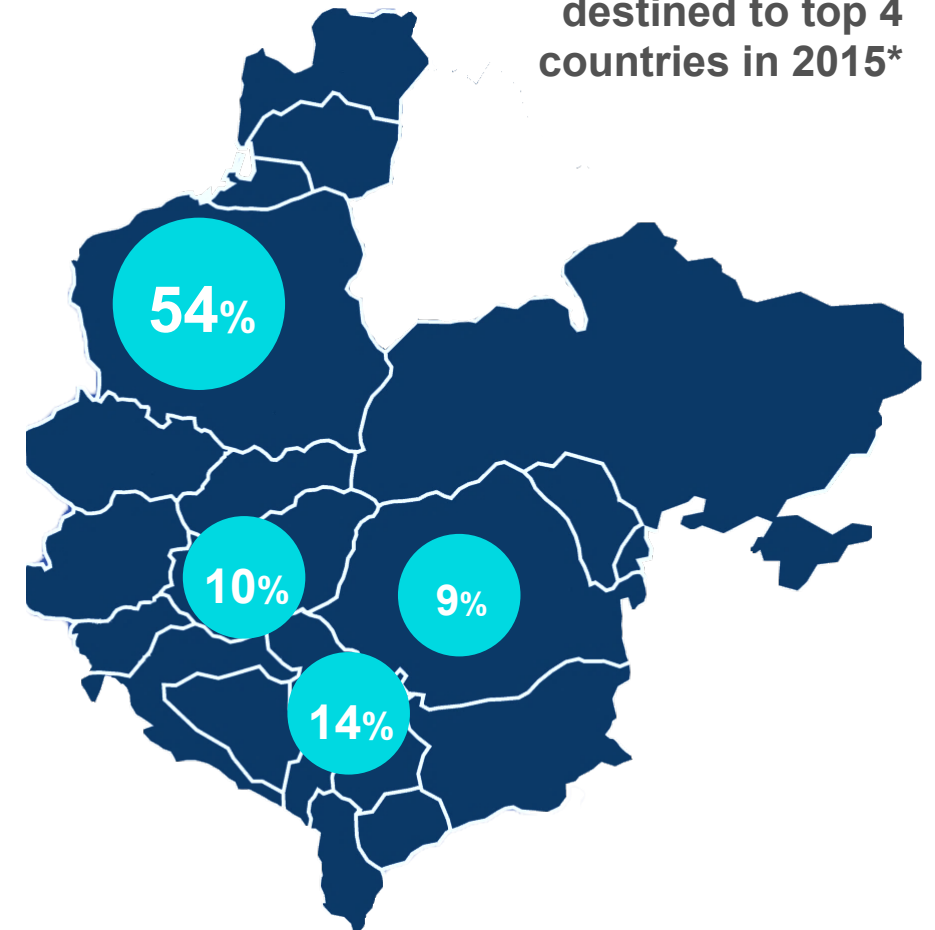
# Central European PE : 4 leading countries

Yearly average of the  
4 leading countries

Annual investments in the top 4 PE  
markets of the CEE region\*



Percentage of PE investments  
destined to top 4  
countries in 2015\*



\*Source: Invest Europe, « Central European Private Equity Statistics 2015 », August 2016

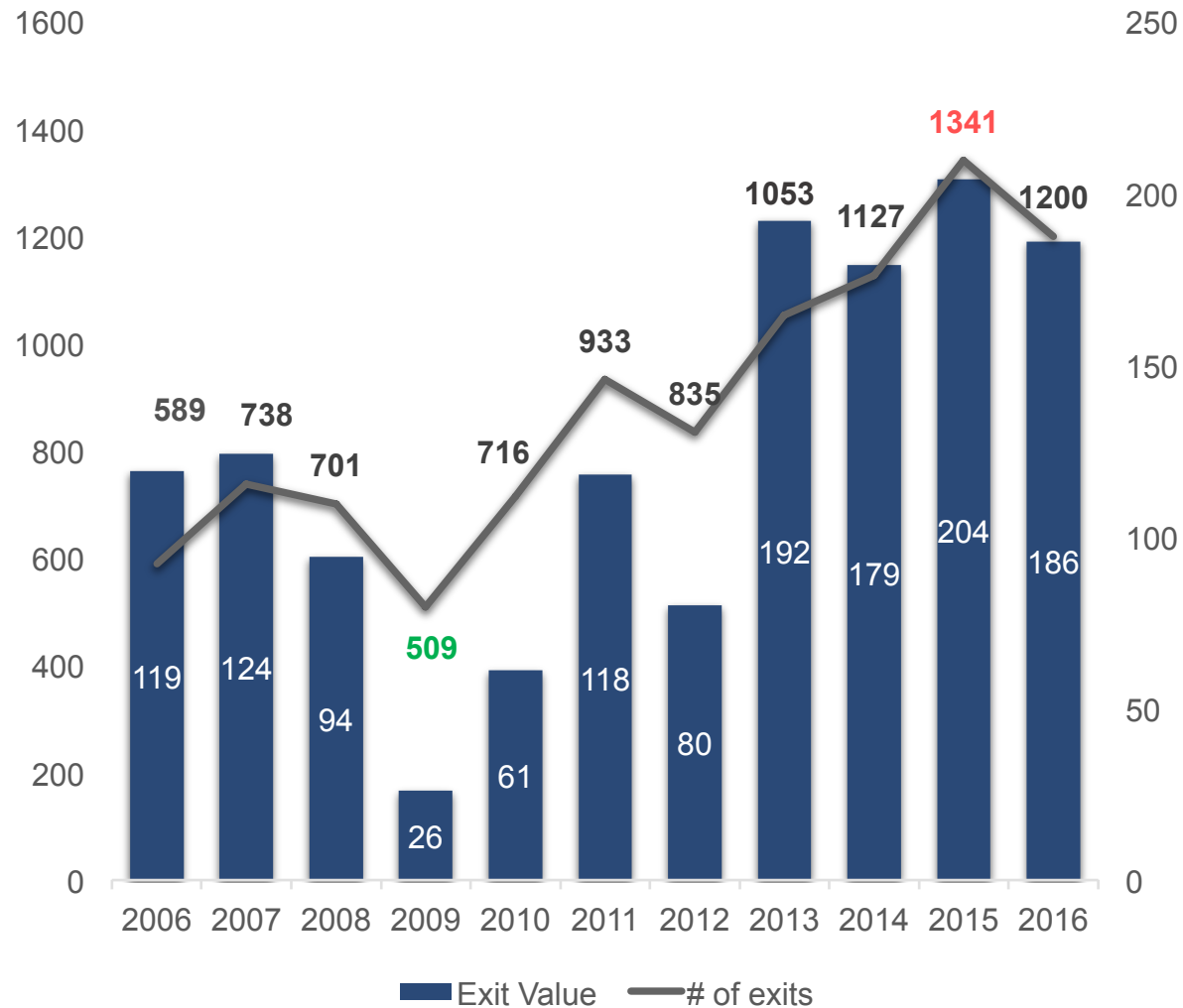
\*Other" includes : (Romania, Lithuania, Bulgaria, Latvia, Estonia, Ukraine, Slovakia, Slovenia, Croatia, Bosnia & Herzegov., Macedonia and Montenegro)

NB: we define the top 4 according to the four greatest average annual investment value from 2012 to 2015



# European PE : Exit overview

## Exits in Europe from 2006 to 2016



The number of deals has been on the rise since 2013...

2013 was a **breakout year for number of deals** in Europe, which has been sustained ever since.



... As well as the value of deals

In 2013, there was an even more important **breakout in deal value**, which has also been sustained.



... As a result, average deal size has increased over the years ...

Average deal size in the Merrill Corporation database in 2006 was €200 million. It fell to €85 million in 2009.

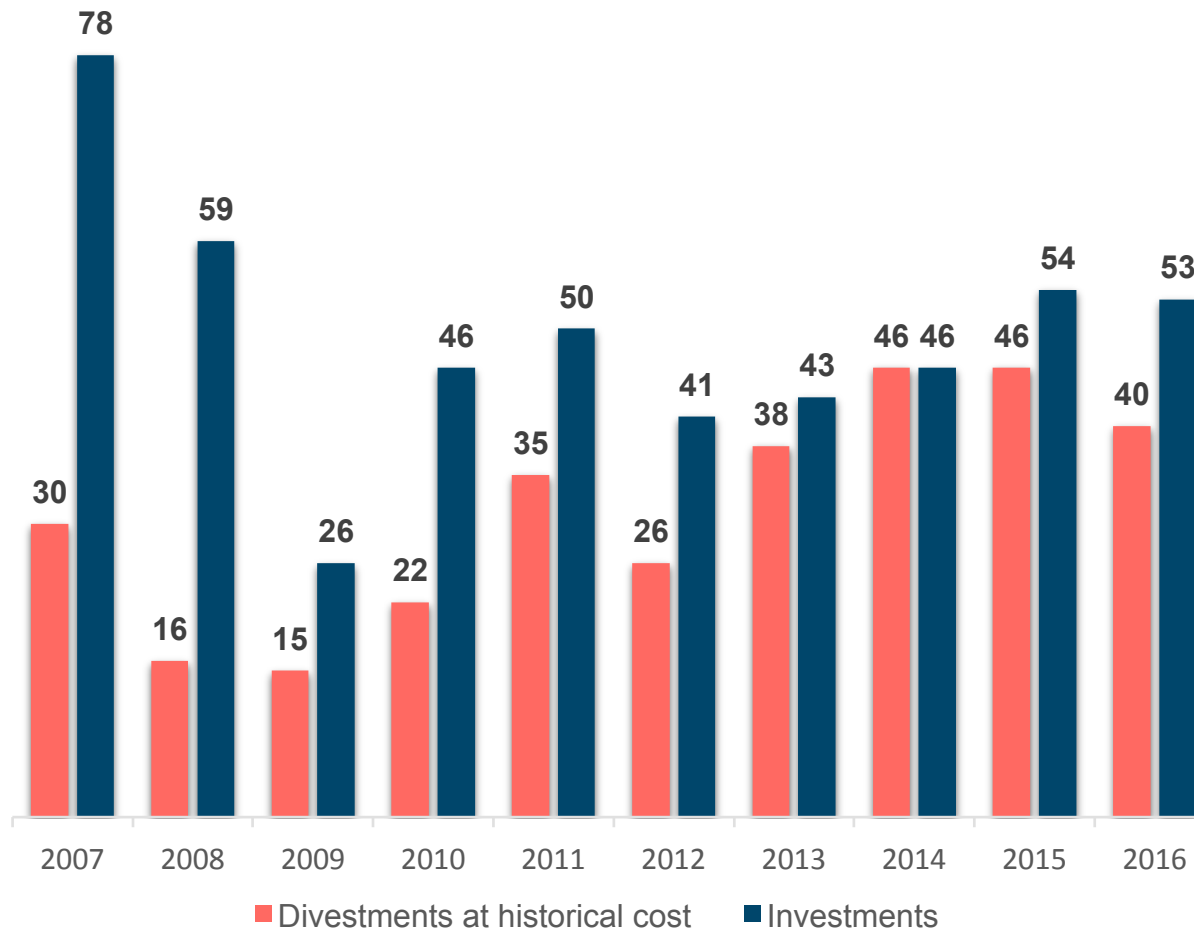


... emphasizing the **post-crisis stabilisation**

It headed back to an average size of €155 million in 2016.

# European PE : Exit overview

## Investments and divestments at cost in Europe (2007 to 2016)



Exits have increased in value (using historical cost) from 2013 to 2014

While the last graph showed an **decrease in exit value** for the same period.



There is a decreasing number of exits expected in 2017

It appears that there may be a link between the low level of investment in 2012 and the diminishing exit level in 2016



Pre-crisis “stranded assets” from 2005 to 2008

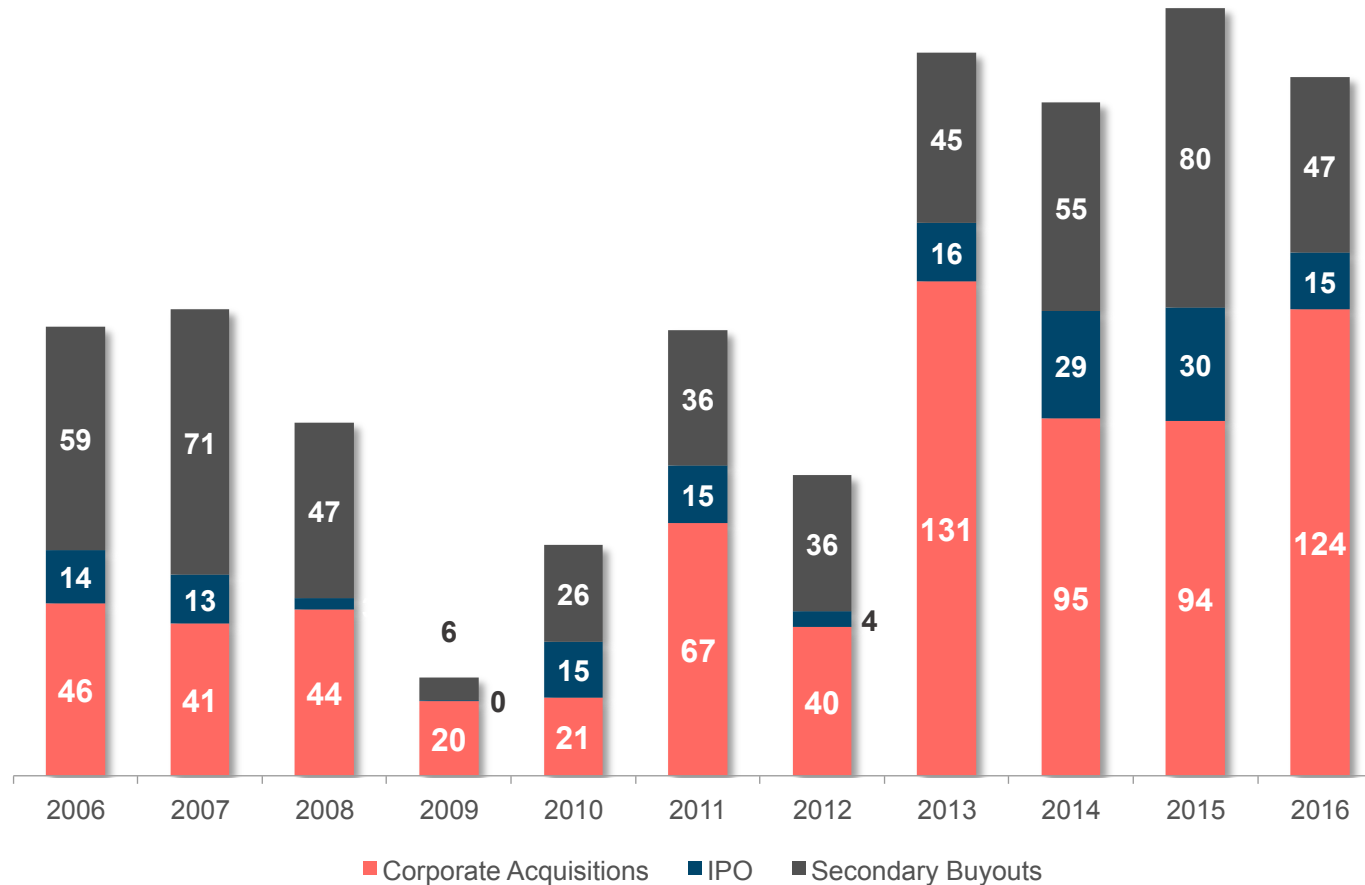
increased **2014-2015 level of divestment**, where PE firms used more favorable conditions to sell unrealized assets acquired pre-crisis.



There appears to be a **post-crisis stabilisation since 2013**

# European PE : Post-crisis SBOs are on the rise

European PE-backed exits by Type



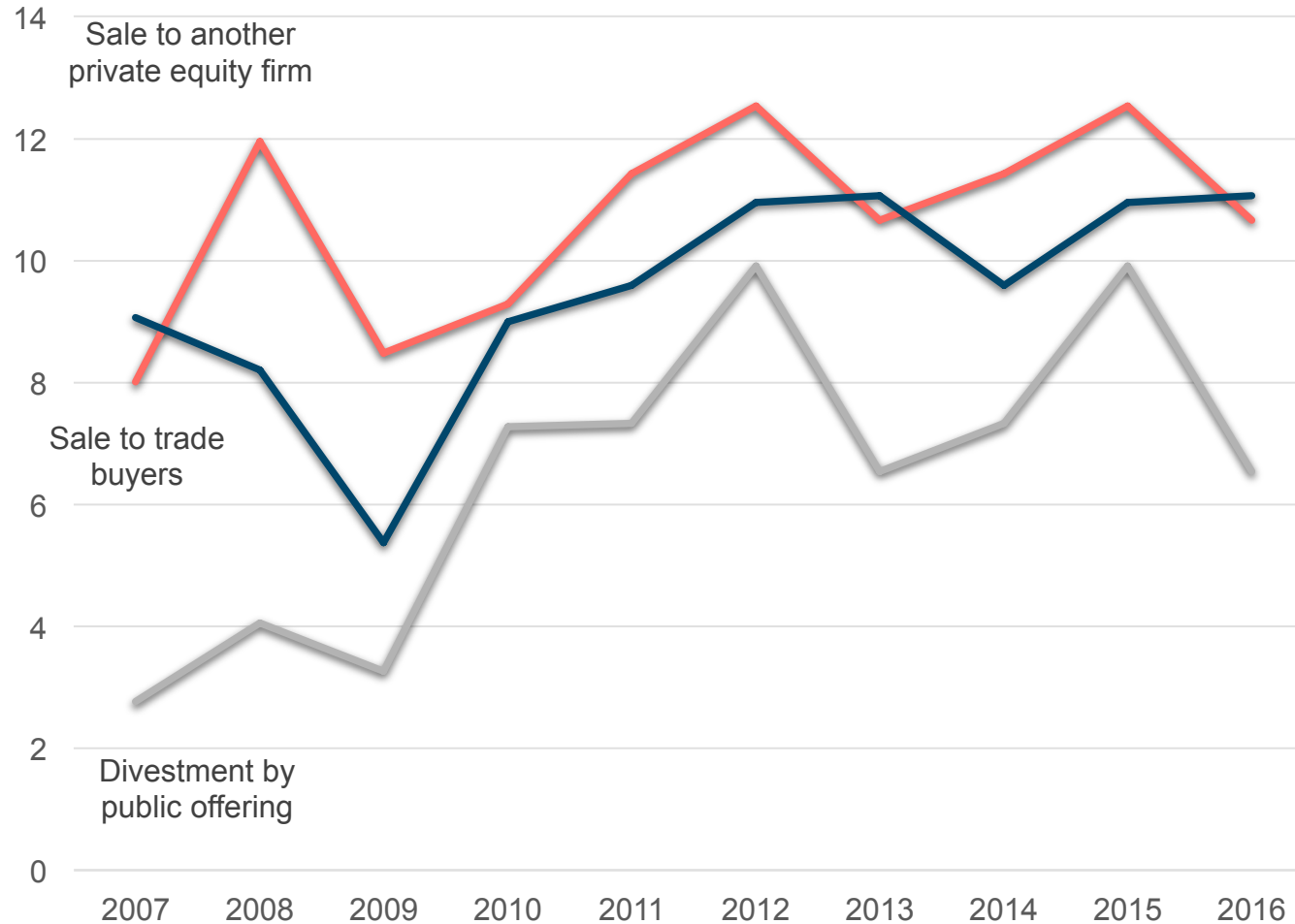
In **2016**

trade sales dominated exits  
(calculated by entry cost).

However, value at entry cost  
represented by exits via **secondary  
buyouts** is on an upward trend – not  
yet reaching pre-crisis level.

# European PE : Post-crisis SBOs are on the rise

Divestments at cost by exit route (in € billions)



At historical cost, **secondary buyout (SBO)** is the most important exit route in 2016, contrary to when it is measured by exit value (as shown on the previous slide).

Indeed : **29%**

of divestments at historical cost realized in 2016 were derived from **secondary buyouts**, exceeding **trade sales (27%)**.

# III. EURO-PHOENIX PRIVATE EQUITY SURVEY

Our methodology

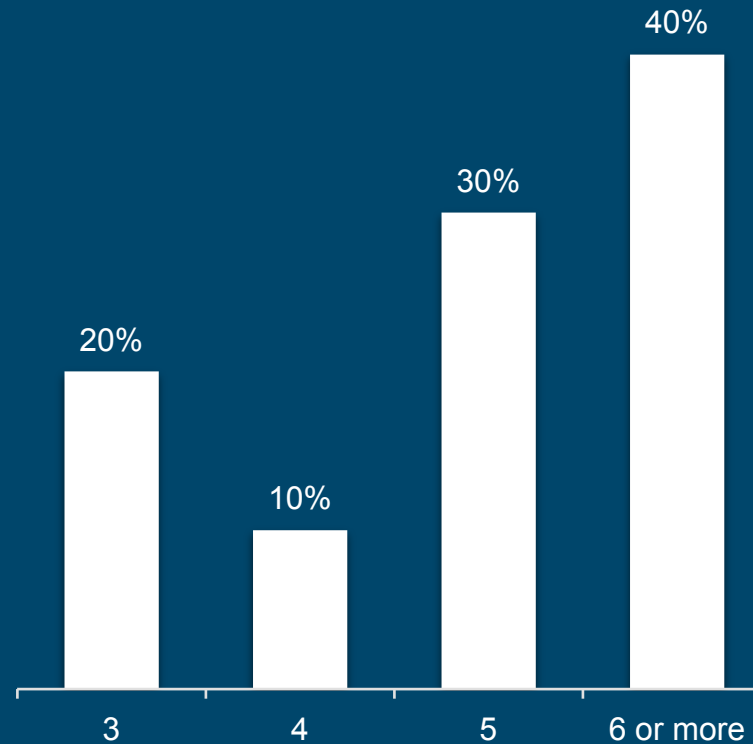




47

invited to  
participate

## Number of exits performed by the PE firms surveyed



We limited our survey to PE firms  
that have performed **3 or more  
exits in the CE region** since  
January 1<sup>st</sup>, 2014.

The majority of  
participating Private  
Equity firms were also  
interviewed

10

participated – many did not  
participate because they  
had fewer than 3 exits

Our sample was most heavily  
invested in :

- 1 Poland
- 2 Czech Republic
- 3 Romania

Source: « CE Private Equity survey » - August  
2017 - Euro-Phoenix Ltd.

# IV. EURO-PHOENIX PRIVATE EQUITY SURVEY Findings



Euro-Phoenix Financial Advisors Ltd. ©

**89%**

**OF PE FIRMS SURVEYED FORMULATED A  
WRITTEN EXIT STRATEGY PRIOR TO  
COMPLETING AN INVESTMENT IN A  
COMPANY**

Examples of “written exit strategies” as requested in the Euro-Phoenix Private Equity Survey, August 2017 :  
documents that identifies likely investors, ways of improving the company to be more responsive to the needs of such investors, etc.

Source: « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

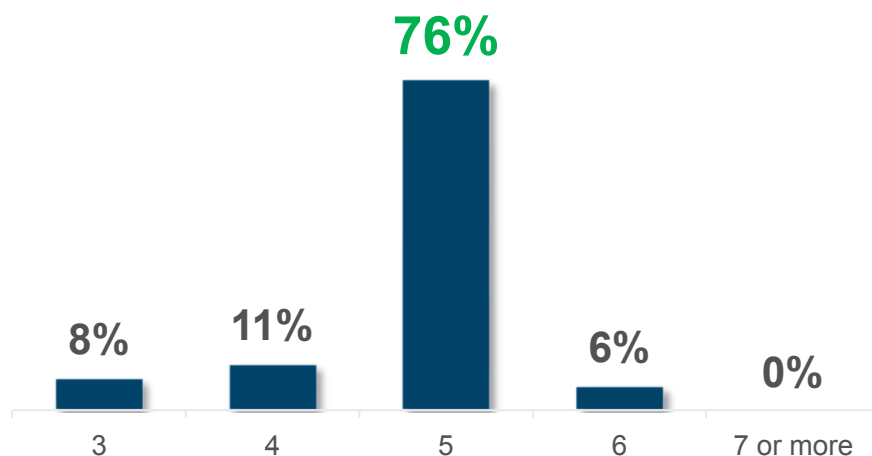
# PE Exit Survey : Holding Periods

## 4.8

CE overview

years on average, after investing. \*

At the time of your acquisition, in what number of years do you generally plan to exit ?

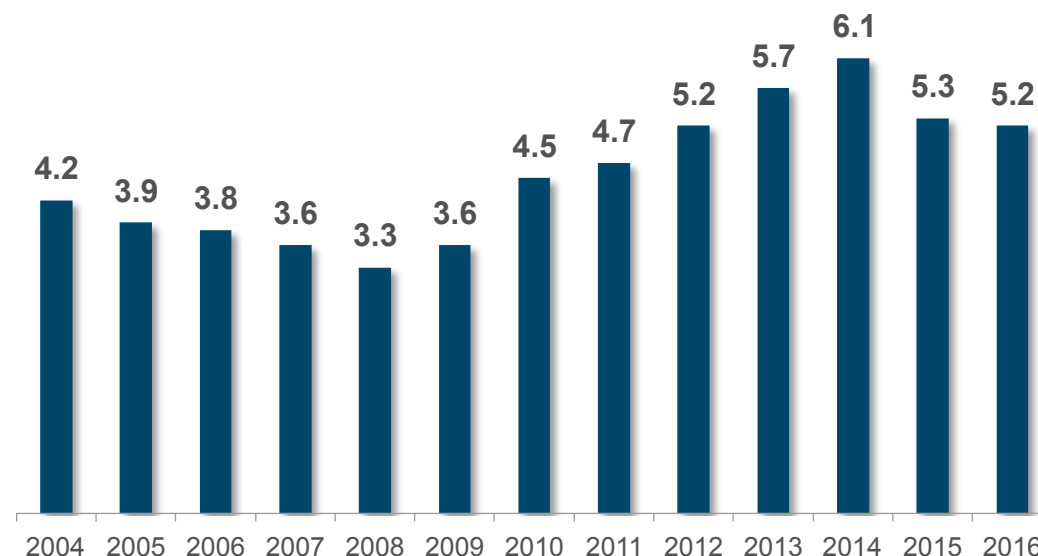


## 5.2 in 2016

Global overview

Median holding period for buyout-backed companies.\*\*

Median holding period for buyout-backed companies\*\*



\*Source: « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

\*\*Source: « Global Private Equity Report 2017 » - Bain & Company

# PE Exit Survey : Exit Overview

ACCORDING  
TO OUR  
SURVEY ...

FROM THE  
SELL-SIDE  
...

## 75%

of Private equity firms surveyed are generally open to an “**opportunistic bid**”.

## 31%

of corporate and PE executives answered “**opportunistic**” at the question “what triggered your most recent major divestment ?” \*\*.

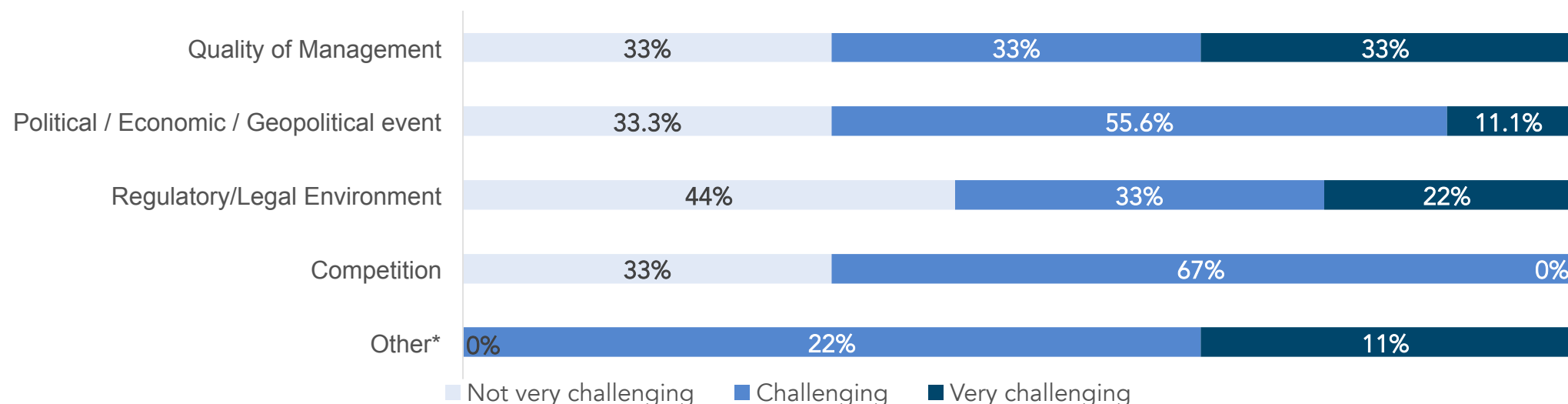
\* Source : « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

\*\*Source : « Global Corporate Divestment Study 2017 », EY, 2016., survey on 900 corporate executives and 100 PE executives from companies across the Americas, Asia-Pacific, the EMEA region, India and Africa surveyed in Q4 2015



# CE Private Equity : Exit Challenges

What have been the most challenging issues (e.g. either delayed closings or reduced returns) related to your exits in the Central European region since January 1st, 2014 ?



\* "Other" :

- "corruption", "very challenging"
- "small size of the market and lack of active PE ecosystem", "challenging"
- "strategic investor interest in CEE in recent times", "challenging"

# PE Exit Survey : Investment Environment

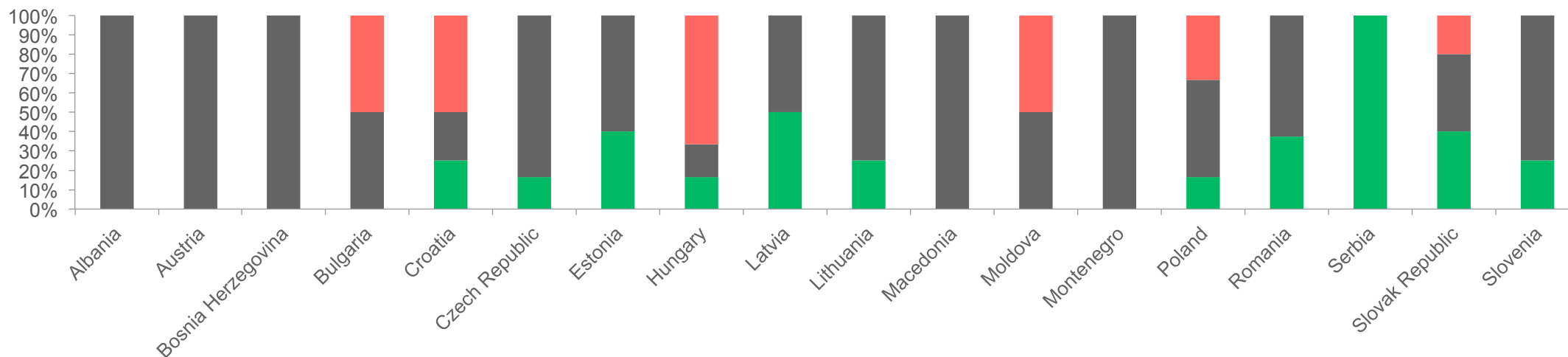
## Serbia

had the most votes for **investment environment improvement** since Jan 1, 2014

## Hungary & Poland

had the most votes for **investment environment deterioration** since Jan 1, 2014

For the country / countries you are permitted to invest since January 1, 2014, please provide your impressions as to the investment environment.



■ The investment environment deteriorated   ■ The investment environment is about the same   ■ The investment environment improved

Source : « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

# CE Private Equity : Recent key events

**Favorable developments  
in the exit environment**



## Romania

Romania records the highest M&A market increase in CEE in 2014 (24% more transactions have brought a 186% increase in the value of transactions in 2014.), which indicates a growing easiness for PE funds to match their portfolio. Indeed, between 2014 and 2015, Private Equity investments increased by 80%. Romania is projected to be the region's fastest growing economy in 2017 with an expected expansion of 4.6%.\*



## Serbia

UE pre-adhesion reforms : Mr. Vucic, Serbian Prime Ministers stated that the results of its reform agenda and other measures means the country is on track to meet a four-year plan paving the way for it to join the EU by the end of the decade. \*\*

# CE Private Equity : Recent key events

## Unfavorable developments in the exit environment



### Poland

“The EU has launched legal action against the country for breaking the bloc’s laws and heightened uncertainty and concern over the quality of Poland’s institutes could impact the business climate, investment and the country’s financial assets.” \*



### Hungary

“The situation in Hungary justifies the triggering of the procedure which may result in sanctions” EU’s Parliament stated in a resolution adopted in May 2017, referring to migrants and CEU crisis.\*\*



### Romania

Despite a 4.6% expected growth in 2017 in Romania, the new government stepped back from some of its promises, such as a further VAT cut, eroding investor confidence\*.

\* Sources Romanian & Polish news : focus-economics.com, August 2<sup>nd</sup> 2017 / \*\* Source Hungarian news : European Parliament, May 17<sup>th</sup> 2017 / Source logos : Telemom, Michal Kuk, Alex Tai, Anbileru Adaleru, Bence Bezerey from Noun Project  
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# CE Private Equity : Investment criteria

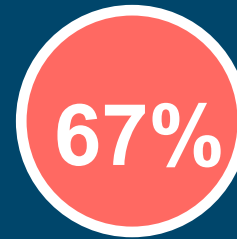
When making an investment, what are the attributes of the company that you consider most relevant ?



Organic  
Growth  
potential



Quality of  
management and its  
willingness for  
eventual exits



Current market  
share/market  
position



Potential for  
bolt-on or  
add-on  
transactions



Cost cutting

42%

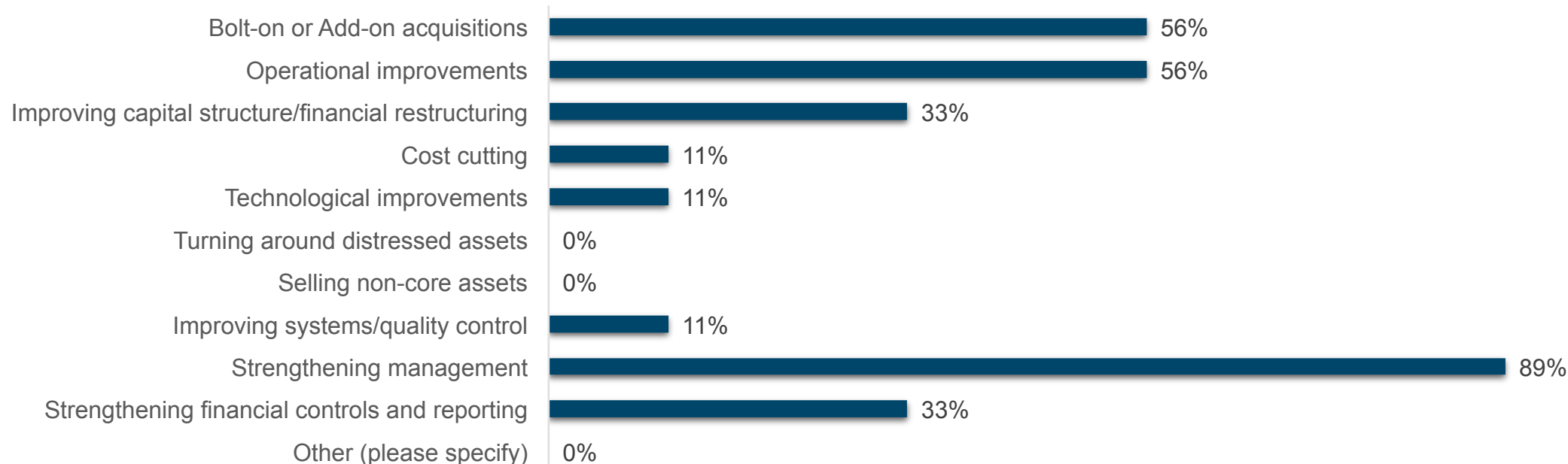
**FOCUS ON THE QUALITY OF MANAGEMENT:**

of PE firms found it necessary to implement major management changes in companies they have exited since January 1<sup>st</sup>, 2014



# CE Private Equity : Exit Management

**With which of the following activities do you try to build value to prepare for exit?  
(Please select the 3 most important elements of your strategy)**

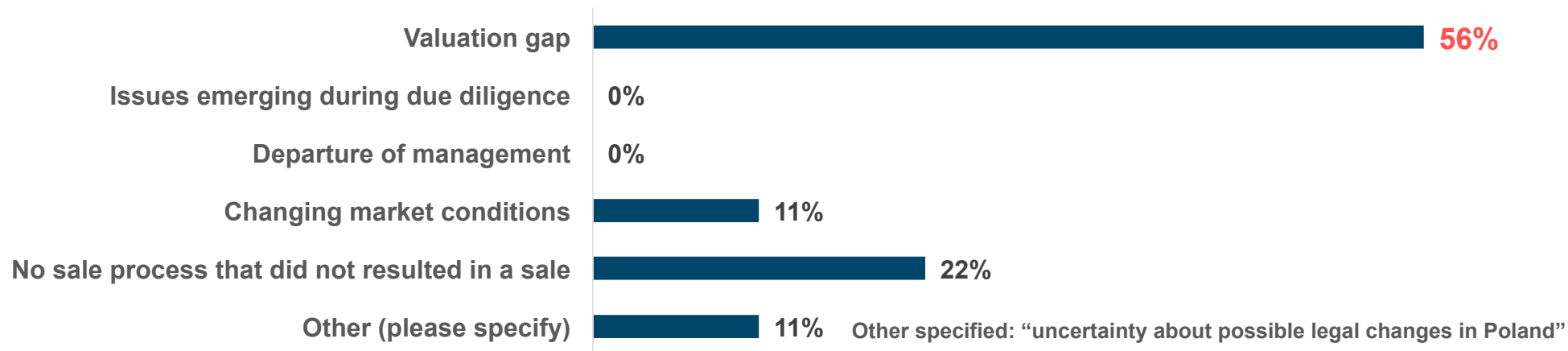


# CE Private Equity : Exit Management

**22%**

Of PE executives surveyed believe there was an inadequate pool of buyers willing to pay their minimum price expectation with respect to their last 3 exits.

**In case a sale process did not result in a sale, what was the most important reason for non-closure of the transaction ?**



Euro-Phoenix Financial Advisors Ltd. ©

**66%**

**OF ONE-INVESTOR  
SALE PROCESSES  
RESULTED IN A SALE**

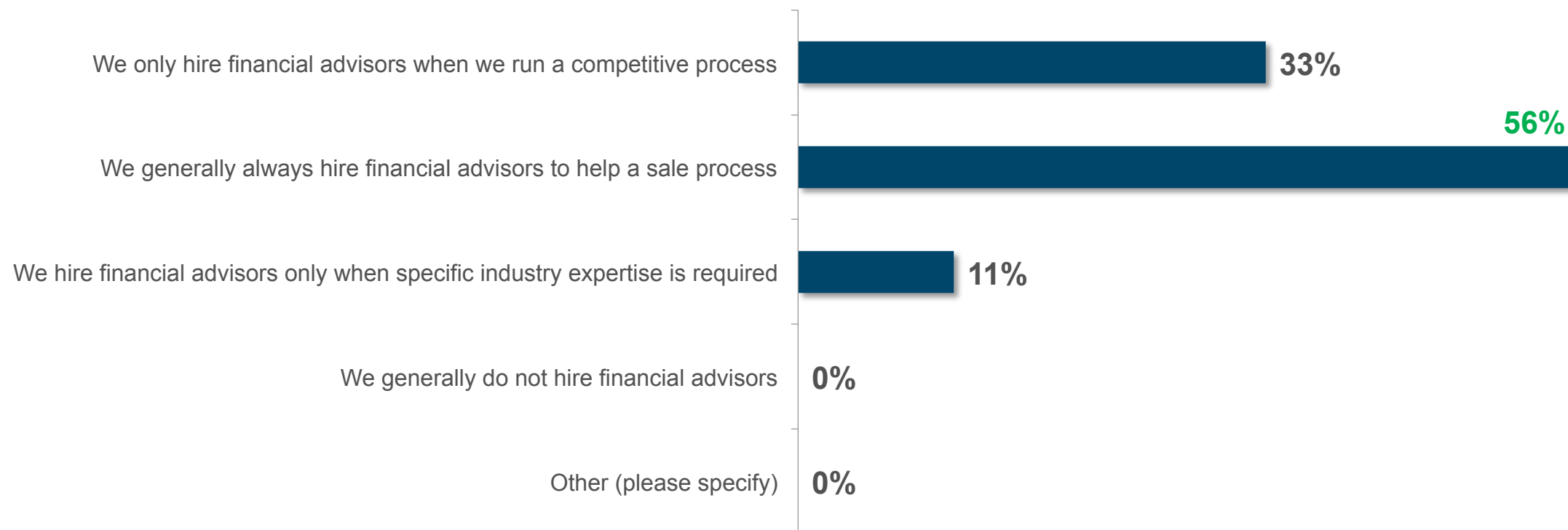
**78%**

**OF COMPETITIVE SALE  
PROCESSES RESULTED  
IN A SALE**

Source: « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

# CE Private Equity : Financial Advisory

Which statement best describes your firm's policy with respect to hire financial advisors on the sale of a portfolio company?



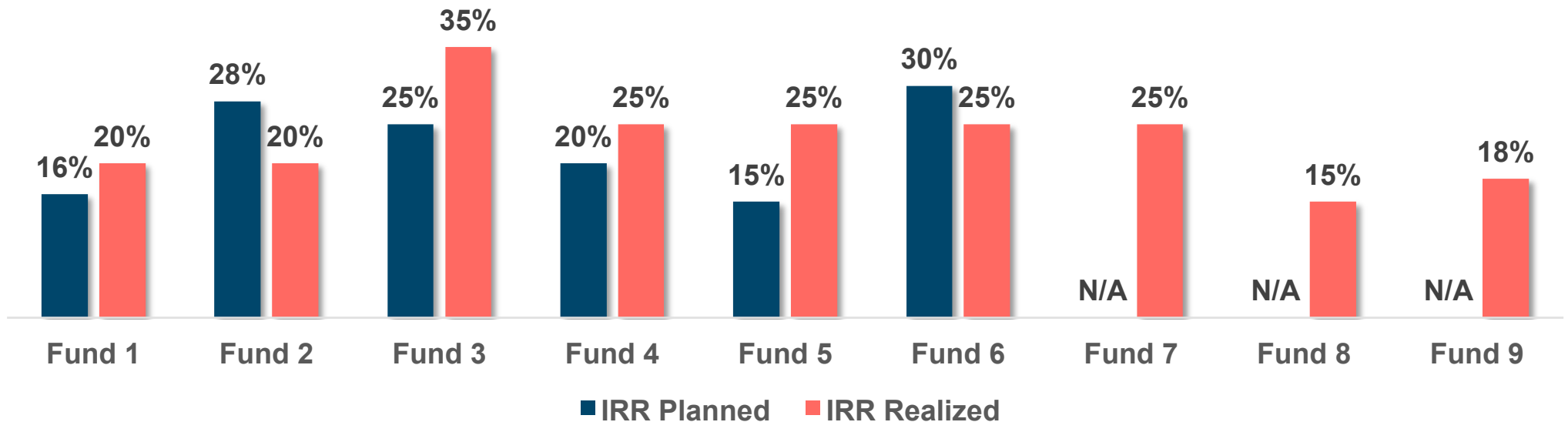
# CE Private Equity : IRR

For all exits realized since January 1<sup>st</sup> 2014 :

**23.1%**  
Average IRR  
Planned

**22.3%**  
Average IRR  
Realized

**3** PE firms didn't share their realized IRR  
**50%** of the remaining PE firms had a IRR realized better than expected  
**50%** of the remaining PE firms had a IRR lower than expected



# V. EURO-PHOENIX PRIVATE EQUITY SURVEY

Concluding comments

## Interviews : Deteriorating investment climate in Poland & Hungary

“I have not yet felt deteriorating investment climate in Hungary or Poland, even though I realize it probably exists.”

Interview feedback 1

“Cannot make the conclusion that multiples are coming down in Poland—not enough experience yet.”

Interview feedback 2

“The [Polish] Government doesn't seem to be impacting valuations on the way in, nor on way out, but there are some nuances around the edges.”

Interview feedback 3

# Interviews :

## Deteriorating investment climate in Poland & Hungary

“Tax authorities in Poland are not only becoming more savvy, but also more aggressive, and not just with foreign owned companies.”

Interview feedback 4

“Media storm [affecting Poland] has impacted fund raising, particularly from American investors, but the reality is that they're quite happy. Country image has taken a battering... It is not as bad as might be perceived by people who are not present here.”

Interview feedback 5



## FOCUS ON SBO

**Secondary Buyout**  
mostly for \$/€ 100 +  
**million** transactions

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Funds are still reluctant  
to target **secondary  
buyout exits** as part of  
their strategy



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## FOCUS ON IPO

Financial institutions  
require more and more  
**robust** candidates for  
**IPO's**

---

Relatively **few**  
**institutional players** set  
the tone of demand for  
**IPO's**

---

*« We much rather try to  
orchestrate a competitive  
process, **we might even  
threaten an IPO to keep  
the heat on.** »*

# Interviews : Improving value in portfolio companies

## Interview feedback 1

“We usually want to improve internal processes, make the company more corporate, make it more interesting to a strategic buyer. “

## Interview feedback 2

“We try to make the company more independent of the founder.”

“

### INTERNAL RATE OF RETURN:

Our [Baltic] fund outperformed thanks to higher than expected corporate growth, and exit at higher than entry multiples.

PLANNED IRR

20%

REALIZED IRR  
OVER ITS LAST 4 EXITS

28%

”

# Interviews : Pool of investors available at exit

Source : « CE Private Equity survey » - August 2017 - Euro-Phoenix Ltd.

## Interview feedback 1

“There are not as many strategic investors targeting CE as in pre-Lehman era... Probably most people who want to be in this part of the world are already here.”

## Interview feedback 2

“In the post-Lehman there were only bottom feeders. Things are better now, but it is still harder to do trade sales than pre-Lehman.”

## Interview feedback 3

“Exit is highly dependent on timing. Buyers can change their strategic focus or lose interest.”

## Interview feedback 4

“It has become harder to ring out a premium, even on a quality asset.”

## Interview feedback 5

“There is still an inadequate pool of buyers—hence the fund sometimes compromises on price. We were surprised that there were fewer really motivated buyers than expected, willing to pay a premium price, for a really attractive, well-growing company. But there were typically still one or two.”

## Interview feedback 6

A mid-sized Czech based fund: “Wealthy individual investors, mostly entrepreneurs who have sold their businesses, and their family offices, are becoming a relevant class of investors”.

# BUSINESS EXIT PLANNING



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Hungarian, Italian, Polish, Serbian, Russian  
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# THANK YOU FOR YOUR ATTENTION

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