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Central and Eastern Europe

COVERING NEWS OF THE PRIVATE EQUITY MARKETS IN CENTRAL & EASTERN EUROPE

Issue 1

APRIL 2011

CEE buyouts set for strong year

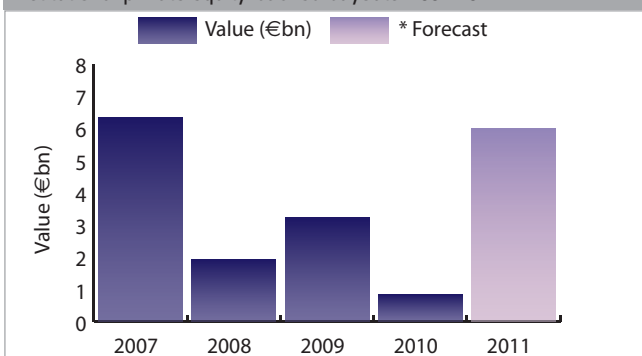
THE LACKLUSTRE YEAR that was 2010 may just have been the quiet before the storm, with more than €6bn on the cards for buyouts in Central and Eastern Europe this year. The region has already clocked up €427m, or half of last year's €847m (*see graph*). If achieved, it would be the strongest year since 2007's heady peak of €6.3bn.

More than half of this year's value prospects lie with the privatisation of Polish telco Polkomtel (*see page 15*). Some are sceptical it will transpire, given the government's hefty price expectations of nearly €4bn (reminiscent of more bog-standard vendors of yesteryear). The tight deadlines also deter, with one private equity bidder already shut out after missing the second bidding deadline.

This, along with the complex ownership structure, may mean the asset ends up on the Warsaw Stock Exchange instead. One person close to the situation said: "Two key executives are very well plugged in at the level of government. I think it's a challenge for a straight private equity bid, but who knows."

Even if Polkomtel doesn't go to private equity, this year should see a strong performance. A deal in Turkey may fetch \$1.7bn, but the rest of the value was made up by upper mid-market transactions of €150-400m – a very sweet spot to be in (*see table*). The secondary buyout of Polish grocer Zabka from Penta to Mid Europa was the first at €370m, while TP Emitel went for €425m. Finally, Permira-backed Provimi Pet Food may fetch up to €200m and Czech CS Cargo could go for €150m.

Institutional private equity-backed buyouts: 2007-2011*



Source: unquote

Bumper year: More than \$6bn up for sale in CEE

Target	Country	Value
Polkomtel	Poland	\$3.7bn †
TP Emitel	Poland	€425m
Zabka	Poland	€370m
Doğan Yayın	Turkey	\$1.7bn
Provimi Pet Food	Hungary	€190m
CS Cargo	Czech Republic	€150m

† Government's price

Source: unquote



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Consumer-focused Investor in CEE



Centrum Medyczne MAVIT Sp. z o.o.
Network of specialized medical clinics
Poland

Capital increase and partial buyout
EURO 12 million
November 2010



Interchem S.A.
Wholesaler and retailer of HHPC products
Poland

Capital increase and partial buyout
EURO 18 million
January 2011



SPS Handel S.A.
Food retailer and wholesaler
Poland

Capital increase
EURO 16 million
February 2011



Melvit S.A.
Grain processing company
Poland

Capital increase
EURO 8 million
February 2011



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Multiple worries

■ According to the man on the street, multiples nowadays stand at around 7x EBITDA for assets, up to 9x if it's a "quality asset" (meaning it stands at 9x, since I know of no GP willing to admit he buys low-quality assets). This is down markedly from the double-digits seen yesteryear when leverage was plentiful and Lehman Brothers still existed.

But now it's back. The latest issue of *Private Equity Europe* features at least four deals with double-digit EBITDA multiples: leading the pack is Gambro at 15x; in second place is Opodot, then Zabka, Marlow and Guascor. These four are probably a third to a half of the true total, given how cagey GPs are about disclosing such sensitive figures.

To support these expensive deals are mammoth debt packages: First Reserve's €1.23bn acquisition of Ansaldo (which admittedly was just under the 10x EBITDA multiple) saw the PE backer pump just €225m into the deal. It was supported by a five-year-term bank loan of €300m; a revolving credit facility of up to €350m; and a vendor loan of €273m. Who said the debt markets were dead?

What is interesting, however, is that many of these deals are in fact disposals by GPs, not acquisitions. For example, Gambro was a sale by EQT and Investor to a trade buyer – meaning that private equity isn't just buying assets at high multiples, it can also sell them at high multiples.

Therefore, the local tut-tutting of Mid Europa's acquisition of Zabka may be unnecessary. The 12.7x multiple shrinks to 10.5x if you look at Q4 2010 earnings instead of full-year – which is acceptable for fast-growing businesses. Someone close to the deal said it is likely to be a single-digit multiple by the time the deal closes this summer. Montagu has also just paid top-dollar for TP Emitel.

There are certain assets within certain sectors that warrant high prices. A handful of investors are capable of identifying these and monetising them. Until they lose money, the multiples are not too high.

Yours sincerely,



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Russia seeks private equity partners in \$10bn fund

THE RUSSIAN GOVERNMENT is seeking global private equity partners in a \$10bn fund aimed at attracting international money into the country, with Apollo, Carlyle and Blackstone all believed to have been approached. It is not the first time the government has tried to promote the sector: five years ago, Vladimir Putin put hundreds of billions of rubles into seed funds hoping to promote the industry.

Rusnano, that government fund, was valued at around \$130bn last year; however, it was entirely made up of government money. The Russian Venture Company (RVK) was set up to invest this money, but there remain some impediments: venture and private equity funds are still treated as mutual funds, and Russia does not yet recognise limited liability partnerships.

This may be about to change. Russian president Dmitry Medvedev is pushing the issue of investing in innovation hard, stating in a recent session of the Commission on Modernisation and Development: “I charge the Presidential Administration and Russian Government with preparing propositions on disciplinary responsibility of the heads of state corporations. I have approved a number of solutions on state structures already, and they will be published soon.

“Investments do exist, and there is money available for these investments. But, practically, there are no innovations at all. And there is little high-tech competitive products” (translation from Russian Private Equity & Venture Capital Association).

Turkey may be about to host one of Europe’s largest deals – again

BUYOUT TITANS KKR and TPG are the last two private equity firms still in the running for assets of Turkish media group Doğan Yayın. Bids are said to be starting at \$1.7bn, with Goldman Sachs appointed to lead the process. Trade player Time Warner is also in the running, and already partners with Doğan in their CNN Turk joint-venture.

It is not the first time Turkey has made headlines for hosting a mega-deal: in early 2008 BC Partners won a contested auction to win the \$3.25bn Migros Turk deal. Carlyle, Russia’s Alfa, Bain Capital, Turkven-BC Oartbers and KKR had all looked at the deal. Just in February, TPG and its Turkish partner Actera announced the \$2.1bn sale of Mey Icki to Diageo.

Other parties have already dropped out of the Doğan bidding, with 12 initially believed to have been interested, largely owing to pricing concerns. Apax Partners is cited as one such group.

However, the uncertainty surrounding the deal could also be a factor: The bids are non-binding, and some suggest the auction is being run to exhaust options while the owner dukes out a court battle over back taxes and penalties, and may not ultimately lead to a sale. The penalties stem from a ruling by the Turkish watchdog back in October and are supposedly down to the group’s unfavourable coverage of the AK Party. They amount to more than \$3bn.

Turkey is attractive to investors for a number of reasons, not least its population of 78 million people – one of the largest in Europe – and Brussels’ negotiations to eventually permit the country into the European Union. Reflecting increasing interest in the country, global law firm Clifford Chance opened an office in Istanbul in November.

Doğan was also reported to be putting its flagship paper, Hurriyet, on the blocks. However the parent company put out a statement denying this at the beginning of the year.

BC Partners hits €4bn first close

BC PARTNERS HAS raised €4bn at the first close of its ninth buyout fund. The GP offered an “early-bird discount” special, with 5% off fees for those entering at first close – a sign that GPs can and must compete on terms, as well as their track records, in today’s difficult fundraising backdrop.

The company started the fundraising process in September 2010. The vehicle has a target of €6bn.

Late last year, BC Partners-backed gym chain Fitness First sold the Dutch arm of its business to fitness club operator HealthCity International. BC Partners purchased the health club group as part of a management buyout from Cinven in October 2005.

The private equity firm injected £300m of equity, while £500m of leverage was provided from Mizuho Corporate Bank.

Hands appeals court ruling on EMI deal

TERRA FIRMA CIO Guy Hands has appealed against the US court ruling that cleared Citigroup of all charges in the EMI case, according to reports.

Hands claims that Citigroup tricked Terra Firma into the deal by saying there was a rival bidder. This was declared not to be the case by a New York jury in November 2010.

The £4.2bn buyout of EMI in May 2004 saw Terra Firma

inject £1.75bn of equity. After running into financial difficulties, the company is in danger of breaching the terms of the Citigroup loan.

Unless Terra Firma injects fresh equity to meet the terms of the loan, the bank is likely to acquire EMI through a debt-for-equity swap.

It is believed that the appeal process will take about 18 months.

people moves

Altius appoints IR head

Altius Associates Ltd has appointed Dr Eric Warner as head of investor relations.

Prior to joining Altius, Dr Warner was a partner with Mercer Human Resource Consulting, where he was responsible for the company's business in private equity and M&A. He has also worked for Société Générale, NatWest Capital Markets and Security Pacific Hoare.

Based in Altius' London office, Warner will look to expand the firm's global investor base.

Clifford Chance opens office in Turkey

Global law firm Clifford Chance has established a new office in Istanbul. The legal adviser believes that the office will allow it to expand its services in the Turkish and southeast Europe market.

The office will be operated with support from Clifford Chance's Turkish cooperation partner Yegin Legal Consultancy (YLC) and its head Mete Yegin. Simon Williams will head the operation, which is due to open in spring 2011.

CalPERS recruits Larry Jenson to new CRO role

The California Public Employees' Retirement System (CalPERS) has appointed Larry Jenson as chief risk officer, a newly created position.

The appointment comes after a rocky few weeks for CalPERS, in which it saw two of its top fund managers leave the business: Joncarlo Mark, who had been with the firm since 1999, and Mike Dutton, who had looked after CalPERS' large buyout remit since 2006, both left last month.

Jenson served as an interim chief risk officer since October, when he was appointed to head the office of enterprise risk management and to assess risk independently for CalPERS.

Previously, Jenson was the assistant executive officer for the administrative services branch since January 2010.

OMERS PE hires director

OMERS Private Equity has appointed Martin le Huray as a European director.

Huray will be based in the OMERS Worldwide office in London, where he will be responsible for sourcing, executing and post-acquisition management of direct private equity transactions across Europe.

He joins OMERS after six years at 3i, where he most recently held the position of director.



Industry consolidation

Three years ago, the Boston Consulting Group sent shockwaves through the industry when it predicted the demise of up to 40% of buyout funds. Alas, it has not happened – though some consolidation is taking place. Notably, it's in the venture and funds-of-funds space...

Quest and Capricorn Venture to merge

Quest Management and Capricorn Venture Partners are set to join forces following a proposal by their respective boards of directors to merge the two companies.

The manager of tech vehicle Quest for Growth and Capricorn, which advises several pan-European venture capital funds, will

become one entity once an application to Belgium's Banking, Finance and Insurance Commission has been granted.

The shareholders of the Belgium-based private equity firms will also need to approve the merger, which will see Capricorn acquire all of Quest's activities, personnel, assets and liabilities.

ACG PE acquires Gimar fund-of-funds

ACG Private Equity has acquired Gimar Capital Investissement, a fund-of-funds management company, from Gimar Finance.

Following the deal, Laurent Gillot, director, and Patrick Grange, associate director, will be joining ACG's private equity team as managing director and investment director respectively. They will also form part of the firm's investment committee.

The combined entity will take charge of managing seven dedicated and multi-investor funds-of-funds, which have stakes in around 70 private equity funds in Western and Eastern Europe.

"With this first acquisition, ACG Private Equity increases its assets under management and aims to participate actively in the restructuring of the private equity industry as a consolidator," said Wladimir Mollof, founder and president of the company.

Alliance Trust shuts PE arm

Alliance Trust, the £3.7bn investment house, is closing the door on its private equity arm, Alliance Trust Equity Partners.

The firm was set up in 2006 when Alliance Trust acquired the shareholding of Albany Venture Managers Ltd, an amalgamation of three venture capital funds founded in 2000 with committed equity of £25m. The respective managers joined to lead Alliance Trust's then new private equity team.

Alliance Trust Equity Partners backed two UK businesses in 2008: it led a £2.6m round into Digital Healthcare, and

it participated in an £8m series-C round for Ranier alongside FirstVentures. Around two years ago, the outfit told *unquote* "it was seeking 20 GPs to invest in.

The firm is winding down over the next few months, "in order to maximise the returns to the shareholders." The move is part of a strategy that will see Alliance Trust focus on its equity and fixed income product.

Alliance Trust Equity Partners employs six people and managed £110m at the end of February. ■

Quantifying alpha

Alpha does indeed exist, and is strongest in private equity deals with active ownership; particularly when frequent interaction with – and even changing of – management is involved.

Kimberly Romaine reports

This was one of the findings by McKinsey Active Ownership research, presented at the EVCA Investors' Forum in Geneva in March by Conor Kehoe, partner at McKinsey & Company.

The robust research put numbers behind what private equity executives have shouted about for years: that hands-on investing in companies can generate significant outperformance over public companies. The study suggests that the best deals – those involving the highest returns – involved management change; with 56% of top tercile exits involving new faces at the top. “Do it and do it quickly,” Kehoe suggested.

The study further found a positive correlation between alpha and “active ownership” for organic deals, with “active

ownership” involving not only changing management, but strong support from the private equity team throughout the holding period. This, Kehoe suggested, should involve the private equity backer having weekly meetings – or more – with the portfolio company CEO.

Alpha accounts for a quarter of the total IRR from large deals in Europe, or up to half when leveraged, according to the study. It found that an IRR of 41% would, on average, be comprised of eight percentage points from sector growth, 10 from alpha and 23 from leverage (on both sector and alpha).

The study was based on 102 realised European deals acquired between 1995 and 2005, with a bias towards larger buyouts. ■

Let the good times roll

Readers of *unquote* are positive about the outlook for this year, but remain concerned about the future, according to our survey

Nearly 80 readers of *unquote.com* gave us their views on the market in 2010 and their expectations for the future. Though 2010 was seen as a major recovery in comparison to a very difficult 2009, the market was far from healthy, and *unquote* readers expect continuing challenges in the year ahead.

A huge 67% of *unquote.com* readers believe dealflow will increase in 2011, and just 4% expect it to fall, a positive sign for the industry. While dealflow in 2010 was considered to be in-line with or even above expectations, there were concerns over the extent to which these became successful deals. When asked about dealflow, no respondents felt dealflow in 2010 was significantly below their expectations, but when asked about completions, 7.4% said these were significantly below what they expected.

Leverage conditions could play a part in this. While almost 56% of respondents said leverage was easier to obtain, 7.4% felt it was more difficult to secure debt for transactions in 2010 compared with 2009. Over the past 12 months, many market commentators have stated that leverage conditions have improved, but major

packages can still only be achieved for the very best assets with reliable cashflow. Those looking to buy more risky assets may still have found the bank doors closed to them, making it difficult to complete investments despite good dealflow.

Other concerns included pricing, which has been a contentious issue throughout 2010. Many market players have told *unquote* that asking prices were much higher than they had hoped given the uncertain economic situation. Almost 50% of respondents said pricing in 2010 was higher than it had been in 2009. Furthermore, 50% of respondents say they are worried that Europe is at risk of a double dip recession, while just 19% said a secondary economic dip was not a concern. Clearly, private equity players are mindful that the economic crisis following the failure of the banking system is not yet over.

Overall, market players believe 2010 was a better year, and expect 2011 to see continued improvement. Early signs suggest deal activity has maintained momentum since the beginning of the year, and *unquote* will continue to monitor the latest trends. ■

Portfolio companies: paying down debt

Like many industries, private equity was hit hard by the financial crisis and ensuing recession, with tough fundraising conditions, few exit opportunities and widespread restructurings. But new research from SVGA suggests private equity has strengthened its portfolio companies in the downturn

SVGA Advisers (SVGA) says private equity has always been a cyclical business, with its fortunes rising and falling in line with prevailing market sentiments. However, SVGA research suggests PE portfolio companies performed considerably better during the downturn, suffering only a short period of falling profits. It analysed 50 unrealised underlying portfolio companies within its fund-of-funds over the past four years.

The research suggests the average private equity portfolio company saw EBITDA contract for just one year during the downturn, before returning to growth. This comes despite revenue growth falling through both 2008 and 2009, implying that management actions were largely responsible for maintaining profit margins. SVGA says that, within its own fund-of-funds, it found private equity managers had taken significant strategic action to ensure the smooth running and continued profitability of their investments.

SVGA also discovered many private equity fund managers had worked with portfolio companies to deal with debt burdens, which can put major strain on companies even if they remain profitable. In 2006, net debt in portfolio companies was approximately 6.3x EBITDA, but despite falling revenues this is estimated to have fallen to around 4.7x in 2010. Restructurings and renegotiating maturity periods are largely responsible for the fall in debt levels, according to SVGA.

However, the fund-of-funds manager warns portfolio company management not to get complacent. The economic situation remains fragile, with Ireland's sovereign debt crisis late last year, and the risk of further shocks in the months ahead. Private equity would not be immune from a double dip recession, SVGA says, but with the right action portfolio companies should weather a second deterioration in market conditions. ■

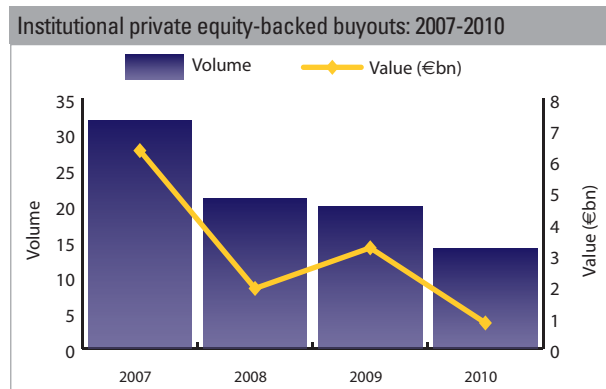
European buyouts 2010: statistical overview

Latest figures from the *European Buyout Review 2011* show subdued deal activity in CEE in the last year. That said, as this is not a homogenous region, dealflow continues to vary strongly among individual countries. By *Emanuel Eftimiu*

The following forms part of the CEE chapter of the European Buyout Review 2011. Please email Kimberly.Romaine@incisivemedia.com to purchase your copy.

Having held up relatively well in 2009, buyout activity decreased 30% to a new low of just 14 deals in 2010. While in previous years the region had recorded the odd buyout at the larger end of the value spectrum, the absence of any deals valued at more than €250m meant that overall value collapsed compared to 2009, by 74% to just €833m. Consequently, the average deal value fell to just €59m, a little over a third of the 2009 average and the lowest in the sample period.

Historically, more than 80% of the region's buyouts have taken place in the less than €250m size range and 2010 was no different. In fact, while previous years had seen the odd mega-buyout completed, such as the €1.66bn acquisition of Bulgarian Telecommunications Company in 2007 and CVC Capital Partners' €1.53bn buyout of the CEE operations of Anheuser-Busch InBev in 2009, no such deals were recorded throughout 2010.



Source: unquote/Private Equity Insight

While all 14 recorded buyouts were completed in the smaller deal brackets, the shift towards the mid-market that could be observed over the last few years continued. Only four transactions were seen in the less than €25m value bracket – half of the 2009 total and lowest in the sample period. At the same time, four deals were signed off in the €25-50m bracket – one more than in 2009. Notably, activity in the €50-250m size range mirrored that of the previous year with six completed transactions, which resulted in this bracket accounting for 43%

Institutional private equity-backed buyouts by value: 2007-2010

Value (€m)	2007	2008	2009	2010
<25	11	5	8	4
>=25 and <50	8	11	3	4
>=50 and <250	7	3	6	6
>=250 and <500	3	0	2	0
>=500 and <1000	1	2	0	0
>=1000	2	0	1	0

Source: unquote

of dealflow in 2010. This is by far the highest share observed in the past four years, and significantly up from the 15% seen in 2008 and 30% in 2009.

Although the deal value was not disclosed, IK Investment Partners' acquisition of Polish food products producer and seller Agros Nova is estimated to have been the largest deal in the region in 2010, with a value at the top end of the €50-250m bracket. Another notable transaction in this size range was Abris Capital Partners' acquisition of auto fleet management business Masterlease Polska, which represented the first time a financial-sponsored transaction accessed the bond market for replacement capital in Poland.

Buyouts by sector & source

Despite the difficult market conditions, buyouts were completed in all but the services sector, which historically has seen the least private equity dealflow. Interestingly, deal completions in the media sector, which had recorded four transactions in 2009, were subdued in 2010 with only one buyout: GED Capital's small-cap acquisition of Romanian printing services provider Infopress Group. The by far most active sectors in the region continued to be the consumer and industrials sectors. Nonetheless, compared to the average dealflow from 2007-2009, volume in both sectors was down in 2010.

The consumer sector recorded four deals, a drop of 33% from 2009's total and less than half of the nine deals recorded at the peak of the market in 2007. Three of the four deals fell into the smallest size bracket of <€25m: Resource Partners' purchase of household products importer and distributor Interchem, Penta Investments' buyout of supermarket chain PR Market and Enterprise Investors' acquisition of tour operator Orbis Travel. Notably, the largest deal of the year in the CEE region was also completed in the consumer sector: IK Investment's acquisition of Agros Nova.

Activity in the industrials sector saw a slight increase in 2010 by one transaction to four deals. That said, this is still lower than the average of five deals recorded in this sector from 2007-2009. Although the deal value was not disclosed, the secondary buyout of Croatian supplier of calcium aluminate cement Calucem by ARGUS Capital Partners from Mid Europa Partners is reported to have been the largest industrials deal.

Institutional private equity-backed buyouts by sector: 2007-2010

Vendor	2007	2008	2009	2010
Consumer	9	7	6	4
Financials	6	0	1	2
Healthcare	2	5	3	2
Industrials	6	7	3	4
Media	1	0	4	1
Services	3	0	1	0
Technology	5	2	2	1

Source: unquote

Private and family-owned businesses remain the most common source of dealflow in the region, accounting for five of the 14 buyouts in 2010. That said, completions from this vendor type have continued to drop from 13 in both 2007 and 2008 and seven in 2009. Anecdotal evidence suggests that, while the gap between buyer and vendor pricing expectation has narrowed, many vendors are still holding out for improving valuations before returning to the market.

Institutional private equity-backed buyouts by source: 2007-2010

Vendor	2007	2008	2009	2010
Corporate spinoff – Foreign	5	2	4	2
Corporate spinoff – Local	2	2	2	3
Family/private vendor	13	13	7	5
Other	2	0	0	0
Public to private	3	1	2	0
Secondary buyout	7	3	5	4

Source: unquote

Secondary buyouts continued to be a reliable deal source in the region. While such transactions had seen a substantial fall in Western Europe during 2009 and only reappeared with improving market conditions in 2010, institutional vendors have produced a steady uninterrupted dealflow in the CEE region. Four secondary buyouts were recorded in 2010, including the largest deal of the year, with IK Investment Partners acquiring Agros Nova from ITR Investment Partners. Other notable transactions were the aforementioned Calucem deal and Advent International's acquisition of Romanian chain of medical clinics, Centrul Medical Unirea, from 3i.

Buyouts by country

Tellingly, Poland was the most active private equity market in the CEE region in 2010. It accounted for more than half of all recorded buyouts in 2010. Dealflow in the country – one of the most established markets in the region – was further polarised by the fact that it was the only economy to post positive growth in 2009. Fellow established countries Czech Republic and Romania recorded two buyouts each, despite their gloomy economic outlooks. Bulgaria did not see any buyouts in 2010 following the remarkable four completions the previous year. ■

CEE: Bumper year ahead

Last year's deal trough may just have been the quiet before the storm, with €6bn of deals on the block in 2011. Kimberly Romaine reports

2010 was a year of two halves: the first six months were marked by a continuation of portfolio management seen in 2009. The second half of the year saw all this hard work bear fruit, with a handful of handsome exits. And 2011 has got off to a strong start, with Mid Europa Partners' €370m acquisition of Zabka.

"The first half of 2010 was admittedly slow," says Mike Wilder, partner at PricewaterhouseCoopers in Warsaw. "But the second half saw activity take off. A lot of work was going on looking into deals." That the numbers don't stack up is because of increasingly active corporates – the deals did get done, albeit by trade buyers. For example, the sale of Polish cable provider Aster by Mid Europa ultimately went to a trade buyer, though a handful of private equity firms put a lot of diligence into buying it.

Is the slowed rate of deal-doing worrying? No, says Henry Potter of Alpha Associates. "Looking at our funds, none are behind in their investment pace. Most of the main raised their funds before the crisis and will raise again in the next few years." So a lack of any pressure to deploy may be behind the snail-pace investing, while an eye on a fundraise around the corner may be prompting disposals.

"There were a lot of exits in 2010 following a slow first half of the year," Wilder confirms. Indeed: Aster was one third of Mid Europa's exits hat-trick last year. Aster was sold to UPC Polska in a deal that valued the cable business at €600m, while Česká

Radiokomunikace, sold in the same month as Aster, went to Macquarie for €574m. Mid Europa also sold Croatian business Calceum in a secondary buyout to Argus Capital.

Mid Europa wasn't the only one busy generating returns. Enterprise Investors sold 35% of its stake in Harper Hygienics through a listing on the Warsaw Stock Exchange for €13.3m. Separately, BAML Capital Partners, Ares Life Sciences and Montagu Private Equity-backed Euromedic sold its dialysis care division in a €485m sale to Fresenius Medical Care, generating a partial exit for the trio. Finally, 3TS Capital Partners sold Internet Mall/Netretail to Intel Capital and MCI PrivateVentures FIZ.

The exit activity was not only down to the previous year's portfolio management, but also a high pricing environment, according to Joanna James, partner at Advent International:

"Selling activity, whether by corporates, families, entrepreneurs or other private equity funds, is driven by high prices.

It's a sellers' market"

Joanna James,
Advent International

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Bumper 2011

But if last year was about exits, this year is surely about large deals being back *en vogue*. We've already seen the €370m secondary buyout of Polish grocery store operator Zabka by Mid Europa, which paid incumbent private equity backer Penta 10.5x EBITDA, based on Q4's €35.5m EBITDA. Mid



Europa beat off competition from BC Partners to win the deal. Zabka has 2,350 outlets in Poland, and sold its Czech operations to Tesco for \$53m previously.

Other large deals this year will be driven by corporate disposals. This was the driver in 2008, CEE's last big year, according to Mid Europa's Craig Butcher: "They were indirect credit crunch disposals to shore things up." And it persists, according to Potter: "There is still a backlog of overleverage on some corporate balance sheets, and these companies will have to sell some assets to cope. Not necessarily this month, but in the next year or two."

As is often the case, Poland will lead the pack, with half a dozen deals EV >€200m in the pipeline. Top of the list is Polkomtel.

The Polish mobile operator is on the privatisation block, with the government seeking €3.7bn for the asset.

Too pricey, say some, meaning that it may end up on the Warsaw Stock Exchange instead of in private equity hands. But at the time of going to press, a handful of suitors were circling it, including TeliaSonera, TPG, Blackstone, CVC Capital and Apax.

TP Emitel has just gone to Montagu Private Equity for \$600m – nearly twice the price initially touted for the Polish

Telecom transmission subsidiary, with Innova, EQT and Advent all believed to have looked at it.

Finally, Permira-backed Provimi Pet Food, a regional pet food business, may be offloaded in a €190m deal, while the Czech Republic's CS Cargo may be sold by private shareholders in a €150m deal.

Turkey: delightful, but expensive

Although Poland is likely to be host to the region's largest transactions of the year, it is not the only source of dealflow. Turkey may host one of Europe's largest deals this year, with Doğan Yayın on the block for \$1.7bn. KKR is submitting a joint-bid with Yildiz Holding, a trade player, while TPG is also in play alongside Time Warner.

It wouldn't be the first time Turkey takes centre stage as host to a mega-buyout: in early 2008 BC Partners won a contested auction to win the \$3.25bn Migros Turk deal. Carlyle, Russia's Alfa, Bain Capital, Turkven-BC Oartbers and KKR had all looked at the deal. Just in February this year, TPG and local partner Actera sold drinks business Mey Icki for \$2.1bn to Diageo.

"Turkey will do well this year, though the pricing pressure is even worse than in CEE," points out Wilder. "This is because

"There is still a backlog of overleverage on some corporate balance sheets, and these companies will have to sell some assets to cope"

Henry Potter, Alpha Associates



they're relatively new to the game. It's fast growing and so more people are keen, which drives prices up." This may have turned some off Doğan, with 12 bidders believed to have dropped out of the bidding due to pricing concerns. Apax Partners was cited as one such group.

Turkey is attractive to investors for a number of reasons, not least its population of 78 million people – one of the largest in Europe – and Brussels' negotiations to eventually permit the country into the European Union. Reflecting increasing interest in the country, global law firm Clifford Chance opened an office in Istanbul in November, while Advent International also set up a team there in July 2010. Advent has been active in the country since 2001, initially alongside local partner Turkven.

The dealflow across CEE is likely to attract international players to the region. For many years, global buyout houses deliberated over the best way to cover CEE. Several hired local people and some even set up local offices – but have since quietly bowed out. Now Butcher suggests all look at the region, though from afar: "There are no longer any newcomers, but likewise, there are now no large funds that do not have someone covering Poland and Turkey."

Hyper-inflated pricing

While pricing is believed to have come down – and that is largely what is driving dealflow in western Europe – it remains high in CEE. "As people see economic stability return to Western Europe, they'll look more to CEE again. The question will then remain pricing – it remains very high for quality assets," Wilder says. Indeed. The Zabka secondary buyout saw a 10.5x multiple based on Q4 2010

earnings; that multiple escalates to 12.7x if you look at the full-year 2010 EBITDA.

Fortunately, banks seem to be answering their phones again, according to Mid Europa's Craig Butcher, as he confirmed that Goldman Sachs provided a fully underwritten staple for the České sale. Consensus is that margins are still high at 375-425 basis points for A-tranches, and banks still require a 40-50% equity cushion. Banks are providing 4-4.5x EBITDA for most deals, with the highest-quality assets fetching up to 5.5x.

"As people see economic stability return to Western Europe, they'll look more to CEE again"

Mike Wilder,
PricewaterhouseCoopers (Warsaw)

Should these aforementioned deals transpire, 2011 may see a €6bn tally for CEE – beating even 2008's stellar €2.5bn: "There is a lot more to come in 2011," says Wilder, "with lots of couple-hundred-euro deals on the block." The fear is that it will be a drive to quantity rather than quality, cautions James: "PE funds have dry powder and corporate are cash-rich and under-leveraged. There aren't too many deals, but the prices are high, and returns for this vintage will be subdued." ■

Bumper year: More than \$6bn up for sale in CEE

Target	Country	Private equity	Value
Polkomtel	Poland	TPG, Blackstone, CVC, and Apax reportedly bidding	\$3.7bn +
TP Emitel	Poland	Innova, EQT, and Advent reportedly bidding	€425m
Zabka	Poland	Mid Europa bought from Penta	€370m
Doğan Yayın	Turkey	KKR, and TPG reportedly bidding	\$1.7bn
Provimi Pet Food	Hungary	Permira-owned Provimi Group carve-out	c€190m
CS Cargo	Czech Republic	Private owners selling	€150m

† Government's price

Source: unquote

€4bn Polish telco on the block

A bloated price may mean this telco is headed for the stock exchange. *Kimberly Romaine* reports

Europe's deal of the year may stem from one of Europe's newest members, with the sale of Polish mobile operator Polkomtel SA underway and valued by banks at around €4bn. Local press reports link Apax, KKR, Bain and Providence to the deal. They are up against Polish tycoon Zygmunt Solorz-Zak, as well as Nordic trade buyers TeliaSonera and Telenor. Some reports link TPG and Blackstone in a joint-bid.

The telco is majority owned by the state, making it a quasi-privatisation. Trade players America Movil and Telefonica are also eyeing the target. Bids are due in April, with two or three expected to be selected to conduct due diligence.

But the deal may not come to fruition, a source told *unquote*, given the Polish Treasury's hefty price expectation. "If bids come back too low, the government may abandon the idea altogether, and opt for an IPO instead," the source said, adding they would "get their name on the list" of potential suitors and consider bidding, but that "at that price, we won't take the lead". At the time of going to press, TPG and Blackstone were rumoured to be preparing a joint bid, with CVC and Apax each prepared to go it alone.

Price is one factor that may thwart the deal; a complex ownership structure is another. The firm has five parents, each

of which has its own adviser. UK's Vodafone, Polish oil refiner PKN Orlen and Polish copper miner KGMH each hold a 24.39% stake. Polish energy giant PGE holds 21.85% and coal miner Wegloks the remaining 5%. The Treasury owns stakes of between 27.52-100% in all the owners except for Vodafone.

Telcos are the darling of CEE private equity, with buyout houses proving adept at consolidating local markets and selling on to global trade players – or each other.

Mid Europa is one GP that has been a leading force in the sector: in 2004 it teamed up with GMT Communications Partners to purchase Invitel, then Hungary's second largest fixed line telecoms operator, from Vivendi Telecom International for €325m. Three years later, the buyout houses sold the asset to Hungarian Telephone & Cable Corp for €470m. Then, in 2010, Mid Europa re-acquired a 92% stake in the company in a deleveraging acquisition, which saw Mid Europa buy back €85m of Invitel senior debt and €125m of PIK notes. Invitel is one of several CEE telcos to have undergone a number of iterations of private equity ownership.

The advisers involved in the Polkomtel buyout include ING Securities (advising PGE), Rothschild (advising KGHM) and Nomura Holdings (advising PKN). ■

Telcos: The darlings of the CEE private equity industry

Deal name	Deal date	Country	Deal value €m	Equity	Vendor
Invitel (formerly Vivendi Telecom Hungary)	May 2003	Hungary	325	GMT Communications Partners, Mid Europa Partners	Vivendi Telecom International S.A
Invitel Holdings A/S	Sep 2009	Hungary	200	Mid Europa Partners	TDC
Latt telecom Group	Oct 2007	Latvia	404	Blackstone Group	Latvian Government
Aster	Mar 2006	Poland	424 (estimate)	Mid Europa Partners, Intermediate Capital Group	Hicks Muse and Argus Capital
Bité	Feb 2007	Lithuania	450	Mid Europa Partners	TDC (owned by Apax, Blackstone <i>et al.</i>)
GTS Central Europe	May 2008	Hungary	500	Bessemer Venture Partners, HarbourVest Partners Limited, Oak Investment Partners, Columbia Capital Partners, Innova Capital, M/C Venture Partners	Group Menatep Ltd (GML)
Falcon Group	Jun 2006	Czech Republic	1,200 (estimate)	Al Bateen Investment Co, Lehman Brothers, Mid Europa Partners	Bivideon
Bulgarian Telecommunications Company	May 2007	Bulgaria	1,661	PineBridge Investments (formerly AIG Investments)	Novator and Viva Ventures

Source: *unquote*



Secondaries starting to go, but for less

The wave of secondaries so long anticipated has finally come.

But with this sign of market maturity comes the reality of lower returns. *Kimberly Romaine* investigates

Last year saw secondaries make the noise the industry has been awaiting for years, with 2010 seeing more than \$20bn of transactions done. The peak – more than 2.5x 2009's \$7.5bn – was reached as primary fundraising for private equity funds hit a six-year low of \$200m for 2010. The figure was comprised of a number of transactions worth more than \$1bn each, according to research from specialists Cogent Partners and Triago.

What has driven this? The need for liquidity is the obvious driver for sellers but it is no longer the entire story. This is because most cash-strapped limited partners had to sort themselves out three years ago. Now they've familiarised themselves with the merits of secondaries, why not use them more often?

"Many large institutional investors are increasingly using the secondary market as an active portfolio management tool rather than just a pure liquidity solution," says Stephan Schäli, partner at Partners Group. "Portfolio management through the secondary market has become a more important tool for private equity investors, adjusting their exposure to different vintages (but also regions and stages) based on their view of the market."

Now secondaries sales are driven by legislation, too. The banks are being forced to increase their reserves on the back of Basel III, while the Dodd Frank act is pushing banks to have their private equity businesses as standalone entities. In March, for example, Coller Capital started talks with Crédit Agricole to buy €500m worth of stakes in buyout funds.

"We are in a new wave of secondaries," says Elly Livingstone, partner at Pantheon. The first was driven by legislation and liquidity issues for banks, he explains, while the second is portfolio management. "People are not saying 'I want to sell 20 relationships so I can create 20 new ones.' They are simply looking to cull." Pantheon itself is aiming to shed around a third of its relationships, bringing the number down to 30.

Indeed, the frenetic pace of trading may be driven by the market's maturity, according to John Gripton, partner at Capital Dynamics. "Many investors in the market for 15 years or so now have 50 manager relationships or more. Such a large number is extremely administratively cumbersome and, as a result, a number of LPs are looking to re-balance their portfolios."

CalPERS is a case in point. It is selling \$800m of its private equity stakes in firms such as KKR, Carlyle and Apollo. The move was initially mooted in February, when the institutional giant indicated it was reconsidering its allocation to mega-funds in favour of supporting more mid-market and growth capital opportunities. Currently, 38% of the pension fund's alternative assets – a \$30bn+ warchest – are in the large/mega-fund space. Tellingly, CalPERS' large buyout chief, Mike Dutton, left the firm in February.

A spokesman for the firm indicated that the move is not a marked retrenchment from the private equity space but is merely consolidation of CalPERS' private equity portfolio, which is overallocated (14.1% vs 14% target).

SL Capital Partners will look to maintain its number of manager relationships, but the fund-of-funds may shed some larger buyout houses and invest in more lower mid-market funds. This was the message from SL at this year's SuperReturn event, where the firm stressed it was part of natural attrition and not a change in strategy.

Many investors are looking to slice a fifth of their relationships, with pension funds, on average, culling smaller numbers of relationships than other institutions. And banks are making the deepest cuts – up to 50% of relationships in some instances. Says Gripton: “You will have to determine the future values for your relationships. This won't always be as straightforward as looking at the current NAV of a fund, but consideration will have to be given to future value and who is and isn't core to your relationships going forward. You need think about whose next vehicles you want to invest in.” This is because selling certain positions now that could fetch a premium and thereby crystallise any gains could result in exclusion from that fund manager's next vehicle.

The price is right

Last year's bumper activity levels were also – and obviously – driven by increases in pricing. “In 2009 everyone was talking, but the heavy discounts of 40-50% meant very little actually got done,” Gripton says. “Sellers weren't willing to part with assets at such prices. Last year's increase in done deals was stimulated by converging price expectations.”

Cogent put buyout fund pricing at 89.8% of NAV for the second half of last year, up from 86.4% in the first six months

of the year. Triago recorded a climb of 31.3% since a Q1 2009 low. According to Triago, this pricing increase is more to do with increased productivity and low wage growth than it is down to any major expansion in sales. Cogent also suggests the 20% increase in the S&P index during the second half of 2010 was a contributing factor.

Pricing was helped by three factors: high-yield markets re-opening; improved visibility on earnings; and many companies

being restructured rather than allowed to fail. “The world was a better place than everyone thought it would be,” Livingstone explains. “That Armageddon didn't happen brought more vendors to market in

Increasing prices has done little to deter buyers.

In fact, it seems demand for secondaries is insatiable, according to some

2010.” Multiples on mega-deals stood at 9.1x EBITDA in Q3 2009, an 18% premium on the 10-year average, according to S&P's LCD, figures last seen during the boom years of 2007 and 2008. Should we re-enter recession, this could again dampen pricing prospects and thus the growth of the secondaries market.

In fact, the increases saw some assets go for a premium to NAV. “Although assets at the larger end of the market tend to be fairly fully priced, for quality positions at the small end of the market, we saw some premiums.” Gripton estimates this was a very small number – maybe 5%. “Due to IFRS, many funds trade close to their market value in general and therefore large premiums across the board, as seen in 2006, cannot be expected,” Schäli explains.

Shopping spree

Increasing prices has done little to deter buyers. In fact, it seems demand for secondaries is insatiable, according to some. “The market has gone mad,” says one player who wished not to be named. “The market had great prospects two years ago, but in 2010 it went out of control. The rapid price increases prove that we're creating a bubble.”

Funded or unfunded?

Assets being sold are increasingly funded, according to Cogent: the average fund marketed in the second half of last year was 76.8% called, up a bit from the previous six months. The number of unfunded positions, on the other hand, has fallen steeply, with only 6.6% less than 25% funded, against 26% in H2 2009.

Bubble or not, returns expectations are already coming down. “Secondaries players used to target 15-20%, but over the course of last year, that’s come down,” explains Christian Hinze of Swiss Re Private Equity Partners. “Now, since the end of last year, around 12% seems more realistic.”

Livingstone concurs, but optimistically: “Yes, the market is maturing, but also volumes are growing. As with any market, efficiency should mean downward pressure on returns over time, but performance volatility of underlying funds, and assets

primary private equity market grow again.” The aforementioned pricing increase should also, eventually, dampen demand.

But not yet. “2011 will be another big year – around the \$20bn mark again,” Livingstone reckons. The scale of problems built up in 2005 through 2008, and the impact of the credit crisis, means there is still a while to go before LPs will be where they want to be. We’ve got three years of activity ahead of us. It takes a long time, unlike the public markets where corrections can be made quickly and efficiently.

The scale of problems built up in 2005
through 2008, and the impact of the credit
crisis, means there is still a while to go
before LPs will be where they want to be

combined with differentiation between buyer strategies, may well contribute to a greater dispersion of returns across the buy-side.”

Another bit of sombre news for the market may be a shift away from LP money in the first place. The market is increasingly populated with evergreen funds and permanent capital vehicles, as GPs seek new sources of funding.

“But this doesn’t erode our prospects. The desire for liquidity is not going away; these new funding types are merely new ways of accessing it,” Gripton says. He adds that such new funding methods will continue to be the exception and not the norm: “I don’t see premonitions of the death of the LPA. We’re now entering the first wave of post-crunch funds. The majority will be LP funds. There is not a systematic shift in place.”

Still growing

The market is likely to grow a bit more before retracting again, reflecting an inverse correlation to the primary market. In fact, Triago estimates that 2011 will see \$25bn transacted this year, a 25% increase on last year’s record \$20bn.

But this isn’t sustainable. “We are seeing a bulge at the moment,” Gripton concedes. “It is the 2006 and 2007 commitments that are being rectified and as that period sorts itself out we’ll see the

The buoyancy of the market could also be helped by increasing interest rates, which is surely on the cards for the eurozone and Britain for this Summer. This is because when interest rates go up, institutional investors, particularly those seeking yield, could be tempted to shift more of their allocations into fixed income.

This may mean that existing investors are incentivised to sell, and that would-be investors in primary fundraisings may be more difficult to persuade.

The wave of primary fundraising expected this year and next should drive sellers, according to Schäli. “Primaries are actually a driver of dealflow in the secondary market. Many investors would like to invest in the 2011 vintage funds, but have no liquidity to invest in these funds. They use the secondary market to offload some of their older vintage exposure and use the proceeds and freed up unfunded exposure to invest in primary funds that are being raised.”

In fact, Gripton reckons that we may see pricing increase again. “It is a pendulum and may be about to swing too far the other way, causing another pricing mismatch and, in doing so, decreasing deal activity. But because it is a pendulum, it will always be swinging and so will come back again.” ■

PE-backed IPOs: Set for a comeback?

The difficulties encountered by private equity-backed IPOs in 2010 reignited the debate on the public markets' cautious attitude towards such assets. *Greg Gille* reports

Hearing that the global financial crisis dealt a crushing blow to private equity-backed IPOs will not be a surprise. According to *unquote*’ data, flotations of PE-backed European companies fell by 93% between 2007 and 2008, from 62 to just four. The situation has somewhat improved since then, with *unquote*’ recording 22 listings last year.

Nevertheless, this figure remains a far cry from the one witnessed during the market heyday. What is more, a number of 2010 listings saw share prices tumble on public markets in the months following their IPO. The worst performing private equity-backed listings took place in the UK, with companies such as Cambria Automobiles Holdings, Promethian Technologies Group and Ocado experiencing sustained price falls throughout the year.

This phenomenon led many observers to comment on a lack of appetite for PE-backed assets, partly rooted in the image of private equity funds taking a company private, saddling it with debt and re-listing it to make a swift exit. William Belcher, capital markets partner at Taylor Wessing, indeed advised PE shareholders to consider longer lock-in periods to attract public investors, as they are generally seen as an incentive for management to stay involved and ensure a smooth transition process.

Panellists at the Taylor Wessing seminar however dismissed the idea of a general mistrust of PE-backed assets. “I wouldn’t single out the PE community for the breakdown of trust with public markets” said one participant, before pointing at pricing issues as a factor in the counter performance of many recent IPOs: “Ocado constitutes a pivotal event – pragmatism on pricing is key.”

The share price range suggested by Ocado’s management was indeed widely criticised for being unrealistic prior to the IPO, given that the company had yet to post a profit.

Craig Fraser, head of research at Arbutnot Banking Group, highlighted the importance of carefully assessing the value of a business before listing it: “Don’t even think about an IPO before you have undergone a full and proper valuation based on forecast earnings and use of funds.”

STOCK NAME	BID	OFFER	EXECUTE
SET	16027		
SET50	12-31	259	036
SET100	12-31	302	044
AGRI	12-31	608	044
BANK	12-31	095	040
BUILD	12-31	095	040
COMUN	12-31	-415	-111
FIN	12-31	691	009
ENERG	12-31	015	018
FOOD	12-31	140	090
INSUR	12-31	2143	-029
PRINT	12-31	2439	-318
PROP	12-31	5435	-100
TEXT	12-31	-025	

Pricing is not the only key to investors’ hearts though, with a strong business model being equally important: “Premiums can also be obtained if you can demonstrate attractive characteristics such as a dynamic growth story, a market leading position and a strong management team. Consider these points carefully; otherwise you may not get value for money,” Fraser continued.

The recent listing of US-based hospital operator HCA – the largest private equity-backed IPO since the financial crisis – apparently ticked all the boxes, and might encourage GPs to consider the public markets as a viable exit route in the coming months. Panellists however pointed at a sustained period of instability for global markets in 2011 in light of the ongoing events in the Arab world and Japan, and the negative effect this could have on IPOs.

At a time when most GPs are rushing to return money to investors before going fundraising again, it remains to be seen whether exiting via the public markets will be a bet worth making – especially as corporate buyers are currently displaying a strong appetite for M&A opportunities. ■

Hitting the fundraising trail: what to expect

This generation of funds will be more difficult than ever to raise.

Innovation and patience will see the top performers through.

Kimberly Romaine reports

The next 18 months should see no shortage of CEE GPs on the fundraising trail: 3TS is nicely on its way to its €160m target, while Enterprise Investors' and Abris' PPMs should be hitting desks this spring. Mid Europa Partners' exit spree is putting it in good stead to tap up its 60+ LPs early next year, and Accession Mezzanine Capital and Syntaxis are both seeking investment for the mezzanine market in CEE.

Such a line-up marks the busiest time for CEE fundraising. This fact, combined with LPs' nearly universal "rationalising" of their private equity allocations, means it will be extremely challenging this time around for GPs.

But not impossible, if you are, as 50% claim to be, in the top-decile of CEE fund managers. "It is a case of 90% of the world's LP capital chasing 10% of the funds," says Warren Hibbert, partner at Asante Capital Group. "This is resulting in an outlier effect being observed in a few cases (typically the top 10% within any given strategy or geography) with the rest of the market going sideways as everyone tries to launch the fund they had delayed launching during the height of the financial crisis."

Even if the GPs are top-decile, the road ahead is a long one.

"Going out to market now takes much longer," says Steve Buckley, partner at Innova Capital, which raised €388m for its fifth vehicle. "We've just spent two weeks with our investors holding their hands to give updates on what we're up to."

And that's after their final close – indicating just how much TLC is required nowadays, on an ongoing basis, not just during the raise. "A GP needs to be thinking of building their fundraising materials and changing the mode of their dialogue with their existing and some select new LPs from 'update' to 'gearing up for launch'," says Hibbert. "This means they need to start sounding out their LP base and getting as accurate an assessment of how much of their next fund will be spoken for in a first close." This, he adds, should commence anything from 6-12 months ahead of the actual launch timing, depending on the specific complexities involved.

Innova's latest vehicle was raised with some creative structuring in mind. Back in the first half of 2008, the GP had five deals lined up and so began approaching investors. They succeeded in getting some soft-circle commitments, and then Lehman collapsed. "Some investors, largely US endowments, came to us saying

**"It is a case of 90% of the world's
LP capital chasing 10% of the funds"**
Warren Hibbert, Asante Capital Group



that the changed backdrop meant they had to reconsider their commitments.” This represented Innova’s largest prospective investor base. To boot, Innova’s largest existing investor base, family offices (40% of Fund IV) all but disappeared.

Rather than stop the fundraise in its tracks, the comments spawned some creative thinking by Innova’s team: “New investors would have to be an unusually high percentage of the first close,” Buckley said, with funds-of-funds and pension funds in the UK and Nordic region specifically targeted. In fact, the GP reached a first close equal to the size of its previous vehicle just 10 weeks after commencing the fundraise. “The state of affairs meant we’d have to renegotiate with our five prospective investment targets as well, meaning our investment pace would surely slow down. As such, we’d have a hiatus between our closing and eventual investing.”

And so enters the innovation: the GP agreed with long-term investors that they would not start drawing fees until they made their first investment. The quid-pro-quo was that the LPs would therefore not mark the official start to the investment period until the fees kicked in.

The strategy worked, and Innova managed to raise the €388m from 25 LPs, over half of which were funds-of-funds and just four family offices – once Innova’s largest investor base.

Such fee tinkering is not new and seems to be gaining popularity lately, but should only be used to influence timing of

“Emerging markets the are the most interesting prospect for LPs right now”

Steve Buckley, Innova Capital

commitments, not intended as a hook in and of itself. “In 99.99% of cases, a fee incentive will not influence the LPs decision to commit to a fund – this is in almost every case an independent decision and offering an incentive in the face of poor LP

support/interest will only further weaken the offering,” says Hibbert. BC Partners recently offered a reduction in fees for investors coming in at first close – but it served to expedite the close, not draw in new interest. It worked – the GP secured €4bn against its €6bn target last month.

The going is tough, though not impossible, and Buckley is confident that firms hitting the trail now may have timing on their side: “In a recent straw poll, 500 delegates at the recent Commonfund conference named emerging markets the most interesting prospect for LPs right now. So CEE is likely to benefit from institutions’ need for higher returns.” ■

CEE – A continuing opportunity

Nearly 20 years of investment history, superior returns, a universe of experienced fund managers; yet Central and Eastern Europe is neglected by many LPs. *Henry Potter* and *Peter Wolfers* of Alpha Associates discuss CEE's private equity culture

Private equity has been in the CEE region for almost two decades. While the early years were characterised by privatisations and first phases of commercialisation and professionalisation, now private equity has been dominated by later-stage expansion capital and buyout transactions. There is a large number of target companies that benefit from structural growth driven by emerging middle classes and the resulting increased consumption. Debt and mezzanine financing is available, and first-wave entrepreneurs are willing sellers, having built business for over a decade. Unlike in many neighbouring Western European countries, PE is accepted as a financing option throughout the region.

A solid foundation

Although perceived as one region, CEE is not homogenous. But most of its countries are EU members and all are democracies, which have adopted EU standards

in their laws and regulations, ensuring a reliable investment environment. Poland and the Czech Republic have led the development of the region and boast the largest economies and PE markets. These countries are also the two least affected by the financial crisis. In fact, Poland was the only country in all of Europe to report GDP growth in 2009. In 2011 and 2012, all major CEE economies, including Hungary, are forecasted to grow at higher rates than the eurozone, some more than double. Contrary to widespread perception, government and household debt figures are more solid in the CEE than the eurozone average, and in Hungary lower than in Germany, the UK or France.

In PE portfolios, pre-crisis investments have fared relatively well given low levels of leverage deployed in transactions, the underlying growth of portfolio companies and capital scarcity keeping competition and prices low in comparison to more developed markets. Fundraising in CEE and CIS combined peaked at \$5.5bn in 2008, which represents only a fraction of some single buyout funds raised in the developed markets and compares to \$40bn raised for emerging Asian private equity the same year. CEE never faced a capital overhang like Western Europe and the US, or China and India.

Over the past 10 years, the CEE private equity market has outperformed not only developed Europe, but also all other emerging markets. According to the European Bank for Reconstruction and Development, 10-year net horizon returns from PE in CEE are 16.9% in USD as of 31 December, 2009.

While the region's public markets have advanced, they still tend to be concentrated on a handful of large often former state-owned companies and do not present a diversified sector profile. The public markets lack sufficient access to the region's strongest growth sectors, in particular medium-sized consumer-facing businesses. Private equity has access to this segment, with

With peak fundraising in 2008 at \$5.5bn, the market of the entire region still only represents a fraction of single large buyout funds

the benefit of a stronger alignment of interest between shareholders and management.

The private equity industry has matured over the last 20 years and today's GPs

in the region are a stable group. Since there is no wall of money arriving in the region, and few new-entrant managers are being financed, investors do not have to take the risks associated with first-time fund managers and pay for their learning curves. Most of the region's GPs have a long-lasting investment history and have gone through different market cycles. With this, selection risk can be much more mitigated than in other emerging markets.

As in any other market, investing in private equity funds is ultimately about investing in talented people. Managerial and investment talent has significantly improved over the years; successful GPs have invested a number of successor funds and have worked together with portfolio companies through prior crises. There are numerous highly qualified teams that can show they have been able to navigate difficult market environments. They are arguably equipped to deliver superior results to mediocre teams that have only operated in great environments.

Historically, post-crisis vintages have generated higher returns in CEE and CIS, as proven by investments made after the 1998 Russian crisis and after 2001 in CEE. We are currently in the post-2008 crisis window, and we do believe history repeats itself. ■

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Mid Europa pays €370m for Penta's groceries

Transaction

Mid Europa Partners has paid €370m for Polish grocery store operator Zabka Polska, seeing the buyer beat off competition from Tesco and BC Partners. The purchase price corresponds to 10.5x EBITDA based on 2010 Q4 figures.

Zabka Polska was sold by Penta Capital, which is believed to have made an IRR of more than 60% on the deal. It acquired the business in May 2007 from AIG for €129m.

Under Penta's stewardship, 460 new stores were opened, helping drive profits up by almost 40%.

Company

Zabka was founded in 1999. Today it generates revenues of €650m from its 2,450 stores across Poland under the Zabka and Freshmarket brands. EBITDA for 2010 stood at €31m.

People

Jack Roszyk is CEO of Zabka. Pawel Padusinski and Tomasz Blicharski led the deal for Mid Europa.

Advisers

Equity – Vienna Capital Partners (*Corporate finance*); CMS Cameron McKenna (*Legal*); Beragua Capital (*Commercial due diligence*); PricewaterhouseCoopers (*Financial due diligence*).

General Atlantic invests in Kaspersky Lab

Transaction

General Atlantic (GA) has provided Russian IT security solutions firm Kaspersky Lab, with growth capital funding of an undisclosed amount. GA is now the second largest shareholder in the company. Founder and CEO Eugene Kaspersky retains a controlling stake in the business. The PE investor stated it was impressed with Kaspersky's management team and believes the company is well-positioned for continued growth. The investment opportunity also fit with GA's experience in the software sector. Kaspersky will now look to grow in the endpoint security market for both the consumer and corporate sectors. It will also aim to expand its technology and products portfolio to meet needs related to cloud-computing.

Company

Founded in 1997, Kaspersky specialises in computer security software, notably anti-virus protections. The company is based in Moscow and employs more than 2,000 people worldwide.

Innova acquires Provus from Turkven

Transaction

Innova Capital has acquired 96% of Romanian card processors Provus Services Provider and Romcard. The deal was a secondary

Providence buys Ukrainian FiberNet

Providence Equity Partners is making its second foray into Ukraine with the purchase of CEE communications business FiberNet's operation in the country: CDC Falstap. FiberNet is owned by Hungarian telco Invitel, whose Hungarian operation is owned by private equity firm Mid Europa Partners.

Invitel announced a sale and purchase agreement regarding the sale of FiberNet assets at the end of last year. UPC Hungary now owns one third of FiberNet, and Providence is acquiring its Ukrainian operations. Rothschild advised FiberNet on its restructuring and the disposal of its Ukrainian operations.

Invitel acquired FiberNet in January 2010, one link in a chain of private equity ownership for the two companies.

Argus owned the company in the early noughties, selling it on to Warburg Pincus in 2004, which held the business until January 2010, when Mid Europa-backed Invitel bought it.

Invitel too has a rich history of private equity ownership: GMT and Mid Europa acquired Invitel in May 2003 from Vivendi Telecom International S.A. for €325m. Under their ownership, EBITDA increased from €59.1m in 2002 to €82.4m in 2005. The two owners completed a partial sale back to management in 2006 before fully exiting the company in 2007 for €470m to Hungarian Telephone & Cable Corp.

Providence's entry into the Ukraine came in 2007 when it purchased Volia Limited from Ukrainian PE firm SigmaBleyzer.

buyout from incumbent backer Turkven Private Equity and was fully financed with equity. The value was less than €25m.

The new owners know the sector well: Innova cashed in on Polcard in 2007 when it sold the Polish banking card company in a €243m sale to e-commerce provider First Data International.

Innova and GTECH had acquired the company in 2003 in a deal that valued the firm at \$60m. Just two years later, Innova sold 11% of its stake to GTECH, yielding an IRR of more than 60%.

Turkven had acquired a 70% stake in Provus in November 2007 as part of a €14m deal.

Company

Provus started operations in 2001 and is a Visa and Mastercard certified gateway. It manages more than 1,200 ATM terminals, 4,500 POS terminals, 2.5 million cards and two million transactions per month. In 2004 Provus acquired its competitor, AKK Bilisim Hizmetleri (previously Anadolu Kredi Kartlari).

Romcard was Romania's first card processing centre, set up in 1994. It is now the only 3D secure e-commerce platform certified by Visa and Mastercard in Romania.

People

Izzet Cem Yenigul is a member of the companies' supervisory boards. Krzysztof Kulig is partner at Innova and chairman of the Provus supervisory board.

Advisers

Equity – PricewaterhouseCoopers (*Financial due diligence*); Badea Clifford Chance (*Legal*).

Argus backs Calucem MBO

Transaction

ARGUS Capital Partners and the management team have acquired Calucem, a Croatian supplier of calcium aluminate cement from Mid Europa Partners.

Mid Europa acquired Calucem in June 2006 through its Fund II. It had taken a 92.4% stake from Heidelberger Cement Group in Istra Cement, a production facility based in Croatia, as well as two trading entities in Germany and the US.

Company

With production facilities based in Croatia, and sales offices in Germany, the US and Singapore, Calucem supplies high-quality and specialty cement to the global refractory and building chemistry industries.

It was formerly known as Heidelberger Calcium Aluminates but changed its name to Calucem in July 2006.

People

Laszlo Grubits represented ARGUS and Robert Knorr worked on the deal on behalf of Mid Europa. Gilles Bonaert is the CEO of Calucem.

Euromedic partial sale for BAML, Ares LS, Montagu PE

Transaction

A trio of private equity firms have inched closer to a sizeable exit in Hungary, selling part of Euromedic. BAML Capital Partners, Ares Life Sciences and Montagu Private Equity-backed Euromedic has sold its dialysis care division in a €485m sale to Fresenius Medical Care, the world's largest dialysis services provider.

The sale comes three years after Ares and Merrill Lynch Private Equity led the secondary buyout of Euromedic from incumbent backer Warburg Pincus.

Montagu became a shareholder around nine months later, in September 2008.

Company

Euromedic is a Hungary-based, pan-European provider of medical services. Its sale of International Dialysis Centres is part of a strategy to focus on core businesses in the field of diagnostics and cancer treatment.

Euromedic is the largest provider of dialysis services in Eastern Europe, treating over 8,200 patients in nine countries. Fresenius currently serves more than 210,000 patients globally and more than 17,000 patients in Eastern Europe.

Advisers

Equity – Bank of America Merrill Lynch (*Financial due diligence*); Linklaters (*Legal*); White & Case (*Legal*).

Mid Europa sells Aster to UPC Polska

Transaction

Mid Europa Partners has agreed to sell media and communication services business Aster to UPC Polska, an affiliate of Liberty Global Inc. The transaction, which remains subject to regulatory clearance by the Polish authorities, will value the business at some €600m and will generate a 2x money multiple for Mid Europa.

The backer acquired Aster from Hicks Muse in a March 2006 deal reportedly worth around €425m. Intermediate Capital Group provided equity and mezzanine to support that original transaction. Roughly 18 months later, Mid Europa Partners completed the recapitalisation of the business, raising €415m through a combination of senior, mezzanine and pay-in-kind facilities from new and existing lenders. The deal represented the largest recapitalisation in Poland to date and included the largest local currency denominated senior credit facility in a leveraged financing in CEE.

Credit Suisse underwrote the financing and coordinated the amendment process.

Company

Aster is the fourth largest cable TV operator and largest broadband provider in Poland, with over 365,000 video subscribers, as well as 177,000 and 70,000 fixed telephony subscribers.

Mid Europa divests České for €574m

Transaction

Mid Europa Partners has announced it is to sell České Radiokomunikace to a consortium of funds managed by Macquarie for approximately €574m.

České Radiokomunikace was wholly owned by Falcon Group, which was controlled by Mid Europa and a consortium of investors.

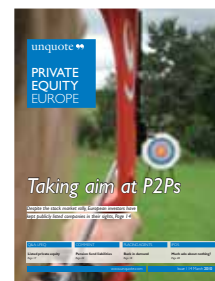
The company provides nationwide broadcasting and telecommunications tower infrastructure in the Czech Republic. Since the 2006 original investment, investors have supported the company in increasing profitability and refocusing on its core activities.

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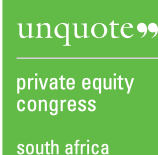
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