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Identity Crisis?

C5 CEE Private Equity Forum

Event Summary by Squire, Sanders & Dempsey L.L.P.

Winter 2010

INTRODUCTION

Private equity in Central and Eastern Europe is in the midst of an identity crisis. As the line between Central and Western Europe becomes increasingly blurred, CEE is losing its distinctive emerging markets personality. With this convergence, will the raison d'être of regional private equity funds also disappear? Or will the indigenous fund managers maintain their advantage over global and pan-European players on quality of deal flow and ability to execute on proprietary opportunities?

C5 and global law firm Squire, Sanders & Dempsey L.L.P. are pleased to bring you an overview of the perspectives and insights of leading industry experts from the 16th Annual C5 CEE Private Equity Forum held in London on 14-15 October 2010.

We would like to thank all presenters for their thoughtful comments on the current state of the market and the Forum delegates for their contributions to the discussions at the Forum.

Squire Sanders' CEE Private Equity Team

Winter 2010

C5 CEE PRIVATE EQUITY FORUM: HIGH RETURNS IN AN INCREASINGLY FRAGMENTED MARKET

Central and Eastern Europe continues to be a testing market for private equity. Whilst the region is stabilising following the impact of the global credit-crisis, deal flow is picking up and credit is available to finance those deals, private equity funds are facing new challenges in fundraising, securing deals at acceptable prices and, once again, competition from global or pan-European players.

- With increasingly more LPs looking towards the emerging markets of Brazil, China and India, GPs are finding it challenging to raise CEE-focussed funds. The large capital overhang in the region also seems to be inhibiting fundraising.
- The balance of power between LPs and GPs has continued to shift in favour of LPs, who have voiced concerns over the levels of management fees and who are requiring more regular communication from GPs.
- Credit has become more readily available in the region, mezzanine is proving popular for growth capital purposes and the use of high-yield instruments is on the rise.
- Deal flow is improving, but competition from global or pan-European funds is pushing up prices. The lower, mid-market continues to offer good opportunities for proprietary deals.
- With regard to the most popular jurisdictions for investment, the message was "Turkey, Turkey and Turkey," followed by Poland, the Czech Republic and Slovakia.
- The industry is being subjected to increasing regulation in the form of the AIFM Directive, and delegates were warned to consider the effects of the US Foreign Corrupt Practices Act and the UK Bribery Act.

WHAT THE EXPERTS SAID

Assessing the Current Environment

Garret Byrne of **Deloitte** reminded delegates that "last year we talked of some cautious optimism," and he reported that statistics from the recent Deloitte Business Sentiment Index showed that "from a year ago, sentiment has risen about 14% overall." He explained that "49% of our respondents were positive about economic prospects in the future, whereas 20% were negative and the rest were neutral." Mr Byrne posed the same interactive questions to gauge the mood of the Forum delegates, and the responses reflected a generally similar sentiment. CEE economies were broadly expected to "improve somewhat," credit was considered to be "somewhat available" and delegates were "fairly positive" about the financial prospects of their funds and portfolio companies. Mr Byrne summarised the overall mood by saying that "there is a little bit more optimism in the room here than there was a year ago."

> *"There is a little bit more optimism in the room here than there was a year ago."*
>
> *– Garret Byrne*

Joanna James of **Advent International** addressed the issue of whether Central and Eastern Europe is an emerging market. Ms James described the development of the private equity industry in CEE in the context of the evolving stories that have been told by GPs to investors over the years. She began with the convergence theory: "Central Europe was on its way to the EU, and so you had this marvellous combination of emerging market growth combined with European risks." In time, fund managers adopted a new pitch: you can buy companies in CEE for consistently low prices. When prices started to rise, the story changed yet again: you will pay the same prices as in Western Europe, but you will have higher growth. Finally, growth in CEE had become a consumer story, where investments were driven by "increasing disposable income and increasing consumer demand." Ms James observed that what we had actually been seeing all these years was, in fact, a typical emerging market boom, concluding that "Eastern Europe is no longer an emerging market and that this is a story we're going to have to stop telling."

Saki Georgiadis of **Hermes GPE** supported this position in the context of fundraising, saying, "I don't think the issue is that LPs don't have money to allocate. The issue is that we have sold the asset in a particular way all these years and now we need to recalibrate our pitch because what we sold doesn't exist anymore. We can't deliver it anymore."

"We have noticed that in certain markets in the region, there are market participants that are drifting toward completing more minority-staked deals, more non-control deals, in an effort to deploy capital."
– Brian Wardrop

In considering whether there has been any strategy drift in the Central European market, **Brian Wardrop** of **ARX Equity Partners** commented, "In particular, in the smaller deal size segment of the lower mid-market, being the €10 to €50 million enterprise value range, it's quite difficult to complete control deals, and history has proven that non-control investments in Central and Eastern Europe through the '90's and early 2000's tend to carry more risks." He continued by saying, "We have noticed that in certain markets in the region, there are market participants that are drifting toward completing more minority-staked deals, more non-control deals, in an effort to deploy capital."

Robert Luke of **GED Capital Development** considered the components of strategy drift as being "significantly less leverage and longer holding periods," resulting in a need for much more hands-on operating experience. Therefore, "the nature of the professional teams may be changing as well."

Thierry Baudon of **Mid Europa Partners** offered an alternative view from the perspective of funds operating in the larger end of the market, stating, "In our case, there has not been any need to shift strategy whatsoever. We do effectively two things: one is to buy fairly small assets and then go for buy and build strategy, so as to grow dominant platforms in a usually domestic service sector. We've done it in cable; we've done it in health care. The other is to buy a fairly mature company in need of a lot of work, either to grow the top line, but more often to bring efficiency to the system. We've done it in broadcast infrastructure, and we've done it in telecoms."

Fundraising

It was clear from the speakers and delegates at the Forum that fundraising continues to be extremely difficult for investments in the region. In response to an interactive question about the appetite for new fundraising in the current market, 100% of delegates indicated that the appetite is low.

Saki Georgiadis observed that there is a reduced appetite from the ultimate LPs and "there is a discrepancy between what LPs are willing to allocate and what GPs expect the LPs are willing to allocate, which I think we are seeing in the current fundraising cycle."

Helen Kenyon of **Preqin** presented fundraising data her firm had collected, observing that "2007 saw massive fundraising for the region. We tracked 43 funds that reached final close at that point, raising €10.2 billion. This dropped off, unsurprisingly, in 2008, to €6.7 billion, a lot of which had been secured prior to the onset of the financial crisis. In 2009 we saw funds focussing exclusively on the region raising just €2.7 billion, so this is quite a significant drop – 60% from the year before."

William Watson of **Amundi Private Equity Funds** queried the Preqin findings, asking, "If about 40% of Central European funds were in the top quartile of the European funds, why can we not raise more money?" **Helen Kenyon** responded, "I think we are seeing a lot of LPs sit back and do very little at the moment because a lot of them don't need to. We estimated the level of dry powder for Central and Eastern European managers as more than €5.4 billion at present and Central and Eastern European-focussed funds are sitting on €12 billion, so there's a lot of capital there that LPs have committed to funds that has yet to be called."

> *"I think we are seeing a lot of LPs sit back and do very little at the moment because a lot of them don't need to. "*
>
> *– Helen Kenyon*

Jim Strang of **Dunedin Capital Partners** reinforced this position by commenting that "evidence from a recent report by Bain & Co suggested that if GPs invested on a normal run rate, it could take them up to seven years to invest the capital they currently have." **Alex Barker** of **Harbourvest Partners** agreed with the dry-powder theory, advising LPs that "if you're looking at potentially adding to that, you have to think very carefully about whether the manager has a real differentiated strategy for deploying money in an increasingly competitive space."

With regard to what LPs will be looking for when making future investments, **Alexander Kondrashov** of **Rusnano** commented that "the performance of existing funds is certainly a top issue for the LPs." **Jean-Philippe Burcklen** of the **European Investment Fund** said, "We look at the strengths of the people and the team. We are not always able to find the relevant track record, but we obviously look at track records." **Artur Galstyan** of **New Russia Growth** agreed and advised GPs to focus on management teams, both at the GP level and in portfolio companies, adding that GPs should seek to "motivate people, select the best and make the turnover of staff as low as possible."

> *"We all say that you're only as good as your last deal, well, when it comes to fundraising, we're only going to be as good as our last fund."*
>
> *– Joanna James*

Ophir Shmuel of **MVision** observed that the old rules of fundraising no longer apply, commenting that "we no longer see increasing fund sizes or 12-month fundraises. You can no longer rely on your investors to be there next time around." Acknowledging that fundraising is becoming much more challenging, **Joanna James** commented that "we all say that you're only as good as your last deal; well, when it comes to fundraising, we're only going to be as good as our last fund."

Artur Galstyan focussed on the positives of the new fundraising reality, pointing out that "the market needs better quality GPs, and now LPs will have a deeper approach when they are investing and considering what kind of team they are choosing to deal with their money. The situation is driving better decisions, and I am absolutely convinced that this is a good situation that will develop into a new wave of good investments."

GP and LP Relationships

A panel of LPs considering the alignment of LP and GP interests were generally consistent in their views. **Helen Kenyon** reported that "this year Preqin asked LPs whether they felt that GP and LP interests were properly aligned, and 42% of the LPs that we surveyed said that they didn't think interests were properly aligned. To put this into context, in 2009 when we conducted the survey, 31%

of LPs felt that interests weren't properly aligned, so we've seen a pretty large shift, with more and more LPs feeling that interests have fallen out of alignment."

Ms Kenyon summarized the issues that LPs cited as most in need of adjustment, including high management fees, stated by 64% of respondents to the survey, followed by carry structure, mentioned by 25%, and the amounts of GP commitments, singled out by 19% of the survey respondents. The responses to the interactive questions posed to delegates at the Forum showed that 27% thought the level of GP commitments should be increased, followed by 20% seeking a rebate of deal-related fees, 17% commenting on management fees and carry structure being highlighted by only 7%.

Alex Barker agreed that the level of management fees was a major area of concern and said, "There is a genuine debate to be had about fees and remuneration and whether funds could still justify their position." With regard to GP commitments, **Tim Creed** of **Adveq** commented, "We like to see GPs put in enough money so that it hurts, but not enough money that it really kills them. It's a fine line."

"We like to see GPs put in enough money so that it hurts, but not enough money that it really kills them. It's a fine line."

– Tim Creed

When considering the level of communication LPs receive from GPs, **Scott Penwell** of **Parish Capital Advisors** explained that "ideally we would like to communicate monthly with our GPs just to hear what they're up to." He went on to say to the GPs in the audience, "If we're only hearing from you quarterly, at least in my opinion, we're not hearing from you enough.… We don't want to be perceived as just a provider of capital; we want to be perceived as a partner."

Tim Creed agreed and went further, saying, "You should have calls when something happens, positive news and negative news, and I think that the second one is the one that GPs don't always do." **Scott Penwell** reinforced this view, saying, "The ultimate sin, from an LP's perspective, is to not be notified of something right away." **Alex Barker** confirmed this position, saying, "Anytime that you find something else out from another LP rather than from the GP, it's pretty bad." It was generally agreed that GPs that employ a dedicated investor relations professional fared better in this regard.

Summing up, **Helen Kenyon** reported that Preqin's results showed that "81% of LPs felt that the balance of power had shifted in their favour, with 54% seeing this as a longer-term change, a third thinking it was change for the medium term and just 9% of the sample saying it was a short-term change."

Debt Finance, LBOs and Mezzanine

With regard to the availability of credit in the region, **Bela Seres** of **Deloitte** explained that, according to the Deloitte Corporate Confidence Index, "executives in Central Europe say that there is readily available debt for their business needs in Central Europe."

Supriya Saxena of **UniCredit Markets & Investment Banking** agreed with these findings, remarking in response to the question "is debt available?": "Unfortunately it is not a straight yes or no answer. The short answer is yes. The longer, more considered answer obviously depends on the circumstances, the country and the sector." She went on to explain that "I think we have seen in the last nine to 12 months that the economic situation in the region has improved. Some of the FX fluctuations that we were concerned about have abated, albeit not completely, and banks are gaining more confidence from that. I think credit committees have become comfortable that a lot of the gremlins in the closet around restructuring have gone away and are now really focussed to put new capital to work."

Ms Saxena reported that deal activity is increasing and relationships with sponsors are key. **Piotr Nocen** of **Resource Partners** supported this position, saying, "Leveraging mid-market deals or lower mid-market deals is back to normal, but banks are being very selective in the business profiles that they want to support and are looking for conservative financing structures." Ms Saxena agreed and added that "the banks have become much more transparent in terms of what their expectations are when they are financing." **Jonathan Young** of **Gryphon Emerging Markets** went further and said that "banks and mezzanine providers are getting much more focussed on real operational value-add to the businesses they are proposing to lend to," and they are "more conservative in terms of the operational excellence of the company and the sponsor."

> *"The banks have become much more transparent in terms of what their expectations are when they are financing."*
>
> *– Supriya Saxena*

Supriya Saxena also highlighted that "there is the possibility to add more leverage to the company through high-yield instruments, and that is something we are seeing creep into the region as an alternative to bank financing." **Piotr Nocen** agreed that "high yield is seriously competitive to mezzanine structures from the lower end, as the buyers of these facilities don't care about the total leverage multiples, especially for earlier-stage companies. It is quite a cheap form of financing which may create some tensions a few years down the road."

Claire Scott-Priestley of **Squire, Sanders & Dempsey** considered the responses of delegates to the interactive questions posed to them by the mezzanine panel. 53% of respondents considered that mezzanine's best quality when used in a transaction is to bridge a funding gap between senior debt and equity to get a deal done. However, **Sean Glodek** of **Darby Private Equity** challenged the audience's views on the market for mezzanine, saying that "by and large we spend most of our time on value-adding additional leverage in the capital structure, which helps entrepreneurs and professional investors grow or restructure middle-market and small and middle-market companies."

Chris Buckle of **Mezzanine Management GmbH** agreed, saying, "Traditionally mezzanine has been used to boost equity returns by increasing the leverage, as mezzanine is cheaper than equity. Additionally mezzanine is increasingly being used for growth capital and add-ons. One of the benefits of mezzanine, as opposed to senior debt, is that it actually retains more of the cash flow in the business for growth. We've heard that senior debt is available, even at reasonable pricing, but it has short maturity, amortizing quickly, so the banks very generously lend you the money but then start taking it back immediately. One of the advantages of mezzanine is that the borrower retains that money for seven or eight years, thereby keeping its cash flows to grow the business. The value added by growth can more than offset the cost of mezzanine."

Sean Glodek supported this position, saying, "More than half of the companies we are talking to are eventual buy-out candidates, with owner-managers who are not ready to sell right now. They're talking to us because it's a cheaper, cost-effective way for them to grow their business, maintain control and then sell when they're ready."

"More than half of the companies we are talking to are eventual buy-out candidates, with owner-managers who are not ready to sell right now from a deal flow perspective."

– Ryan McGovern

The responses to the interactive questions also indicated that pricing and return expectations were hot issues for those considering mezzanine. **Ryan McGovern** of **Nomura Mezzanine** highlighted a current problem, pointing out that "there's a structural imbalance at the moment where there are a number of private equity funds that have a lot of money to invest in a fairly limited time period, and the last couple years have been pretty stark from a deal flow perspective. So, to get deals done, they're putting a large amount of equity to work and thus sometimes accepting a base case equity return expectation that is similar to a typical return expectation for a mezzanine investment."

Market Trends

Amongst the overarching debate about whether Central and Eastern Europe should continue to be viewed as a separate region, several speakers gave their opinion on the countries and sectors that seemed to be experiencing the most private equity activity.

Matthew Saal of the **EBRD** delivered some positives by saying, "As the US prints money and it goes out into the world and doesn't find a home in China, it's finding a home in Turkey, Poland and some other countries in our region as the search for yield goes on." He continued, "There's a fair amount of investment going into Russia and Turkey, for example, but it's really only scratched the surface in terms of the size of those economies."

During his panel discussion, **Richard Seewald** of **Alpha Associates** asked delegates the interactive question: "on a risk-adjusted basis, in what part of Central and Eastern Europe and South Eastern Europe do investors expect the most attractive returns going forward?" The responses revealed 45% for Turkey and 27% for Poland, the Czech Republic, Slovakia and Hungary. Mr Seewald highlighted that Turkey had not even featured when that question was asked a year ago.

Armando D'Amico of **Acanthus** delivered the results of the Acanthus annual survey in response to the question: "where within the region do you see the most interest over the next three years?" "Central Europe is still the favourite with 67%, but that is down from 87% last year. Russia doubled to 22% from 11% last year, and South Eastern Europe, including Turkey, leapt to 11% from 2% last year."

The responses to interactive questions revealed Poland and the Czech Republic as being the countries which offered the best opportunities to generate proprietary deal flow. **Brian Wardrop** supported this position and justified it in saying, "One of the unique characteristics of the region from a demographic perspective that is, in our view, unprecedented globally in any other market is the succession wave of deals that's hitting an inflection point now, in particular, in the Czech Republic and Poland." He explained that in these countries there are greater opportunities to "identify the motivated, reinvesting owner-manager who has a desire to take the company forward to the next phase of growth alongside a private equity firm."

Supriya Saxena pointed out that "the easiest jurisdictions in which to raise financing are what I would term the golden four, which are Poland, Czech Republic, Slovenia and Slovakia."

Patrick O'Brien of **ADM** offered a different view, naming the Black Sea region (Ukraine, Turkey and Romania) as the most attractive. "One of the things that we're finding very interesting as relative newcomers here is the extraordinarily large amount of inter-regional trade around the Black Sea," he said.

"One of the things that we're finding very interesting as relative newcomers here is the extraordinarily large amount of inter-regional trade around the Black Sea."

– Patrick O'Brien

Joanna James gave her view of the high-growth sub-sectors that would be interesting for investment as being first, "necessities," those things that consumers actually spend their money on when they have less money, largely, health care and education. Second, "quality goods at affordable prices"; she highlighted that "export is something we have tended to overlook in the last few years because we were doing so well with companies that were driven by domestic consumption." Last, the development of "low cost leaders" where it is possible to invest in reducing the cost of producing a unit to increase sales.

Increased Regulation for Private Equity

Speakers at the Forum delivered warnings of increased regulation. **Carol Welu** of **Squire, Sanders & Dempsey** spoke about why CEE private equity players should worry about US and UK anti-corruption laws. Ms Welu explained that the US Foreign Corrupt Practices Act (FCPA) has an ever-increasing jurisdiction and "prosecutions continue at a record-setting pace. Just in this year alone, there were 23 enforcement actions by July on top of 40 in 2009 and 33 in 2008." Ms Welu presented the top 10 list of the fines imposed under the FCPA, of which she noted "half of those cases are in 2010 and six of the 10 on that list are non-US companies." She highlighted that "the fines are getting higher and extra-territorial jurisdiction is getting more expansive."

In addition, **Ms Welu** explained that the UK Bribery Act is due to come into force in Spring 2011 and will create four categories of offences, including a new offence for failure by a commercial organisation to prevent a bribe being paid for or on its behalf. She warned that liability for such failure is strict; however, it will be a defence if the organisation has adequate procedures in place to prevent bribery. The Act will apply to any company that carries on any part of its business in the UK, which could mean even a single transaction.

Ms Welu observed that such anti-corruption legislation should be a concern for delegates, as "corruption is more prevalent in Central and Eastern Europe and CIS than North America and Western Europe. There is more state involvement in business and old habits die hard. If you combine that with increased enforcement, you really have the perfect storm for an explosive situation." Her closing advice was to "get your compliance programmes in place as soon as possible and enforce them from the top."

Christopher Rose of **Squire, Sanders & Dempsey** and **Barbara Nowakowska** of the **Polish Private Equity Association** discussed the latest developments with the AIFM Directive and presented their thoughts on how this is likely to impact the European private equity industry. Mr Rose warned delegates to "brace yourselves for a new regulatory environment." Ms Nowakowska agreed, saying that “everybody is going to be affected, be it EU fund managers or non-EU fund managers if you have European investors.”

> *“Brace yourselves for a new regulatory environment.”*
>
> *– Christopher Rose*

It was explained that all fund managers will have to obtain authorisation to conduct their business, but that authorisation, in theory, is going to be valid for all Member States. There will be minimum capital requirements for fund managers and restrictions on remuneration which, **Ms Nowakowska** explained, “must not encourage risk, and compensation of staff in control functions cannot be related to performance of business.” However, she delivered good news that industry negotiators have had some success in addressing the main concerns about the Directive such as valuation, as “there is no longer a requirement to employ an independent valuator; the valuation can be carried out in-house, but it is to be separated from the portfolio and remuneration policy.”

The Directive also contains some exemptions for leveraged funds with less than €100 million and non-leveraged funds with less than €500 million under management. **Ms Nowakowska** confirmed that “those people who manage relatively small funds wouldn’t have to comply with the Directive; however, even these fund managers will have to register with competent authorities and provide information on the funds under management, investment strategies, principal exposures and main concentrations.” In addition, there will be no passport for exempted funds, which means that they can be marketed in a country where they are registered but cannot be marketed under the same registration across Europe. However, all funds can opt into the regime laid down by the Directive, but in such circumstances they would need to comply with all applicable provisions.

> *“Until 2015 the seas are going to be calm but the Directive should be fully implemented by 2018.”*
>
> *– Barbara Nowakowska*

With regard to timing for implementation, **Ms Nowakowska** indicated that “until 2015 the seas are going to be calm but the Directive should be fully implemented by 2018.” **Robert Manz** of **Enterprise Investors** spoke up in support of continued vigilance in regard to the Directive, saying, “Family offices and oligarchs will have an advantage with portfolio companies over your funds after this legislation goes into place because they will not be subject to all of these regulatory requirements.” He encouraged delegates to continue to participate in the next phase of the legislative process as the Directive gets implemented into local legislation, arguing that “we as an industry cannot sleep during that period.”

Prospects for Private Equity in CEE

Joanna James provided some statistics on economic growth in support of the comments that she made about emerging markets. Ms James highlighted that “Brazil, in this year of crisis, has had 7% growth; China has had 10% growth and India has had 8% growth.” Conversely, Western Europe has had an average growth of 0.85% in 2010 with the Central European average just above 1.31%. She added, “If you take Turkey and Ukraine out of this Central European average, you get 0.68% average growth which is less than Western Europe.”

Petr Rojicek of **Alpha Associates** supported these statistics and commented that “allocations to emerging markets seem to be growing; however, this is not very good news for this region because for LPs in the US and outside Europe, what is on top of their list is Asia, followed closely by Latin

America, particularly Brazil." **Henry Owainati** of **ConsulCapital** agreed and recounted that the view of many US LPs is that "if you want to be in emerging markets, you want to be in the growth markets of Asia. Eastern Europe is seen as wedged between an aggressive rising Russian power and a sluggish Western European economy."

However, when considering risk-adjusted returns, **Mr Owainati** delivered a more optimistic message, saying, "Central and Eastern Europe is certainly an attractive region, as the risks are lower because the institutional setup increasingly resembles what a developed economy looks like." He cited Poland as being a much lower-risk jurisdiction than China, for example. He continued by explaining that "the types of deals are also lower risk because most of the stuff you see in Asia is minority situations and the type of deals we like to get involved in are control positions." He also observed that "valuations here remain more reasonable than in Asia."

"Valuations here remain more reasonable than in Asia. ."

– Henry Owainati

Joanna James presented statistics regarding LPs worldwide, saying, "50% of all the private equity ever invested by LPs were drawn down in the years 2005 to 2008. That means that there is US$500 billion worldwide of unfunded commitments and 60% of limited partners are actually above their target allocation for private equity." She went on to highlight that "in the middle of this year, 51% of all LPs were showing net returns of less than 10% since they began investing in private equity." However, it was not all bad news, with Ms James adding that "it is consistently true that the highest private equity performers consistently beat the other asset classes and tend to show a consistent track record, so, private equity is not something that is going to be abandoned by LPs."

Jim Strang agreed that LPs will not abandon the asset class but thought that "funds could lose up to a quarter of existing LPs in the current shakeout and up to a third of commitments from this group." **Michael Wunderlich** of **BC Partners** surmised that "PE has been perceived in a too aggressive way and we need to think about what PE can do when you look at the track record of an existing well-run fund. I think it is still the best asset class in town."

Many of the speakers voiced their opinions that Central Europe is increasingly no longer being viewed as a separate market to Western Europe. **Matthew Saal** stated, "There is no real Eastern Europe region; it's a bunch of very different countries, some of whom share certain common ties."

"There is no real Eastern Europe region, it's a bunch of very different countries, some of whom share certain common ties."

– Mathew Staal

Daniel Lynch of **3TS Capital Partners** shared lessons from his recent discussions with LPs, saying, "It is very clear to us that we are not being benchmarked just against other Central European funds because that line between Central and Western Europe is no longer relevant for LPs. We are being benchmarked against all their alternatives, which include Western European GPs as well. As a market, we in Central Europe have to acknowledge that this is here to stay and that LPs are now quite educated about the differences between Poland and the Czech Republic and Romania and Bulgaria and how they compare to their Western European counterparts." However, **Matthew Saal** observed that "the idea of regional funds still seems to have primacy."

With regard to the private equity market generally, **Joanna James** pointed out that, particularly in the larger deal segment, "the deals are back, but of course, so is competition, not only from the dedicated funds but also from some of the global or pan-European buy-out funds and, as a result, prices are high." **Ms James** explained that the usual trend was that funds tend to make the best returns on deals after a crisis because prices come down; however, recent experience has shown that "it's not the absence of leverage that is the problem; it's the high prices. The global funds are finding it difficult to invest, and so they are fishing in our markets."

It was generally agreed that there was greater competition in the higher end of the market and the mid-market and lower-mid market was considered to be attractive by many. **Richard Seewald** commented that "at the higher end, 80% of the money in the region is chasing 20% of the deals. In this segment the indigenous fund managers maintain an advantage over the pan-European players on quality of deal flow and ability to execute on proprietary opportunities. In the mid-market and lower mid-market, an imbalance of supply and demand of capital and certain meaningful demographic drivers are producing very significant opportunity in the region." **Lizette Sint** of **Rabo Private Equity** supported this position, saying that "the mid-market is a very attractive sector as it offers a high ability for proprietary deal flow."

"The mid-market is a very attractive sector as it offers a high ability for proprietary deal flow."

– Lizette Sint

However, **Robert Luke** highlighted the need to "explain better the value-added activities of private equity, and, moreover, to prove them through doing deals in which the staff of the private equity firm is actually creating value not only for the PE fund investors, but for the other shareholders."

The biggest challenges to origination of deal flow in the next six to 12 months were cited as being excessive valuation expectations, the slowdown of growth in the region, the amount of time that is spent working on proprietary deals that do not convert and a lack of credit appetite, despite a return of bank liquidity.

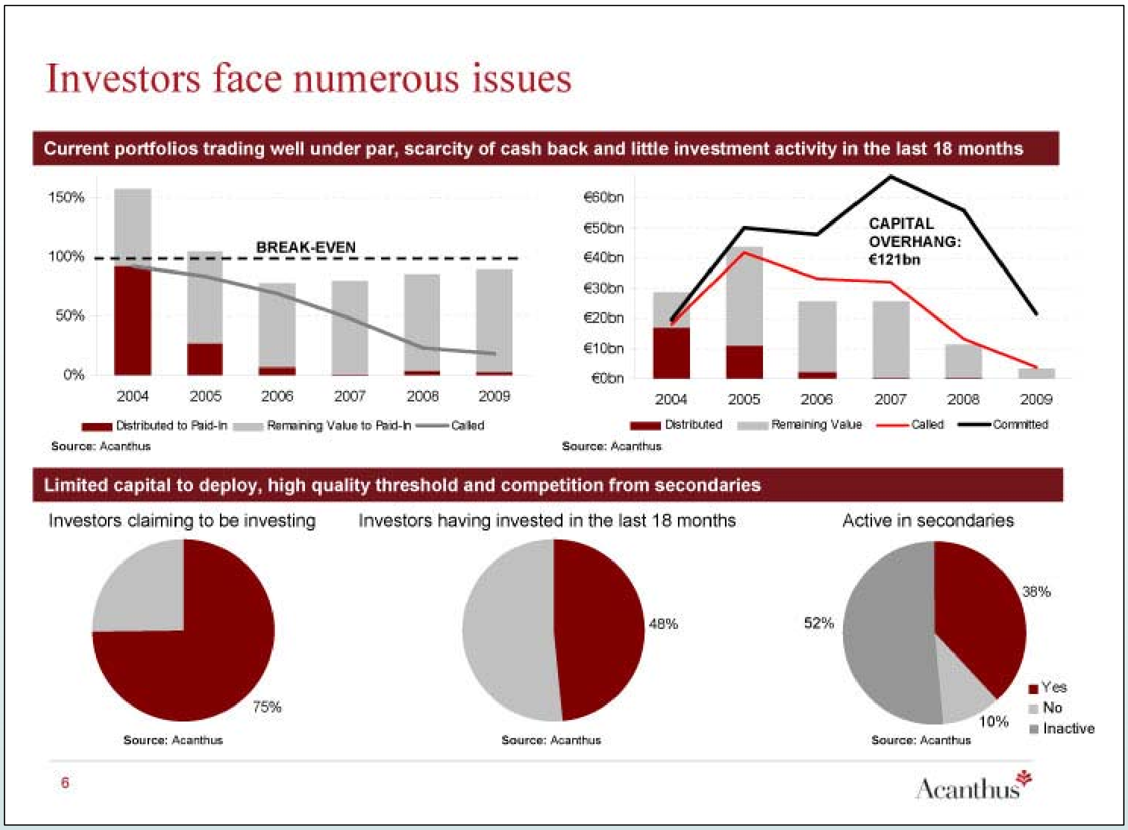
William Watson speculated about what GPs could do to increase their survival rates and summarised four strategies. The first is the top strategy: "don't change anything, but just write up a different marketing brochure; just spin it a different way." The second was the groundhog strategy: "whatever happens, we are back in the hole for at least another six months after this conference – no fundraising, no spring, we go to ground and make the best of it." The third was the chameleon strategy, which is different to the top strategy: "you do actually change something, but you tell everybody you were doing it the same way anyway." The final strategy is "probably the hardest one. It is the Olympic strategy, which means you have to get in shape. You have to make the tough cuts in your team, tailor it to what you need, adjust your portfolio, make sure your portfolio companies are working as hard and as well as they can and really take the time to have that view for the next cycle or opportunity."

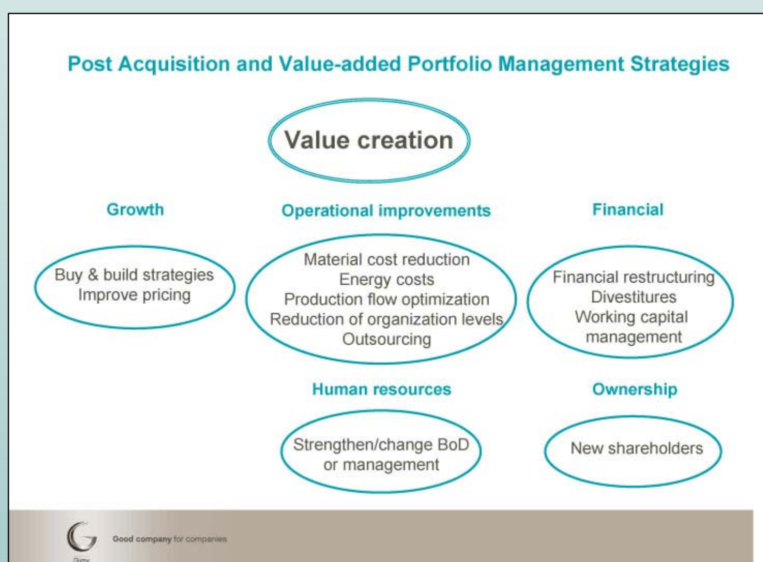
Alexander Kondrashov of **Rusnano** stated that he is "optimistic in the long term, but the short term is difficult."

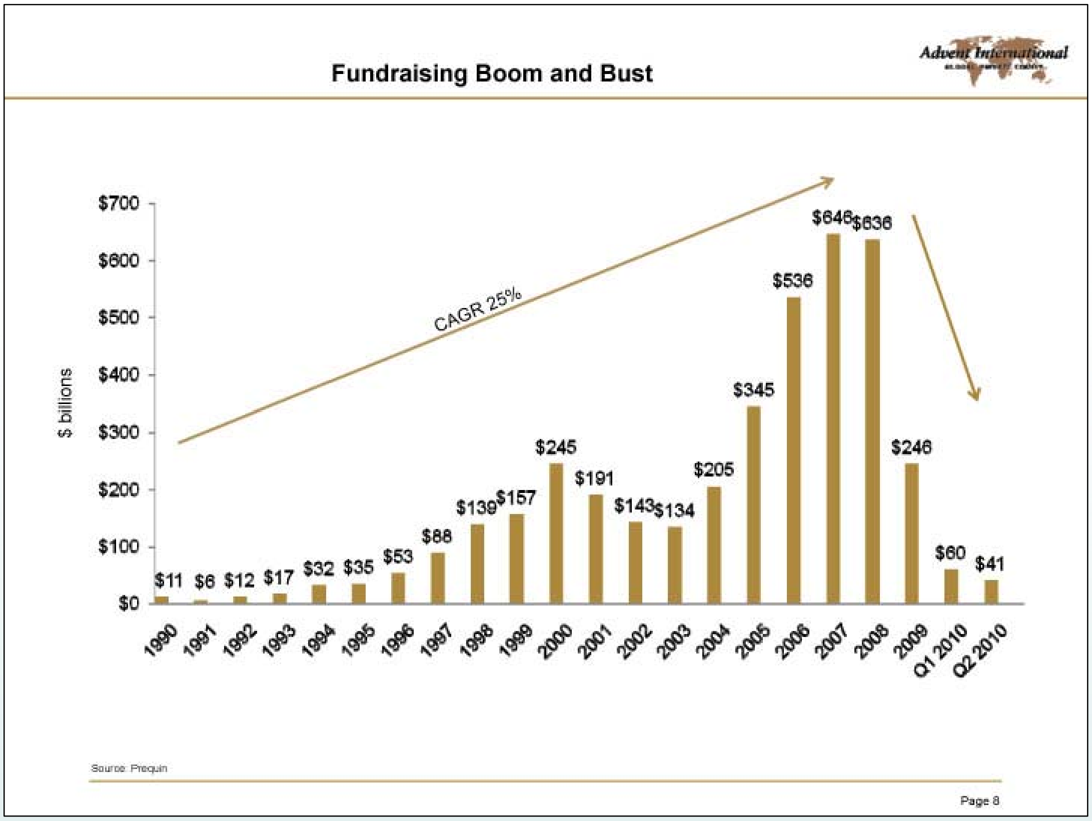
Joanna James summed up her opinion of the future: "in a world where capital will be scarce and competition for that capital will be fierce, there is only one thing I believe that will save the Central European private equity industry, and that is performance. Perform or die!"

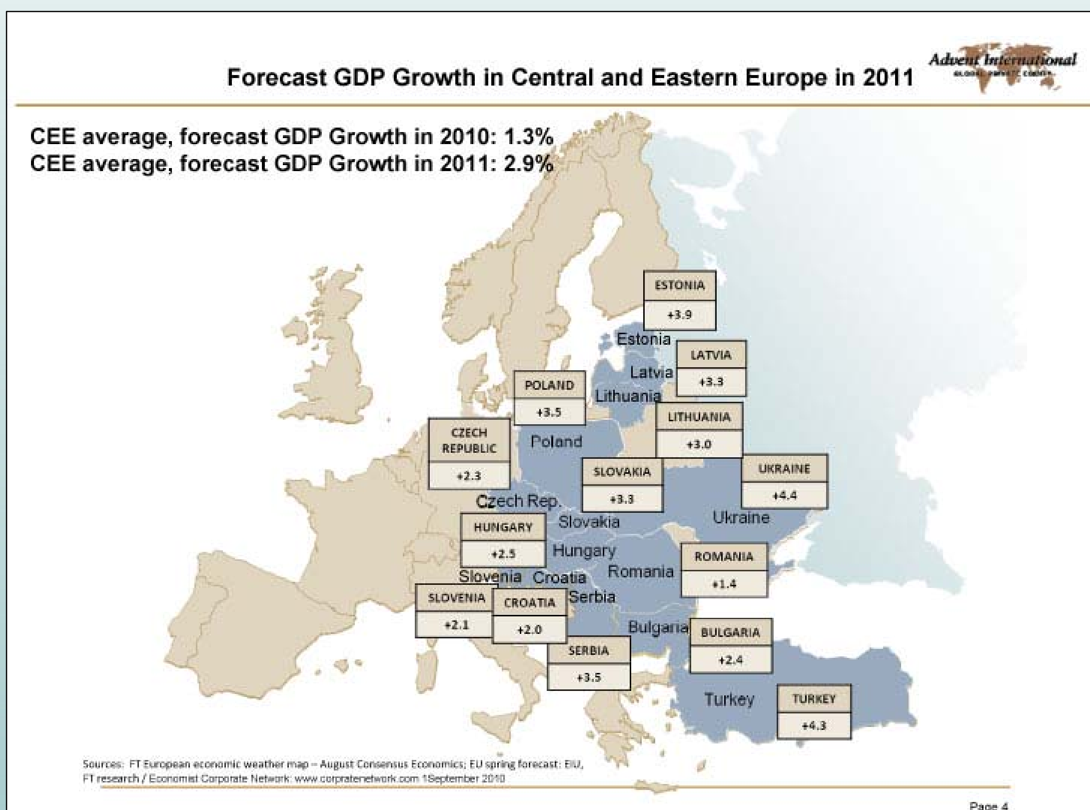
WHAT THE NUMBERS SAY

Below is a sample of slides that were shared by some of the speakers in their presentations. Thank you to **Matthew Saal** of the **EBRD, Joanna James** of **Advent International, William Watson** of **Amundi Private Equity Funds, Barbara Nowakowska** of the **Polish Private Equity Association, Jan de Wijngaert** of **Gimv** and **Armando D'Amico** of **Acanthus** for permitting us to include these in our event summary.



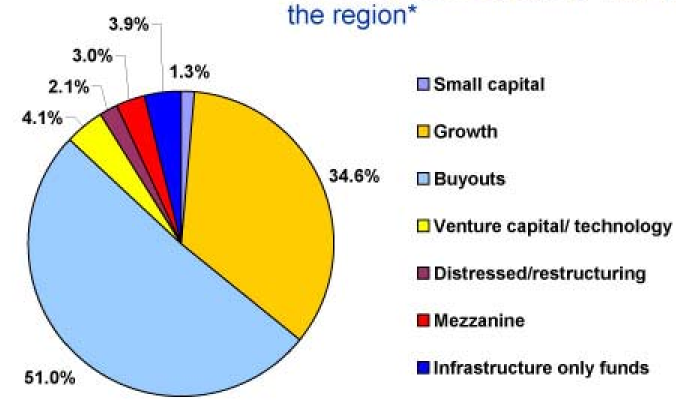



Advent International
Fundraising Boom and Bust
$700
$600
$500
$400
$300
$200
$100
$0
$ billions
CAGR 25%
$11 $6 $12 $17 $32 $35 $53 $88 $139 $157 $245 $191 $143 $134 $205 $345 $536 $646 $636 $246 $60 $41
1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 Q1 2010 Q2 2010
Source: Prequin
Page 8


Advent International
Forecast GDP Growth in Central and Eastern Europe in 2011
CEE average, forecast GDP Growth in 2010: 1.3%
CEE average, forecast GDP Growth in 2011: 2.9%
ESTONIA +3.9
Estonia
LATVIA +3.3
Latvia
POLAND +3.5
Lithuania
LITHUANIA +3.0
CZECH REPUBLIC +2.3
Poland
SLOVAKIA +3.3
UKRAINE +4.4
Czech Rep.
Slovakia
Ukraine
HUNGARY +2.5
Hungary
ROMANIA +1.4
Slovenia Croatia
Romania
Serbia
SLOVENIA +2.1
CROATIA +2.0
Bulgaria
BULGARIA +2.4
SERBIA +3.5
Turkey
TURKEY +4.3
Sources: FT European economic weather map – August Consensus Economics; EU spring forecast: EIU, FT research / Economist Corporate Network: www.corpratenetwork.com 1September 2010
Page 4

Most of the capital is focused on buyouts and growth

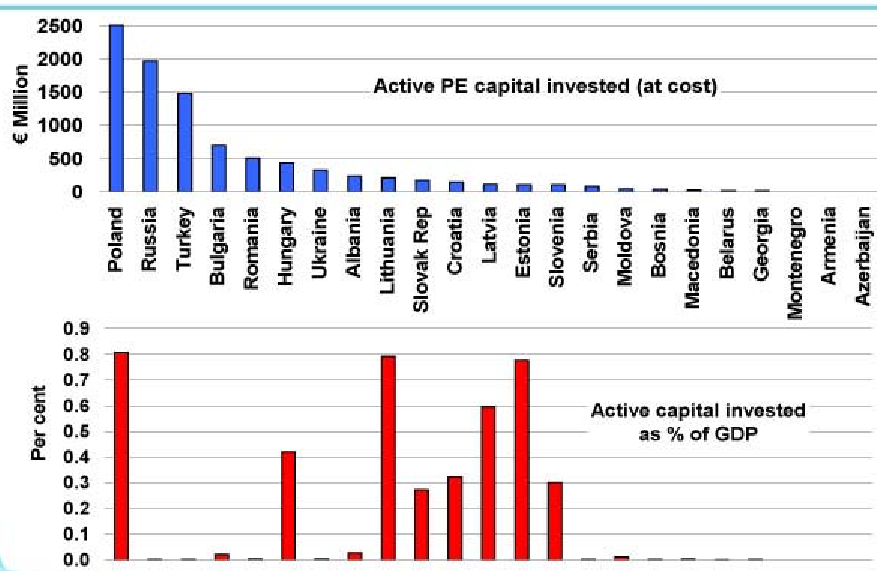
Net committed capital, by fund type, across the region*



Includes CEB, SEE, EEC, Turkey and Russia.
Source: EBRD, EMPEA, Prequin and Mergermarket.

www.ebrd.com

but economic penetration varies widely across markets…



Source: EMPEA, Prequin and Mergermarket.

www.ebrd.com

Polskie Stowarzyszenie Inwestorów Kapitałowych
Polish Private Equity Association

AIFM Directive – Capital requirement

- Capital requirement for AIFM
  - EUR 125 K;
  - Additional capital 0,02% over 250 M;
  - But not less than ¼ of the fixed overheads of the AIFM (Directive 2006/49/EC on the capital adequacy). In fact, ¼ of management fee!!!!
  - Capped at EUR 10 M
  - 50% of additional capital may not be paid-in but an AIFM must have a guarantee or insurance of the same amount
  - Own funds to be invested in liquid assets; not to include speculative positions

5

Polskie Stowarzyszenie Inwestorów Kapitałowych
Polish Private Equity Association

AIFM Directive – Authorisation

- Member States shall ensure that no AIFM manages one or more AIF unless it has been authorised in accordance with this Directive.
- Authorisation requirements for AIFM:
  - Identity of persons effectively conducting the business of AIFM
  - Identity of AIFM shareholders or members
  - How AIFM is going to comply with some specific requirements of the Directive
  - Remuneration policies
  - Delegation to third parties
- Authorisation requirements for AIF:
  - Investment strategies
  - Master AIF for feeder structures
  - Depositary
- Quarterly information on granted authorisations to ESMA. Public register

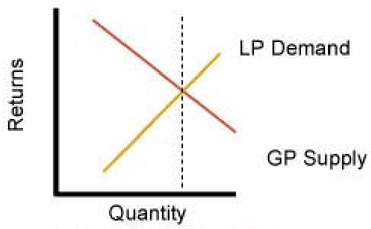
The authorisation shall be valid for all Member States

4

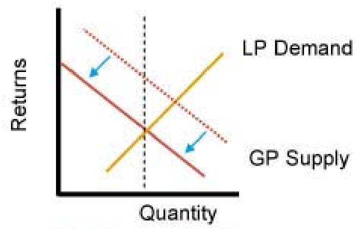
Amundi

Where has the bar moved?

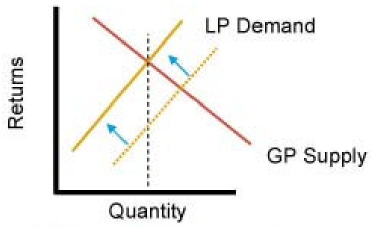
SGAM Eastern Europe



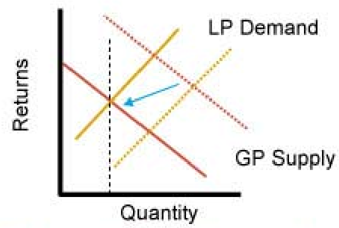
1. Pre Crisis Equilibrium



2. GPs can't deliver returns



3. LPs can't deliver funding



4. Equilibrium at lower volume and returns

Strictly Confidential

Amundi Private Equity Funds -- page 3

Amundi

CEE and the Investment Opportunity Bar

SGAM Eastern Europe

Positives.

- Core CEE thesis of its competitive position in Europe remains.
- World problems reinforce CEE advantages.
- Investment valuations low / lower.
- Deal pace accelerating for both investments and exits.
- CEE markets stabilising with the worst over.

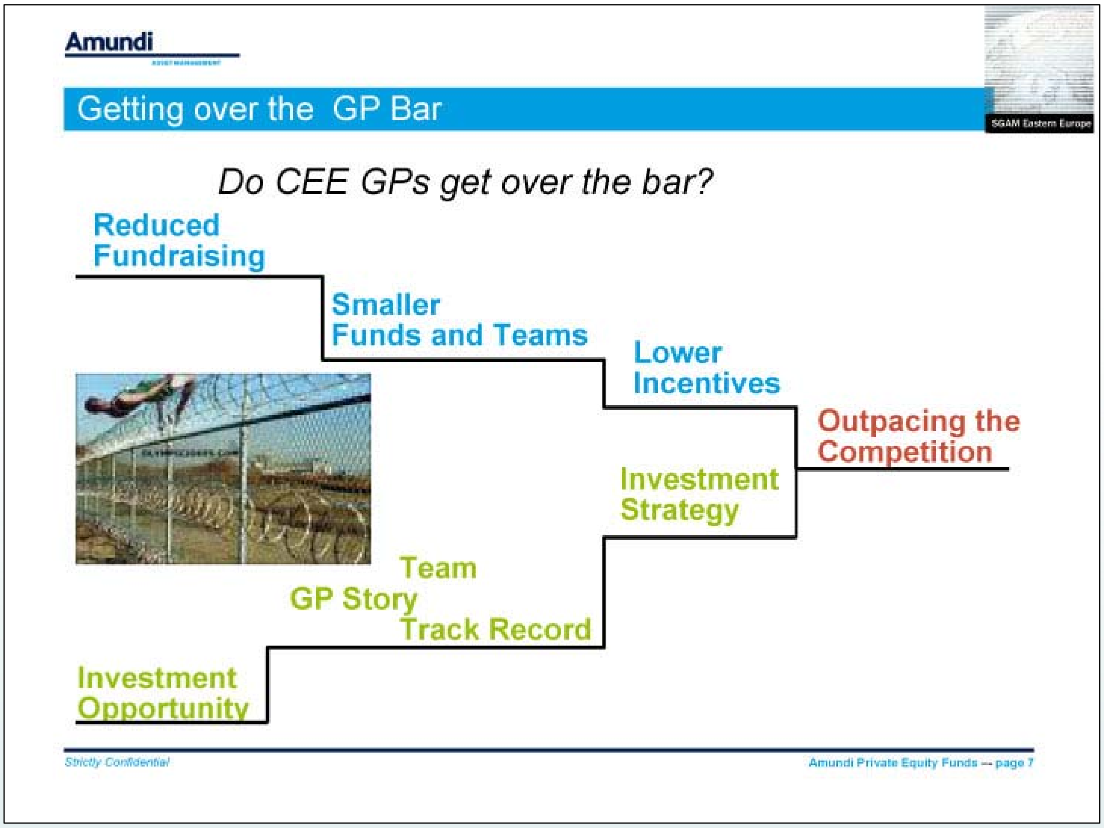
Negatives.

- Credibility of CEE severely dented; media versus reality.
- Future economic / fiscal outlook has risks.
- Bifurcated market: very large or very small deals
- Exit valuations low / lower.
- Sellers not fully convinced now is the time to sell.
- Debt supply is reduced.

Does the CEE regional opportunity get us over the bar?

Strictly Confidential

Amundi Private Equity Funds -- page 5


Amundi
Getting over the GP Bar
SGAM Eastern Europe
Do CEE GPs get over the bar?
Reduced Fundraising
Smaller Funds and Teams
Lower Incentives
Outpacing the Competition
Investment Strategy
Team
GP Story
Track Record
Investment Opportunity
Strictly Confidential
Amundi Private Equity Funds -- page 7

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

About Squire Sanders

Founded in 1890, Squire, Sanders & Dempsey L.L.P. has lawyers in 32 offices and 15 countries around the world.

On the ground in seven CEE countries, and backed by the global expertise of our Emerging Markets Private Equity Group, our tightly integrated CEE Private Equity Team works together to seamlessly serve our clients' transactional needs – whether the deal is undertaken in one of our resident countries or across multiple borders.

We advise on all types of private equity investments and exits and have a deep understanding of the issues peculiar to key industry sectors including chemicals, communications, energy, food and beverage, financial services, hospitality and leisure, logistics and infrastructure, media, natural resources, real estate and technology.

For more information, please contact our CEE Private Equity Team:

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About C5

For over 20 years the C5 Group of companies, including the American Conference Institute (ACI), The Canadian Institute (CI) and C5 Communications Ltd., have developed and hosted strategic conferences, summits and executive briefings providing the business intelligence that senior decision makers need to react decisively and effectively to challenges and opportunities in the marketplace.

Based in London, C5 Communications Ltd. holds conferences across Europe and has grown to produce over 90 events a year, attended by thousands of senior delegates from all over the world. Globally the C5 Group produces over 500 conferences and events per annum.