Economic **summary** from **experts** for business

CEE Expert Report

3Q2020

FORDATA®

Edition #1 The way security is.

> **The year 2020 will be remembered as a global test. Markets partially collapsed, millions lost their jobs, remote trends kick-started and paradigms started to shift. How have Central and Eastern European economies found themselves in the new situation, when just a year earlier they were unanimously hailed as one of the most promising investment destinations? What is our "here and now" like?**

FORDATA CEE Expert Report is an insider's attempt at answering these questions. Quarter after quarter, we will invite local experts in different fields of economy and ask them to present their individual, professional take on the current situation, and to share their hopes and expectations. Our goal is to collect a varied array of thoughts and commentaries on the CEE economy that will serve as a kaleidoscopic record of market reality, rather than be a periodic, data-centred analysis. We believe that in this way we can help build a more relatable and engaging platform for dialogue, which will also go beyond the pages of this publication.

However, to find a common ground for all the commentaries, each quarter, we will come up with a topical issue. Something which is deeply present in our "here and now", yet ambiguous enough to be approached from different perspectives. **In the first edition of the report, we focus on security.** Security has acquired a special meaning in 2020. In what ways are or aren't we safe, besides the obvious? How do investors, advisers and company owners perceive this term today? How does the nearest future look from the current perspective of Central and Eastern European markets? Are we able to eventually get used to the new conditions?

On behalf of this edition's experts, FORDATA invites you to become part of that dialogue. We are eager to know your opinion under the **#ceeexpertreport** tag.

Aleksandra Prusator

Member of Board,
Sales & Marketing Director at FORDATA

Summary

Fear, uncertainty and doubt seem to have ceased in the third quarter of the year to a degree that sparks new hope for recovery in the CEE region. Clearly enough, though, investors and banks are now inclined toward financing assets which are least at risk of closing down, comes the second wave of lockdowns, whereas many sectors still remain non-bankable.

Although the number of M&A deals in CEE increased in 3Q, it seems that it is in part due to the closing of mid- to long-term processes. Nevertheless, the economic turmoil caused by the COVID-19 threat, and a change in consumers' behavior that resulted from it, has created new opportunities for investors, who now look closer at industries boosted by the new circumstances - health-care, IT, FMCG or logistics sectors being among those.

On the other hand, the distressed trends have increased, yet the governmental aid, which improves the general sense of security, makes it difficult to assess how deeply markets have really been affected.

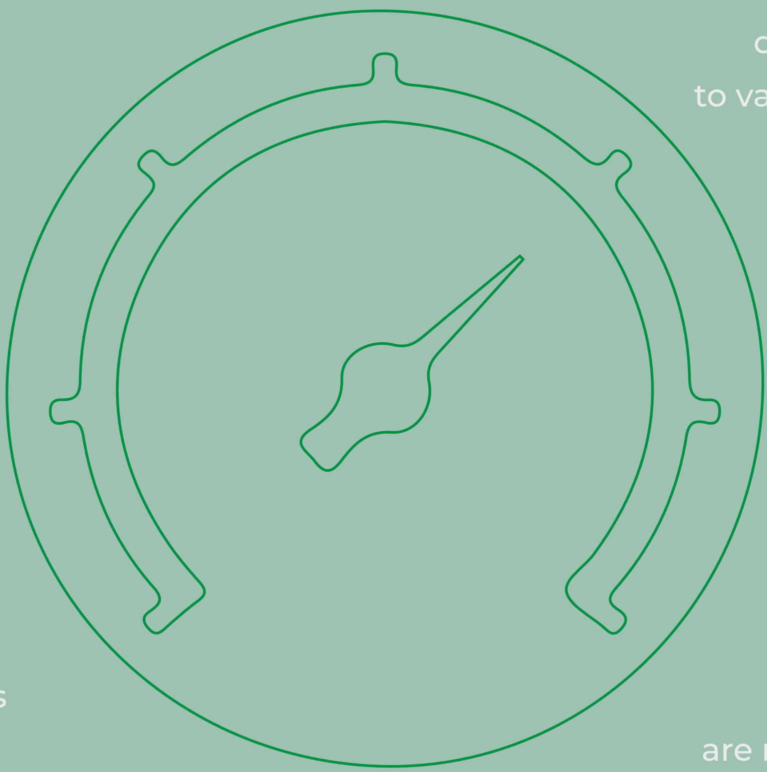
The situation is far from clear. And the need for security has been fulfilled only partially. As companies have switched to remote modes - immediately causing a stir in the RE industry and fortifying the IT industry at the same time - to secure their workflows, they cannot predict their future economic environment. And so cannot the investors. What is certain, though, is that we are in a safer place than in spring. We have data and new organizational models which have been field tested for six months now. Let's hope in three months we will have much better perspectives.

CEE Market Barometer in 3Q2020

EV/EBITDA
or EV/Revenues multiples
are being combined
with “EV/COVID” multiple

More demand
for M&A processes
and Due Diligence

Lower security in deal
valuations could be
diminished thanks
to various price structures



Big deals struggle,
mid-market
is resilient

Real estate sector
still can help achieve
wealth security

Distressed assets
might become
a big trend

German bonds
are negative, Czech bond
yields are just below 1%

Emergence of built-to-rent
model in RE next to
the typical built-to-sell model

Gastronomy, hotels
and leisure still
suffer the most

*as pointed out be the report experts

Torsten Adam

Founder & Managing Partner at ARTEMIS Group

Torsten has more than 25 years of work experience in Mergers & Acquisitions, Corporate Finance and Advisory Services. His core competencies are in M&A transaction management, cross-border projects, structured and project finance as well as advisory services. He has been involved in numerous projects in the sectors such as automation & industrial engineering, renewable energies, agriculture, food & beverages and financial services. Mr. Adam was responsible for various cross-border M&A transactions with involvement from Asia, Africa, Americas and Europe, including CEE.

The Global M&A market experienced a significant impact in the first three quarters of 2020 out of the severe economic conditions triggered by the COVID-19 pandemic.

But the type and extent of the impact have been very different across industries and economic regions. As the US deal flow was down sharply, European M&A negotiated the first half of 2020 impressively despite severe economic disruption. Big deals have been struggling while the mid-market remains resilient. Not surprisingly, healthcare and the technology sector have been in the focus of M&A deals. For example, the deal value in the European healthcare sector has recorded the best first-half year performance in more than ten years.

The CEE region, as well as other developed regions around the world, is currently affected by recent development of financial markets and by global and national measures and restrictions following the spread of the COVID-19 pandemic. Till now, the activity on the M&A market in CEE has not seen significant decline. However, a decline in deal numbers and deal volume will be the most likely scenario in the period ahead.

CEE market participants remain cautious about the prospects of an M&A recovery in the CEE region. Regardless of the social and economic risks relating to a second wave of the pandemic, activity is reigniting in selected sectors, albeit under "next normal" conditions.

Most probably, M&A deals in defensive, non-cyclical sectors such as technology, food and beverages /consumer products, (renewable) energy and infrastructure/utilities will dominate the market in the next quarters and will continue to attract investor interest.

Infrastructure-related sectors are widely seen as resilient in the face of economic turbulence and are therefore a safe investment. Stable levels of activity and attraction of new investors are also expected in the renewable energy sector (solar, onshore and offshore wind, biomass) due to still stable cashflows of these assets and the ongoing switch from conventional to green energy.

The technology sector will also originate a lot of potential M&A deals in the CEE region, especially the e-commerce segment. Growing revenue and improving profitability as a result of shifting consumer behaviour during the pandemic will be the deal drivers in the next months.

Significant activity can be also expected from buyers with good liquidity who might be interested in buying companies that are currently facing economic problems. There is also expected to be more companies selling non-core central European assets so that they can focus on other geographies or raise cash from divestments.

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Michal Tesař

Partner & Co-owner of NEWTON Business Development

Michal has been active in the CEE M&A activity for about 20 years. He is the Partner & Co-owner of NEWTON Business Development, a Prague based investment boutique, part of Pandion Partners which is an M&A-focused international advisory Group with 20 members around the globe. Michal is not only leading the M&A practice, but also the Public Infrastructure Advisory segment at NEWTON. Besides, he is a Director at Pandion Partners responsible for expansion, where he has doubled the Group in the span of 3 years.

Spring this year reminded me of the financial crisis in 2008 and the outcomes for Mergers & Acquisitions market not only in the CEE region. The experience from that time was clear. Lots of promising deals had been cancelled followed by 1-2 years of balancing the gap between the very different price expectations of buyers and sellers. Buyers were looking for a bargain price and sellers were not willing to sell based on the current bad underlying financial results leading to unattractive price conditions. This year's summer gave me hope that it would be different in the COVID-19-lead crisis. The initial general market pessimism has vanished, but it is true that the hardest-hit segments like hotels, leisure sector and others still suffer.

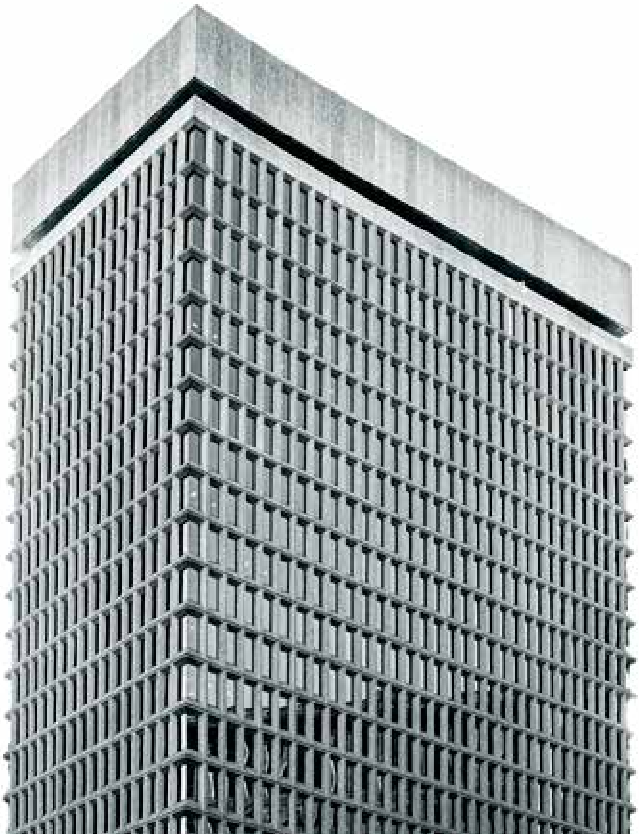
I closed 2 deals in 3Q 2020. One in e-commerce support services – entry of Heureka Group (the Europe's largest price comparison website) into Testuj.to (a start-up focused on building up customer communities) – and another in renewable energy – an acquisition and related bank financing of a group of small hydro power plants in Italy for the Czech-based Renfin Group. I have been luckily involved in segments not significantly harmed by the crisis.

However, the underlying economic environment has been still fuelled by governmental and central banks support. Which means that the real disaster is hidden and it still waits for the moment of a real coming out. Together with the increasing COVID-19 issue again in autumn, it slowly moves my mind into pessimistic territory.

The underlying economic environment has been still fuelled by governmental and central banks support.

Even the segments initially not hit by the spring chaos like Information Technology are starting to experience cost/investment cutting of their customers, even the ones who have not been significantly hit by the crisis. Besides that, bank financing of takeovers are at obviously worse parameters than before, with an increasing number of segments not bankable at all.

That all makes a mix that naturally leads to an expected downturn in the M&A activity, with the exception of distressed segments that are going to have a harvesting time.



Jan Slabý

Partner at ECOVIS Corporate Finance

Jan has gained experience in investment banking in the Czech Republic and Slovakia since 1996. Before he joined ECF, Jan had spent more than five years with WOOD & Company, where he worked in the Corporate Finance department. He obtained a lot of experience with M&A transactions. He was involved in significant transactions in various sectors in the Czech and Slovak economy. Jan also worked in China for a year as the head of the analytical department and a project manager for PPF Investments.

After almost moveless 2Q20, due to a mixture of restrictive measures adopted by the governments across the whole world, we could see an increased M&A activity within the CEE region in 3Q20. Many deals which had been put on hold in spring were relaunched and a number of new opportunities emerged on the back of a release of the restrictions. These were a combination of distressed asset situations and still attractive leads.

Some of the industries have been dramatically hit, such as travel and automotive, whilst others even benefitted from the lock-down, like medical equipment manufacturing or telco services providers. However, all of the opportunities have something in common, i.e. a huge uncertainty about the near future development. Typically used EV/EBITDA or EV/Revenues multiples, when evaluating any target company, are being combined with a kind of EV/COVID multiple. As the number of COVID cases is on the rise, the relative valuation tends to decrease in general, which is even more apparent now, when a new set of restraints are being implemented.

We hope and believe, though, that this high-risk period will float away soon and, again, we will be able to rely on short- to mid-term predictions. And the COVID situation will hopefully become one of the chapters in history books, as was the Spanish flu a century ago. And the EV/COVID multiple period will become only one of the abnormalities in M&A transaction statistics.

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Andy Thompson

Director, Capital Markets Cz/Sk,
Colliers International

Andy joined Colliers International in 2015 as Director for Capital Markets for the Czech Republic and Slovakia, having worked for 15 years in senior real estate roles where he successfully led various award-winning departments and businesses. Andy focuses on structuring and executing real estate sales and providing due diligence services.
He differentiates his service through long term exposure to the Czech/Slovak markets and exceptional client care and attention to detail.
Andy is an active member of the Member Royal Institution of Chartered Surveyors (MRICS).

Investors are typically concerned about two things: wealth preservation and wealth creation. But what should investors do these days? Global bonds are the most expensive in history. German bonds are in negative territory and Czech bond yields are just below 1%. Global equities similarly are also very expensive with P/E ratios currently above 25 (significantly above a long-term average of approx. 19) (Conseq, Sept 2020), at a time when most sectors, with some exceptions, are expected to have a bumpy ride in the near future.

Is real estate the answer? Well, there is no doubt that a lot of Czech investors think so. Real estate is often considered a diversifier within a wider portfolio of stocks and bonds and has the benefit of being inflation-defensive given that rents are typically linked to CPI. Importantly, real estate investments also provide the opportunity for investors to generate real returns – through both income and capital growth and can support leverage.

In recent years in the Czech Republic, the investment market has matured significantly. Local and international investors have poured into the Czech market helping to under-pin valuations through a reduction in liquidity premiums. Despite this, there remains a significant spread between prime real estate yields and the risk free rate. Indeed this is even greater today than at the trough of the GFC which suggests that real estate in some sectors represents excellent value at today's pricing.

Does real estate investing provide sufficient security for investors?

Certain real estate sectors in particular are attracting enormous interest. Both logistics and residential real estate have demonstrated their value as safe havens. Office real estate remains attractive especially now that questions of the impact of home-working have been largely put to bed as the world realises that it does need office space.

Retail and hospitality real estate are likely to require a stronger constitution in the short-term for obvious reasons, but there is no doubt that both sectors will also present significant opportunities for investors.

Domestic investors understand that real estate, whilst not without risks, can provide the required returns that investors crave. And today there are also plenty of vehicles through which to get exposure to real estate in the Czech Republic including, for example, via various fund structures, direct real estate investing and even through participating in crowd-funding structures.

The market will certainly continue to develop and provide continued opportunities for investors to achieve wealth security.

Milan Svoboda

Director, Transaction Services & Due Diligence at BDO

Milan has specialized in due diligence and transaction services since 2017. Prior to joining BDO, Milan had worked more than 10 years in the TS team at BIG4. Milan has experience from many industry sectors, primarily in engineering and manufacturing, real estate, technology, services, pharmaceuticals and media. He led and participated in more than 150 transaction and due diligence projects for various clients such as PKP Cargo, Inven Capital, Genesis Capital, Avallon, RSJ, KKCG, CBRE, Unilabs / APAX, Bain Capital, Macquarie, CME, PPF, Vodafone, T-Mobile, Medtronic and AVG. Milan is also a co-founder of the Czech Investor's Club klubinvestoru.com.

As far as the Czech M&A market and the recent deal flow is concerned, we see significant changes in everyday business routine and security of all parties involved.

The lockdowns in certain countries over the recent months and another wave of COVID-19 related limitations happening in the Czech Republic resulted in the deals that started before the coronavirus crisis in CEE now being often significantly delayed. The travel restrictions are an obvious reason as many buyers feel constraints visiting the Target's sites and premises. A number of management meetings obviously switched from off-line to on-line and video calls as people fear the risk of health issues. However, some large deals, such as the sale of CME, a CEE media and TV Group, to PPF, have been closing despite the delays.

There have been also issues when it comes to different price expectations. In many cases, the sellers still demand high multiples. However, the buyers often request the discounts for uncertainty, lack of business plan visibility and revenue outages.

There is still plenty of liquidity among PE funds and some robust businesses are still attractive targets for some of them (e-commerce businesses, construction companies, some B2C, FMCG, etc.). Lower security in the deal valuations could be diminished thanks to various price structures (earn-out mechanisms, etc.).

Despite all the COVID-19 related specifics, we still see that opportunities may arise for the well-funded buyers that have negotiation power to conclude a deal with the right price structure.

The buyers often request the discounts for uncertainty, lack of business plan visibility and revenue outages.

Daniel Janecek

Senior Manager at PwC Czech Republic

Daniel has been within the M&A industry for almost 12 years. He started his career in the in-house M&A of CEZ Group, a Czech utility company. Since 2013, Daniel has been with the M&A team of PwC Czech Republic.

Within the past few months COVID-19 has introduced several new types of insecurity to M&A transactions. One of the most important is the higher level of uncertainty regarding the future development of the target companies. Currently, it is more difficult than before to forecast the future and create a reliable business plan and, above all, to achieve it. As this would lead, among others, to buyers offering lower valuations which sellers would not be ready to accept; we have seen many transactions being postponed or put on hold in the second quarter of 2020.

Now, although the insecurity connected to COVID-19 remains, we are witnessing growing activity on the market.

It seems that the confidence of both sellers as well as buyers have increased and, in the past one or two months, we have seen a number of new transactions starting up. In spite of the gloomy expectations from the spring and summer of this year, the transactions do not concern companies in COVID-19-related troubles but typically well-performing companies seeking investors for further growth or companies with succession issues, a trend that has already been ongoing for several years.

Alicja Kukla-Kowalska

Head of Sales EMEA at FORDATA

Alicja is a graduate of the Gdańsk University of Technology, the University of Economics and the WSB University in Poznań, she is responsible for managing key clients and sales development in the international M&A markets. Alicja has many years of managerial and sales experience in the IT and Data Security market in the EMEA region, now helping companies realize various processes with the use of the Virtual Data Room software. She is the author of quarterly commentaries in the M&A Index Poland Report, published by FORDATA in cooperation with Navigator Capital, where she summarizes the activity and trends on the local M&A market.

Pandemic has significantly limited investment activities in Poland and the entire CEE region, putting both companies preparing for sale, and buyers to a standstill. Many industries "stopped" to realistically assess the new reality and their market attractiveness. Many buyers have started looking for solutions to market difficulties in consolidation, business expansion and the acquisition of subcontractors.

After several months of slowdown, there was, however, a significant recovery in the Polish M&A market. In the third quarter of 2020, as many as 74 transactions took place - 22 more than in Q2 - which shows that the local market is not completely rigged to COVID-19 spring lockdown, at least not yet. This is the highest quarterly number on the Polish market in five years but the result comes mainly from the closing pre-lockdown proceedings and companies' long-term acquisition plans, rather than distressed trends.

Still, for entities that still have dry powder for investments (in particular PE / VC funds), there will be an opportunity on the market to take over interesting assets at lower and attractive prices. The scale of restructuring of companies that failed to cope with the lockdown is expected to increase as they seek cost cuts and savings by reselling their assets. These industries include retail, automotive or tourism. The trend has been significantly limited with governmental subsidies but next year we might observe an increase once companies have made their annual statements.

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The use of the Virtual Data Room system as a tool for organizing not only Due Diligence, but also other business processes has become more visible.

During this time, investors, companies and entrepreneurs alike moved their activities, businesses and meetings to the online world to a great extent. While investment advisors had used Virtual Data Room solutions to securely conduct transactions and Due Diligence research before, the awareness of security and sharing confidential data now gained importance to other companies. The use of the Virtual Data Room system as a tool for organizing not only Due Diligence, but also other business processes has become more visible. As companies plan to continue hybrid operation, as research shows, even after the COVID-19 threat ceases, it will allow them to increase general information security and the convenience of remote work.

Back in April, we kept asking ourselves how long COVID-19 would negatively impact Polish M&A market. Now we are wondering if the current uptrend will stay with us longer, and whether the re-escalation of the coronavirus will cause another lockdown, which proved so devastating for many industries and the M&A market all around, and at the same time so unpredictable.

Vojtěch Wolf

Investment Analyst
at Savills Czech & Slovak Republics

Vojtěch joined Savills in 2017, shortly after the establishment of the Prague office, as an Investment Analyst in the Capital Markets department. He works on commercial real estate transactions, advising and representing clients throughout the acquisition or disposal process. In the Czech Republic, Savills has been present since 2017. It has built a full service office in Prague employing over 50 staff covering the sectors of investment advisory, valuation, leasing agency, property management, building and project consultancy and research. It covers major commercial property sectors such as offices, industrial and retail as well as so called alternatives such as leisure, hotels, co-living and student accommodation.

In times of significant uncertainty in the markets and the situation with Covid-19 being far from predictable, investors seek properties that can offer them greater security of income streams and value preservation.

This can be seen in an increasing demand for industrial properties, especially those in the logistics sector. This sector has benefitted from an accelerated proliferation of e-commerce; a trend that already existed pre-Covid but one that has been significantly boosted by changes in consumer behaviour prompted by the epidemic-related restrictions.

The epidemic has also prompted higher caution in the banking sector, leading to more stringent conditions for mortgage origination which has made purchasing an apartment or a house more difficult. This has been one factor in the recent emergence of the built-to-rent (BTR) product within the Czech residential market, which has for a long time functioned almost exclusively on the built-to-sell model. BTR properties are multi-family schemes with tens of apartments, developed to be sold as a whole project (i.e. not as separate dwellings) and owned by a single entity. BTR produces stable income and is backed by strong fundamentals of high residential (rental) demand and longstanding low residential supply (particularly in Prague). This makes BTR an attractive asset class for institutional investors seeking stable income.

This increased investor appetite for ‘beds and sheds’ can be defined as a search for products associated with essential needs, since such products act countercyclically in economic downturns and serve as an insulating element within mixed asset portfolios.

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Harmeet Dhiman

Senior Private Equity Analyst at Rocsearch Limited

Harmeet currently works as a Senior Private Equity Analyst at Rocsearch Limited, a boutique research and consulting firm based out of the United Kingdom. He has over two years of experience across M&A, private equity consulting, deal advisory and investment research and is a keen follower of the alternative investment industry.

The economic crisis posed by COVID-19 has given more demand for M&A globally. Companies that faced sudden drops in demand of products and services were subject to two alternatives – raising private debt or seeking an acquisition by a larger market player. Extremely capital-intensive businesses like Oil & Gas and airlines relied on the former, barring a few exceptions like the investment by Bain Capital into the Australian business of Virgin Airlines; whereas big players in other industries took the advantage of lower valuations and higher leverage businesses to consolidate market position. There was a steep rise in LBOs (Leveraged Buyout Transactions) too by private equity firms, complimented by easier availability of private debt from financial institutions and opportunities across a variety of industries, from consumer to industrial, led to a fruitful use of dry powder available for private equity firms. Especially across Europe there was a lot of restructuring in terms of debt financing or business ownership, with involvement of hedge funds, private equity funds, and other asset management companies. Many firms also raised capital for new funds, especially distressed funds with increased investments across turnaround business structures and providing debt to businesses, this was actually a time full of opportunities for alternative capital financial institutions in terms of finding the right business, and navigating them through these unpredictable times.

However, there is an added layer of security which has not gone unnoticed. Speaking of corporates, there is more due diligence to look at the longevity of businesses and even more risk assessment and scenario analysis, especially the survival and ability to navigate through another situation like COVID-19 where the world just stops, and the demand of certain goods and services dip.

Another concern or security factor is balancing out the risk the parent holds. For example, during a downturn, if the parent is suffering a loss of business and financial performance, how affected will the new acquired business be? Would it be able to offset risk and losses that the parent suffers? For companies, how many people they employ and give a livelihood to is an important criterion for private and public investors, so keeping jobs secure at this time was also a key security factor for corporates. Even though the valuation of targets for these corporate acquirers have dropped during the pandemic, there is more due diligence involved than ever, with more stress testing and risk analysis, no matter how easily available credit is during this time or how attractive the target felt.

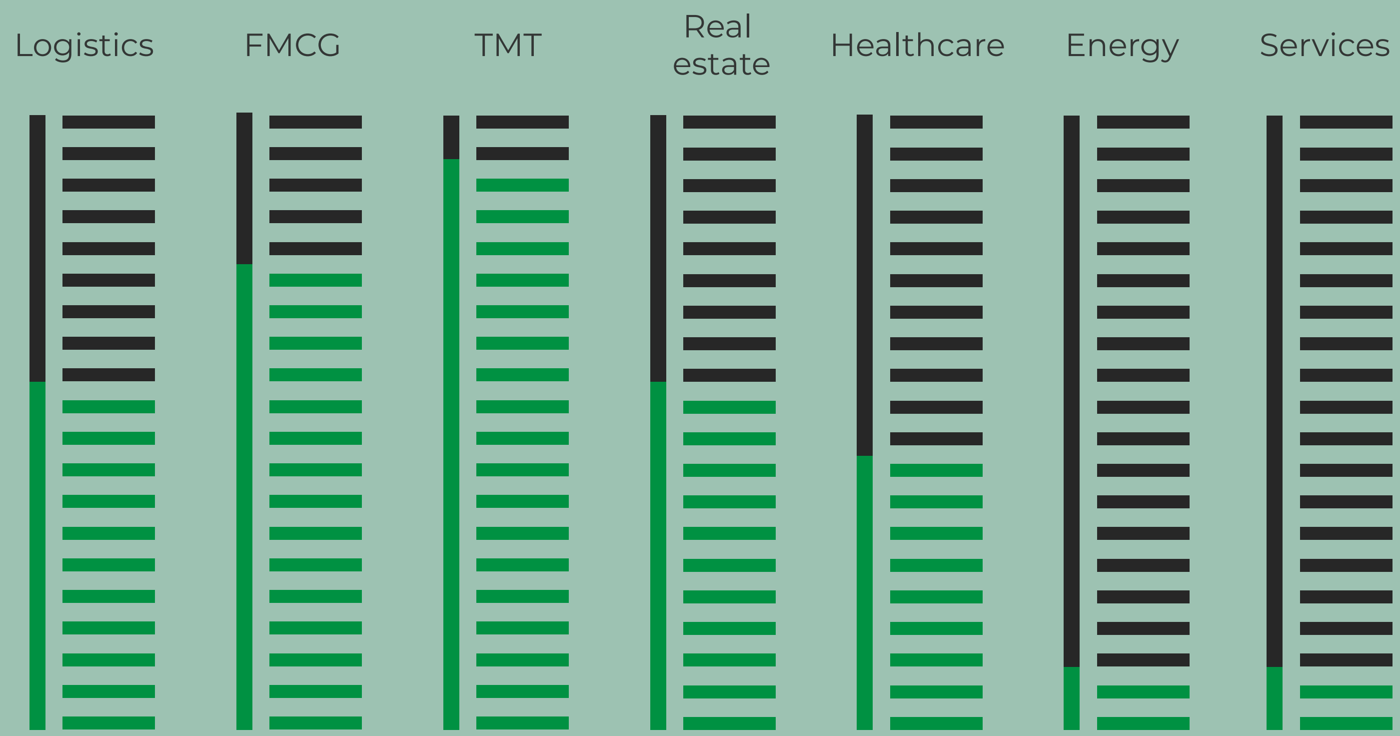
Private Equity Firms have been aggressive during this period, barring the initial few weeks where everything was closed or restricted to working from home. However, certain sectors gained a lot of importance and high valuation gains, like pharmaceuticals, healthcare, clinical care, diagnostics, Fast Moving Consumer Goods (FMCG), TMT, supply chain, logistics and transportation as these sectors proved the most in demand irrespective of how the world had slowed down. Investments already made by Private Equity firms across these industries were seeing a rise in demand of goods and services. One of the biggest obstacles faced by private equity firms, investment bank and M&A advisories is that as the macro economies suffer, in certain developed countries the interest rates went extremely low resulting in the risk free rate which is defined by government securities (mostly bonds), dipped to zero or even negative in certain cases, so valuing businesses has not been that straightforward. The coming few months should be interesting to look at as many Private Equity Firms look to invest in opportunities across their focus industries and maybe venture out to new industries to balance portfolios.

There is more due diligence involved than ever, with more stress testing and risk analysis.

M&A activity has picked up rapidly in the last 3 months as businesses start to reopen, and other restrictions like travel and working remotely have been lifted. We can clearly expect corporates and Private Equity funds to be more acquisitive across orthodox and new sectors depending on the risk appetite and opportunities presented. However, exit strategies are a very important space to look out for, as more than ever the valuation and price will be defined by the robustness of the business and how the business fares in stressful conditions like COVID-19. A lot of IPOs are expected as compared to Private Equity secondary transactions, as Private Equity firms would look at exit opportunities where there can get higher business value be it through private or public investments.

- Czech market will certainly continue to develop and provide continued opportunities for investors to achieve wealth security.
- Currently, it is more difficult than before to forecast the future and create a reliable business plan and, above all, to achieve it.
- Job security and how many people companies employ and give livelihood to is an important criterion for private and public investors.
- After almost moveless 2Q20, we could see an increased M&A activity within the CEE region in 3Q20.
- Awareness of security and sharing confidential data now gained importance to companies outside M&A.
- Bank financing of takeovers are at obviously worse parameters than before, with an increasing number of segments not bankable at all.
- In many cases, the sellers still demand high multiples, while the buyers often request the discounts for uncertainty.
- Most probably, M&A deals in defensive, non-cyclical sectors will dominate the market in the next quarters and will continue to attract investor interest.
- Investor appetite for 'beds and sheds' can be defined as a search for products associated with essential needs, which now act countercyclically.

The most bankable industries in CEE markets in 3Q2020, as pointed out by the report experts



Thank you for reading the first edition of the FORDATA CEE Expert Report. Hosting some of the most experienced market experts in the region makes us very proud. As security has not been a more important global issue since 2008, economies seem to have survived the hardest hit, and we are quite sure that such an observation is common to all the commentaries we collected in this publication.

We hope that you will share this report with professionals from your circle. Our goal is to connect experts in different fields and from different countries, and create a lively platform for discussion on the CEE economy. Please follow FORDATA LinkedIn page and the **#ceeexpertreport** tag to join us.
FORDATA is a Virtual Data Room software provider since 2009. We help companies and experts securely share confidential documents and information in various processes. Our aim is to promote best business practices, bring closer the topic of online security and make data sharing in the B2B sector faster, secure and more convenient.

FORDATA has prepared detailed quarterly reports on Polish M&A market since 2013. Together with invited experts, we published The Code of Best Transactional Practices and The Code of Best Restructuring Practices as part of our For Better Data Flow campaign in 2015 and 2016.