EMPEA Brief

The Case for Private Capital in CEE

EMPEA

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This EMPEA Brief *explores Central and Eastern Europe's place in the global private capital landscape, with an eye to the challenges and often overlooked opportunities posed by its "in-between" status vis-à-vis emerging and developed markets. A closer look at the historic trajectory of private capital in CEE and the current deal-making environment suggests that investors who can manage the nuances of the market may find advantages in the region's relative obscurity.*

Sweet Spot, or No-Man's Land?

Central and Eastern Europe (CEE) represents a small corner of the global private investment landscape by any metric. Funds raised for the region amounted to just US$982 million in 2017—comprising 1.3% of capital raised for Europe as a whole and 0.2% of funds raised globally.[1] Despite being home to over 120 million inhabitants and eleven member states of the European Union, private capital activity in CEE is dwarfed by that of its continental neighbors. Indeed, most European fund managers seem satisfied to invest the majority of their capital in Western Europe, while occasionally flying further east for one-off deals. This preference comes despite the fact that CEE is home to some of Europe's fastest growing economies and a burgeoning consumer class now a generation removed from its communist past.

Within the context of emerging markets, limited partners (LPs) and general partners (GPs) alike are often eager to allocate to major economic powers like China and India, as well as frontier markets in Sub-Saharan Africa and Southeast Asia, but less so to CEE. While acknowledging the often unstable political situation in many emerging markets, not to mention fluctuating currencies and opaque legal systems, investors are

In Summary

- Private capital in CEE offers a potential solution to the tradeoff between the stability and predictability found in developed markets and the growth potential of emerging markets. However, the region remains overlooked by many investors.
- CEE experienced a glut of private capital just before the Global Financial Crisis, but an upheaval soon followed. Fund managers betting on growth stemming from the integration of CEE with the rest of the European Union generated strong returns, which drove record fundraising from 2006 through 2008. However, the crisis caused limited partners to pare down their new private capital commitments, with allocations to emerging markets such as CEE among the first to be curtailed.
- After several lean years in the wake of the Global Financial Crisis, conditions appear to be favorable again for private capital in CEE. Big-ticket investments are again attracting pan-European players, and fund managers have had success returning capital to investors in recent years, with upticks in both strategic sales and public market exits since 2014.
- Economic growth in CEE remains stronger than in Western Europe—leading to continued growth in wages and consumption—while the region has largely avoided the currency volatility and growth downturn that has plagued other emerging markets, especially commodity exporters, over the last several years.
- CEE remains underserved by investors. On one hand, the region has failed to attract significant capital from the largest global investors, as most of its funds are not large enough to absorb these LPs' ticket sizes. On the other, EM-oriented investors eschew CEE for other regions with greater developmental need and a perceived higher growth ceiling. Few local institutional investors exist to fill the gaps.
- The lack of private capital in CEE represents a potential opportunity for shrewd allocators, especially when viewed in the context of increasingly crowded alternative investment markets in the United States, Western Europe and Asia. Fund managers in CEE who can successfully raise funds, especially those in the middle market, may enjoy stronger competitive positioning than their global peers.

1. Sources: EMPEA, PitchBook. Includes private equity and venture capital, private credit and private infrastructure and real assets.

keen to invest in these countries in order to tap into their rapid growth and have a stake in their rising futures.

What some investors may be overlooking is that CEE combines high-growth economies, increasing consumer demand and strong E.U. political and judicial institutions. The region has failed to see a significant influx of capital in recent years, with stagnant fundraising numbers since the Global Financial Crisis representing only a fraction of pre-crisis totals. This *Brief* seeks to understand why a region that seems to combine many of LPs' desired traits has yet to reap the rewards in terms of increased allocations from investors.

Excitement, Then Exodus

Ten years after the fall of the Iron Curtain, the countries of Central and Eastern Europe had made economic progress, but still found themselves still lagging behind their Western European neighbors. As the region's economies transitioned from centrally planned to market-based systems, consumers were still seeking the goods and services to which their western neighbors had become accustomed, from cars and household goods to real estate. Beginning in the mid-1990s, the pioneers of private capital in CEE had raised their first funds in order to capitalize on the region's entrance into the worldwide market economy, but they remained outliers in an environment defined by a shortage of financing options for private businesses.

Within this milieu, the prospect of accession to the European Union became a new driver of investor interest in CEE and brought with it a new wave of private capital. E.U. accession would compound the potential for growth and development in the region. Membership in the European Union would also bring closer economic ties between CEE and Western Europe, as well as higher political and judicial standards for newly-accepted member states. Robert Knorr, Co-Managing Partner at CEE-focused buyout firm Mid Europa Partners, recalls, "The main investment thesis in those days was E.U. accession. What that meant to us was that by accessing the European Union, CEE was getting closer to a nearby developed market, and the wealth of CEE was therefore increasing. More industries from Western Europe and the broader world were moving to CEE, which was creating jobs and raising salaries. As part of this process, peoples' spending power increased, and they were able to spend more of their disposable income on goods and services. So private equity was able to invest in companies that catered to this growing middle class." CEE countries comprised the majority of the ten nations that would join the European Union in 2004 in the largest wave of accession in its history, spurring the growth of new businesses and a new generation of consumers.

About EMPEA

EMPEA is the global industry association for private capital in emerging markets. An independent, non-profit organization, the association brings together 300+ firms—including institutional investors, fund managers and industry advisors—who manage more than US$5 trillion in assets across 130 countries. EMPEA members share the organization's belief that private capital can deliver attractive long-term investment returns and promote the sustainable growth of companies and economies. EMPEA supports its members globally through authoritative research and intelligence, conferences, networking, education and advocacy.

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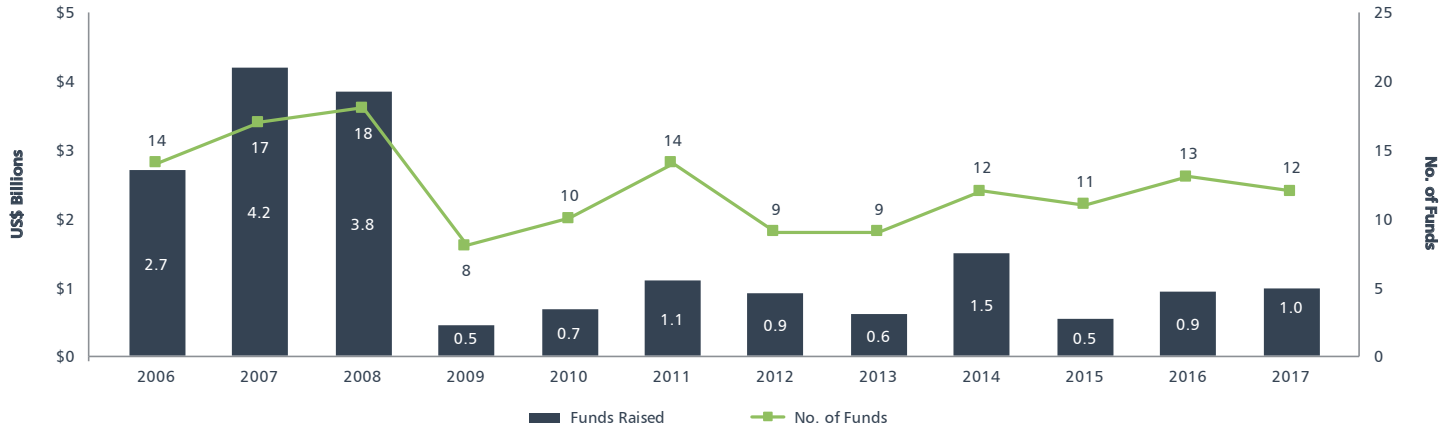
Exhibit 1: CEE Fundraising by Year, 2006-2017



Source: EMPEA. Data as of 31 December 2017. For the purposes of this report, 'CEE' includes Poland, the Baltics, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, the countries of the former Yugoslavia and Albania. 'CEE' excludes Turkey and markets in the Commonwealth of Independent States.

With the broader opening of CEE to private capital, investors in the market found a great deal of success. Strong returns drove further fundraising, as fund managers from within and outside the region used their early achievements as a proof of concept. From 2006 to 2008, fund managers raised nearly US$11 billion for CEE-focused funds, more than the US$6 billion raised from 2001 to 2005, as well as more than all funds raised for the region since 2009 (see Exhibit 1). Given strong returns in the region, many LPs were happy to recommit to even larger funds. Bill Watson, Managing Partner at CEE-focused middle-market fund manager Value4Capital (V4C), remembers, "I think the reason why Central Europe was successful pre-crisis was that there was a lot of money returned to investors, and it's that, in my view, that drives fundraising." Anne Fossemalle, EBRD's Director of Equity Funds, ascribes this strong performance to not only the region's fundamentals, but also a skilled corps of fund managers in the region: "Firms in CEE were able to achieve outsize returns relative to other regions because there are some very good GPs there."

46%

The percentage of GPs with fund closes in 2006 through 2009 who have failed to raise a follow-on fund for the region

Between 2006 and 2008, four funds reached final closes of over US$500 million, including Mid Europa Fund III and Advent Central and Eastern Europe IV at US$2.1 billion and US$1.6 billion, respectively. Leading up to the end of the decade, more managers with larger funds were competing for fewer assets in a relatively small market. Value4Capital's Watson continues, "The problem in 2008 was that there were some large funds raised: essentially too many funds for the size and scale of the market. That was not in anybody's book a sustainable environment." The countries of CEE had only had a decade and a half to develop market economies, and private companies large enough to be acquired by US$1 billion-plus funds were few and far between. Mid Europa's Knorr agrees, remarking, "Investing a US$550 million fund raised in the early 2000s was harder than it is investing the US$1 billion-plus fund that we have today. Aside from privatizations and some corporate restructurings, it was very hard to find companies of the size needed for a US$550 million fund."

Just as private capital in CEE was at its most crowded, the financial crisis of 2008 sent shockwaves through the global financial system. Needless to say, the region's private capital ecosystem was disrupted, as the crisis caused turmoil for funds that had already been raised and their portfolio companies. At the same time, LPs began to pare down their private capital balance sheets in order to rebalance their portfolios and meet the obligations of their beneficiaries.

Allocations to CEE and other emerging markets were among the first to be curtailed. Sever Totia, Partner at CEE regional GP 3TS Partners, notes, "There is an adage that if the U.S. sneezes, the rest of the world catches a cold. With the U.S. quite ill in 2008 and 2009, the rest of the world was dramatically affected. In the context of global capital flows, CEE is a small fraction. Massive shifts in the direction of capital reduced, if not wiped out, flows to smaller regions." After raising over US$10 billion from 2006-2008, GPs focused on CEE managed to raise just US$452 million through eight funds in 2009. Furthermore, of the 39 fund managers that reached a close for a CEE-focused fund from 2006 through 2009, 18, or 46%, have failed to reach a close for a subsequent fund in the region.

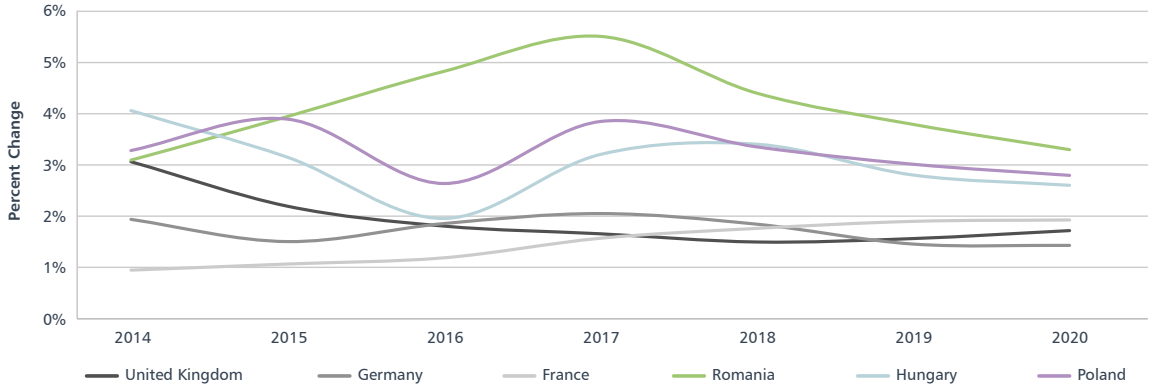
On the Upswing

After a lengthy recovery, overall macroeconomic conditions appear once again to be favorable for private capital in CEE. Topline growth in many countries remains well above that of the major Western European markets. As France and Germany hover around 2% GDP growth, some markets in the region are growing twice as fast (see Exhibit 2).

Integration with the European Union, beginning with E.U. accession in 2004, has been key to sustained economic growth in CEE. E.U. requirements, argues Mid Europa's Knorr, are essential to CEE's success: "Almost all of the countries we invest in, with very few exceptions, are members of the European Union, which means they have to adhere to all of the legislative and regulatory rules that the E.U. imposes on them, which in and of itself reduces risk in CEE." Totia of 3TS maintains that the stability brought by the E.U. is what enables confidence in CEE's future for citizens and investors alike. He remarks, "Central Europe's position as an investment sweet spot depends on stability. The region is important because over 120 million people in CEE are experiencing a 400-500% increase in earnings, a major economic growth driver unseen in the developed world. If there isn't stability, we know the results, as we have seen in other countries. At the current pace, CEE represents EM growth, with Western European risk."

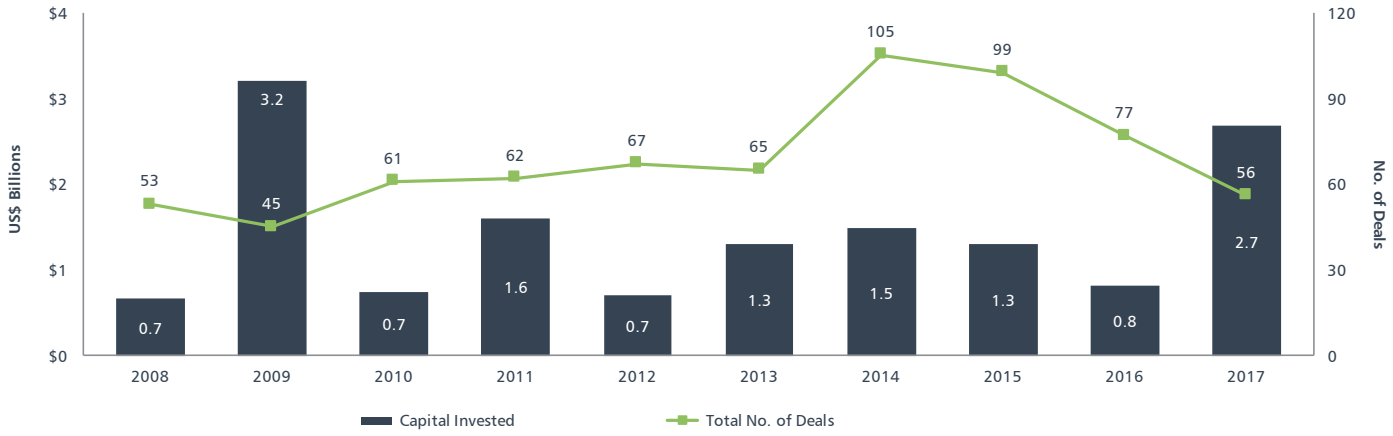
The growth in wages across CEE that Totia describes is key to the developing parity between CEE and Western Europe. As he explains, the region is undergoing a second wave of equalization: "The first 'catch-up' was from CEE's communist past to its open-economy future. The region was striving for basic standards of living twenty and thirty years ago. Now, the next question is whether Central European countries and consumers can catch up with their German and French counterparts. On a purchasing power parity basis, how much economic growth will close the gap between CEE and Western Europe remains to be seen."

Exhibit 2: GDP Growth Rates for Select European Markets, 2014-2020



Source: IMF World Economic Outlook Database, October 2017. Estimates begin after 2016.

Exhibit 3: CEE Investment by Year, 2008-2017



Source: EMPEA. Data as of 31 December 2017.

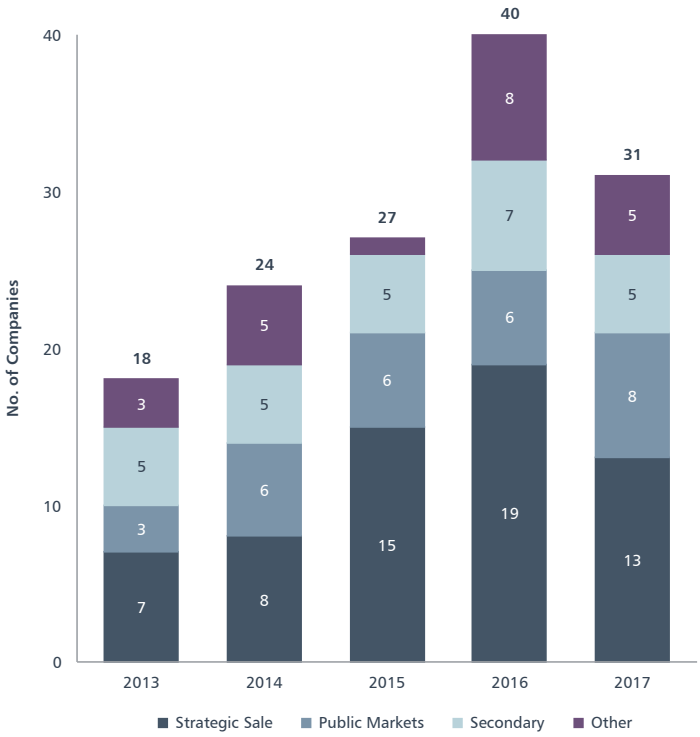
During the mid-to-late 2000s, investments in telecommunications were a popular way for private capital fund managers to secure a stake in this convergence. Mid Europa Partners, 3TS Capital Partners, Innova Capital, Value4Capital and other regional veterans acquired stakes in telecom networks across the region. Many of these investments have since been exited to larger Western European telecommunications networks, or to larger GPs—as was the case with Mid Europa's exit of Serbia-based SBB/Telemach Group to global alternative asset manager KKR in 2013. More recently, telecom investment activity has tapered off, with consumer goods and services proving to be the most dynamic sectors in the region. The US$3.3 billion acquisition of Polish online auction website Allegro by Mid Europa Partners, Cinven and Permira in 2017—which included $2 billion in equity, making it the largest deal in CEE recorded by EMPEA—drove disclosed capital invested in the region to its highest level since 2009 (see Exhibit 3).

Beyond consumer-driven growth, Central Europe also offers an attractive talent pool and manufacturing base from which to supply Western European markets with goods and services. Due to its proximity to the rest of Europe and integration with neighboring markets under shared E.U. rules and regulations, CEE is well-suited to manufacture a broad swath of goods. The region also has a rich pool of technology and engineering talent stemming from its communist history. Service providers in the region, such as software developers, are able to provide superior products compared to their competitors globally at a similar price point, argues 3TS's Totia: "It doesn't matter if it is customer support, product development or project management. The cost advantages in CEE are not about saving money, but the ability to go faster. Companies can invest the same amount of capital, but get three or more times the productivity. I would put CEE's product development teams against any other countries' in terms of tenacity, creativity, quality and results."

Ten years removed from the Global Financial Crisis, GPs in CEE are once again translating these innate strengths into results. Fund managers in the region completed disclosed exits of 98 companies from 2015 through 2017, compared to only nine exits as recently as 2012 (see Exhibit 4). This total includes 47 strategic sales, one fewer than the number of such exits completed in the previous seven years combined. Moreover, public markets have proven to be an increasingly viable exit pathway. In the past two years, managers have completed six IPOs in CEE, including the first PE-backed listings in Bucharest and Budapest recorded by EMPEA. While it is likely that strategic sales will remain the mainstay exit option for GPs in CEE, the ability to tap capital markets gives fund managers flexibility, as well as welcome visibility to the region's private capital industry.

In short, the countries of CEE appear to share many fundamental strengths with Western Europe, while also enjoying advantages such as stronger economic growth, an inexpensive labor force and growing consumer demand more typical of emerging markets. More importantly, managers' efforts in exploiting these advantages are bearing fruit in the form of resurgent exit activity. While one would suspect an increase in investor commitments to the region is in the offing, institutional capital actually remains a scarce resource in CEE.

Exhibit 4: Disclosed Exits in CEE, 2013-2017

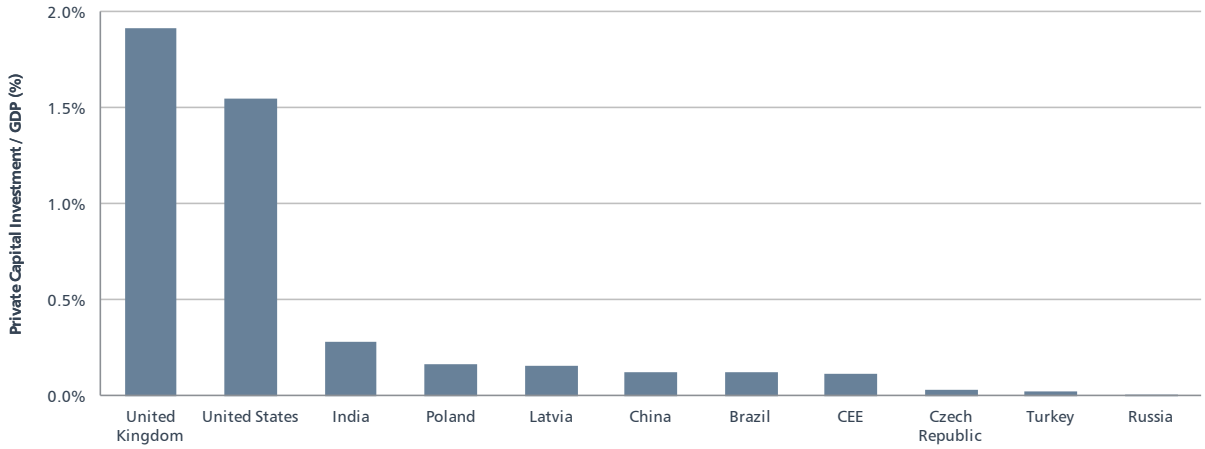


Source: EMPEA. Data as of 31 December 2017.
Note: 'Public Markets' includes all private capital-backed IPOs and follow-on public market sales.

Looking for Investors

Although CEE appears to combine many of the better attributes of developed and emerging markets, the region remains underserved by capital in comparison to both. Across the board, emerging economies are under-penetrated by private capital compared to their developed market peers, and CEE is no different. The United States and the United Kingdom both boast ratios of private capital invested to GDP of greater than 1.5%, while the rate for CEE overall averaged 0.12% over the past five years—on par with other emerging markets such as China and Brazil (see Exhibit 5). Despite possessing higher overall income levels and a greater level of economic sophistication compared to other EM regions, CEE has not attracted any more capital relative to the size of its economy than its peers, and it often attracts even less. Anne Fossemalle, Director of Equity Funds at EBRD, one of the region's longest-tenured investors, agrees, "It's definitely still an underfunded region. It's underfunded in relation to other regions, but it's also underfunded in relation to its own investment needs."

Exhibit 5: Private Capital Penetration for Select Markets, 2013-2017



Sources: EMPEA, PitchBook, IMF World Economic Outlook Database (October 2017).

According to investment professionals active in the region, this shortage of private capital has less to do with the region's fundamentals, and more to do with a lack of LPs willing or able to invest in CEE. As Value4Capital's Watson puts it, "My biggest problem is not selling the story of private capital in CEE, but rather finding an audience for the story." This challenge could simply stem from the fact that few LPs are familiar with private capital in CEE. The region routinely ranks near the bottom of EMPEA's annual *Global Limited Partners Survey* in terms of perceived attractiveness for GP investment (see Exhibit 6). Alpha Associates' Partner Henry Potter argues that these results are less about the region's private capital environment and more reflective of LPs' lack of experience in the region, remarking "I look at the survey and wonder if the people filling it out are in charge of EM allocations and don't cover Central and Eastern Europe because their European team takes care of that."

> "My biggest problem is not selling the story of private capital in CEE, but rather finding an audience for the story."

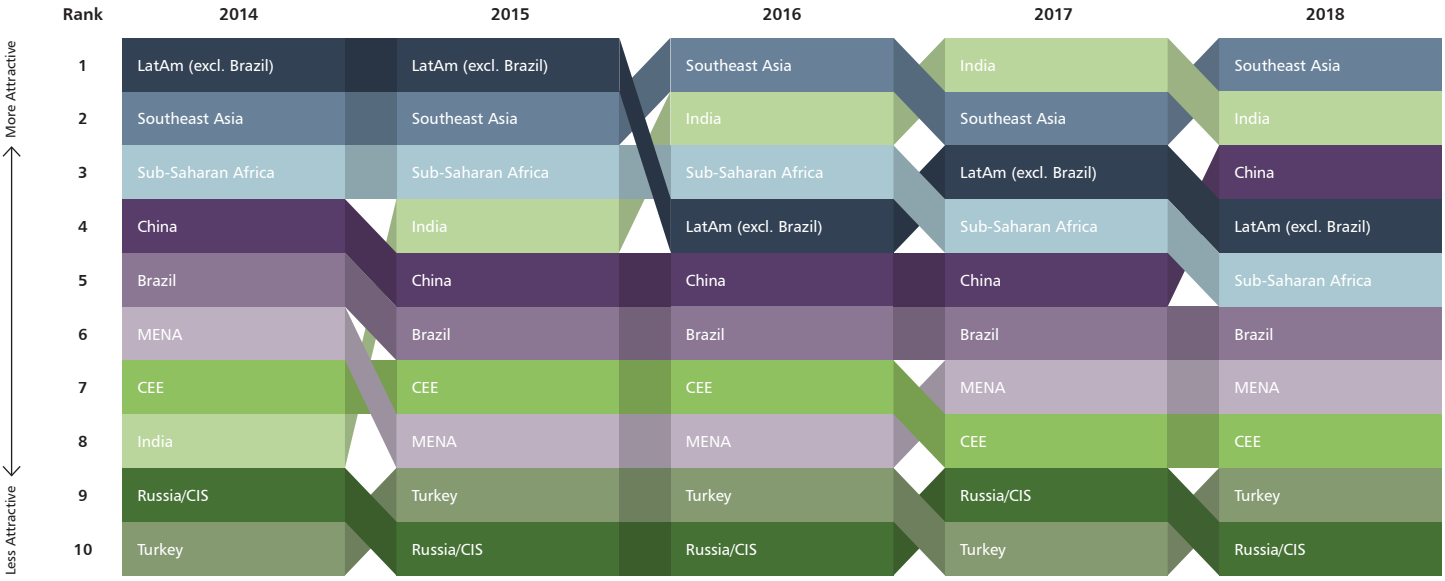
20%

CEE's share of markets in the top 30 of the World Bank's 2018 Ease of Doing Business Rankings

Political risk and currency risk often dominate the discourse among investors about the perils of investing in emerging markets. While some respondents to EMPEA's survey cite these factors as deterrents to investing in CEE, the region's economies possess stable democratic institutions and adhere to E.U. regulatory standards. Moreover, its currencies have exhibited much less volatility than other EM currencies, and several countries use the euro, a dynamic that may be lost among some observers. EBRD's Fossemalle notes, "This is what separates the LPs who carry out their due diligence from the LPs who just work off a risk perception. It just fascinates me that LPs put money in emerging markets including China, but worry about risk within CEE. Of course there is political and currency risk, but this is global—look at Brexit and the recent course of the pound. These CEE countries are either part of the E.U. or they're accession countries. When you look at indicators on business regulations like the ones the World Bank produces, CEE performs better than some emerging markets and even better than some of the core E.U. countries. So it's very important to actually look at the data."

Many GPs in CEE have faced this perception paradox firsthand. Elvin Guri, CEO of Bulgaria-focused venture capital firm Empower Capital, explains, "I attended an emerging markets conference last year, and people seemed ready to throw money at Southeast Asia and Sub-Saharan Africa. The moment I mentioned Southeastern Europe, I saw people frowning. People asked, 'Is it not too risky and corrupt there?' EM people think of the region as probably either too developed or too corrupt, whereas typical LPs who look at the E.U. would probably include Bulgaria on their exclusion lists."

Exhibit 6: The Attractiveness of Emerging Markets for GP Investment Over the Next 12 Months



Source: EMPEA 2018 Global Limited Partners Survey.

Many EM-oriented investors do not regard CEE as an emerging market, and overlook the region in favor of others. Among the most prominent investors in emerging markets are the development finance institutions (DFIs), which account for a large proportion of commitments to private capital funds in emerging markets across the globe. However, few DFIs regularly commit to CEE-focused funds, with EBRD and EIB among the few that are consistently active in the region. The result is a relative shortage of GPs investing in the region. Indeed, none of the respondents to EMPEA's 2018 survey indicated that an oversupply of funds was a deterrent to investing in CEE (see Exhibit 7).

Of course, the world's leading global institutional investors do have the knowledge and capacity to consider allocations to CEE-focused funds. However, the sheer size of these institutions and their need to deploy large amounts of capital often prevent them from allocating to a region like CEE, which only has capacity for so many large buyouts each year. These investors may be content to get exposure to CEE via large pan-European funds, which tend to do a handful of sizeable deals in Central Europe in most years. A case in point is Mid Europa's 2017 buyout of Allegro, in which the firm partnered with pan-European players Cinven and Permira.

Nonetheless, there are only so many companies in the region that can absorb tickets of several hundred million dollars. Furthermore, these buyouts often take months or years of relationship-building and due diligence. Dariusz Pietrzak of CEE-focused fund manager Enterprise Investors explains the region's challenges: "We invest in succession-driven buyouts. Sometimes it takes quite a bit of education and long-term relationship-building before you convince a founder to consider such a path. We do not have an environment like in the United States, for example, where there are entrepreneurs who set up businesses with the plan to sell to a venture capital or private equity house as soon as they are successful."

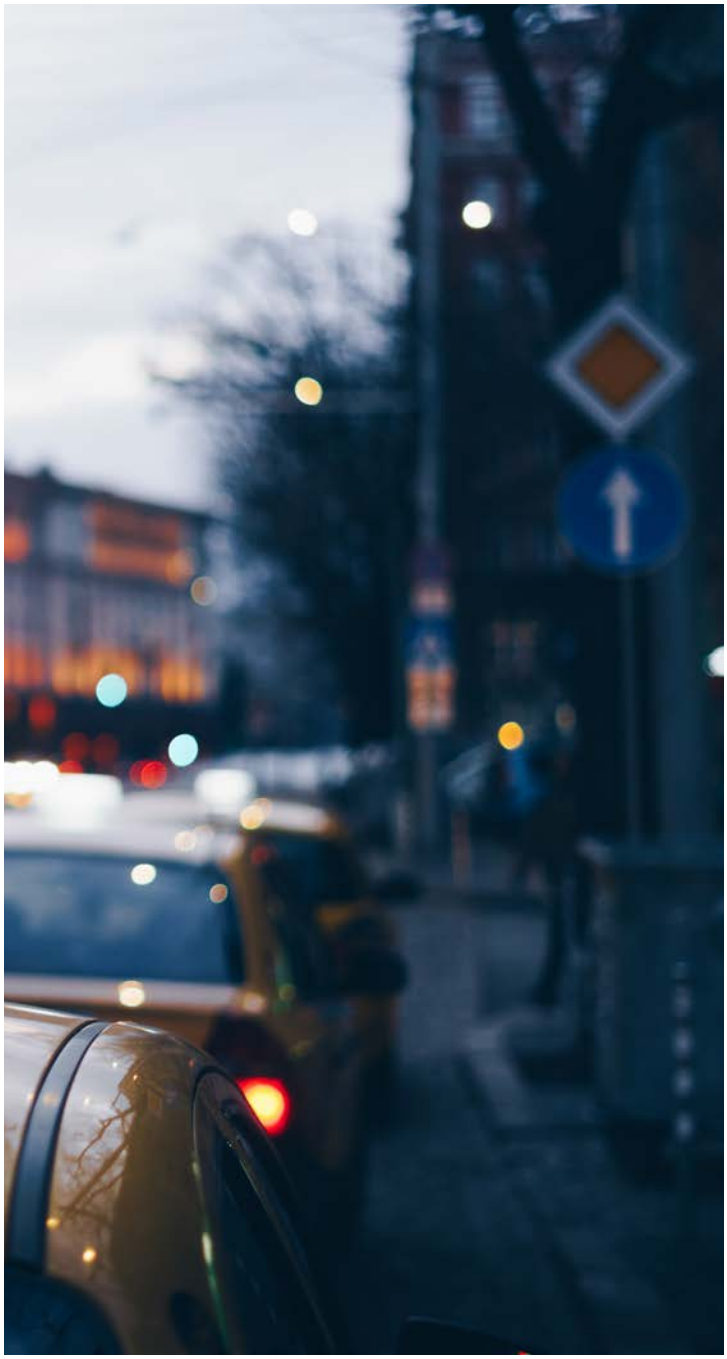
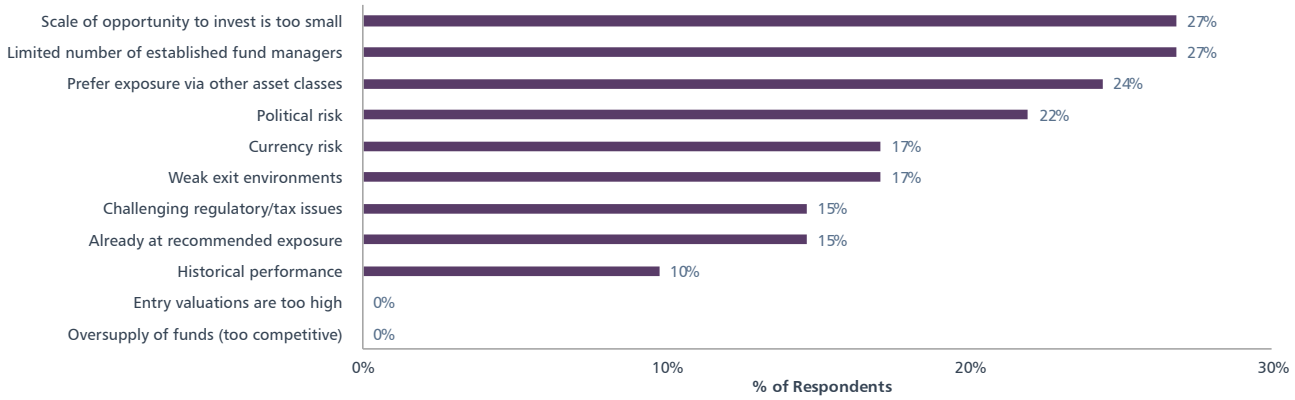


Exhibit 7: LP Views – Factors Likely to Deter Investors from Commiting to CEE



Source: EMPEA 2018 *Global Limited Partners Survey*.

Central and Eastern Europe's private capital ecosystem likely cannot support that many additional large regionally focused funds, in addition to the even larger pan-European firms investing selectively in the region. The majority of funds focused on Central Europe are much smaller and as such would seek LP commitments anywhere from several million dollars to US$40-50 million. Unfortunately, CEE also lacks a substantial base of domestic LPs that would be well positioned to make these smaller commitments. Value4Capital's Watson concludes, "I think where all of the CEE markets are still lacking is the investment of domestic capital. Until recently, you almost completely lacked domestic institutions or even domestic individuals supporting the middle market in the way you would see in the United Kingdom or even the United States. I think this is an often-missed reason why there are just lower levels of investment relative to GDP, because there is less money from domestic sources to fill that pipeline. That has been, I think, the biggest impediment to the growth of the industry overall."

Pension funds in some of CEE's markets are legally restricted from investing in private capital funds. Even where pension funds and other institutions are allowed to invest in alternatives, they often skew toward public markets, according to Aleksander Majewski, Partner at CEE-focused Syntaxis Capital: "Compared to the public markets, there is not as deep a tradition of investing in closed vehicles. I think the tradeoff from the transition from communist times during the late 1990s was that there was a bigger push toward public markets and investing in stock exchanges and funds." However, restrictions on local institutions investing in private capital are not universal in CEE. EBRD's Fossemalle describes, "If you look at the Baltics, or if you look at Romania, you do have local capital investing in these funds. Poland is the most advanced of the private equity markets, but it doesn't have local pensions investing. But in the Baltics and Romania, they do. The Baltics have quite active banks and pensions." Yet as long as domestic institutions' commitments to private capital in CEE remain piecemeal, mid-market funds and industry newcomers will struggle to gain traction.

The Advantage of Obscurity

While many observers recognize CEE's lack of capital as a problem, it is likely an advantage for GPs with deep roots in the market and capital available to deploy. The high barriers to entry for private capital in CEE protect incumbents from outside players recognizing the region's advantages and swooping in to overtake them, as well as from new upstarts attempting to upstage them. Firms that have raised multiple generations of funds over a decade or more have built successful relationships with a select group of LPs that are interested in CEE and proven to these investors that they are able to return capital. Moreover, many of these same investors express satisfaction with the competitive dynamics in the region. Longtime CEE investor Rune Jepsen, Principal at Queensland Investment Corporation (QIC), explains, "One of the attractions to us is that there aren't more fund managers in this market. So, if you were to see a trebling of managers, then we would probably have to re-think things."

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Firms active in CEE note that their business is much more relationship-based than in markets like the United States and Western Europe, and they rely on their networks and experience to find proprietary deals that might otherwise elude GPs investing selectively in the region. Enterprise Investors' Pietrzak notes, "We have recently closed an investment which we've been discussing with the entrepreneurs for two years. It's not a business you can simply jump into and participate in. The market is also less intermediated. If your idea would be to step into CEE and simply participate in auctions and have the Big Four offer you interesting opportunities, this might not be the case."

This factor helps explain why entry valuations in CEE have historically been among the lowest across both emerging and developed markets. According to PitchBook, the median EV/EBITDA multiple for Eastern European buyouts completed from 2006 through 2017 was only 5.8x, the lowest globally (see Exhibit 8). In contrast, the median multiples for Western Europe, the United States and Canada all eclipsed 9x over the same period.

In order to gain exposure to proprietary deal flow, LPs must commit to managers equipped to find these hidden gems. Jepsen of QIC comments, "Committing to a big European manager in order to get one or two large deals in CEE is probably the last thing we want to do. I think the dynamic we're looking for is owning companies that can be sold into these types of funds." Many firms in the region have had success in selling first-generation investee companies to larger funds. A recent example is Mid Europa Partners' sale of Polish convenience store chain Zabka Polska to CVC Partners in April 2017 for EUR1 billion (approximately US$1.1 billion). Mid Europa's Knorr explains, "We look at ourselves as someone who knows the region intimately, and as someone who can take more educated views on investment opportunities than someone who would participate in an auction of a well-developed company that has already gone through a cycle of private equity ownership."

New Horizons

Despite barriers to entry, GPs and LPs active in the region—not to mention the private capital penetration data—suggest that there is ample room for new funds in CEE, especially in the middle market. Alpha Associates' Potter observes, "It is debatable whether there is room for another EUR1 billion-type dedicated CEE fund, or even that many more EUR500 million-sized ones. It's in the EUR200-million to EUR300-million range where there is a real shortage of capital and interesting deal-making conditions." Watson of V4C agrees: "We believe that the lower mid-market—that is, funds from US$100 million to US$250 million—is almost nonexistent today. That's not normal, and it creates opportunities."

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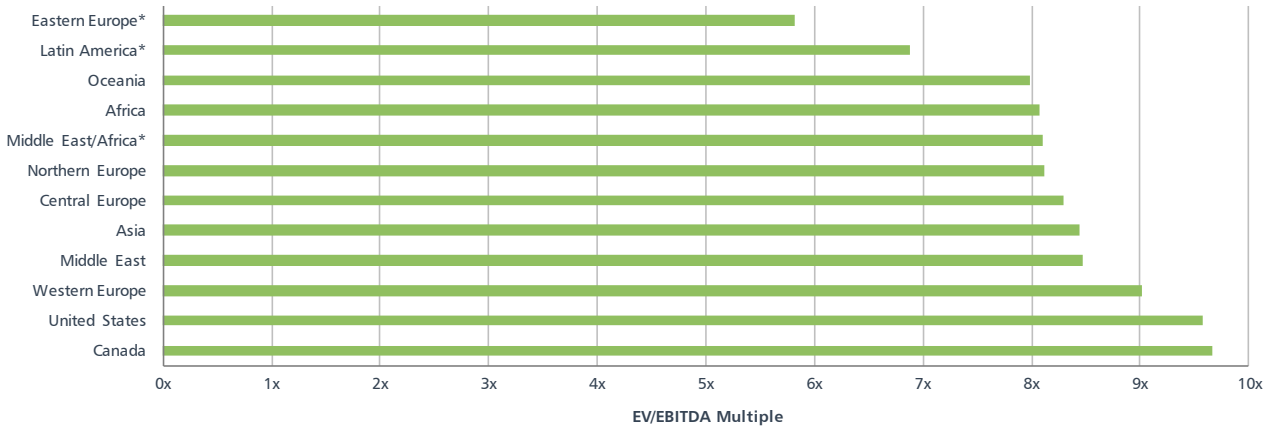
However, the path forward for funds of this size may not be as clear cut as for larger, established GPs in CEE. Stephen O'Neill, Managing Director and Co-Founder of emerging markets-focused asset manager 57 Stars, explains, "I think for small to mid-sized funds, the fundraising environment is even tougher. And when these GPs seek to explain their investment strategies, they need to be able to articulate a differentiated value bridge for the investments they are making: are they investing at more attractive valuations, do the portfolio companies have more options to drive growth, have they expanded the universe of potential acquirers?"

Exhibit 8: Median Buyout Multiples by Region, 2006-2017



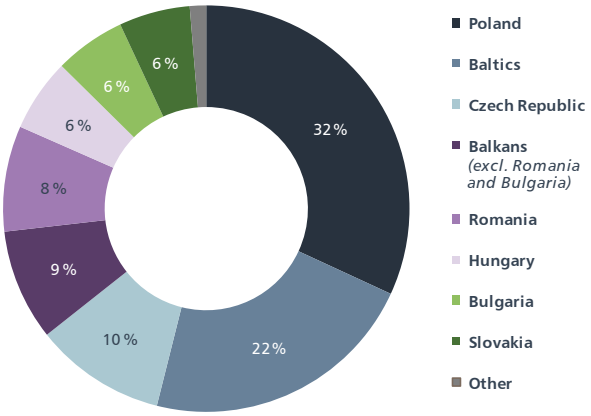
*Eastern Europe n=18, Latin America n=26, Middle East/Africa n=21.
Source: PitchBook, "Exploring buyout multiples: Where can PE firms find attractive valuations?" Includes deals from 1 January 2006 through 5 June 2017.

Beyond the middle-market buyout opportunity, a wider range of strategies can offer additional choices for investors. Across all emerging markets, EMPEA has observed a multi-year shift in the fundraising mix in favor of PE-adjacent strategies including private credit, infrastructure and real assets. Such strategies are as of yet largely underrepresented in CEE. While investors' motivations for pursuing specific opportunities will differ, private credit in particular may lend itself to more risk-averse investors who are exploring the region for the first time. Majewski of Syntaxis Capital explains, "We believe that as private credit specialists, our strategy is safer. We are more confident in generating returns while also protecting capital on the downside by investing credit instead of equity." Private credit remains a nascent strategy in CEE, however, with only a handful of active firms. O'Neill of 57 Stars remarks, "I am surprised that there is not more private credit activity in CEE, particularly as mezzanine and private credit opportunities seem potentially attractive in those markets."

Other firms active in the region may be able to differentiate themselves by moving beyond the Poland-centric fund model. Many CEE-focused GPs base their operations and invest the majority of their funds in Poland, with a handful of deals in neighboring countries such as the Czech Republic or Hungary (Exhibit 9). This dynamic leaves a wide swath of CEE that is even less covered by GPs, and may yet be fertile ground for private investors. Southeastern Europe is perceived to be riskier than the other parts of CEE, but has even less competition than the rest of the region. Empower Capital's Elvin Guri believes this funding gap is an advantage, especially if Poland and other markets further north become more crowded. He explains, "I believe the lack of GPs in Southeastern Europe is an opportunity. These markets are very close geographically to the developed markets. The region is ideal for nearshoring of anything—from textiles to all sorts of retail and food products, as well as software development, machine building and the automotive industry—in a way that China today is not. Southeastern Europe has the advantage not only because of logistics and geography, but also because you probably get better quality goods even at a lower cost."

Further expansion of private capital activity in Southeastern Europe will require support from DFIs, such as EBRD. Fossemalle argues that there is a need for her institution's support in all of the region's markets: "From a development perspective, there are still things to do. You have the whole of Southeastern Europe and the Balkans, where the private capital ecosystem is very underdeveloped, but there are great investment opportunities. Even in countries like Poland, we really can't say that it's fully developed. We have been able to work with a few first-time managers each year. So from a development perspective, I do think we still have a role to play."

Exhibit 9: CEE Investment by Country, 2008-2017 (% of No. of Deals)



Source: EMPEA. Data as of 31 December 2017.

Given a Chance

Demand for private capital in Central and Eastern Europe has outstripped supply over the past decade. A confluence of factors, including the fallout from the Global Financial Crisis and the overall size and fragmentation of the region, has contributed to private capital in CEE's status as a niche asset class, even within emerging markets. However, as this *Brief* has explored, there are ample reasons for LPs to take a harder look at Central and Eastern Europe. EM-oriented investors seeking high growth rates and dynamic consumer sectors can find them in CEE, and Europe-centric allocators can take comfort in CEE's strong fundamental legal and institutional frameworks.

Ultimately, commitments from investors will depend on the sustained performance of the region's GPs, many of whom have steered their firms through economic shifts and crises to once again deliver results for their investors. This experience is likely as important as broader macroeconomic trends. As EBRD's Fossemalle puts it, "You can do all of the top-down analysis you want about macro this, that and the other, but you can be in a beautiful region, pick the wrong GP and have it all wrong; or you can be in a difficult region with a fantastic GP and have great returns."

Exhibit 10: Sampling of Fund Managers Active in CEE

Fund Manager	Fund(s) (Final Close Year, Amount Raised)	Firm Type	Website
21 Partners	21 Concordia (2015, US$127m)	Buyout, Growth	21partners.com
3TS Capital Partners	3TS TCEE Fund III (2015, US$137m), Catalyst Romania (2012, US$19m), 3TS Cisco Growth Fund (2007, US$43m)	Growth	3tscapital.com
Abris Capital Partners	Abris CEE Mid-Market Fund III (2017, US$566m), Abris CEE Mid-Market Fund II (2013, US$608m), Abris CEE Mid-Market Fund (2008, US$407m)	Buyout	abris-capital.com
ARX Equity Partners	Arx CEE IV (Fundraising, US$60m), ARX CEE III (2009, US$149m)	Buyout, Growth	arxequity.com
Avallon	Avallon MBO Fund II (2013, US$144m), Avallon MBO Fund (2007, US$68m)	Buyout	avallon.pl
AVIA Capital	AVIA Capital I (Fundraising, US$28m)	Buyout	aviacapital.eu
Baltcap Management	BaltCap Private Equity Fund II (Fundraising, US$116m), BaltCap Growth Fund (Fundraising, US$46m), BaltCap Latvia Venture Capital Fund (2010, US$42m), BaltCap Lithuania SME Fund (2010, US$27m), BaltCap Private Equity Fund (2009, US$92m)	Growth, Venture Capital	baltcap.com
Birdeye Capital	Birdeye Timber Fund (2017, US$8m)	Real Assets	birdeyecapital.com
BlackPeak Capital	BlackPeak Co-Investment Fund (Fundraising, US$36m)	Growth	blackpeak-capital.com
Blue Sea Capital	Blue Sea Capital Fund (2013, US$49m)	Buyout	blueseacap.com
BPM Capital	BPM Mezzanine Fund (2015, US$81m)	Mezzanine	bpmcapital.eu
Credo Ventures	Credo Stage 2 (Fundraising, US$38m), Credo Stage 1 (2011, US$25m)	Venture Capital	credoventures.com
Darby Private Equity	Darby Converging Europe Fund III (2011, US$205m), Darby Converging Europe Mezzanine Fund (DCEMF) (2007, US$398m)	Growth, Mezzanine, Infrastructure	darbyoverseas.com
Earlybird Venture Capital	Earlybird Digital East Fund (Fundraising, US$135m)	Venture Capital	earlybird.com
Empower Capital	Empower Capital (2014, US$26m)	Growth	empowercapital.net
EMSA Capital	CEE Special Situations Fund (2014, US$132m), CEE Private Equity Fund (2006, US$80m)	Special Situations	emsacap.com
EnerCap Capital Partners	Enercap Power Fund I (2008, US$143m)	Growth, Infrastructure	enercap.com
Enterprise Investors	Polish Enterprise Fund VIII (2017, US$592m), Polish Enterprise Fund VII (2013, US$415m), Enterprise Venture Fund I (2008, US$143m), Polish Enterprise Fund VI (2006, US$834m)	Buyout, Venture Capital	ei.com.pl
Fil Rouge Capital	Fil Rouge Capital Fund (Fundraising)	Growth	filrougecapital.com
Fribourg Capital	Fribourg Digital I (2017, US$24m)	Venture Capital	fribourgcapital.com
Genesis Capital	Genesis Private Equity Fund III (2016, US$91m), Genesis Private Equity Fund II (2009, US$56m)	Buyout, Growth	genesis.cz
Innova Capital	Innova/5 (2009, US$484m), Innova/4 (2006, US$291m)	Buyout	innovacap.com
Inovo Venture Capital	Inovo Venture Fund I (2011)	Venture Capital	inovo.vc
Jet Investment	JET I (2015, US$131m)	Buyout	jetinvestment.eu
Joint Polish Investment Fund Management (JPIF)	Joint Polish Investment Fund I (Fundraising, US$42m)	Venture Capital	jpifund.com
Karma Ventures	Karma Ventures I (Fundraising, US$68m)	Venture Capital	karma.vc
KJK Capital	KJK Fund II Balkan Discovery (2016, US$84m)	Growth, Hedge	kjkcapital.com
Krokus Private Equity	Nova Polonia II (2007, US$132m)	Buyout, Growth	krokuspe.pl
LAUNCHub Ventures	LAUNCHub Fund II (2016, US$19m)	Venture Capital	launchub.vc
LitCapital	LitCapital I (2012, US$33m)	Growth, Venture Capital	litcapital.lt
Livonia Partners	Livonia Partners Fund I (2015, US$76m)	Buyout, Growth	livoniapartners.com
Mezzanine Capital Partners	Accession Mezzanine Capital IV (Fundraising), Accession Mezzanine Capital III (2012, US$265m), Accession Mezzanine Capital II (2008, US$385m)	Growth, Mezzanine	mezzmanagement.com
Mid Europa Partners	Mid Europa Fund IV (2014, US$1095m), Mid Europa Fund III (2007, US$2130m)	Buyout	mideuropa.com
Minerva Investments	METIS Private Equity Fund (Fundraising, US$108m)	Growth	minervazrt.hu
Neulogy Ventures	Slovak Entrepreneurs Fund (2015, US$25m), Slovak Innovation Fund (2014, US$10m)	Venture Capital	neulogy.vc
NEVEQ Capital Partners	New Europe Venture Equity II (2013, US$26m), New Europe Venture Equity (2008, US$34m)	Venture Capital	neveq.com
Oriens	Oriens II (Fundraising, US$28m)	Buyout	oriensim.com
Orion Asset Management	Orion Alternative Energy Fund (2014, US$14m)	Venture Capital, Infrastructure, Hedge	orion.lt
Practica Capital	Practica Seed Capital Fund (2016, US$10m), Practica Venture Capital Fund (2014, US$21m)	Venture Capital	practica.lt
Resource Partners	Resource Eastern European Equity Partners I (2011, US$235m)	Buyout	resourcepartners.eu
SEAF	SEAF Impact Serbia Fund (Fundraising, US$5m), SEAF Macedonia II (Fundraising, US$5m), SEAF South Balkan Fund (2008, US$16m), Southeast Europe Equity Fund II (2007, US$320m)	Growth	seaf.com
South Central Ventures	Enterprise Innovation Fund (ENIF) (2017, US$46m), Prvi Sklad (2008, US$30m)	Venture Capital, Mezzanine	sc-ventures.com
Syntaxis Capital	Syntaxis Mezzanine Fund II (2009, US$183m), Syntaxis Mezzanine Fund I (2008, US$165m)	Buyout, Growth, Direct Lending, Mezzanine	syntaxis-capital.com
Value4Capital	V4C Poland Plus Fund (Fundraising, US$89m), V4C Eastern Europe II (2007, US$198m)	Buyout, Growth	value4capital.com

Source: EMPEA. Data as of 31 December 2017.