CENTRAL AND EASTERN EUROPE

HUNGARIAN PARLIAMENT

SPOT THE DIFFERENCE

Thanks to growing demand from western investors and global players, along with high energy prices and strong exports, CEE markets are optimistic. However, as hesitation continues across European markets, how far will markets such as Hungary, Poland, the Czech Republic, Ukraine and Romania successfully maintain this impetus?

Anastasia Hancock reports

IT IS impossible to make blanket statements about the CEE markets as a whole, and the economic climate varies wildly between markets. Certain markets, such as Poland, for example, have outperformed comparable jurisdictions, while others, such as Hungary, continue to struggle through the downturn. However, there are trends to identify in these regions, such as the growing influx of foreign investors, particularly those stemming from Asia. Andrew Kozlowski, international managing director and managing partner at CMS Cameron McKenna's Warsaw office notes developments in investor profile. 'Traditionally investors come from large European markets and US, there is also growing activity of Chinese firms in the CEE. We observe that investors are still interested in the region, if they postpone their projects it is rather due to financing issues than fears or doubts of CEE as a region to invest'.

While transactional levels across many of these markets are fairly strong, the CEE has been affected by a climate of uncertainty. 'Investment processes take longer, investors and sellers are not rushing with decisions. Acquisition processes are longer and more difficult, require higher level of service, out of the box thinking and tailored approach to every transaction. It affects the final number of transactions closed' explains Kozlowski.

There is no escaping the fact that M&A levels have fluctuated across the markets here, and while activity in the CEE during 2011 was somewhat better than predicted, volume and value is still down on pre-crunch levels and the extent of the decrease clearly differs from country to country. 'Poland is still a quite active market compared to the Czech Republic. The deal activity in Hungary and Ukraine is very low, due to investor-hostile laws and the political and economical environment' points out Alexander Popp, Schönherr's head of corporate and M&A. 'In all markets the volatility of transactions is very high – many projects are cancelled or suspended'.

The difficult climate across the CEE has necessarily resulted in the rise of the strategic investor and the decreasing visibility of private equity funds. 2012 has also seen the profile of active investors shift somewhat away from the west in favour of domestic deals among local, CEE, Russian and Asian players.

'In all CEE markets the demand for assistance in dispute resolution and restructurings has definitely increased in the last few years. Further compliance related work as investigations, implementation of compliance programs and trainings have increased' notes Popp. Nonetheless, there are certain hot sectors that have withstood the uncertainty across a number of the CEE markets. 'We see a high demand for renewable energy projects, in particular in markets with aggressive incentive schemes as in for example Romania. Also the oil and gas sector is still very active' he adds.

For the most part, the CEE markets are not necessarily seeing a drop in investor confidence, but face hurdles in the availability of financing. 'Many investors who already know the region and appreciate the opportunities it offers, experience difficulties in obtaining financing, which slows down their investment processes' Kozlowski adds. However, the situation is, generally speaking, sending positive signals. 'I believe the CEE has proven over the last 15-20 years to be a reliable, predictable region that can offer enormous return from investment'.

POLAND

Poland's success in the face of uncertainty across the Eurozone region has had a lot to do with the provisions made for the county's hosting of Euro 2012. The tournament prompted investment in infrastructure and development amongst other areas, and while the situation varies across the major CEE hubs, Kozlowski says that 'in Poland, which was almost entirely immune to the worldwide and European economic slowdown, last year's results were still quite strong from a business development perspective'.

Within the CEE markets, this jurisdiction is widely perceived by international investors as a predictable business environment. This can, in part, be put down to the stabilising measures introduced by the government. This, explains Warsaw-based Ewelina Stobiecka, Taylor Wessing enwc partner, is set to continue. 'For 2012 the coalition government has proposed further deficit-reducing reforms to fulfil its promise to enact business-friendly reforms. The investors surveyed ranked Poland ahead of other CEE countries with which it competes in terms of foreign investments'.

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Crucially, investor confidence in the Polish market has remained high. This clearly factors in the growth of the economy which in turn goes on to improve the stability of the economy in what is regarded as a virtuous circle. 'Poland is still ranked higher than many European countries by the investors, in particular higher than other CEE countries such as Hungary and the Czech Republic' says Stobiecka. 'It has coped with the effects of the global crisis much better than other countries, maintaining its position as one of the fastest growing economies in the European Union over the last two years. Increased interest of investors in Poland among foreign investors additionally improves the country's image'.

Tomas Rychly at Wolf Theiss in Prague

THE CZECH REPUBLIC

The Czech Republic has been notable in the framework of the CEE markets for the growth of its domestic players. 'Local investors and financial groups have grown in the last ten years and became much more ambitious' confirms Tomáš Rychly, managing partner of the Wolf Theiss' Prague office. The past year, for example, has seen Czech group EnergoPro acquire an electricity distribution grid in Bulgaria from E.On and the Czech lottery leader Sazka has been bought by KKCG and PPF. However, the relative size of the market here does play a part in curbing major international interest. 'While this does not mean that the global players avoid the Czech market, it is quite possible that their strategic focus remains on larger markets which still show a noticeable growth'.

Top of the agenda for investors – both domestic and international – is energy, and the most high-profile deals in the market are linked to this sector. Deals such as the potential sale of the conventional power plants by ČEZ and the sale of the Czech transmission system Net4Gas by RWE are good examples of this. While Rychly does state that his firm has seen a large number of energy-related transactions, he does point out that while there has not been a noticeable change in investor sentiment the health of nearby markets is key. 'The main issue is the stagnation of the broader region and the impact of the slowdown of the EU on the region. The Czech economy is strongly dependent on exports to the EU, particularly Germany, so even a fractional slowdown is immediately felt in the Czech economy'.

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Dagmar Dubecká, managing partner at Kocián Šolc Balaštík, notes that while he has not seen a notable change in the profile of investor clients here, they are increasingly 'sensitive both to price and risk factors, as well as requiring a definite exit strategy'. This market is certainly not exempt from the uncertainty affecting the regions, despite its size. 'Confidence is still largely driven by conditions in investors' home jurisdictions' explains Kocián Šolc Balaštík's founding partner Martin Šolc. 'An additional factor affecting investors in the Czech Republic is the domestic political debate in respect of budgetary issues, which is weakening attempts by the conservative government to implement reforms'.

While these factors have had a considerable impact on the deal value and volume here, hot sectors beside energy include manufacturing, engineering, IT and real estate. 'Lately there has been a return of big deals in the form of strategic acquisitions' notes Prague based Taylor Wessing enwc partner Markéta Deimelová. 'Investors express cautious confidence in Europe's future attractiveness. Although the confidence may not be back, there is more M&A and private-equity activity' she adds.

UKRAINE

While the Ukraine is not part of the Eurozone, the market is not immune to the effects of the downturn across the CEE. As Olena Stakhurska, Taylor Wessing enwc partner in Kiev points out, 'currency issues are very sensitive considering the exchange rates and import-export operations of the local market players, as well as operations in the financial sector'. Legislation concerning foreign currency has seen some recent developments directed at preserving the balance between local and foreign currencies, 'introducing clear regulations and possibilities also for foreign investors in specific cases to agree upon the payments in the local currency'.

While M&A level have seen a drop, there has been a general hiatus from domestic players in advance of the parliament elections at the end of October this year, which will no doubt have had an effect on investment here. 'The macroeconomic situation in the country influences the decision of investors entering the market or those investing abroad' adds Stakhurska.

Olena Stakhurska at Taylor Wessing in Kiev

The presence of Russian banks and companies here is considerable, and their profile is particularly visible given the activity in the energy sector. The privatization of state companies, including energy companies and mines, has been a considerable factor and an incentive for investors. 'Ukraine is still a country of opportunities. Depending on the political situation and further economic developments, any concerns will remain cautious and the development itself may surprise everyone. Nevertheless Ukraine is a very interesting market and Russian and European investors are optimistic while not expecting short-term results'.

HUNGARY

Hungary continues to suffer from the effects of the downturn, and represents one of the more severely affected markets throughout the CEE. It has seen some hefty international investment, but despite this there has been a 15% decline in its economy since the crunch first bit. This country is regarded as one of the most 'historically pioneering CEE countries', however, the past seven years have seen a dwindling in foreign investment. 'Budgetary cuts and austerity measures such as the crisis taxes levied on, among others, the banking sector, plunged new bank crediting by -11% this year which add further to the very tough market conditions. The immediate future trend will largely depend on how much longer the Hungarian government is willing to stall with its drawn-out negotiations with the IMF' explains János Tóth, Budapest-based partner at Wolf Theiss.

While M&A activity has remained low thanks to difficult to obtain financing and a risky market, there is a bright spot on the horizon in the shape of domestic private equity firms, which are 'now enjoying some fresh resources from JEREMIE II', the joint initiative by the European Commission, EIB and EIF to improve access to finance for SMEs. 'Interest from Russian and Asian investors has also been growing' says Tóth, 'as these buyers can now take advantage of their own – almost unlimited – financial resources and the current low price expectations to secure attractive deals'.

János Tamás Varga, managing partner at VJT & Partners in Budapest

While signs of real recovery in Hungary are still remote, the market has been shifting towards this end goal. 'The last two years in Hungary have been spent rebalancing the state budget and reshaping labour and employment legislation to create a more flexible labour market' explains János Tamás Varga, managing partner at VJT & Partners in Budapest. Investment from Asiatic countries is the aim. 'The Government's defined goal is to attract international production companies and manufacturers to set up Hungarian operations. The success of this is illustrated by the opening last year of Mercedes-Benz's car assembly plant in Kecskemét and Audi's significant expansion of its car plant in Győr' adds Varga.

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Hungary's strong export industry stands, however, to strengthen its economy. 'Independent monetary policy gives Hungary a certain flexibility, which is an important advantage, given that all CEE countries are strongly dependent on export' points out Budapest-based Dénes Szabó of Taylor Wessing enwc. This policy is good news for the market here; 'for a small open economy it means higher competitiveness in the global economy'. ■