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Family Fortune

Family succession investments and buyouts have become a crowning opportunity, attracting PE investments to the CEE region. While Covid uncertainty intensifies first generation founders' questions over what to do with their family business, it is also forcing major opportunities in disrupted markets.

Simon Thompson reports

Three decades after the collapse of communism set off an explosion of CEE entrepreneurialism, founder managers of what have become leading CEE businesses, are today planning how to best pass on the "family fortune". While succession buyouts and investments have long been among cornerstone investment strategies for CEE-focused PE firms, the Covid-19 pandemic's rapid digitisation of industries and complete upending of markets, are recasting them into even more illustrious PE investments.

A GOLDEN OPPORTUNITY

While companies weakened in the wake of Covid, and opportunities for market consolidation are widespread, Michał Kędzia partner at Enterprise Investors says they are even more acute in CEE countries where markets haven't been as long standing and a larger proportion of companies are founder led. "We are seeing more healthy companies deciding to take advantage of the situation, push the pedal to metal, to accelerate development and consolidate markets." To do it, they are looking for experienced partners that know how to acquire companies, enter into neighbouring countries and professionalise teams and founder-led businesses.

According to Krzysztof Kulig, senior partner at Innova Capital, Covid consolidation opportunities are bringing first generation companies to the table that weren't there before. "It is much easier for founders to accept financial investors that would take majority stakes, if it facilitates building a much larger pie." CEE- focused firms are also targeting investment into companies with capacity to bridle Covid-19's rapid and large scale digitalisation occurring in a spread of different industry sectors.

However, founders' increased interest in selling their businesses might be as much about hedging against its uncertainty, explains Gregor Piechowiak, managing partner at transaction advisory JP Weber, co founder of a global Eight International advisory. "Founders' readiness to sell now is much higher than it was before the pandemic. It has shown that things can happen in the market that are totally beyond their control. Many are looking to de-risk and take some of their money out."

GETTING IN WITH THE FAMILY

Family Business Institute (Instytut Biznesu Rodzinnego IBR) reveals just how big of an opportunity the lack of succession planning in the CEE is for PE investors. For instance, while 74 per cent of founders in Poland would like to hand over companies to the younger generation, only 8 per cent of second-generation successors are actually interested in taking over family businesses.

But, that doesn't mean succession deals are coming easy for PE firms looking to step in. In fact, without a longstanding corporate finance community like the rest of Europe, most firms have to depend largely on internal proprietary deal sourcing. "These are not first dates. We know these people for years before investing and we consistently chat with them over the years and observe how their companies are developing", Kędzia explains.

Succession buyouts can be also elongated and are often most effectively executed as an incremental play, claims Wojciech Jezierski, partner at Abris Capital Partners. A partnership with PE is usually a bridge to a full succession. Jezierski reveals that they often propose an acquisition of c.50 per cent, combined with a carefully drafted business professionalisation plan and a strategy to significantly increase the scale of business and finally a joint exit through a sale in 3-5 years time.

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ALL THAT GLITTERS

Instability of current market conditions might be bringing more founders to market, but this is also further complicating the success of CEE succession deals.

PE firms are increasingly turning to earn outs to hedge against the uncertainty of valuations and the unreliability of future cash flow modelling. Helen Rodwell, managing partner of law firm, CMS says earnout arrangements might be commonplace in the M&A world, but they are notoriously difficult to negotiate with first generation founders, especially in the CEE.

"It makes them nervous from the outset. Founder sellers want certainty of what they are going to walk away with," Rodwell says. Earnouts can also present a major upside for founders, if agreed targets are exceeded, but Rodwell maintains that that is of marginal comfort or value for this generation of CEE founders. "The profile of someone who is 65-70 years old, who is selling the family business from that generation; they want certainty and to be rewarded for building up their prize asset of their life. Earnout negotiations tend not to go down very well."

Whether or not first generation succession deals get over the line, or not, often comes down to the performance of the corporate finance advisors on the sell side. "You need an advisor who can hedge or bridge the gap between a successful entrepreneur and the PE world. Someone who can explain the legal construct, and market standard provisions of the M&A world, demystify, and provide simple explanation and comfort on the standard contract provisions," Rodwell suggests.

GROWING UP

While the CEE includes Romania and Bulgaria, Marek Malík, partner at Jet Investment argues that more significant market maturation and sophistication in the Visegrád countries (Czech Republic, Poland and Slovakia) have put them in a separate class when it comes entrepreneurialism, industry and investment opportunities.

"These nations are accessing the EU standards and Western European standards quite quickly and they are economically closer to Germany and Austria." Malík adds that that internationalisation is increasingly becoming a key value driver of the succession opportunities Jet Investment is pursuing in these countries. The CEE abbreviation might be becoming a greater symbol of a shared communist past than any modern regional economic parity.

Moreover, advancing beyond the first generation of successions, many of the CEE founders and oligarchs that have sold off the family jewels are returning to the M&A market as investors. Many are starting their own family offices.

Rodwell says she often sees family offices competing on deals against PE firms. While CEE founders were skeptical of PE in the past, PE's credibility and rapport has come a long way over the last 10 years. Compared with counterparts in the rest of Europe, GPs are finding that CEE founders place an even higher priority on sale/cash value than any other, mitigating legacy issues or concerns over how the company will be managed once they have exited.

The quantity of Covid-enhanced opportunities simultaneously unfolding in the CEE is a golden opportunity for PE to fortify itself as the go to capital source for succession exits in the region. While the first generation of business successions are often the most difficult to put in place, those taking place have the potential to set PE in stone as the standard for family succession exits, for generations to come. ●