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THE 2011 RESULTS OF THE PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY
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The Protracted Crisis

Even in 2011, the slowdown caused by the crisis still persisted in the Central and Eastern European (CEE) private equity and venture capital industry. Similarly to Europe as a whole, the first half of 2011 showed signs of recovery; thus, investments and exits of significant value were made in the region. However in the middle of the year, a new wave of the European debt crisis broke the upwards trend. In 2011, the region again represented nearly 3% of European investments; however, the increase in the volume of capital committed for the purpose of investments here in the region reached only one tenth of the European dynamic which signifies the deterioration of the region's competitive position. However in terms of exits of investors from portfolio companies, the region improved its position in Europe as a result of some very high-value exits; the share of local divestitures rose to 4.5%.

In 2011, the Hungarian private equity and venture capital market regained its earlier second position in terms of volume of investments in the region; moreover, in terms of exit value, it was first in the region. The Hungarian market achieved an outstanding position not only in the region but also Europe-wide due to the launch of the activity of the Jeremie funds. In 2011, *it ranked sixth in Europe in terms of the ratio of the value of* early stage investments *i.e.* the *venture capital investments* functioning in the classic sense of venture capital *to the GDP*. Also, it ranked 14th on the European list which includes growth capital investments and divestitures beside early stage venture capital investments while in 2010, it only ranked 22nd.

Table 1

Ratio of the Annual Value of Private Equity and Venture Capital Investments to the GDP in the European Union and Hungary, 2007-2011 (percentage)

	2007	2008	2009	2010	2011
European Union	0.56	0.40	0.19	0.33	0.34
Hungary	0.21	0.45	0.23	0.07	0.19

Source: PEREP_Analytics

According to the data of EVCA PEREP_Analytics, *the value of private equity and venture capital* invested into Hungarian enterprises *tripled* in 2011 and rose to EUR 195 million due to some high-value investments closed in the first half of 2011. And the *number of* Hungarian *companies* receiving investments more than *doubled* and rose to 37. The majority of the companies, 32 enterprises, received private equity and venture capital from the given investor for the first time. In 2011, buyouts carried out by private equity investors represented 80% of the total value of investments made in Hungary; however, *80% of* the target *companies* were

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early stage companies. In 2011, the average investment value per company rose 40% compared to last year and reached EUR 5.3 million.

Table 2

Value of Private Equity and Venture Capital Invested into Hungarian Companies, Number of Investments and Average Equity Value Invested in a Transaction by Years, 2002-2011 (million EUR, number of deals)

Year of investment	Value of invested equity (million €)	Number of investments	Average investment value (million €)
2002	127	29	4.4
2003	117	32	3.7
2004	108	41	2.6
2005	131	26	5.0
2006	535	39	13.7
2007	491	26	18.9
2008	477	25	19.0
2009	214	12	17.8
2010	65	17	3.8
2011	195	37*	5.3

**number of target companies*

Source: 2002-2006: HVCA database; 2007-2011: PEREP_Analytics

The Positive Effect of Investments on Innovation

While prior to 2010, the value and number of classic venture capital investments provided to Hungarian startups for the purpose of early stage development and growth was very low, in the past two years, a significant change occurred due to the investment of Jeremie funds. The distribution of private equity and venture capital investments by size has changed: the share of small transactions has increased, whereas the share of large transactions has dropped. In 2011, more than one fifth of the investment value and nearly 90% of the investments functioned as classic venture capital in the target companies. The upturn of early stage investments was primarily due to the eight new Jeremie funds set up in early 2010 as a combination of community funds and equity from private sector investors. These venture capital funds selected their portfolio companies across a wide spectrum and financed a wide range of Hungarian startups and early stage companies having promising growth potential. Largely due to the investments of these funds in 2011, *nearly half of the early stage investment value flowed into the high tech category*.

Similarly to the rest of the region, the significance buyouts in the context of private equity and venture capital investments had also increased in Hungary in 2011. Whereas in 2009, buyouts represented 95% of the value of private equity and venture capital investments in Hungary, following the crisis in 2010 the share of these transactions fell to 62%. By 2011, in line with the rest the whole of Europe, once again *buyouts represented almost 80% of the value of all investments made*. In 2011, the average value of buyouts in Hungary rose from €13 million, as recorded in 2010 to €31 million. Out of the 5 buyout transactions registered, in the case of 3 transactions the equity part of the investment did not reach €15 million, while in the case of 2 transactions the equity part fell within the range of €15 and €150 million. The two latter transactions represented almost 90% of the value of buyouts in Hungary.

Table 3

Value and Number of Private Equity and Venture Capital Investments in Hungary in 2011 by the Life-cycle of the Companies Involved in the Investments (million EUR, number, percent)

Stage of Life-cycle	Investment Value (€ million)	Investment Value (%)	Number of Companies (no.)	Number of Companies (%)
Seed, Start-up and Early-stage	40.0	20.5	29	78.4
Growth Capital	0.5	0.3	3	8.1
Buyout Capital	154.3	79.2	5	13.5
Total	**194.8**	**100**	**37**	**100**

Source: PEREP_Analytics

Within the specialized sectors financed by venture capitalists in Hungary, in 2011 the *sector manufacturing consumer goods was the recipient of the largest value of investment*, worth almost €100 million; understandably so as transactions involved in investing buyout and growth capital were mainly carried out in this sector. From among these transactions the most notable is the buyout of Provimi Hungary Zrt., a company producing pet food, by the CEE fund of Advent International. The *second largest amount*, almost €23 million *was used to finance companies engaged in transportation*. In this sector, the acquisition of a 49.1% interest in Waberer's Holding Zrt. by Mid Europa Partners became rather well known. In 2011, considering the number of transactions Hungarian companies operating in the *computing and consumer electronics sector* benefited the most from private equity and venture capital investments, while the *communications sector* which had also been popular in previous years gave rise to the *second highest number of transactions*. From among the latter two sectors, the companies in an early stage of their life-cycles benefited most from venture capital funding; the Jeremie funds mainly facilitated growth within these sectors.

Table 4

Value and Number of Private Equity and Venture Capital Investments in Hungary in 2011 by Sectors of the Companies Financed (million EUR, number, percent)

Specialist Sector	Investment Value (€ million)	Investment Value (%)	Number of Companies (no.)	Number of Companies (%)
Agriculture	2.5	1.3	1	2.7
Business and Industrial Products	11.8	6.1	5	13.5
Business and Industrial Services	3.8	2.0	2	5.4
Chemicals and materials	0	0	0	0
Communications	8.7	4.5	6	16.2
Computer and Consumer	20.4	10.5	10	27.0

Electronics				
Construction	0	0	0	0
Consumer Goods and Retail	95.6	49.0	3	8.1
Consumer Services	1.4	0.7	2	5.4
Energy and Environment	0	0	0	0
Financial Services	1.7	0.9	2	5.4
Life Science	4.7	2.4	4	10.8
Real Estate	0	0	0	0
Transport	44.2	22.6	2	5.4
Total Investments made	**194.9**	**100.0**	**37**	**100.0**
From which High-tech	19.5	10.0	10	27.0

Source: PEREP_Analytics

Exits of Increasing Values

In the CEE region and in particular in the Hungarian market, the increase in the number and value of exits was a sign of a temporary relief from the effects of the crisis in the first part of 2011. The value of exits in the region in 2011 grew to four and a half times of its previous size, while the number of companies involved increased by one fifth, *i.e.* the private equity and venture capital funds had disposed of some partcularly high value investments. In Hungary also, *one very high-value transaction provided 99% of the total exit value of 2011* and half of the value of company sales in the region. Private equity and venture capital funds exited from 11 Hungarian portfolio companies in 2011 of a value of almost €700 million, while the value of the 9 exits carried out in 2010 only just surpassed the €8 million mark. The greatest part of the value of company sales *made to strategic investors* in 2011 was in the *chemical industry*. In a transaction totaling at €1.2 billion with credit-finance, Wanhua Industrial Group took over the control of BorsodChem Zrt. which has been owned by Permira and Vienna Capital Partners since 2006 and in the restructuring of which Wanhua Industrial Group has already been participating since 2010.

Chart 5

Value and Number of Exits of Private Equity and Venture Capital Investors from Hungarian Companies by Exit Methods, 2011 (million EUR, number, percentage)

Exit method	Exit value (million €)	Exit value (%)	Number of companies	Number of companies (%)
Divestment by trade sale	679.2	98.8	1	9.1
Divestment by public offering	0	0	0	0
Divestment by write-off	0	0	0	0
Repayment of silent partnerships	0	0	0	0
Repayment of principal loans	3.4	0.5	8	72.7
Sale to another private	0	0	0	0

equity house				
Sale to financial institution	0	0	0	0
Sale to management (MBO)	0	0	1	9,1
Divestment by other means	4.5	0.7	1	9.1
Total exits	**687.1**	**100.0**	**11**	**100.0**

Note: The chart contains the value of exits registered at cost
Source: PEREP_Analytics

Slowly expanding funds

The protracted effect of the crisis on the private equity and venture capital market can be felt for the longest time when it comes to raising new funds. In comparison to the period preceding the crisis, the size of the funds is decreasing on the one hand, while their establishment also takes longer on the other hand. Accordingly, CEE fund managers in 2011 were also cautious with showing their intent to raise new funds. While the raising of capital dynamically improved on the European market in 2011 with the value of new funds increasing by 80%, the dynamics of the regional capital raising was one-tenth of that. Surveys conducted in respect of investors financing funds in emerging countries also showed the *decreasing popularity of the region*. Almost one-third of the new funds raised for the purpose of investments in the region was provided by umbrella funds already well-acquainted with the local fund managers, while 17% of the capital came from pension funds and 15% from banks. The large corporations mainly involved in the financing of innovation contributed 90%, while the state funds contributed 7% of the capital of the funds intending to make investments in the region.

While in contrast to the leading markets of the region the Hungarian market mostly remained outside of the scope of interest of international financers contemplating to make investments in the region, *the involvement of the state increased in the venture capital market*. It is indicated by the fact that *MFB Invest*, the investment company of the state-owned Magyar Fejlesztési Bank acquired the 60% stake of the Japanese SBI Capital Partners from its venture capital fund called SBI Europe Fund in 2011, and is contemplating investments in the amount of 20-30 billion HUF. *Széchenyi Tőkebefektetési Alap*, established in the summer of 2011, is also going to finance enterprises from budgetary resources, planning to place its funds in seven counties, in the value of 2 billion HUF per region until the end of 2015. The second phase of the Jeremie program will probably commence in 2012, which opens the possibility for further seed capital and growth investments, in the total amount of approximately 40 billion HUF including the contributions from the private sector.

The institutional financing of the seed phase contemplated by the Jeremie program is also of very high significance as earlier seed capital funds operating in an organized form were totally absent from the Hungarian market. An exception to this is the *Day One Venture Capital Fund I* of HUF 402 million closed successfully in the fall of 2011 exclusively from private sector capital for business angel investments.

Mixed Outlook

The outlook of the Hungarian private equity and venture capital market on an international level is determined by its competitive position in Europe and in particular primarily in the CEE region. In this context, the slowdown of economic growth coupled with inadequate national economic policies creates a *highly unfavorable environment* for private equity and venture capital funds contemplating long-term investments.

The Hungarian business environment which has become unpredictable amid the second wave of the European crisis is expected to continue keeping international investors away. Slow growth is expected in the coming years and the strong interventions of the government in market processes in the past period does not help increasing investors’ confidence. However, the state’s strengthened role in providing funds to the Hungarian private equity and venture capital market *significantly improves the chances of innovative Hungarian enterprises* in the early stage of their corporate lifecycle *in obtaining classic venture capital*.

The performance of the private equity and venture capital market will significantly depend on the extent of which the steps of the government’s economic policy can reduce the macroeconomic uncertainties and uncertainties in the capital markets.