



**Deal Advisory**

# Characteristics of transactional processes in Hungary

A summary of our survey results



March 2019

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## Dear Reader,

We are pleased to present you with the results of our survey on the characteristics of transactions in Hungary. The survey, which kicked off in January, attempts to find the answers to questions like what preferences investors have, what specific transactional characteristics are typical, and what strategic and financial investors' expectations are regarding the Hungarian market.

More than 20 major investors participated in our survey, either through personal interviews or by filling out our online questionnaire. All of the respondents tell us they have actively been looking for new investment possibilities in recent years, and the majority, around 90%, have also invested in at least one company, business or commercial property.

The first part of our report provides a snapshot of Hungary's transactions market, after which we present the details and summary of main findings of our survey.

Where the topic required it, we have analyzed separately strategic investors' responses from those of financial investors (mostly private equity and venture capital). Please note that the results of this study are not representative and should therefore only be considered as anecdotal.

We would like to say thank you to all those who took part in our survey, as their co-operation was crucial to the preparation of this report.

We hope that you will find our report informative and that it will help you in considering future business decisions. If you'd like to discuss the results, please do not hesitate to contact us.

Yours faithfully,

**Zsolt Palotai**

# A snapshot of Hungary's transactions market

After ranking 6<sup>th</sup> in 2018, in 2019 Hungary ranked



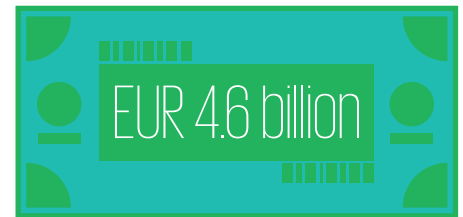
on The Economist's regional business environment ranking.<sup>1</sup>

Direct capital investments<sup>2</sup> in Hungary reached



in 2017. (Hungarian National Bank)

The value of the Hungarian transactions market in 2018 was estimated to be



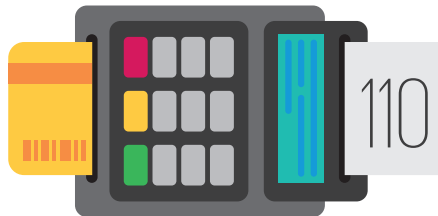
after the 2017 estimated figure of EUR 2.7 billion.<sup>3</sup>

The net asset value of real estate funds, venture capital funds and private equity funds reached



at the end of 2018. (Hungarian National Bank)

The estimated number of transactions in 2018 was



after the 142 transactions estimated in 2017.<sup>4</sup>

The estimated value of the biggest transaction was



in 2018, which was paid by Cinven Partners for Partner in Pet Food.<sup>5</sup>

The volume of real estate investments in 2018 was an estimated



after the EUR 1.9 billion estimated in 2017.<sup>6</sup>

The biggest published real-estate transaction was



which was paid by NEPI Rockcastle for Mammut shopping center.

The Hungarian Competition Authority had



acquisitions announced that exceeded the thresholds of the Competition Act.<sup>7</sup>

## Sources and comments

<sup>1</sup> The ranking included 16 countries: Azerbaijan, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and the Ukraine.

<sup>2</sup> Without SPVs, cleaned from the flow-through capital and the rearrangement of asset portfolios

<sup>3,4</sup> Based on CMS Emerging Europe M&A report in cooperation with EMIS 2017/18 and 2018/19

<sup>5</sup> According to Forbes

<sup>6</sup> Colliers International: The CEE Investment scene

<sup>7</sup> The merger must be announced in case the total revenue of the companies merged exceeds HUF 15 billion, and the increase of revenue exceeds HUF 1 billion.

# Results of the survey

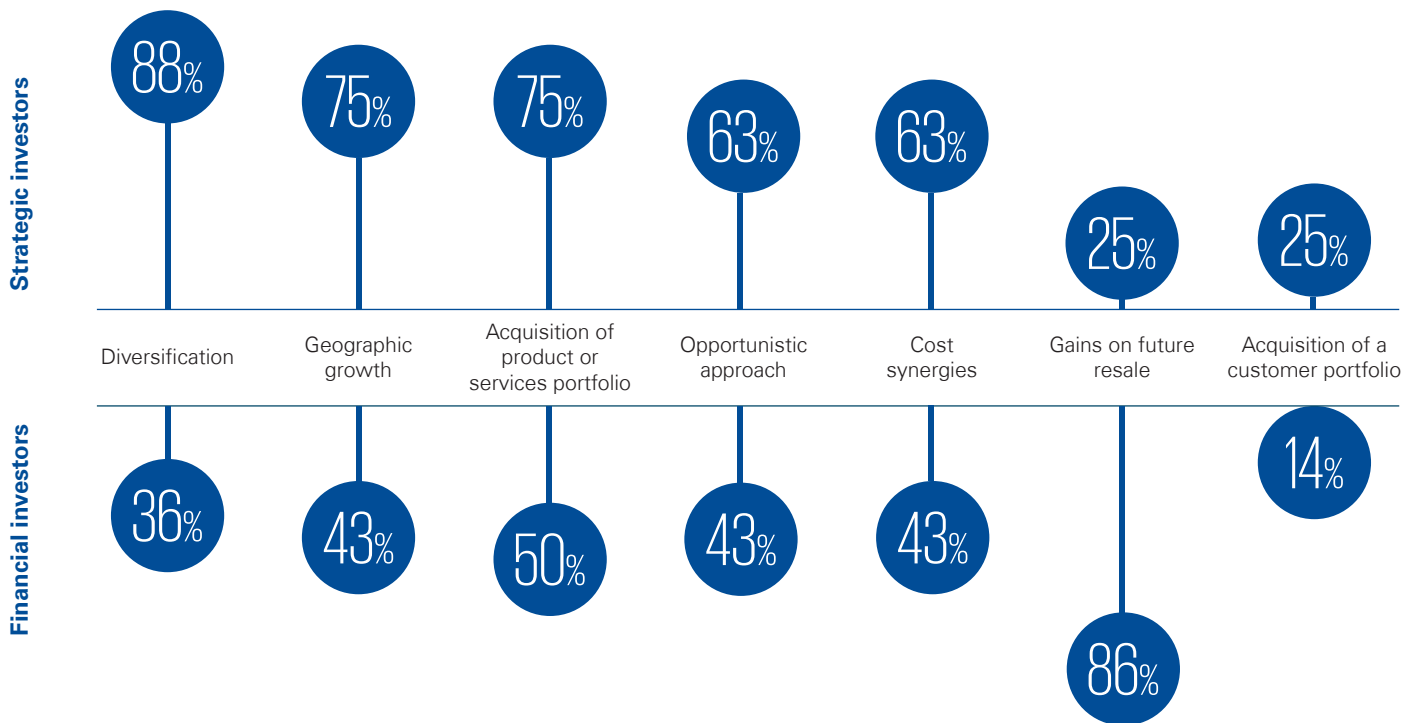
## 1. What drives investments?

For understandable reasons strategic investors and financial investors make investment decisions with different aims. Accordingly, we have analyzed the responses regarding this topic separately, presenting here the percentage of investors who indicated certain drivers as significant.

The majority of strategic investors (88%) chose diversification (meant here in a broader sense) as the most typical driver when making investment decisions. Interestingly, one quarter of them also appear to consider gains on future resale.

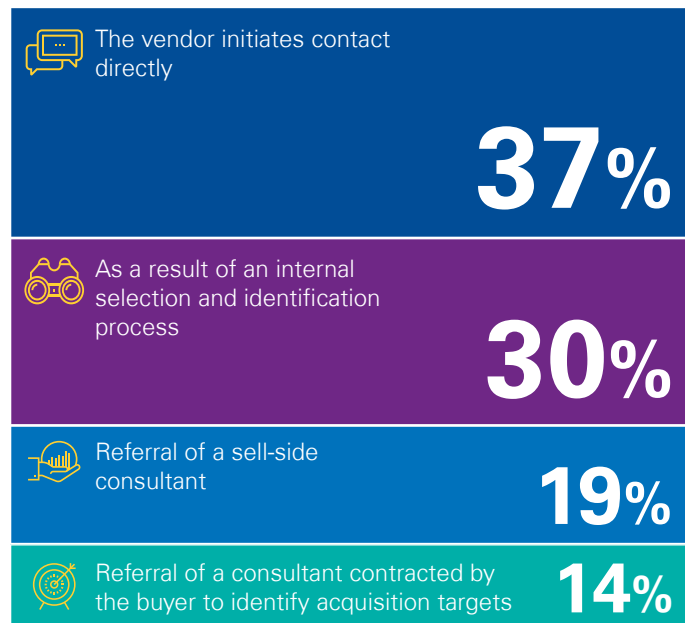
In line with our expectations, the most common response among financial investors as to what they consider the main driver was gains on future resale. However, based on the responses submitted, we can conclude that when it comes to most financial investors, this is not a sole driver of acquisitions: 14% of them are not planning to make the investment profitable by gains on resale, and a remarkable proportion of them also indicate other aspects (between 14 and 50%). The latter is probably explained by the composition of an existing portfolio, or the demands of such portfolio companies.

### Typical acquisition drivers



## 2. How are target companies found?

### Ways of identifying targets



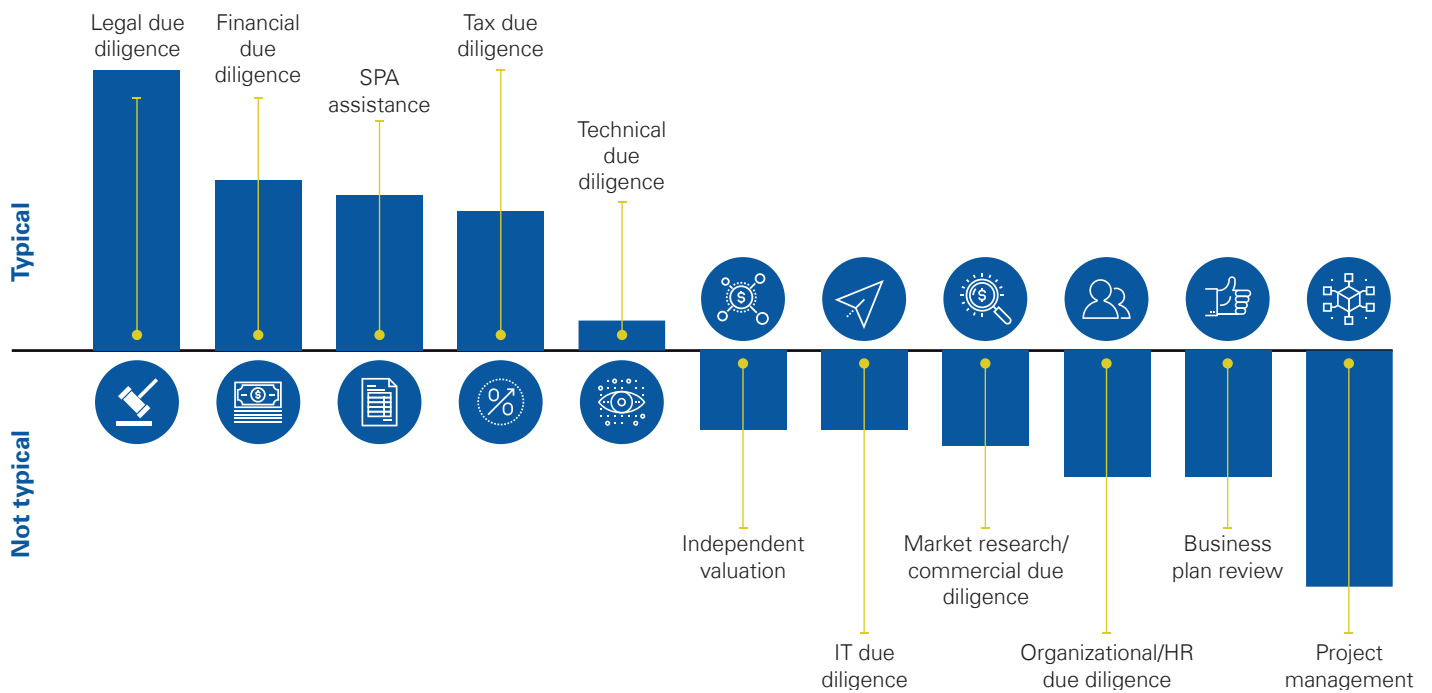
Based on the responses received we can conclude that when it comes to introductions made between potential vendors and potential buyers, the vendor side is more active: according to respondents, in 56% of the cases it is the vendor or its advisor who gets in touch with the potential investor. Nearly one-third (30%) of targets are identified by the investors themselves, using various methods at their disposal (e.g. networking at professional conferences). In case of the remaining 14%, investors find their potential targets by engaging external advisors.



### 3. What services are provided by an external advisor?

The most frequently-sought external professional support is legal due diligence, closely followed by financial due diligence, SPA assistance (mostly related to legal matters, with certain financial and tax questions), and tax due diligence. Despite many respondents emphasizing the importance of market position and organizational/HR matters, the latter especially when it comes to smaller targets, the involvement of external advisors is less typical in these areas according to those surveyed.

#### Typical advisory services during a transaction process



#### Is a “one-stop shop” preferred?



Nearly two-thirds (62%) of respondents prefer that one advisory firm perform as many of the external professional services related to the transaction process as possible.

## 4. What makes a good advisor?

According to investors, the most appreciated characteristics of external advisors are industry and service experience and a pragmatic approach. Understandably in this context, where acquisitions are made by domestic market players in Hungary, an international network is less important, but it seems like relatively lower pricing is not a crucial characteristic either. However, regarding the latter, many investors emphasize that the question of pricing can be decisive in the case of some smaller transactions.

### Order of preference of qualities of external advisors





## 5. What does a typical transaction look like?

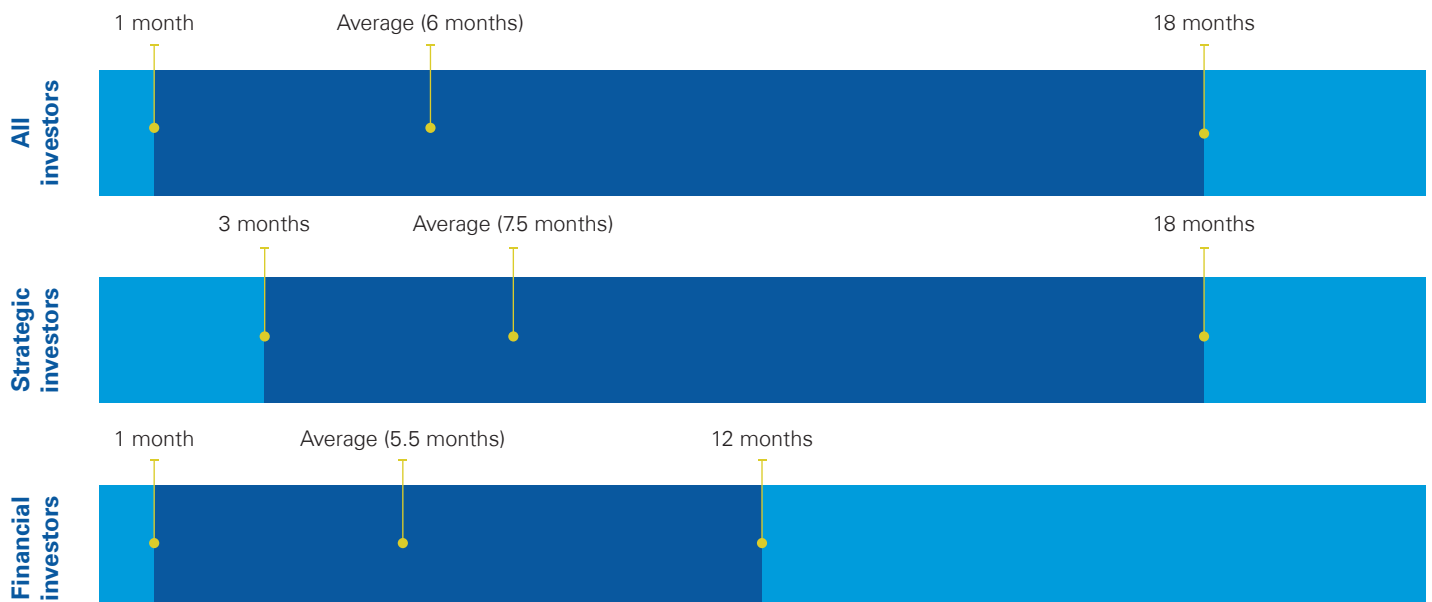


If we had to outline a typical transaction on the Hungarian market, it would be 6-months long, would not include a vendor-side due diligence, the vendor would negotiate exclusively with one potential investor, and the SPA would include a so-called “closing accounts” mechanism.

Regarding the length of the transaction process – starting with the first contact between the vendor and the investor and ending with the signing of the sale and purchase agreement – the respondents report having seen examples for 1-month long acquisitions, but also for 18-month ones. At the same time, many survey participants indicate that an ideal process is less than 6 months long, because the longer the process is, the less motivation the parties have for problem solving, and the lesser the level of enthusiasm.

Based on responses to the survey we can conclude that the process takes longer for strategic investors than for financial investors. This fact can be caused by, inter alia, the complexity of decision-making mechanisms and the time-consuming process of synergy identification and post-merger integration plan formation.

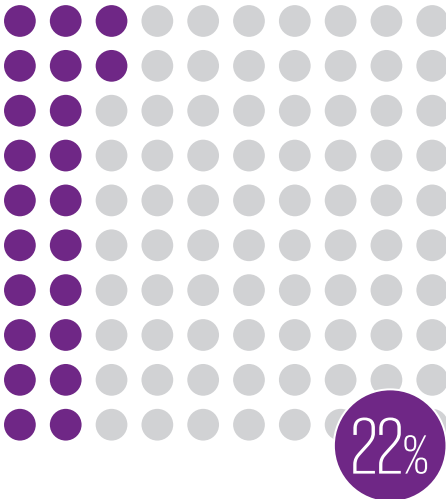
### The length of a transaction process based on experience



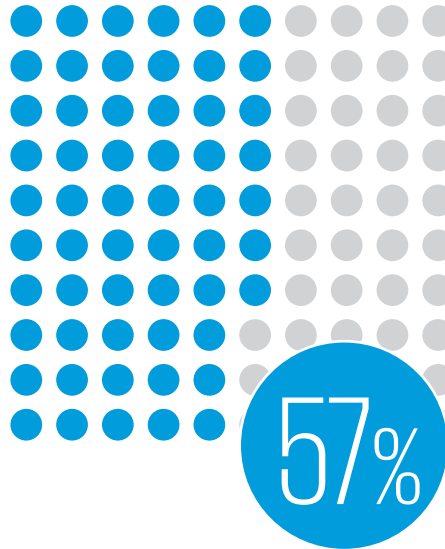
Based on investors' experience, a vendor-side due diligence report is prepared in about one-fifth of cases (22%), in more than half of the cases (57%) the vendor negotiates with only one potential investor, and the so-called "locked box" mechanism which enjoys popularity in Europe, is used in barely 30% of transactions in Hungary.

### Frequency of certain transaction attributes

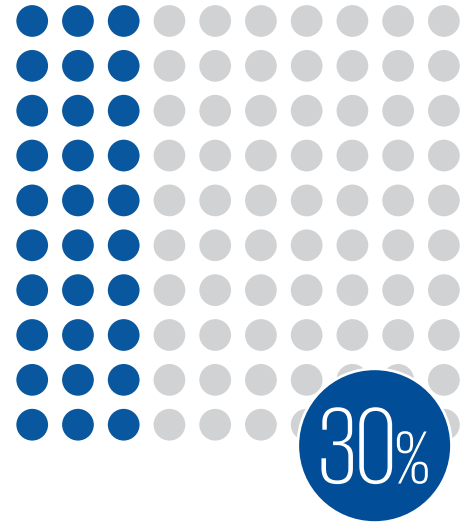
#### A sell-side financial due diligence being conducted



#### The vendor negotiating with only one bidder



#### Use of "locked box" mechanism



### Is there a demand from investors for vendor due diligence?

**68%**

Sixty-eight percent of respondents judge it favorably if the vendor engages one of the top advisory companies to perform financial or tax due diligence. At the same time however, many investors indicate that the vendor-side due diligence reports they have encountered did not have enough depth to satisfy their needs for information or for risk identification, especially the so-called "red flag"-type reports or reports that are made available only after signing "hold harmless" documents.

## 6. What determines the offer price?

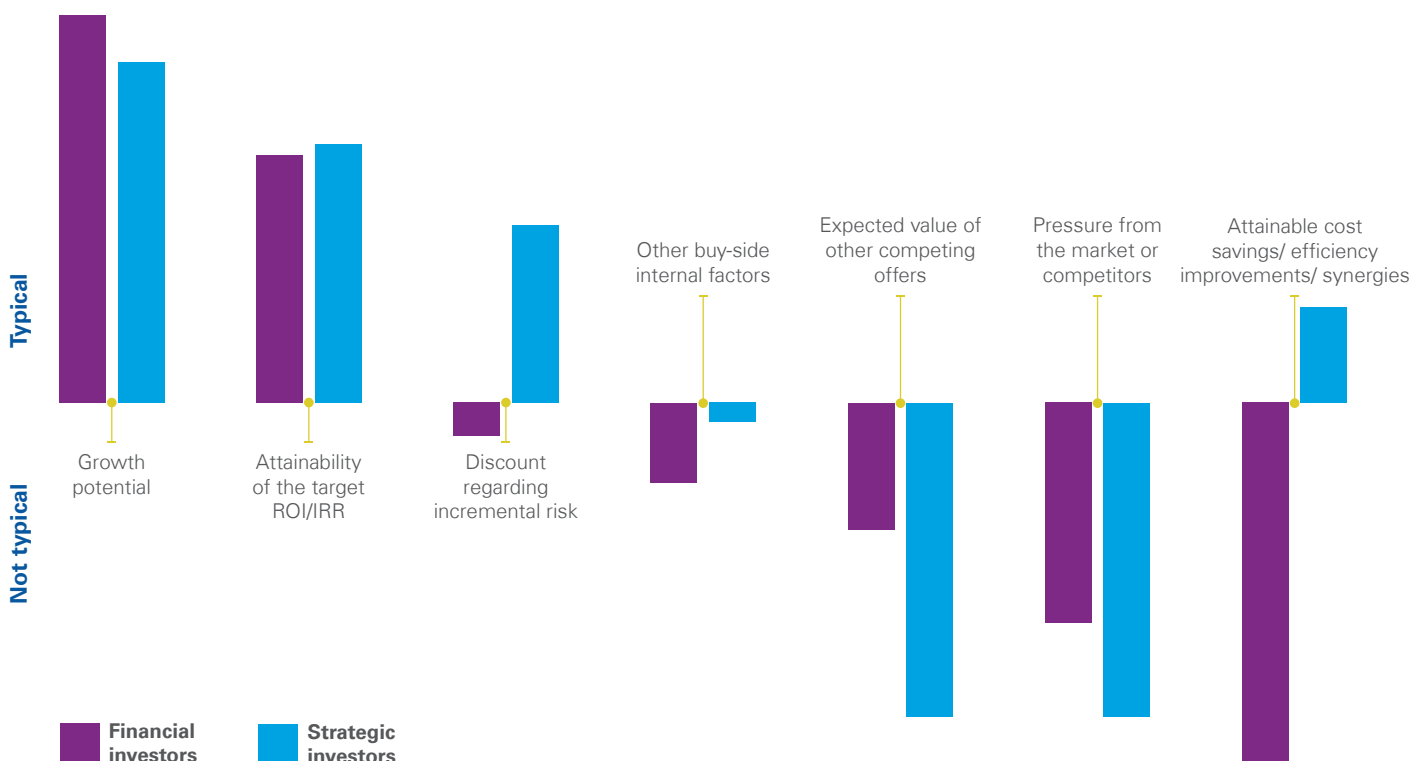


A concurrent opinion for both strategic and financial investors is that growth potential is the most important factor influencing the purchase price, closely followed by the attainability of the target ROI/IRR.

However, the two groups have quite opposing opinions on two factors: while strategic investors regard the discount regarding incremental risk<sup>8</sup> and the attainability of cost savings more important than average, financial investors deem the importance of these two to be below average or not important at all.

The opposing view on cost savings can be explained by the fact that the only way financial investors can realize synergies is if their existing portfolio includes an entity which can be integrated vertically or horizontally with the target.

### Considerations regarding the formation of an offer price



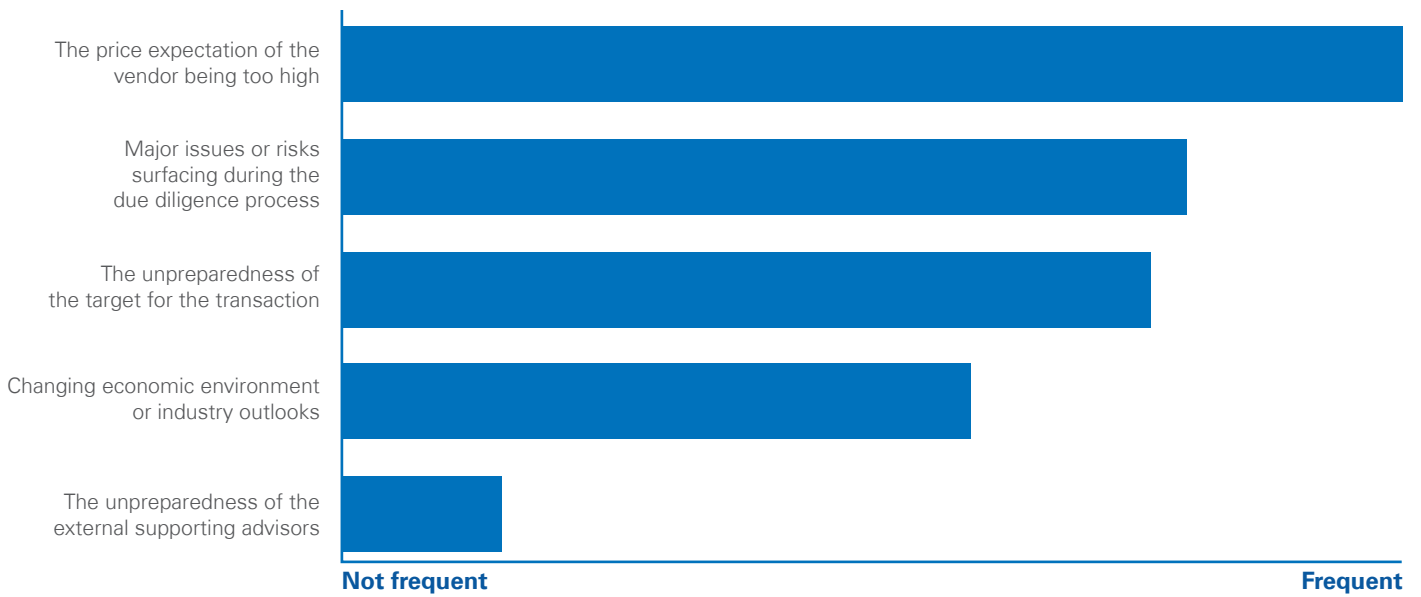
**Sources and comments**

<sup>8</sup> Risk potentially arising with the investment in an entity, line of business or commercial property

## 7. What are the transaction pitfalls?

Based on investors’ experience, some transactions not being closed are mostly attributable to the fact that vendors have price expectations that are too high. This is closely followed by the uncovering of significant issues during due diligence, and the unpreparedness of the target company for the transaction.

### Reasons for transactions not being closed



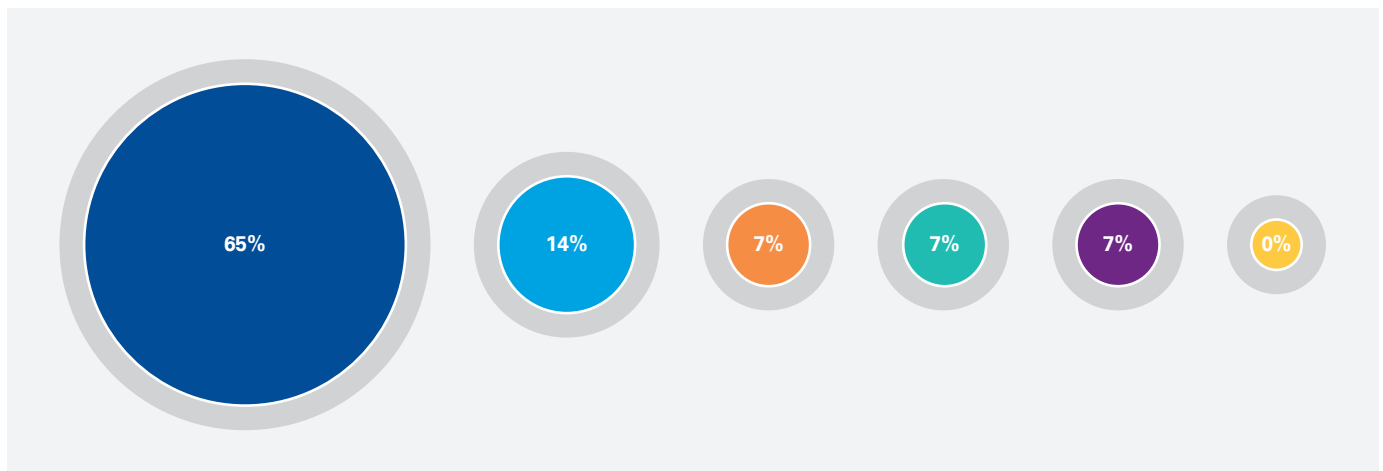
## 8. What makes a closed transaction successful?

When evaluating a transaction, the most important success metrics for strategic investors are whether the pre-determined KPIs and synergy metrics are achieved. Further important success metrics are the achievement of pre-determined ROIs and IRRs and the satisfaction levels of the buyers’ chief executives and owners.

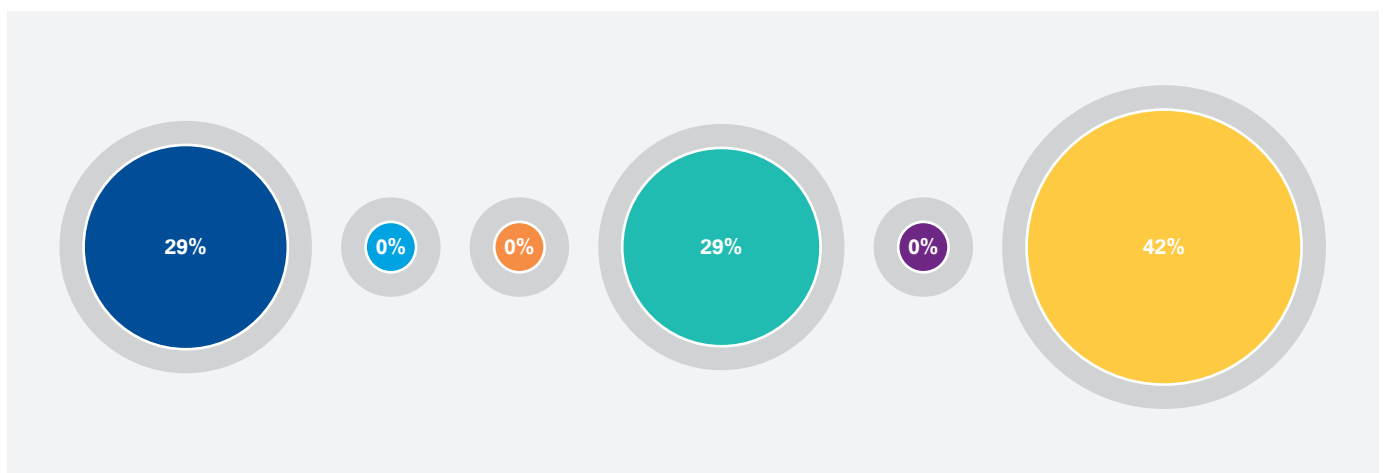
In the case of financial investors, by far the most important success metrics are achievement of pre-determined ROIs and IRRs, as indicated by two-thirds of respondents. Another success metric mentioned by financial investors is the absence of significant issues not divulged previously.

### Key metrics when measuring success

#### Financial investors



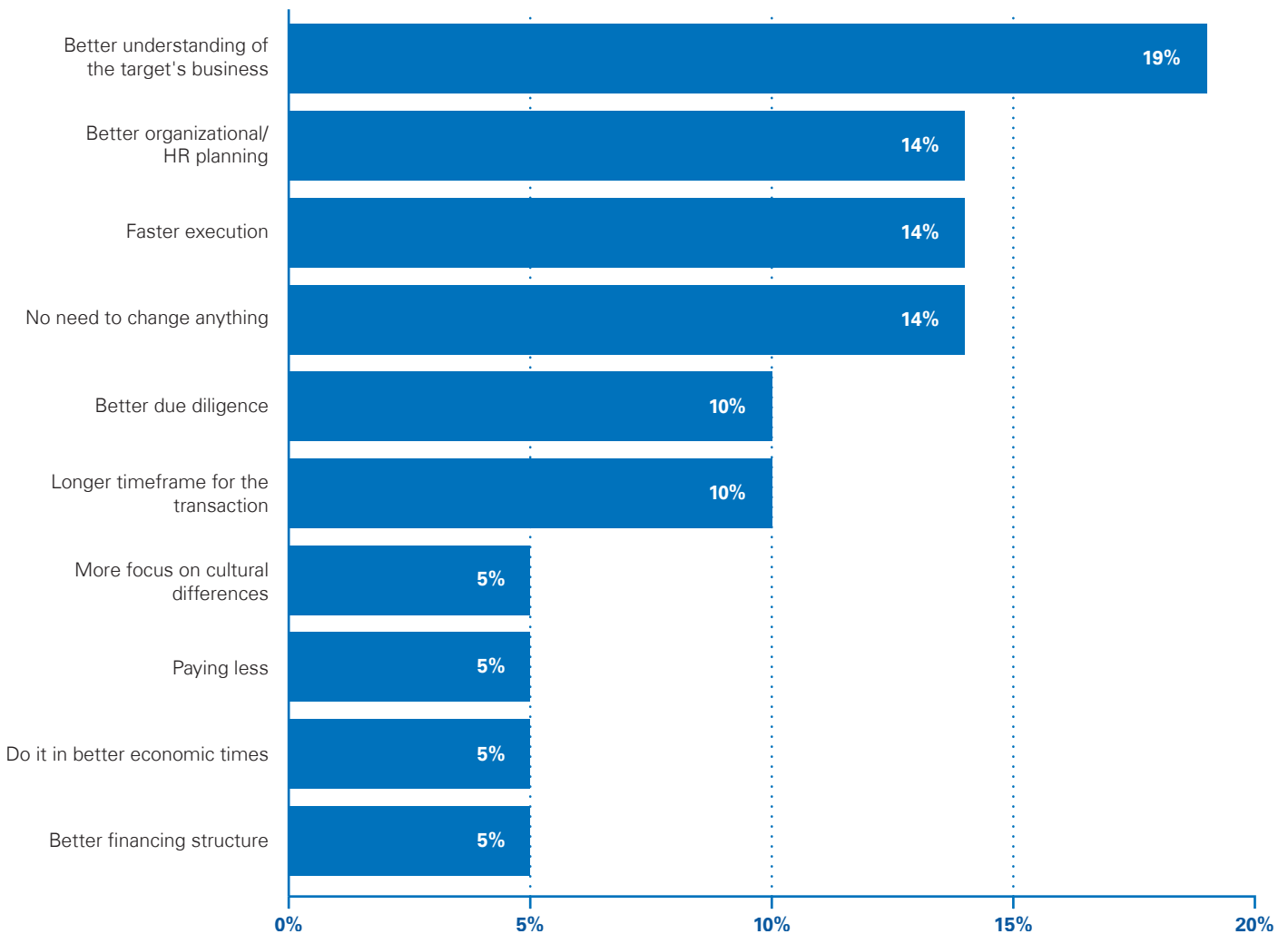
#### Strategic investors



- Whether a pre-determined ROI/ IRR is achieved
- No unexpected issues arising after the completion of the deal (issues that have not been identified during the due diligence process)
- Whether a pre-determined purchase price is achieved
- Satisfaction level of the buyer’s chief executives and owners
- The speed of closing the deal
- Whether specific operating KPIs (or synergy metrics) are achieved

## 9. What should be done differently?

### Investors' considerations regarding future transactions



A majority of respondents, 86%, suggest that they would do something differently when it comes to their next investment. Most investors (19%) would spend more time on understanding the business of the acquisition target. A similar proportion of investors (14%/14%) would undertake more thorough organizational/HR planning and execute the deal faster. Interestingly enough, only one investor mentioned that based on prior experience they would propose a lower offering price for their next transaction.

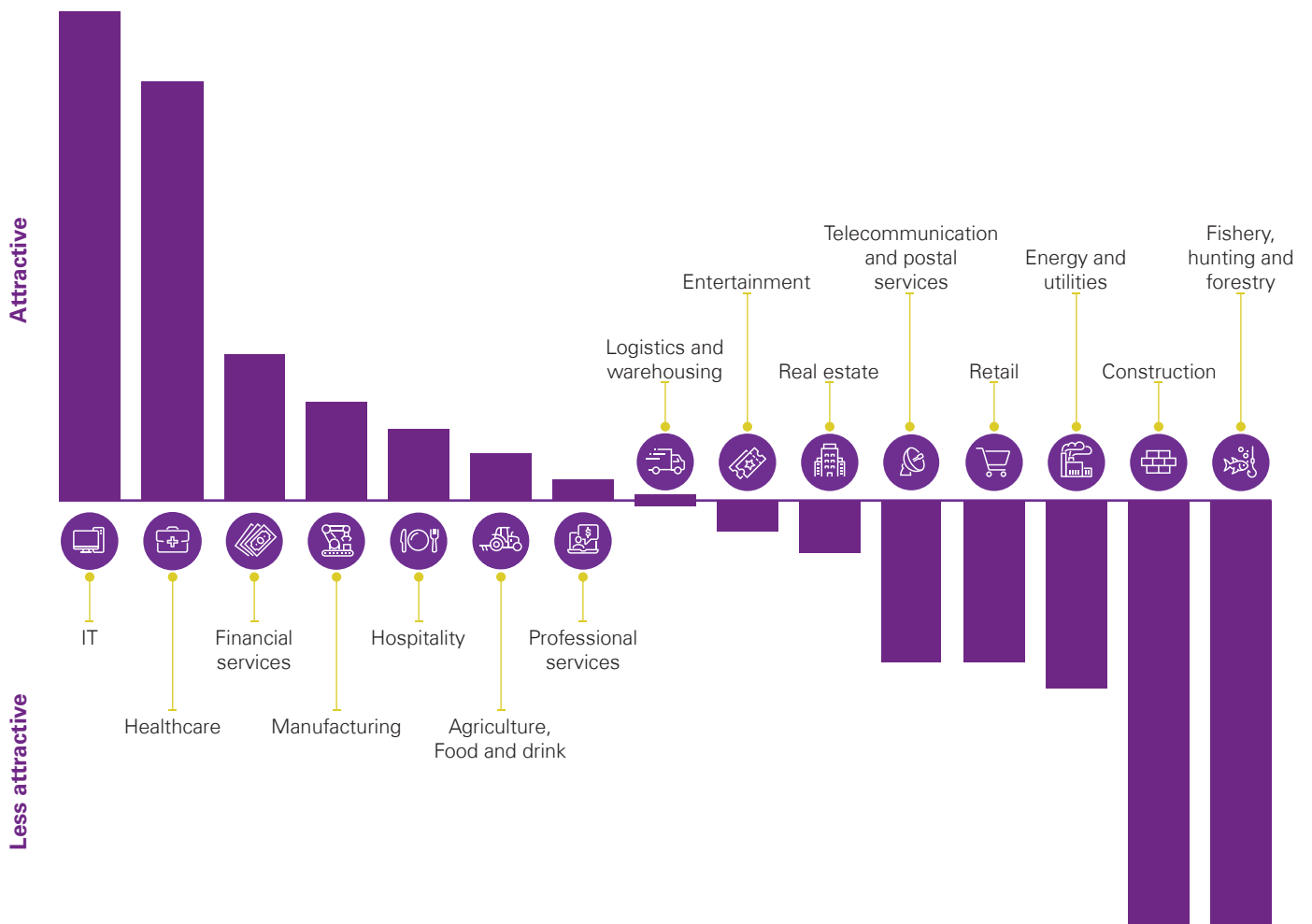
## 10. What are the most attractive industries when it comes to investing?



Investors mentioned IT and healthcare as the most attractive industries for investing in the next 12-18 months. On the other side of the coin, they bear serious reservations about investing in the construction sector or fishery, hunting and forestry, which ranked as the two least attractive industries.

As for the real estate sector, which has been breaking various records recently, it seems like investors do not expect any outstanding performance from it in the near future and its attractiveness is rated below average.

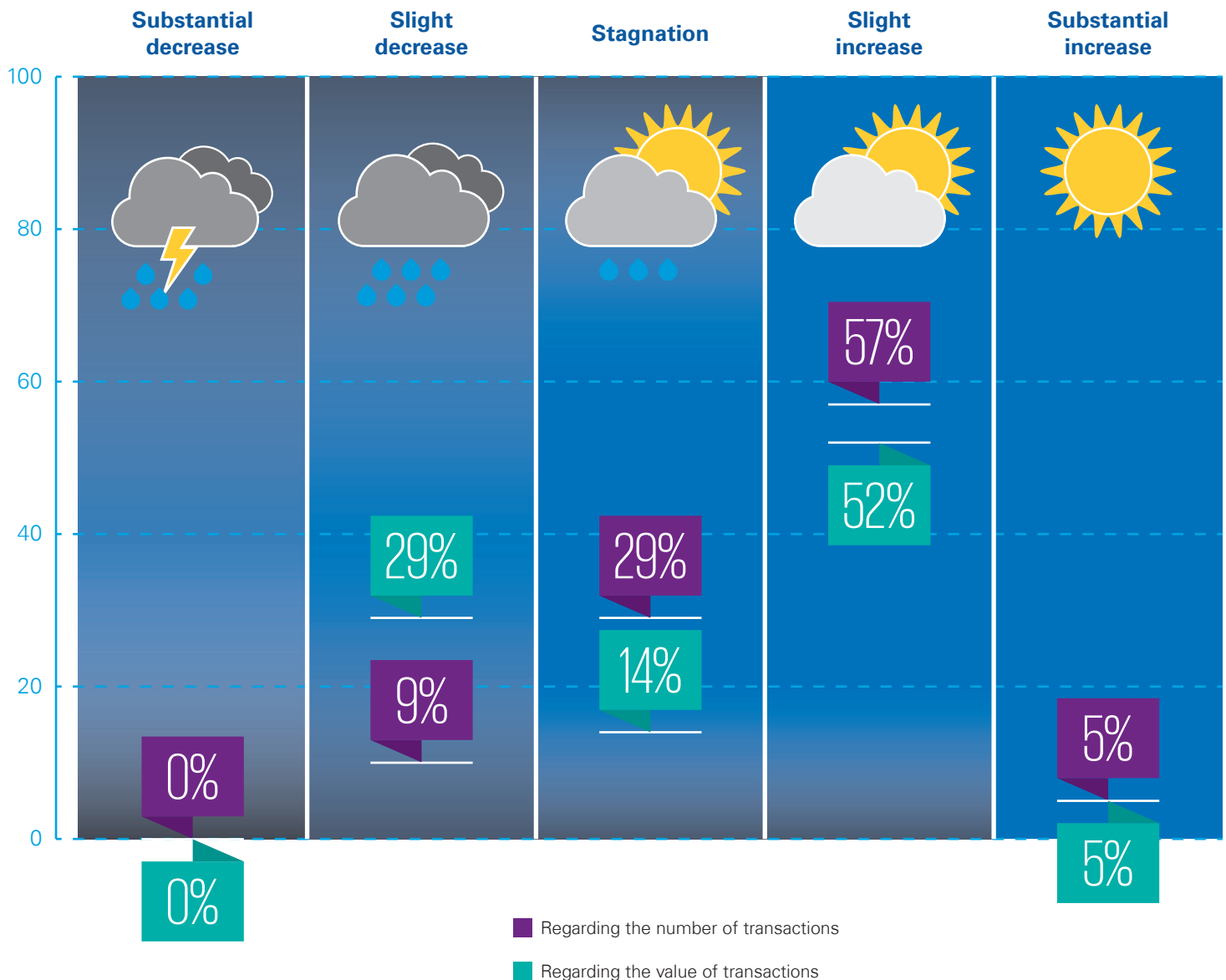
### Attractiveness of various industries in Hungary



## 11. What are expectations for the near future when it comes to transaction activity levels?

In general, investors have rather positive expectations regarding the forthcoming 12-18 months: none of the respondents foresees a significant drop either in the number or in the value of transactions, while the proportion of those who predict a growth, either slight or substantial in either the volume or value, is around 60% (62% and 57% respectively).

### Investors' expectations on transaction market in the forthcoming 12-18 months





# Conclusions



A majority of strategic investors (88%) chose diversification as the most typical driver when making investment decisions, while the most common response among financial investors (86%) was gains on future resale.



When it comes to introductions made between potential vendors and potential buyers, the vendor side is more active: in 56% of cases it is the vendor (or its advisor) who gets in touch with the potential investor.



The most frequently-sought external professional support is legal due diligence, closely followed by financial due diligence, SPA assistance and tax due diligence. Nearly two-thirds (62%) of respondents prefer that as many of the external professional services related to the transaction process as possible are performed by one advisory firm. According to investors, the most appreciated characteristics of external advisors are industry and service experience, and a pragmatic approach.



Regarding the length of the transaction process – starting with the first contact between the vendor and the investor and ending with the signing of the sale-purchase agreement – respondents report seeing examples for 1-month long acquisitions, but also for 18-month ones. Based on investors' experiences, a vendor-side due diligence report is prepared in about one-fifth of cases (22%), in more than half of the cases (57%) the vendor negotiates with only one potential investor, and the so-called "locked box" mechanism is used in barely 30% of transactions in Hungary.



Sixty-eight percent of respondents judge it favorably if the vendor engages one of the top advisory companies to perform financial or tax due diligence.



The concurrent opinion of strategic and financial investors is that growth potential is the most important factor which determines the purchase price, closely followed by the attainability of target ROI/IRR.



Based on investors' experience, the most typical reason for the failure of transactions are vendors' high price expectations. This is closely followed by the uncovering of significant issues during the due diligence and lack of preparedness of the target company for a transaction.



A majority of respondents, 86%, express that they would do something differently than they had earlier when it comes to their next investment. Most investors (19%) would spend more time on understanding the business operations of an acquisition target.



The real estate sector, which has currently been enjoying special attention, is not expected to perform outstandingly in future and its attractiveness is rated below average by investors. At the same time, IT and healthcare seem much more attractive compared to the average.



The majority of investors predict growth in the market, both in terms of the volume and value of transactions.

# KPMG in Hungary

**30** years in the country

Out of the TOP100\* domestic companies

**72** are KPMG clients

**2050** active clients in total

## **Snapshot of 2018**

**EUR 72 million** revenues

**EUR 34.65 million** export revenues

**EUR 21.3 million** central budget payment

**1200+** staff

**2** software robots

**64** hours of training  
(per person per year  
on average)

## **Services**

Audit

Tax & Legal

Advisory

Global Services

\*Based on revenue



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