

Baltics are fertile ground for private equity

Growing economies attract investment; inflation a concern?

By JASON CORCORAN

The Baltic countries of Lithuania, Latvia and Estonia are revving up their economies—and emerging as new hunting grounds for private-equity firms looking to make deals.

All three former Soviet republics joined the European Union in 2004 and have experienced a consumption boom that has driven a surge in economic growth. Estonia and Latvia were the two fastest-growing economies in the EU last year—Estonia's gross domestic product grew 11.4%, while Latvia's economy surged 11.9%.

But that strong growth has fueled inflation and driven current-account deficits to record highs. The environment demands caution from private equity and fund managers as they go about choosing their deals.

"The most likely scenario is a soft landing, although we are concerned about Latvia and the risk of psychological contagion in the other markets," says Marcus Svedberg, chief economist at Nordic fund manager East Capital.

The poster child for the private-equity push is Skype, the Internet phone-call phenomenon. Draper Fisher, a venture-capital firm, made a 100-fold return on its investment in Skype when it was sold to online auctioneer eBay Inc. for \$2.6 billion in 2005. Skype allows users to make unlimited free calls over the Internet to anywhere in the world. The company, which has its main office in the Estonian capital of Tallinn, was founded by a pair of Swedes, but the software was developed by Estonians.

Now Blackstone Group, one of the world's largest private-equity

funds, has been chosen as a strategic partner for the \$575 million management buyout of Latvian information-technology and telecommunications company SIA Lattelecom Group. Blackstone is to invest \$178 million for a 51% stake in Lattelecom, which is majority-owned by the government.

While Blackstone has no plans to set up shop in Latvia or set aside regional allocation, the group said it would look at individual deals in the area on merit.

"This is our first foray into the Baltics. The deal's been approved by the legislature, but it's not closed yet because we need regulatory approval," a Blackstone spokesman said. "All our funds are global. We have no specific sector allocation or a regional one, and we will invest in the region again if we think we can add value."

Lots of other big private-equity players are also testing the waters. Carlyle Group is scouting for opportunities in the Baltics and throughout Central and Eastern Europe from its new office in Warsaw. AIG Global Investments is trawling the same ground for its €523 million (\$738 million) New Europe fund.

But the region remains the preserve of small domestic funds and midmarket regional players such as Advent International, Argus Capital, Enterprise Investors and Mid Europa Partners, which have established relationships with local financial institutions for sourcing and executing deals as well as for co-investment opportunities.

Craig Butcher, a founding partner at Mid Europa, said: "You have to be opportunistic because these are smaller markets than we prefer. Lithuania has four million people, Latvia 2.3 million and Estonia 1.3 million."

Mid Europa has made two investments: Latvia and Lithuania mobile operator UAB Bité Lietuva, in February, and Baltic Rail Services in

2002, sold this year for a profit of €38 million. The €450 million acquisition of Bité ranked as the largest buyout in the Baltics and among the largest in central Europe.

The firm has raised more than €1 billion for buyouts in central Europe, a record for the region.

Mr. Butcher says the pipeline for investments of between €50 million and €200 million in equity remains strong. He said: "We have a large pipeline of deals in various things in the Baltics, which may or may not come to something. We are looking at consumer lending, transportation and infrastructure, retail, telecoms and broadcasting."

Private-equity firm BaltCap, which has offices in all three countries, is raising a €100 million fund, having made three investments from a €50 million fund raised in 2001.

"The Blackstone deal is significant because these funds have been overlooking us," said BaltCap managing partner Peeter Saks. "Each

country is tiny on its own but together we are the size of Sweden, and the three states are homogeneous, especially for certain sectors such as telecoms and mobiles."

BaltCap looks for investments of between €5 million and €15 million. In June, the firm sold its minority position in mobile virtual-network operator Zetcom to the telecom unit of Latvijas Energoceltnieks, for an undisclosed amount. It also recently exited a position in Baltic



office-supplies company **UAB Daily Service** for a 35% return.

While secondary placements are the favored option for exits, Mr. Saks said liquidity on the regional OMX exchange was also attractive for initial public offerings.

Alta Capital, an Estonian firm, is expanding with investments in food and fashion. It controls a growing range of fashion and lingerie brand names in the Baltics and has acquired a Latvian construction company and biofuel developer.

The firm, which has offices in the Baltic capitals of Riga, Tallinn and Vilnius, was set up in 2001 by former investment bankers. Alta founder Indrek Rahumaa said the fund had no specific investment horizon, which allowed his team to manage investments with a long-term view to operational development.

Mr. Rahumaa said Alta was building a portfolio of regional companies capable of operating in the three states and the Polish market.

"We believe transforming local players into regional companies decreases the operational, sales and marketing pressures that smaller companies are facing due to the increased proportion of chain retailers and their bargaining power," he said.

Alta has also moved into real estate and energy and owns **Alta Real Estate Partners** and **Latvijas Enerģoceltņieks**, which is involved in energy and telecommunication infrastructure projects.

Booming Baltics

Top 10 private equity deals in Lithuania, Latvia and Estonia*

Target (Nationality)	Acquirer	Deal value, in millions
UAB Bite Lietuva (Lithuania)	MEP	€583.47
SIA Lattelecom (Latvia)	Blackstone Group	582.56
UAB Palink (Lithuania)	Citigroup Venture Capital	53.00
UAB Eniro Lietuva (Lithuania)	Interinfo Baltic	10.77
Starman (Estonia)	Emerging Europe Capital Inv	9.33
AS Delfi (Estonia)	Findexa AS	7.54
AS Connecto (Estonia)	Eltel Networks Oy	5.08
CV-Online (Estonia)	New Economy Ventures	0.38
UAB MicroLink Lietuva (Lithuania)	AS Martinson Trigon	0.25
UAB Baltijos Kompiuteriu (Lithuania)	AS Martinson Trigon	0.04

*As of Oct. 10

Source: Thomson Financial