



## Czech Republic

### Background

For the Czech Republic, 2006 was a quiet year, with no radical activity in the private equity market. Thus, the country has yet to reach the level of western European countries. Despite an increased number of successful deals (11 investments in 8 companies, five divestments from four companies) the total amount of investments (€12.4 million) decreased when compared to 2005 (€21.4 million). On a more positive note, a number of foreign funds have announced their interest in the Central and Eastern Europe region.

Buyout transactions continued to dominate investment activity representing €11.1 million, or 89.7% of all investments. The divestments were either exits by trade sales with €3.4 million, or secondary management buyouts with €2.4 million. After a significant increase of the funds raised, amounting to €162.5 million in 2005, in 2006 activity declined to €3.4 million, which is close to the amount raised in 2004.

As in previous years, the private equity sector was deeply involved with later-stage projects. Early-stage projects continued to be supported by the government agency CzechInvest, the state investment and business development agency, also offering support through the relationship with the EU structural funds.

### Sources of capital

In 2006, the total amount of funds raised amounted to €3.4 million. This was a substantial decline compared to 2005 when funds raised totaled €162.5 million. Realised capital gains represented the main source of funds with 59.6% of the total funds raised in 2006 (34.4% in 2005). Since 2002, the market has shown significant fluctuations with €4.8 million raised in 2004, €93.8 million in 2003 and €48.6 million in 2002.

Fund of funds were the sole source of fundraising in 2006 compared to funds being raised predominantly from corporate investors in 2005.

The majority of funds raised are expected to be allocated to non high-tech companies in the expansion/development stage and to buyouts.

The share of domestic sources reached 59.6%, funds raised from other European countries 23.9% and non-European countries 16.5% in 2006. In comparison, fundraising came solely from other European countries in 2005 and merely from domestic sources in 2004.

## Investment patterns

The structure of initial versus follow-on investment shows a uniform distribution of invested amount and number of investments/companies in 2006. The total amount invested was €12.4 million representing a 42.2% decrease compared to 2005. However the number of investments (11) and companies (8) remained at the same level as in 2005.

The proportion of the initial investment amount (61.9%) versus follow-on investment (38.1%) has shifted by approximately 20% in favour of follow-on investment when compared to 2005 figures.

Buyout capital amounted to €11.1 million, 89.7% of the total in 2006. The amount invested in replacement capital was down by €5.3 million from 2005 with marginal share of 1.7% in 2006. Share of expansion and start-up capital amounted to 6.3% and 2.3% respectively in 2006. There were no seed investments in 2006.

No syndicated investments were done in 2006 compared to one transnationally syndicated investment of €15.0 million in 2005, representing 70.0% of total amounts invested in that year.

In 2006 all investments were domestic, which is similar to figures of 2005 (96.8% domestic and 3.2% non-European investments).

Investments in 2006 were lead by the communications sector representing 68.0% of the total (€8.4 million) with the remaining 32.0% in other sectors (€4.0 million). By comparison, other services and financial services were in the spotlight in 2005, while in 2006 there was no activity in these sectors.

## Legal and fiscal environment

### Regulatory issues / Legislative environment

Activities of entities engaged in the private equity business in the Czech Republic are not regulated by any specific law and thus, investments of private equity houses in the Czech Republic are structured on the same legislative grounds as in the corporate sector.

Nevertheless, according to the recently enacted amendment to the Act on Collective Investment (ACI) it is possible to establish "special funds of qualified investors" ("FQIs"). FQIs are intended only for a limited number of investors (up to 100) and are subject to few reporting and regulatory limitations. The main benefit of an FQI is the reduction of the overall tax cost (the nominal corporate income tax rate decreased to 5 per cent).

Special funds of qualified investors may be structured and used as venture capital funds. Such funds can be established either as investment funds (in the form of a joint-stock company), which raises funds by subscription of shares and re-investment of such funds in a given property, or as mutual funds (either close-ended or open-ended) without a separate legal standing. These are established by a management company (or by a management company with an EU passport, if contractually agreed) that manages the fund's property. No limitations are placed on gearing, liquidity and the scope of investment. However, due to other obstacles (e.g. unclear stipulation of minimum number of investors, restrictions on in-kind contributions), only a very limited number of investors are currently in the process of establishing an FQI.

Pension funds remain very restricted in their ability to carry out venture capital investments.

### ■ *Capital gains and losses*

There is no special capital gains tax in the Czech Republic and thus, capital gains generated by Czech companies are generally amalgamated with other taxable profits and taxed at a general corporate income tax rate of 24 per cent.

Generally, investments through an FQI may provide attractive tax savings and an alternative for international tax structures.

### ■ *Tax transparency*

Czech companies (with the exception of partnerships) and funds are generally not transparent for corporate income tax purposes, i.e. capital gains derived by each company/fund are subject to tax at the level of the company/fund.

## Legal structures of private equity management companies

The majority of private equity houses that manage investments in the Czech Republic are foreign-based and the Czech target companies are usually acquired and managed through acquisition structures involving multiple legal entities in various jurisdictions.

## Recent changes in regulation

The Czech tax law has been moderately changed recently in only a few technical areas.

It should be noted, however, that at the time of publication this overview, the Czech government intends to radically change the tax system of the country. The amendment, if passed, would for example extend the regime of thin capitalisation rules to non-related parties, restrict tax relief on interest cost and gradually reduce the headline rate of corporate tax with effect from 1 January 2008.

However, as a result of the current political climate in the Czech Republic, it is questionable whether this amendment would be approved as proposed. A vote is expected on the amendment during the course of 2007 when the scope of the proposed changes to tax legislation will become clearer.

#### Other regulatory factors inhibiting or promoting growth in the private equity market

Stock options may be an effective remuneration tool for the management of venture capital investments. However, the Czech tax legislation does not encourage this remuneration tool, as the costs of stock options are generally not tax-deductible.

The current wording of the Act on Investment Companies and Investment Funds does not encourage the market to establish venture capital funds. As noted above, the new ACI may eliminate the disadvantages in this respect.

#### Government sponsored initiatives/incentives

- *Tax incentives and stock options*

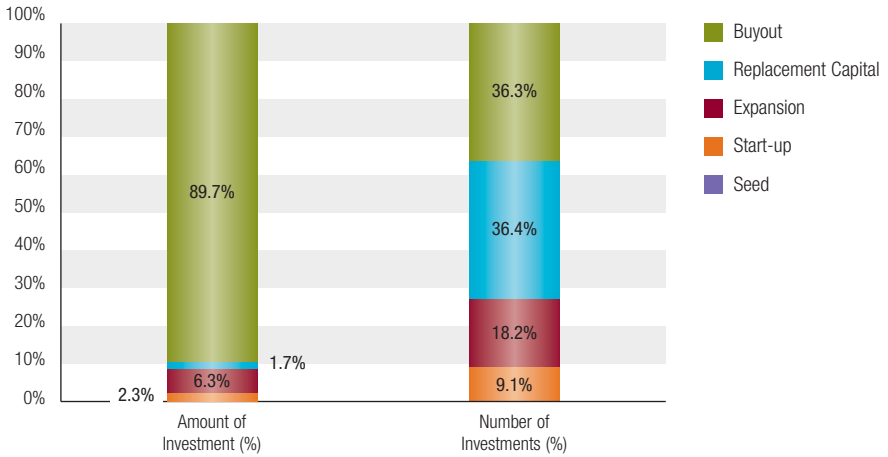
The government does not specifically support the private equity industry. However, general investment incentives are available for investments overall, or Greenfield/Brownfield projects for investments above a minimum size. It is questionable whether and in which form the current investment incentives will be available to investors after the intended tax reform.

## Exiting

The amount divested reached €5.8 million, which was down by 80.3% compared to 2005.

There were five divestments from four companies. Trade sales to strategic investors are the most popular exit strategy making up 58.9% by value at €3.4 million and 40.0% by number of investments in 2006, compared to 78.1% by value at €22.8 million and 80.0% by number of investments in 2005. Sale to management represented the remaining 41.1% of divestments by value at €2.4 million and 60.0% by number in 2006.

Stage distribution of investments in 2006



## Funds raised

Amount (in € x 1,000)	2005		2006	
	Amount	%	Amount	%
<b>Private Equity Raised by Source</b>				
Independent Funds Raised in Year	105,627	65.0	0	0.0
Amount Raised by Captives	882	0.6	1,358	40.4
<b>Subtotal New Funds Raised</b>	<b>106,509</b>	<b>65.6</b>	<b>1,358</b>	<b>40.4</b>
Realised Capital Gains	55,953	34.4	2,000	59.6
<b>Total Funds Raised</b>	<b>162,462</b>	<b>100.0</b>	<b>3,358</b>	<b>100.0</b>
<b>Private Equity Raised by Type of Investor</b>				
Corporate Investors	100,000	93.9	0	0.0
Private Individuals	0	0.0	0	0.0
Government Agencies	0	0.0	0	0.0
Banks	0	0.0	0	0.0
Pension Funds	0	0.0	0	0.0
Insurance Companies	0	0.0	0	0.0
Fund of Funds	0	0.0	1,358	100.0
Academic Institutions	0	0.0	0	0.0
Capital Markets	0	0.0	0	0.0
Not Available	6,509	6.1	0	0.0
<b>Subtotal New Funds Raised</b>	<b>106,509</b>	<b>100.0</b>	<b>1,358</b>	<b>100.0</b>
Realised Capital Gains	55,953	-	2,000	-
<b>Total Funds Raised</b>	<b>162,462</b>	<b>-</b>	<b>3,358</b>	<b>-</b>
<b>Geographical Breakdown of Private Equity Raised</b>				
Domestic	0	0.0	2,000	59.6
Other European Countries	162,462	100.0	804	23.9
Non-European Countries	0	0.0	554	16.5
<b>Total Funds Raised</b>	<b>162,462</b>	<b>100.0</b>	<b>3,358</b>	<b>100.0</b>
<b>Expected Allocation of Funds Raised</b>				
High-Tech Early-Stage	0	0.0	0	0.0
Non High-Tech Early-Stage	0	0.0	0	0.0
High-Tech Expansion/Development	32,492	20.0	0	0.0
Non High-Tech Expansion/Development	64,985	40.0	1,679	50.0
<b>Venture Capital</b>	<b>97,477</b>	<b>60.0</b>	<b>1,679</b>	<b>50.0</b>
Buyout	64,985	40.0	1,679	50.0
Not Available	0	0.0	0	0.0
<b>Total Funds Raised</b>	<b>162,462</b>	<b>100.0</b>	<b>3,358</b>	<b>100.0</b>

## Investments

Amount (in € x 1,000)	2005				2006			
	Amount of Investments	%	Number of Investments	%	Amount of Investments	%	Number of Investments	%
Initial Investment	17,469	81.6	3	30.0	3	37.5	6	54.5
Follow-on Investment	3,950	18.4	7	70.0	5	62.5	5	45.5
<b>Total Investment in Year</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>100.0</b>	<b>8</b>	<b>100.0</b>	<b>11</b>	<b>100.0</b>
<b>Distribution of Investments by Investor Type</b>								
Independent	20,537	95.9	7	70.0	6	75.0	11	100.0
Captive	163	0.8	1	10.0	1	12.5	0	0.0
Semi-Captive	719	3.3	2	20.0	1	12.5	0	0.0
Public Sector	0	0.0	0	0.0	0	0.0	0	0.0
<b>Total Investment</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>100.0</b>	<b>8</b>	<b>100.0</b>	<b>11</b>	<b>100.0</b>
<b>Stage Distribution of Investments in Year</b>								
Seed	0	0.0	0	0.0	0	0.0	0	0.0
Start-up	0	0.0	0	0.0	0	0.0	1	9.1
Expansion	941	4.4	4	40.0	3	37.5	2	18.2
Replacement Capital	5,478	25.6	5	50.0	4	50.0	4	36.4
Buyout	15,000	70.0	1	10.0	1	12.5	4	36.3
Small	15,000		1		1		4	
Mid-market	0		0		0		0	
Large	0		0		0		0	
Mega	0		0		0		0	
<b>Total Investment</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>100.0</b>	<b>8</b>	<b>100.0</b>	<b>11</b>	<b>100.0</b>
<b>Syndication of Investments in Year</b>								
No Syndication	6,419	30.0	9	90.0	7	87.5	11	100.0
National Syndication	0	0.0	0	0.0	0	0.0	0	0.0
Transnational Syndication	15,000	70.0	1	10.0	1	12.5	0	0.0
<b>Total Investment</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>100.0</b>	<b>8</b>	<b>100.0</b>	<b>11</b>	<b>100.0</b>

Amount (in € x 1,000)	2005			2006		
	Amount of Investments	%	Number of Investments	Amount of Investments	%	Number of Investments
<b>Geographical Distribution of Investments in Year</b>						
Domestic	20,723	96.8	8	12,376	100.0	11
Other European Countries	0	0.0	0	0	0.0	0
Non-European Countries	696	3.2	2	0	0.0	0
<b>Total Investment</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>12,376</b>	<b>100.0</b>	<b>11</b>
<b>Sectoral Distribution of Investments in Year</b>						
Communications	4,112	19.2	6	8,417	68.0	2
Computer Related	0	0.0	0	0	0.0	0
Other Electronics Related	0	0.0	0	0	0.0	0
Biotechnology	0	0.0	0	0	0.0	0
Medical/Health Related	0	0.0	0	0	0.0	0
Energy	0	0.0	0	0	0.0	0
Consumer Related	174	0.8	2	0	0.0	0
Industrial Products and Services	0	0.0	0	0	0.0	0
Chemicals and Materials	0	0.0	0	0	0.0	0
Industrial Automation	0	0.0	0	0	0.0	0
Other Manufacturing	0	0.0	0	0	0.0	0
Transportation	0	0.0	0	0	0.0	0
Financial Services	2,133	10.0	1	0	0.0	0
Other Services	15,000	70.0	1	0	0.0	0
Agriculture	0	0.0	0	0	0.0	0
Construction	0	0.0	0	0	0.0	0
Other	0	0.0	0	3,959	32.0	9
<b>Total Investment</b>	<b>21,419</b>	<b>100.0</b>	<b>10</b>	<b>12,376</b>	<b>100.0</b>	<b>11</b>
<b>Subtotal High-Tech</b>	<b>4,112</b>	<b>19.2</b>	<b>6</b>	<b>8,417</b>	<b>68.0</b>	<b>2</b>

## Divestments

Amount (in € x 1,000)	2005						2006					
	Amount of Divestments	%	Number of Divestments	%	Number of Companies	%	Amount of Divestments	%	Number of Divestments	%	Number of Companies	
Divestment by Trade Sale	22,771	78.1	8	80.0	5	71.4	3,394	58.9	2	40.0	2	50.0
Divestment by Public Offering	6,401	21.9	1	10.0	1	14.3	0	0.0	0	0.0	0	0.0
Divestment by Flotation (IPO)	6,401		1		1		0	0.0	0	0.0	0	0.0
Sale of Quoted Equity	0		0		0		0	0.0	0	0.0	0	0.0
Divestment by Write-Off	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Repayment of Principal Loans	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Sale to Another												
Private Equity House	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Sale to Financial Institution	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Sale to Management (Buy-back)	0	0.0	0	0.0	0	0.0	2,367	41.1	3	60.0	2	50.0
Divestment by Other Means	0	0.0	1	10.0	1	14.3	0	0.0	0	0.0	0	0.0
<b>Total Divestment in Year</b>	<b>29,172</b>	<b>100.0</b>	<b>10</b>	<b>100.0</b>	<b>7</b>	<b>100.0</b>	<b>5,761</b>	<b>100.0</b>	<b>5</b>	<b>100.0</b>	<b>4</b>	<b>100.0</b>

## Portfolio at cost

Amount (in € x 1,000)	2005			2006		
	Amount	Number of Investments/ Divestments	Number of Companies	Amount	Number of Investments/ Divestments	Number of Companies
Portfolio at Cost 1st Jan	301,795			294,042		
Total Investment in Year	21,419	10	8	12,376	11	8
Total Divestment in Year	(29,172)	10	7	(5,761)	5	4
<b>Portfolio at Cost 31st Dec</b>	<b>294,042</b>			<b>300,657</b>		

## Geographical flows of private equity

Amount (in € x 1,000)	2005	2006
<b>Funds</b>		
Funds raised by Local Private Equity Houses (1)	162,462	3,358
<b>Investment</b>		
Investment by Local Private Equity Houses (2)	21,419	12,376
(-) Foreign Investment by Local Private Equity Houses	(696)	(0)
Local Investment by Foreign Private Equity Houses (3)	70,704	497,078
<b>Total Investment in Country</b>	<b>91,427</b>	<b>509,454</b>

## Notes:

- (1) Also includes funds raised by local offices of foreign groups that have a distinct local fundraising activity.  
 (2) Also includes domestic investments made by local offices of foreign groups.  
 (3) Investments made by foreign private equity (PE) houses with no local offices.

## Macro economic indicators

	2005	2006
Number of Private Equity Executives	39	35
Private Equity Investment as % of GDP	0.022%	0.011%
GDP (€ billion)*	97.5	112.3
Private Consumption (€ billion)*	47.9	55.3
Public Consumption (€ billion)*	21.9	24.2
Consumer Prices (1995=100)*	154.9	158.9
Producer Prices (2000=100)*	110.9	101.5
Interest Rates (3-month)**	2.15%	2.49%
Interest Rates (10-year)**	3.51%	3.78%
Retail Sales (PRV YR=100)*	103.2	106.7
Unemployment Rate*	8.9%	7.7%
Total value of completed M&A (€ million)	9,056	1,387
Number of completed M&A	72	96
Total value of IPOs (€ million)	-	216.1
Number of IPOs	-	2

Source: Thomson Financial

\* National Source

\*\* European Banking Federation & Financial Market Association

\*\*\* European Central Bank & EUROSTAT

## Note:

Number and amount of M&A deals are split per country based on the location of the target

Number and amount of IPOs are split per country based on the location of the issuer