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The Business & Law Readers Digest

Mergers and Acquisitions

Banking and Finance // Beverages Industry // Corporate // Corporate Dispute Resolution // Due Diligence // Employment // Financial Services // Insurance // Investments // Kyoto Protocol Implementation // Logistics // **Mergers and Acquisitions** // Natural Resources // Oil and Gas // Representative Office // Land // Ukraine and the WTO // Ukraine and Russia // Tourism

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Introduction

The Ukrainian economy can still be classified as an emerging one, which understandably makes it interesting for potential investors. The country's gross domestic product is growing considerably faster than those of most developed economies; therefore, investors are looking at the nation's market with increasing interest.

Ukraine has a big industrial base which it inherited from the Soviet era, and vast agricultural terrain which is also very attractive to foreign investors. During the last few years investors from different parts of the world have begun investing in quite new (for foreign capital in Ukraine) branches of the economy, such as cable television and airports.

Therefore, the mergers and acquisitions market of late has shown higher growth indicators on an annual basis.

Ukrainian regulations for mergers and acquisitions are quite liberal in comparison with European countries or the United States of America. There is no sophisticated regulation for takeovers; there is also no tradition of non-binding norms or codes of practice which serve as guidelines (almost imperative in some branches).

Overview of the M&A market

In 2007 the volume of the mergers and acquisitions market in Ukraine rose to USD 15.6 billion (ISI Emerging Markets report). That is almost three times more than in the previous year. The biggest transactions were concluded in the financial sector, extractive industries, real estate, and the food industry, which proved to be one of the fastest growing markets.

The biggest deal of 2007 was the merger of two metallurgical giants: the Russian-owned Smart Group and Metinvest, owned by the biggest Ukrainian business conglomerate, System Capital Management. As a result, Smart Group transferred its assets to Metinvest while obtaining 25% + 1 share of the latter. The total amount of the deal was USD 4.5 billion (www.news.finance.ua) This is a fairly rare example of a merger in the Ukrainian market, as traditionally almost all M&A transactions in Ukraine are acquisitions.

Other important transactions included the acquisition of Privat Group's metallurgical assets by the Russian Evraz

Group for USD 3.3 billion and the sale of Ukrsotsbank, which is described below.

Last year the record for the cost of a banking deal in Ukraine was broken. One of the largest Ukrainian banks, Ukrsotsbank, was sold to the Italian financial group UniCredit Bank, for USD 2.2 billion - the biggest deal in Ukrainian banking history. This transaction confirmed the long-standing trend of European banking groups coming to Ukraine with the intention of acquiring a bigger share of the national market.

The food industry was one of the most frequently invested in, with Pepsi arriving in Ukraine to purchase one of the biggest non-alcoholic beverage producers, Sandora. The FMCG (fast moving consumer goods) sector is also expected to remain popular among investors due to the good growth indicators shown by Ukrainian companies and the general expansion of the internal consumer goods market.

Russia, Poland, the Netherlands and the United Kingdom have been the biggest investors in Ukraine, with Cyprus and the British Virgin Islands being two jurisdictions where many direct investing companies are based. This is due to Cyprus and the British Virgin Islands still being attractive locations for holding companies.

Recently Ukrainian companies have become more active in their own mergers and acquisitions market. They are now able to participate in much bigger transactions, which make them genuine competitors for foreign investors.

As was the case in previous years, in 2007 we witnessed big bank acquisitions by foreign investors. These investors include European giants such as UniCredit Bank, Commerzbank and Soci?t? Generale Group. There has also been a greater tendency towards purchasing medium-sized or smaller banks, as most bank leaders had already been sold or were not up for sale. Small foreign banks have also been active in the Ukrainian market. Thus, the Cypriot Marfin Popular Bank has acquired the Maritime Transport Bank and the Bank of Georgia has purchased the Universal Bank of Development and Partnership.

Media became a very attractive asset for acquisition in 2007. There were numerous transactions, with the biggest media group in Ukraine - "Inter" - purchasing another television company. Now this group, allegedly owned by media mogul Valeriy Khoroshkovskyy, controls seven TV channels with a wide array of so-called 'niche channels' to cater for a more specific demographic of viewers.

Foreign private equity investors have now also become more active in Ukraine. The American fund Providence Equity Partners has acquired the biggest cable TV and Internet provider in Ukraine for USD 200 million. In 2008 an intensification of American and European private equity funds is expected, as Ukraine continues to be one of the fastest-growing emerging markets.

Trends in 2008

One of the most likely developments during 2008 is the beginning of mergers between the biggest industrial groups. This will certainly include trans-national deals involving the Russian business giants. 2007 was devoted to active negotiations which will now be concluded by final deals. However, it is probable that most industrial groups have not yet made their final decision on these issues.

Due to many rich Ukrainian businessmen choosing to focus their activities on several primary industries, Ukraine may witness a big sale of assets, while companies which are not considered vital for future business may be put on the market.

One of the newest trends, which shall become one of the most dominant, is investment in construction and developing. Numerous business centres, shopping malls and land plots have been purchased by Ukrainian and foreign investors, with residential real estate remaining a very attractive target, too.

As the European football championship in 2012 approaches, more investors will arrive in Ukraine to construct roads, airports, hotels, car parks, and other infrastructure facilities. Therefore, being the first in the market is crucial as Ukrainian and Russian investors are already aggressively trying to consolidate their positions. In the years to come Ukraine will need huge investments into its infrastructure, and this investment will improve conditions for the acquisition of companies in these fields.

With concerns rising about the robustness of the credit market, deals have been harder to put together and in some cases even abandoned. Since the closing months of 2007 more cautious behaviour has been in evidence, as the results of losses due to sub-prime exposure make themselves felt and corporations and their financiers adopt new attitudes to risk-management when conducting deals.

Nevertheless, in 2008 the Ukrainian mergers and acquisitions market is expected to expand by at least 50 % ("Kontrakty" weekly). This will happen despite the biggest international companies' reluctance to proceed with big acquisitions, in view of a possible recession in the global economy. Russian investors will still be one of the biggest investors in the Ukrainian economy. But European companies are also expected to be active in Ukraine due to the country's accession to the World Trade Organisation and the active phase of preparation for the European football championship.

Traditional Ukrainian industries also look set to remain in the spotlight. Metallurgical giants - such as "Zaporizhstal" and the Mariupol Metallurgical

Combine - could be targets for acquisitions, taking into account both their weak situation and lack of own source of raw materials. The Industrial Union of Donbas is said to be looking for a partner to merge with due to leadership plans in the Eastern and Central Europe region.

Second- and third-tier banks will also remain targets for foreign investors looking to invest in the fast growing banking sector in Ukraine. With several banks still left for purchase, up to 15 deals may be made in 2008.

Ukrainian perspective of M&A regulation

One of the problematic peculiarities of the Ukrainian legal system is the lack of protection for minority shareholders, which of course helps if you are planning to acquire a company, but may harm you if you are a target.

Due to the general weakness of the stock market it does not strongly influence state regulations. Therefore, many companies are not public and therefore are not available for potential investors.

As a consequence of the lack of sophisticated corporate regulations it is much easier to acquire or to sell a company in Ukraine (for example, there are no compulsory buyout rules).

Last year we witnessed approval of new Recommendations of the High Business Court of Ukraine. These Recommendations cover corporate disputes and have proved to be highly controversial. According to them, shareholders agreements of Ukrainian companies shall be regulated by Ukrainian law only, even if not all of the shareholders are residents of Ukraine. This is due to the specific nature of corporate disputes which are deemed to be strongly connected with the jurisdiction of the company's incorporation. Therefore, businessmen planning a merger with a Ukrainian company should bear in mind that they will not be able to regulate corporate matters in the shareholders agreements governed by foreign law. However, we believe that it is still possible to regulate certain issues of pecuniary responsibility and sanctions against a party which breaches the agreement. Also, parties may enter into shareholders agreements governed by foreign law if they rely on their enforcement abroad, not in Ukraine.

Moreover, corporate disputes regarding Ukrainian companies shall fall within the exclusive competence of Ukrainian courts, and not of international arbitration courts. The view of the High Business Court judgments is that such arbitration courts shall not be enforced in Ukraine on the basis of a public order clause. We believe that this provision can be contested, as Ukrainian national legislation explicitly provides for parties being able to make corporate disputes subject to an international commercial arbitration court. Because of this fact, we believe that such disputes may indeed be directed to international arbitration courts and that there will be an opportunity to enforce the respective judgments in Ukraine.

We shall see this year whether these Recommendations will be strictly implemented and to what extent they will complicate the process of foreign investments in Ukraine.

In 2008, long-awaited amendments to corporate legislation will hopefully be passed by parliament; this will make the regulation of corporate relations clearer and will bring Ukrainian law in line with legislation in other European countries. However, we do not anticipate the introduction of any requirements that limit foreign investment, or procedures in mergers and acquisitions.

Our experience

Volkov and Partners has vast experience of mergers and acquisitions transactions. We have advised both sellers and purchasers, including acting as local counsellor in international deals.

We provide client service of the highest standard, and creative solutions to complex problems in public and private transactions alike. We are regularly ranked among the leading law firms in Ukraine in mergers and acquisitions.

Our experience includes advising the Bank of Georgia on the acquisition of the Ukrainian Bank of Development and Partnership, advising several Russian investors (including international corporations) on acquisitions and sales of their industrial assets in Ukraine, and advising small companies from both Ukraine and abroad on investing in assets, which were starting points for their business in Ukraine or business in a new field. We work in dedicated cross-functional client teams bringing a wide range of legal experience and industry knowledge to each deal. This integrated approach gives you access to complementary areas of law including Competition, Finance and Capital Markets, Tax, Employment and Litigation, and Dispute Resolution.

We work closely with your in-house team, keeping your commercial objectives at the forefront of our thinking, to minimise any impact on your day-to-day business.

Our company's attorneys participate at all stages of the transaction: our work covers due diligence, negotiations between the parties and drafting respective documents (framework or share purchase agreements, disclosure letters etc.), filing for all necessary state approvals, closing of the deal, and numerous post-completion issues.

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