

AEQUO 



RIISING TO THE CHALLENGE: M&A IN UKRAINE

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DEAL METHODOLOGY

Deals within regular Mergermarket criteria have a transaction value greater than or equal to US\$5 million, except for some minority stake acquisitions where a higher threshold applies. If the consideration is undisclosed, deals are included on the basis of a reported or estimated deal value greater than or equal to US\$5 million. If the deal value is not disclosed and cannot be confirmed to be greater than or equal to US\$5 million, the deal is included if the target's turnover/revenue is greater than or equal to US\$10 million. If neither the deal value nor the target revenue is disclosed, Mergermarket will use other indicators to determine inclusion, including but not limited to number of employees of the target company, assets under management exceeding US\$200 million for the asset management firms, and value of assets/deposits exceeding US\$50 million for banks.

To capture a wider scope of the Ukrainian M&A market, for this report some deals outside of the regular deal criteria have been included.

FOREWORD

In 2016, the Ukrainian M&A market has proven resilient and there is room for optimism in the year ahead despite a slow return to economic stability and continued political unrest.

From agriculture through financial services to technology, media and telecommunications (TMT), transactions in Ukraine have ranged across a variety of sectors. Year-on-year, value and volume both rose substantially as domestic and foreign dealmakers took cautious steps back into the Ukrainian market. Combined disclosed deal value for the year was substantially boosted by a major deal in the banking sector, as Italy's UniCredit exited the country, selling its local UkrSotsbank to Russian-owned, Luxembourg-based ABH Holding in exchange for a stake in ABH.

This deal is part of a wider reform of the financial sector. The weight of non-performing loans and central bank efforts to clear up the banking system are leading to greater consolidation. In December 2016, the government nationalised PrivatBank, the country's largest lender, in a move indicative of the challenges that the sector faces as banks move to recapitalise. However, this is likely to create opportunities for investors over the longer-term.

Although TMT saw a small dip in year-on-year volume and value, the outlook for the sector is hopeful as Ukraine has a range of lively start-ups and established players in outsourcing and software development, as well as a consolidating broadcasting industry.

Liberalisation of the natural gas market has reaped rewards in inbound investment; a lesson that successful reform can provide a significant fillip to dealmaking. In addition, foreign and domestic investors are eyeing long-awaited privatisations, including of electricity distribution companies, which are being encouraged by the International Monetary Fund (IMF) as part of Ukraine's landmark US\$17.5bn deal with the IMF.



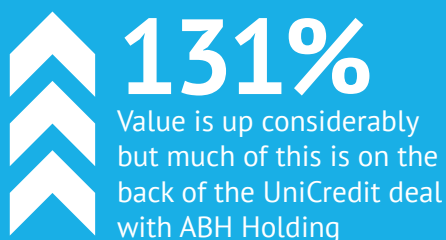
Judicial and legal reform is also in the pipeline and could significantly improve the business environment in the country, though the evolving regulatory framework makes forming local partnerships with experienced legal professionals on the ground ever more important.

However, challenges remain in the country – there are downside risks from the ongoing conflict in Donbas; political risk to the reform agenda; and external shocks from the eurozone, Russia, and US.

Despite, the increase in M&A and the undoubted opportunities that the country offers, Ukraine's economy and its M&A market are not in peak condition. Growth remains below historic levels, while inflation has eroded consumer spending power. However, there is a growing sense that the country is on the right track, with an ambitious reform programme that can help it capitalise on competitive advantages in location, costs, skilled workforce, and resources. Investor interest in the country is increasing, and it will be courageous and quick-thinking, first-movers that benefit.

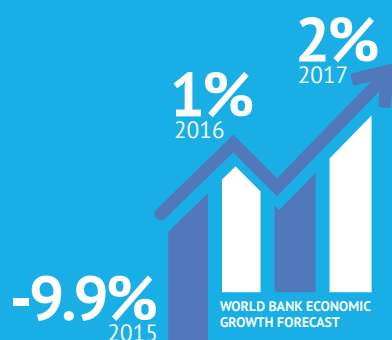
KEY TRENDS IN UKRAINIAN M&A

M&A OVERVIEW



OUTLOOK

Forecast optimistic for 2017



GDP growth to rise to 2% in 2017 (from 1% in 2016 and -9.9% in 2015), according to World Bank data

SECTOR WATCH

FINANCIAL SERVICES



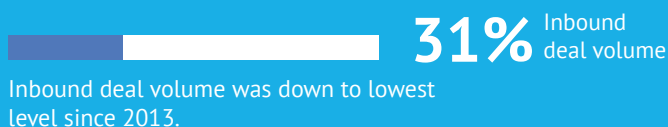
Financial services was by far the strongest sector in terms of both value and volume in 2015-2016. Much of this came from UniCredit's sale of UkrSotsbank to ABH Holdings for €281m. More deals are expected in the sector in 2017 as consolidation continues.

ENERGY, MINING AND UTILITIES



Energy, mining and utilities (EMU) was the second-largest sector in terms of both value and volume in 2015-2016. Indeed, two of the top five deals come from the EMU sector.

FOREIGN VS DOMESTIC





M&A OVERVIEW

After two exceptionally difficult years, the Ukrainian economy showed signs of recovery in 2016, as it emerges from a deep recession, with momentum growing in the second half of the year and the outlook brightening

Despite global headwinds and a number of ongoing economic and political challenges, prospects for dealmaking in Ukraine are gradually beginning to rise. The current IMF deal is encouraging fiscal consolidation and improvements to the business climate, as well as underpinning macroeconomic stability. Reforms have continued, albeit at a slower pace, despite a change of prime minister in April, indicating a degree of political consistency.

THE ECONOMIC LANDSCAPE

Ukraine's GDP grew by 1% in 2016, following a 9.9% contraction in 2015, and growth is expected to pick up to 2% in 2017, according to World Bank data. The economy expanded by 4.7% in the last quarter of 2016 compared to Q4 2015, according to the government, with both industry and agriculture contributing to growth.

The country appears to be reaping some rewards from its tough reform programme of 2014-15, and the US\$17.5bn, four-year funding deal agreed with the IMF in March 2015. Inflation dropped to 12% at the end of 2016, from 43% a year earlier, easing pressure on Ukrainians' incomes. The currency, the hryvnia, continued to fall against the US dollar in 2016, but proved less volatile than in 2015, a course that is expected to continue in 2017.

"We expect devaluation, but that will be commensurate to the situation in the economy overall, and it is not likely that there will be any major drop of the local currency against the US dollar," says Denis Lysenko, managing partner at Aequo.

A new law on financial restructuring introduced in October 2016 allows foreign and domestic creditors to negotiate restructuring with debtors transparently and consensually. It encourages companies in distress but with viable businesses to restructure their debt in cooperation with creditors, through out-of-court orders.

However, the World Bank noted in September that reform momentum slowed from the third quarter of 2015, while IMF loan tranche disbursements have been delayed by faltering progress on Ukraine's commitments under its agreement with the fund.

In a November 2016 report on Ukraine, the IMF praised 'good progress' but said that further forward movement would be dependent on decisive reforms. Several of these would help boost the M&A environment directly or indirectly including improving the business environment, reforming state-owned enterprises, and repairing the financial system and reviving bank lending. IMF funding resumed in early April 2017.

"Looking at the macroeconomic situation and GDP numbers in particular, we can say that Ukraine effectively has passed the bottom of the downturn. We expect that 2017 will be another year of moderate growth in the economy overall, which will probably translate into more deals."

Denis Lysenko, Managing Partner, Aequo

M&A MAKING ITS MARK

Helped by the improving macroeconomic environment, the M&A market saw an uptick, with deal volume rising from 26 to 35, and disclosed value doubling to €310m. Overall value was much boosted by UniCredit's sale of Ukrspotsbank to ABH Holdings for €281m. Domestic deals accounted for 69% of volume, the highest level since 2013, but only 7% of value, thanks largely to the disproportionately large inbound Ukrspotsbank transaction. The sale will lead to the merger of Ukrspotsbank and ABH's Alfa Bank, part of a broader movement towards financial sector consolidation and ownership restructuring being encouraged by the authorities in the wake of a severe banking crisis. The financial services sector accounted for 43% of deal volume over the past two years.

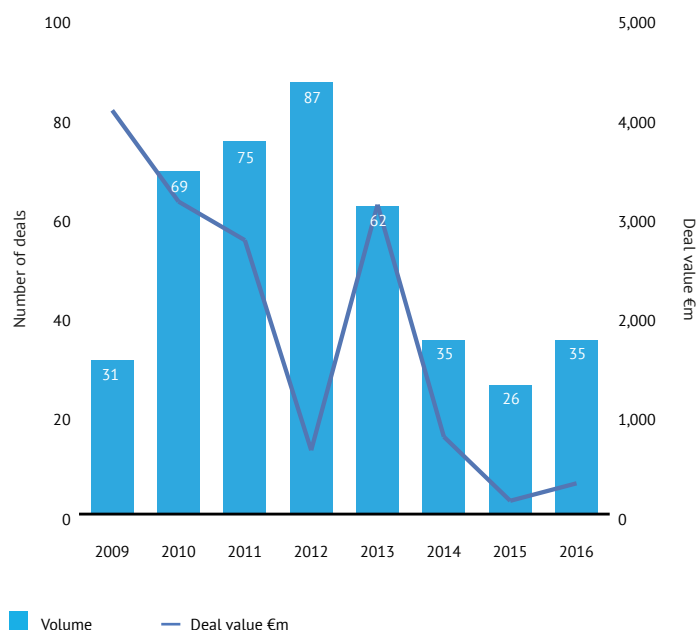
Outside financial services, lively sectors included agriculture, where domestic players are looking to increase their land holdings, and TMT, particularly information and communications technologies (ICT) outsourcing. Both have attracted attention in recent years thanks to their export-oriented nature, with hard-currency earnings making them less vulnerable to the depreciating hryvnia.

In addition, headline figures on public deals do not pick up a significant increase in the number of smaller private transactions between domestic players, a sign of recovering confidence.

"Looking at the macroeconomic situation and GDP numbers in particular, we can say that Ukraine effectively has passed the bottom of the downturn," says Lysenko. "We expect that 2017 will be another year of moderate growth in the economy overall, which will probably translate into more deals."

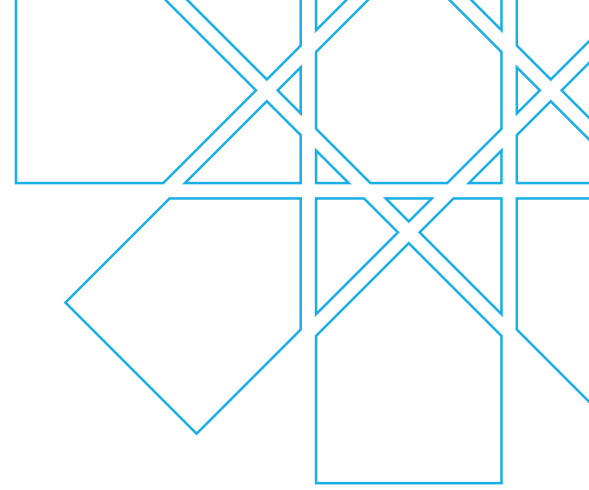
Other than recovering growth, a stepped slide in the hryvnia, and financial sector consolidation, a number of other factors may help catalyse dealmaking in 2017. With IMF encouragement, the government is set to push

Ukraine M&A, 2009-2016

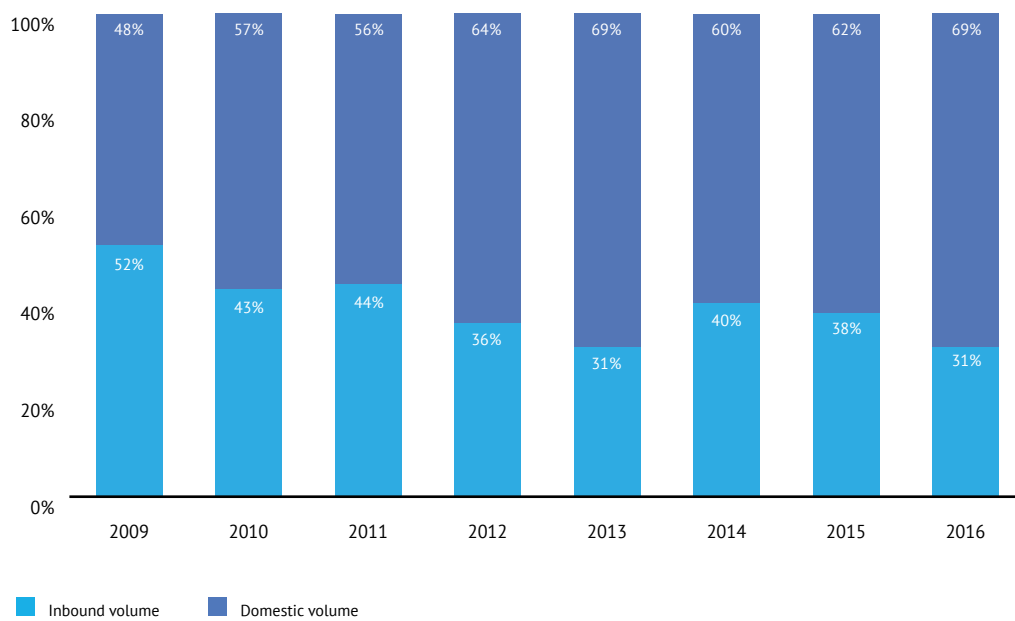


forward privatisations. Companies expected to come onto the market, with stakes ranging from minority to controlling shares, include several regional electricity distribution companies, turbine producer Turboatom, and arguably fertiliser producer Odessa Port Plant (OPP). Two tenders of a 99.6% stake in OPP failed in 2016, with investors put off by the company's high valuation and substantial debts.

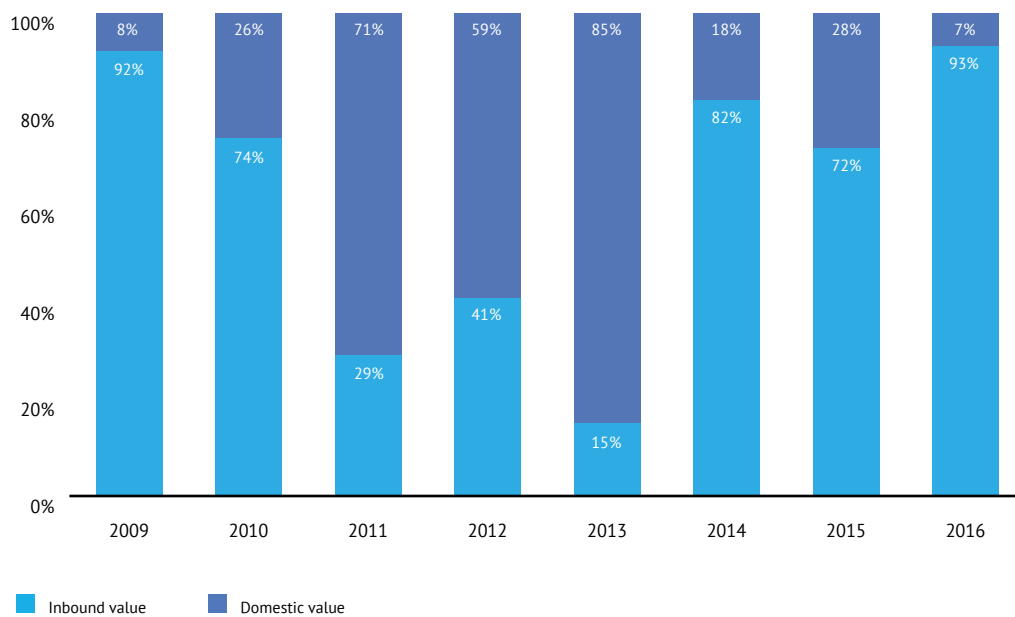
Much still hinges on reform. The planned liberalisation of electricity prices, allowing them to rise more swiftly towards market levels, would help attract investors to the power sector. Changes to corporate law currently in the pipeline should upgrade the regulatory framework to international standards. Finally, long-mooted liberalisation of land ownership by foreigners is again being discussed as one of the key commitments within the framework of Ukraine's cooperation with IMF.



Share of inbound M&A by deal volume



Share of inbound M&A by deal value



SECTOR WATCH

With an 81% share of value and a 43% share of volume over the past two years, it is safe to say that financial services have dominated the Ukrainian M&A market. However, other sectors have also made their mark



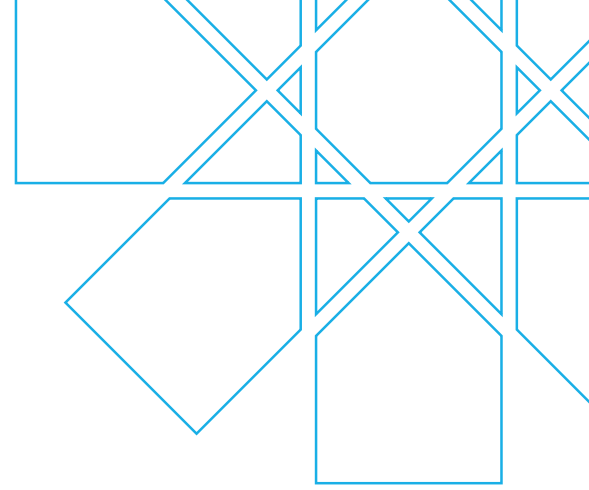
FINANCIAL SERVICES

A perennial favourite, the financial services sector was again the most active in terms of both volume and value, with 14 deals, up from 12 in 2015. The biggest deal of the year was the aforementioned sale of Ukrspotsbank by Italy's UniCredit to Luxembourg-based ABH Holdings, part of Alfa Group. The deal, worth €281m, saw UniCredit take a 9.9% stake in ABH.

The deal is a major consolidation move, merging UniCredit's Ukrainian subsidiary with Alfa Bank, combining the seventh and eighth largest banks by assets respectively, to make the fourth largest. This could have a significant effect on the banking sector, encouraging other mergers as rivals look to strengthen their positions. The deal allowed UniCredit to divest from its unprofitable Ukrainian business, and Alfa Bank to increase its footprint in an important regional market.

There were more than a dozen other public deals in the financial sector. These included the sale of Universal Bank by Greece's Eurobank Ergasias to TAS Group, a financial and industrial group owned by Ukrainian businessman Sergiy Tigipko. TAS Group also acquired Aegon Life from Netherlands-based Aegon NV. Like UniCredit, Eurobank is moving out of Ukraine to focus on its core markets.

TAS Group will merge Aegon Life Ukraine with its existing life insurance brand TAS Life, creating the second-biggest life insurance player on the Ukrainian market. Several other deals involved private investors, as individuals, part of a consortium, or through a family investment vehicle. For example, in August



2016, Russian businessman Yevgeni Giner made a bid to acquire a 50% stake in First Investment Bank, a small Ukrainian lender, from two other individual investors.

“Many banks have been cleaning up their ownership structure,” says Denis Lysenko. “In certain cases, those restructurings of corporate ownership involved attracting third-party investors. In others, we have seen smaller banks effectively draw in private investors, with high-net-worth individuals investing in those banks. In several instances, those were effectively intra-group restructurings, while in other cases, they were by local investors buying out foreign shareholders in local Ukrainian subsidiary banks.”

Banking consolidation is a trend across Central and Eastern Europe, but has been accelerated in Ukraine by the serious financial difficulties created by the country’s deep recession. Non-performing loans (NPLs) exceeded 30% to total gross loans in 2016, according to World Bank data.

The country’s central bank (NBU) is in the process of a sector clear-up and recapitalisation programme under the terms of Ukraine’s IMF agreement. It hopes that changes to the law on corporate restructuring will help ease the burden on banks, but allowing creditors and debtors to cooperate on reforming businesses before cases come to court.

The NBU has been active in shutting down failing financial institutions, with more than 80 ‘zombie banks’ closed. It has also urged parliament to back a draft law that would simplify consolidation, cutting the time taken for mergers to be implemented from one year to three or four months.

The sector is still troubled by the effects of the crisis. In December, the government nationalised the country’s biggest bank, PrivatBank. The

NBU has said that it will guarantee deposits, which include around a third of the total private deposits in Ukraine’s banking system, according to the *Financial Times*.

PrivatBank was accused of lending to companies related to its former owners, and failing to meet the NBU’s recapitalisation requirements. The takeover essentially made the institution a state bank, and was widely seen as a pre-requisite for the continued release of IMF funding.

“PrivatBank has been a major elephant in the room over the last few years while the banking system was being cleaned up of under-capitalised institutions. For a long time this was the largest privately owned Ukrainian bank which competed fiercely with others for retail deposits, although it had a number of critical issues on the related party lending side,” says Lysenko. “This led the government to take it over to make sure that the stability of the banking system is not undermined by the bank remaining under-capitalised.”

He adds that while the move has reassured depositors and reduced risks to the sector, it has also effectively forced other creditors into a ‘bail-in’, which could lead to legal challenges to further restructuring.

Over the longer term, PrivatBank’s assets may be sold off by the state. The bank’s strong branch network and large deposit base would make it an attractive acquisition for a rival or a foreign entrant, though substantial restructuring will be necessary first.

Lysenko expects further M&A activity in the financial sector in 2017 through the ongoing sales of distressed banks, both through the takeover of struggling banks with a view to turnarounds, and through the sales of assets including NPLs and deposits, potentially attracting foreign bidders.



TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS

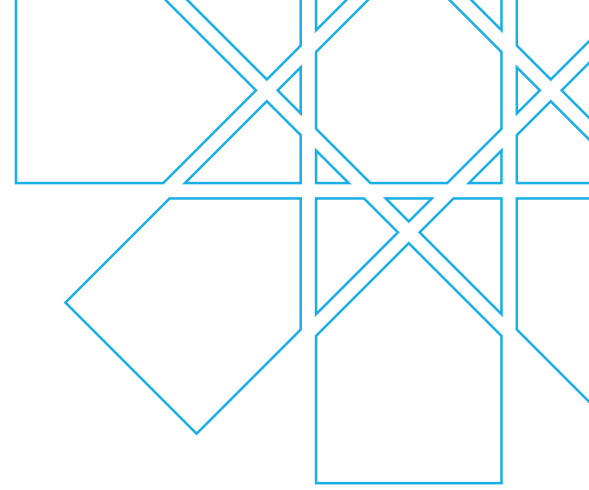
Technology, media and telecommunications (TMT) has withstood Ukraine's economic and political difficulties better than most sectors, partly due to the fact that the sector is relatively recession-proof, but also because export-oriented outsourcing and offshoring ICT businesses have been less affected by the hryvnia's fall, and continue to benefit from strong competitive advantages. These include low costs, geographical location, and a multi-lingual and technically skilled ICT workforce. Nonetheless, the volume of reported deals fell to just four in 2015-2016 from 16 in 2013-2014. Over the same period, the share of total deal value fell from 63% to 3%.

However, the sector did see the second-biggest deal of the year, the acquisition of Viasat Ukraine

LLC – a company operating as a distributor for the Viasat group's pay TV channels in cable, satellite and IPTV (OTT) networks in Ukraine. The buyer Studio 1+1 paid €14m to Sweden's Modern Times Group (MTG) and the deal gives Studio 1+1 access to Viasat's subscriber base of around 150,000 viewers, while continuing MTG's withdrawal from Eastern European markets. The competitive satellite TV segment has been consolidating in recent years, and the Viasat transaction is indicative of a broader trend of foreign players pulling out of difficult markets in Central and Eastern Europe to focus on core assets.

However, continued foreign investor interest in the TMT sector is apparent from the acquisition of software engineering company Lohika¹ by an international group Altran for an undisclosed sum. Lohika is formally based in the US, where

¹ Deal not included in overall deal count due to Mergermarket deal criteria



it generates most of its sales, but most of its operations are in Ukraine. The acquisition is expected to boost Altran's revenues from North America by 40%. Lohika has developed software and software as a service (SaaS) products for clients including Skype and BuzzFeed.

"Lohika was probably the most prominent deal of the last year for the IT sector," says Anna Babych, partner at Aequo, which advised Lohika Inc. on the sale of Lohika Ukraine operations to Altran Group. "It was a merger more than a purchase."

She adds that transactions such as the Lohika deal, that are theoretically through the US but largely involve Ukrainian assets, are common in the TMT sector. Many Ukrainian tech companies register in the US or UK, where establishing a business is easier and visibility and access to investors and clients is higher.

"Ukrainian IT outsourcing is generally growing, and even if formally the target company could be like a US company, the financial facilities could be located in Ukraine, so we treat it as a Ukrainian deal. Major discussions about the risks, and post-completion details, are about Ukrainian issues."

The sector is also attracting attention from private equity (PE) players. In August, local PE fund Horizon Capital announced that it had increased its stake in fixed line and satellite telecoms operator Datagroup to 80%, having had a substantial minority share. The deal gives Horizon operational control of Datagroup.

Other smaller private deals focused on start-ups. The Ukrainian tech start-up ecosystem has proven remarkably lively even during a difficult economic and political period for the country, with software developers flourishing in particular. Ukrainian start-ups attracted US\$100m of PE finance in 2015 alone, according to the *Financial Times*.

"Transparency, working with the business community and ongoing competition law reform are very high up on the list of priorities of the Antimonopoly Committee of Ukraine. Among key developments is the Law of Ukraine on State Aid, which will take effect from August 2017. It is aimed at introducing the national state aid regulations and will set the scene for a fully operational EU-style state aid regulatory system being an important requirement of the EU-Ukraine Association Agreement. Foreign investors as well as Ukrainian companies should take this into consideration when doing business in Ukraine.

Another positive development is the increase of the heavily criticised merger control thresholds in 2016 which has already resulted in a significant decrease in the number of merger clearance applications filed with AMCU – by approximately 25-30%. Business entities save money and time, while AMCU focuses on larger transactions and enforcing compliance."

Yuriy Terentyev, Chairman of Antimonopoly Committee of Ukraine



ENERGY, MINING AND UTILITIES

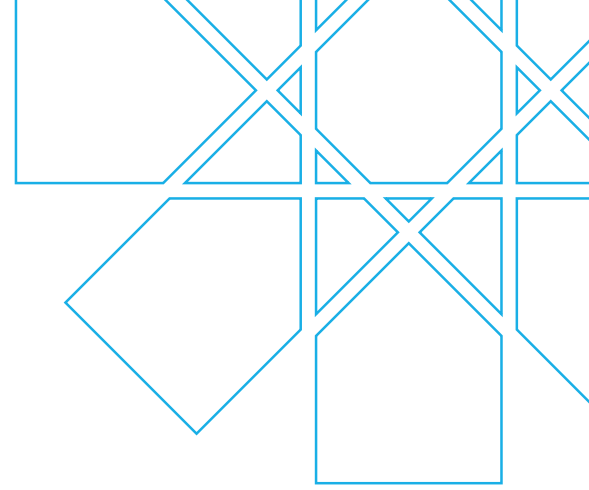
Energy, mining and utilities (EMU) was proportionately the second-largest sector in terms of both value and volume. Indeed two of the top five deals come from the EMU sector, while total number of deals fell to six in 2015-2016 from 12 in 2013-2014.

In July, the UK's Regal Petroleum bought gas exploration and development company Prom-energo for €6m from Ukrainian investment company CJSC Smart Holding. The same month, Slovakian gas exploration and storage company Nafta acquired CNG LLC, which owns the Uzhgorod gas production licence in western Ukraine. Nafta CEO Martin Bartosovic said that he hoped that the deal would be a "first step in creating a portfolio" in Ukraine.

Lysenko says these energy investments are indicative of the benefits of the liberalising reforms that the government is attempting to advance. As well as being linked to IMF-mandated reductions in government spending, Ukraine's efforts to diversify its gas supply and boost its role as a regional transit hub are at the heart of the policy.

"In the natural gas market, the current reform is probably most advanced, with the creation of a liberalised market in 2016," he says. "We are already seeing new entrants into this market, both importing gas to Ukraine, and looking at opportunities to transport gas, and use Ukrainian underground storage facilities. International players are looking at the market and establishing subsidiaries here."

The government is also in the process of liberalising the electricity market, including an ongoing programme of tariff increases. As well as easing pressure on the government budget through trimming subsidies, the price hikes towards market levels are expected to attract more investors to the energy generation and distribution sector by making businesses more viable.



“The government’s agenda to privatise a number of electricity companies in 2017 is to some extent conditional on the approval of RAB-based tariffs which will be consistent with the actual costs that the current operators will incur in properly maintaining and developing their networks,” says Lysenko.

After a series of delays, the government is expected to sell stakes in several electricity distribution companies by the end of 2017. Lysenko says that the assets are most attractive as a group, and thus potential investors will look to acquire several. However, some of the companies already have a range of minority shareholders, differing from company to company, making multiple acquisitions more challenging.

The third major EMU deal in 2016 was the acquisition of coal processing company Kolosnikovskaya CPP from conglomerate System Capital Management (SCM) by Viktor Chmylev, a private investor. SCM is majority-owned by tycoon Rinat Akhmetov, and the plant is in the breakaway Donetsk region, where the company is the major employer. Coal supply from the east is crucial for the Ukrainian power generation and steel industries, and has been cut-off by blockades by 2017.

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Denis Lysenko, Managing Partner, Aequo

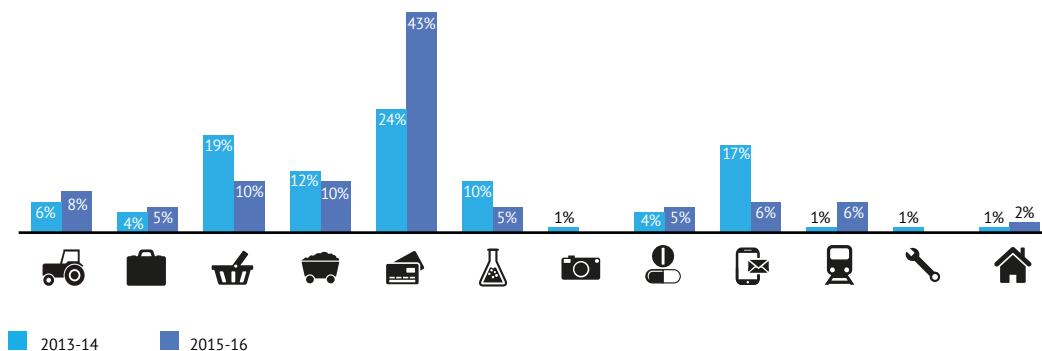
OTHER M&A ACTIVE SECTORS

According to Lysenko, M&A in agribusiness and real estate is also on the rise. Aequo advised Epicenter K, the largest Ukrainian DIY retail chain, on acquisition of a controlling stake in Vinnytsia Agro-Industrial Group², a mix of local companies operating substantial agricultural land bank (in excess of 42,000 hectares) and several significant silos. The deal is notable in several aspects: it represents the first major investment by Epicenter K outside of its core retail business at the time of scarcely

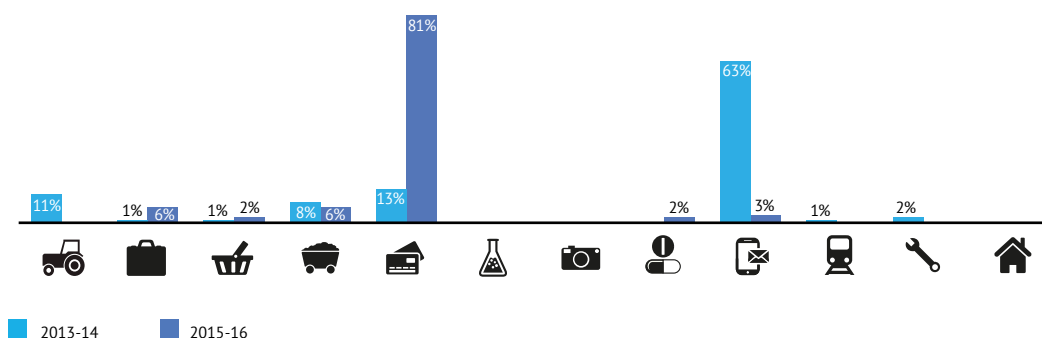
available acquisition funding from any third parties. In addition, the deal value is rather substantial for 2016, according to Aequo, and evidences a growing trend for M&A activity in Ukraine's agribusiness.

² The deal value for Epicenter K's acquisition of Vinnytsia Agro-Industrial Group is confidential and undisclosed (source: Aequo), and has therefore not been included in the M&A value figures for this report

M&A volume 2013-2016, split by sector



M&A value 2013-2016, split by sector



Key:

- Agriculture
- Business Services
- Construction
- Consumer
- Energy & Utilities
- Financial Services
- Industrial & Chemicals
- Leisure
- Pharma, Medical & Biotech
- Real Estate
- TMT
- Transportation

PRIVATE EQUITY IN THE SPOTLIGHT

Private equity (PE) activity in Ukraine has been subdued over the past three years. And activity was fairly static in 2016, with just four deals, all with undisclosed values.

The most significant deal was Horizon Capital's move to take its stake in telecoms company Datagroup to 80%, giving it operational control. The deal came two months after Datagroup appointed a new CEO.

Meanwhile, another PE firm active in the Ukrainian market, Dragon Capital, acquired two logistics centres near Kiev – East Gate Logistic, and a 60% stake in West Gate Logistic. The two companies account for 10% of grade-A warehouse space in Ukraine. The fourth quarter of 2016 saw a further major purchase – Pyramid shopping mall – successfully completed by Dragon Capital in Kiev, a transaction supported by Aequo real estate team led by partner Yulia Kyrpa.

Despite a sluggish few years, PE interest in Ukraine is growing, which could lead to more activity in 2017.

“It's a general trend that PE houses are more active than strategic investors,” says Babych. “We see that PE players are more comfortable with the kind of country risks that they may potentially face in Ukraine.”

As well as risk appetite, attractive valuations may draw more PE deals. Information technology and the commercial real estate segment are already drawing attention, according to Babych. She adds that big international PE funds tend not to be directly active in Ukraine, preferring to work through partnerships with local PE players to invest in medium-sized businesses, sharing risk and benefitting from local knowledge.

“It's a general trend that PE houses are more active than strategic investors. We see that PE players are more comfortable with the kind of country risks that they may potentially face in Ukraine.”

Anna Babych, Partner, M&A, Corporate, Capital Markets, Aequo

However, larger international funds are already investigating further opportunities in the country. Valuations may now be reaching a sweet spot for PE, and a brighter economic outlook will bolster confidence in targets' longer-term performance.

“In many cases, where local companies are hungry for capital or for financing to expand, there are opportunities for PE firms to intervene and at good value both for the target and for their portfolios and future exit opportunities,” says Lysenko.

Ukraine private equity activity, 2009-2016

Year	Volume	Deal Value €m
2009	1	10
2010	6	88
2011	7	146
2012	7	53
2013	8	117
2014	3	7
2015	3	10
2016	4	

THE OUTLOOK FOR 2017 AND BEYOND

From a clearer macroeconomic outlook to increased privatisation and the IMF-supported reform programme, there are four factors which could drive the M&A market in Ukraine.

1 ECONOMIC GROWTH AND POLITICAL REFORM

A GDP forecast growth of 2% for 2017 is far from stellar given the previous slump, but is respectable for a country in Ukraine's situation. Lower inflation should help bolster consumer confidence – it has already proved remarkably robust despite the economic and political situation. The hryvnia is expected to maintain a measure of stability, but Ukrainian assets remain cheap and thus manageable for investors worried about forex risk.

The IMF deal provides not only funds to bolster Ukraine's forex reserves, but support for a rigorous programme of reform that, if implemented, will help strengthen the country's macroeconomic position and create more opportunities for investors in the country, directly and indirectly.

2 PRIVATISATION PLATFORM

The IMF is backing the restructuring of state-owned enterprises, including the privatisation and part-privatisation of assets such as Odessa Port Plant (OPP) and several electricity distribution companies. These are attractive targets, but privatisations have been held back by overvaluation, (in the case of OPP), an unfavourable sector environment, electricity tariff structures and complex minority ownerships. However, pressure is mounting on the government to accelerate reform, and tariffs rising; 2017 may finally see some traction on the sales.

"There are around 400 state enterprises up for privatisation, including around 20 major companies," says Anna Babych. "These are the big ones where Ukraine expects to attract international investors, including PE houses."

3 SECTORAL OPPORTUNITIES

The restructuring of the banking sector should continue over the coming years, with the economy still over-banked and some institutions still struggling to survive. Opportunities come from both consolidation plays and distressed asset sales. The December 2016 nationalisation of PrivatBank is indicative of the challenges the banking system faces, but consolidation also presents medium-term opportunities for investors.

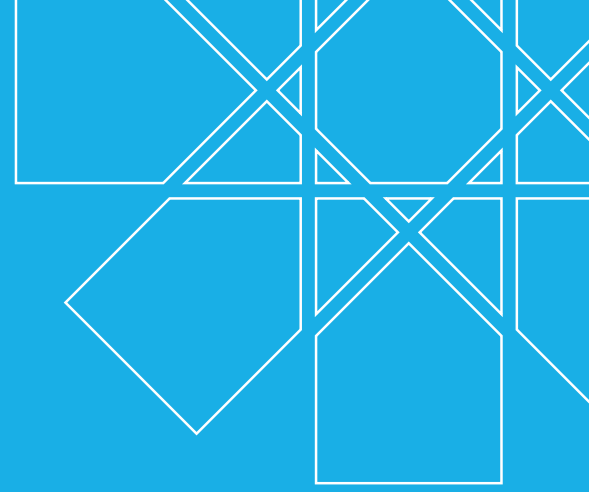
While 2016 saw a downturn in publicly disclosed TMT deals, low-key investments in start-ups continued. The sector remains attractive for investors, with outsourcers and developers export-oriented and thus relatively well-insulated from Ukraine's domestic difficulties. Consolidation in telecoms and media also offers opportunities, as the Datagroup deal indicates.

"Even minor, seemingly 'piecemeal' legislative developments contribute to restoring the trust of investors – both local and foreign. They give investors the comfort that Ukraine is moving in the right direction."

Olyana Gordiyenko, Associate Director, Governance in Economics, Policy and Governance department of European Bank of Reconstruction and Development (EBRD)

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Anna Babych, Partner, M&A, Corporate, Capital Markets, Aequo



Ukraine's agricultural potential is well-known, and 2016 saw local players look to expand their landholdings. The sector's export-orientation make it an attractive target for investors.

Finally, the liberalisation of the energy sector, and Ukraine's efforts to diversify its energy sources and build its place as an international energy transit centre should continue to support activity; the liberalisation of the natural gas market has already borne fruit in important inbound activity.

4 LEGAL REFORMS

A number of legal changes in the pipeline should improve the broader business environment. Babych, one of the initiators and a key driver of Limited Liability Companies (LLC) legislation reform, has witnessed "huge progress" on corporate law reform, with new legislation being prepared for a second parliamentary reading that would substantially modernise Ukraine's corporate law regime. The Draft Law on Corporate Agreements aims to strengthen shareholders' rights through enhancing rules on shareholders' agreements, improve corporate governance, and increase the role that creditors can play in shareholder agreements. Another Draft law on LLCs is the most notable change on corporate governance since 2008 and will liberalise the regime for private companies in Ukraine which are now the key business unit of economy. It will help in harmonising Ukrainian corporate law with EU norms, and is regarded as an important step in improving the business climate.

Aequo also anticipates that ongoing judicial reforms will strengthen the rule of law, benefitting investors. By the end of April 2017, new judges should be appointed to Ukraine's Supreme Court under a far-reaching overhaul of the judicial system.

"This will create a new highest body in the Ukrainian court system empowered to consolidate and contribute to the uniform application of the law in Ukraine," says Denis Lysenko. "The new selection process is seen to be much more transparent and much more competitive than any other previous judges' selection procedure in Ukraine."

The government is also in the process of establishing specialist anti-corruption courts that should help tackle one of the biggest challenges that investors face in the country, and strengthen the rule of law more broadly.

"Privatisation is underway. While the flagship privatisation of Odessa Portside Plant, one of the largest Ukrainian nitrogen fertiliser producers, and privatisation of energy companies remains a challenge for a number of reasons, the State Property Fund of Ukraine was successful in organising the sale of other targets, reaching a threefold increase in planned revenues. The Fund was the only state institution that managed to attract foreign investors in the banking sector by successfully selling the state-owned Ukrainian Bank for Reconstruction and Development (UBRD) to a Chinese investor thus opening Ukraine to Chinese business. We also sold two hydroelectric power stations with 16 investors participating in the auction. Moreover, the Fund sold 135 other companies surpassing the last three-year record. To increase transparency of the privatisation, the Fund launched a website (privatization.gov.ua) disclosing all planned sales of state-owned firms thus demonstrating the commitment to reforms and effective and legitimate privatisation."

Igor Bilous, Head of the State Property Fund of Ukraine

CONCLUSION: RISING TO THE CHALLENGE

A respectable uptick in M&A activity in 2016 was indicative of the country's slowly recovering economic growth. Disclosed deal volumes rose to 35, up from 26 in 2015, as the economy expanded for the first time in three years.

The ABH Holdings/Ukrsotsbank deal maintained financial services as the pre-eminent sector and further consolidation looks inevitable in 2017. The TMT and EMU sectors should also continue to provide a solid number of deals in 2017; however, as Mergermarket's heat chart suggests, the consumer sector could be one to watch this year. Agriculture is another sector of interest, though many deals go under the radar. Domestic investors have been consolidating land holdings in moves that could boost productivity over the longer-term. The export-oriented sector could also benefit from a weaker hryvnia and investors' desire to secure foreign currency earnings.

Despite growing optimism about the outlook for Ukraine, there are still downside risks. At the time of writing, a blockade of rail links between the rebel-held east and the rest of the country had dragged on for a month and caused key industrial assets in the east to be taken over by the Russian-sponsored separatists. The National Bank of Ukraine warned in March that the blockade could halve Ukraine's GDP growth in 2017, a sign of the country's continuing political and geopolitical fragility. Fighting in the east also intensified in February 2017, a reminder that Ukraine has an ongoing war, not just a frozen conflict within its borders.

Meanwhile, relations with Russia, a major investor and trading partner, are frosty. Donald Trump's presidency adds more uncertainty to the geopolitical environment, particularly given his lukewarm support for Ukraine and desire for an improvement in relations with Moscow.

In this context, it may also be more difficult for the government to push the difficult but much-

Ukraine M&A heat chart

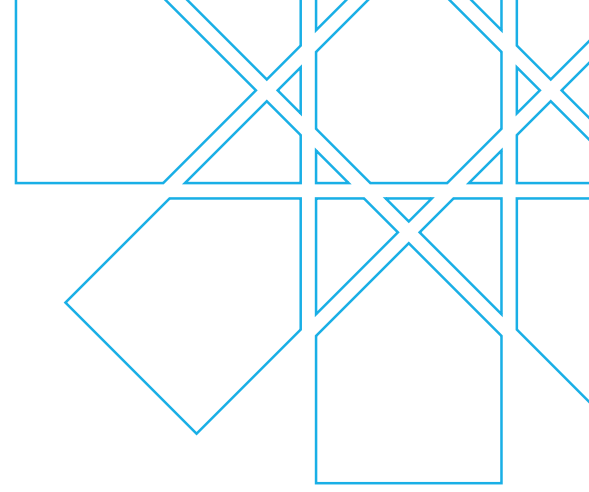
Sector	Number of stories for sale
Consumer	10
Financial services	7
Industrial & chemicals	7
Energy, mining & utilities	5
Business services	2
Construction	2
TMT	2
Transportation	2
Agriculture	1
Pharma, medical & biotech	1

Company for sale stories tracked by Mergermarket between August 1, 2016 – January 31 2017

needed reforms that would stand Ukraine in good stead over the longer-term, including restructuring and part-privatising state-owned enterprises, overhauling the tax system, and cutting subsidies.

Given the complexity of the evolving political and legal situation in Ukraine, foreign investors are advised to choose local partners carefully, with full due diligence into their financial background, reputation, and compliance risks.

"In the situation where a foreign investor would step in as a controlling shareholder



in a local business, it requires an in-depth knowledge and overview of the regulatory framework, which is currently undergoing major changes in various industry sectors,” says Denis Lysenko. “And that is something where local professional advisors are certainly needed to keep track of those changes and be able to forecast what the regulatory environment will look like in at least several years.”

While the recovery is certainly fragile, vulnerable to both domestic and external factors, dealmaking should pick up over the coming years thanks to economic growth, structural reforms, consolidation in sectors including banking and TMT, and privatisations. PE interest in particular is on the rise, with a closing gap between buyer and seller valuations as some players look to exit, and others to capitalise on Ukraine’s strengths in strategic sectors.

“Nowadays, the challenge for the legal community and IFIs based in Ukraine is to streamline and institutionalise communication between the government and the investors and creditors.”

Olyana Gordiyenko, Associate Director, Governance in Economics, Policy and Governance department of European Bank of Reconstruction and Development (EBRD)

“Foreign investment is crucial for significant economic growth in Ukraine. Launched in 2016, the National Investment Council aims to create a stable ecosystem that is attractive for foreign investors, boost legislative reform initiatives and set a dialogue with investors. The Ukrainian economy needs at least US\$4bn-5bn in 2017. In order to attract FDI, we need to implement an efficient and coordinated effort of both the public and private sectors to foster an improved business climate and to succeed with signing agreements with large investors on specific projects. Ukraine’s long-term ambition is to attract US\$10bn of direct investments annually during the next 20 years to achieve economic growth at the rate of 6-9% per year.”

Yuliya Kovaliv, Head of Office of the National Investment Council, National Investment Council

ABOUT THE FIRM

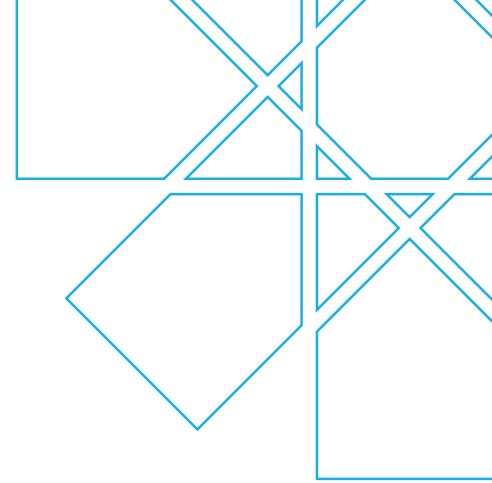
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