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RIDING THE CURRENTS: M&A IN UKRAINE

CONTENTS

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. Additional deals are sometimes added to the database after the end of the year.

FOREWORD

In the five years since Aequo began working with Mergermarket on our annual M&A report, the Ukrainian dealmaking landscape has changed immensely

By Denis Lysenko, Managing Partner, Aequo

This is the fifth report on Ukrainian M&A prepared in collaboration between Mergermarket and Aequo. Our first M&A report was issued back in 2015, a year which saw Ukrainian GDP fall by 9.8% – the most dramatic annual decline since the global financial crisis of 2008. In fact, 2015 appeared to be one of the worst years for the Ukrainian M&A market with just 30 M&A deals, worth a total of only €138m.

Since 2015 the number and value of deals steadily grew to what now seems to be the highest point of the Ukrainian M&A market in recent years: 80 M&A deals valued at €1.19bn.

With a global economic recession now imminent due to the coronavirus pandemic, a decline and significant reshaping of the M&A landscape is looming. So, now is the right time to look back at the Ukrainian M&A market over recent years.

In this edition, we are focusing on the most prominent deals and the overall dynamics of M&A over the past five years. Most visible changes occurred in the agriculture and TMT/IT sectors. These are now the largest sectors by volume of M&A deals and among the top ones by value too.

Expectedly, the most prominent deals over recent years are emerging from these sectors. One was the acquisition of the heavily-restructured Mriya Agro Holding – one of the largest agricultural companies in Ukraine – in 2018 by SALIC, a Saudi state-owned holding. Another one was the purchase of VF Ukraine, the second largest mobile operator in Ukraine, by Azerbaijan-based NEQSOL Holding in 2019.

A major trend of the past few years has been a sharp decline in the number and value of M&A deals in the financial sector. A substantial number of deals in the sector in 2016 and 2017 to a large extent fell into distressed category. Since then, Ukraine's financial sector has seen a gradual recovery, with far fewer players since the market has been cleaned up by the National Bank of Ukraine. After this wave of consolidation, deal activity in the sector slowed down in 2018 and 2019.

Finally, this edition will take a deeper look at the private equity segment, which in 2019 reached its highest annual total of the last ten years with ten publicly known M&A deals. The value of private equity deals has not yet reached a historical record but is still at its highest since 2013.

INTRODUCTION

Against a backdrop of steady GDP growth, Ukrainian M&A rose to the highest annual value since 2013. But with the coronavirus crisis bringing unprecedented disruption, the dealmaking environment will be considerably more challenging in 2020

Ukraine's economy registered its fourth consecutive year of steady growth in 2019, following the sharp recession in 2015. Gross domestic product picked up by 3.2%, despite the cooler global climate caused by trade tensions, slower growth in emerging markets, and uncertainties around the European economy.

In this environment, total reported transaction value grew by 12% compared to 2018, to €1.19bn – the highest annual total since 2013 – although volume dropped by 6% over the same period to 80 transactions. International investor confidence in Ukraine strengthened, and 41% of all transactions were inbound, generating 86% of overall value.

The year also saw a few long-awaited reforms, including the establishment of the High Anti-Corruption Court. Gas market unbundling provided the catalyst for a US$7bn-plus five-year gas transit deal with Gazprom. Towards the end of the year, the government announced plans to privatise three to five major enterprises, notably in the industrial sector.

As elsewhere in the region, private equity (PE) activity continued to pick up, with both international and domestic players active. There were ten PE transactions in 2019, two more than in 2018, and reported deal value almost tripled from €23m to €62m.

The technology, media, and telecoms (TMT) sector led the way in both deal volume and total reported value. While the year's biggest transaction saw Azerbaijan's NEQSOL Holding buy telco VF (Vodafone) Ukraine for €770m, there is also lively activity around Ukraine's growing tech businesses.

In December 2019, the government tentatively agreed a US$5.5bn three-year loan deal with the IMF. If finalised, as seems likely, the package should further bolster investor confidence and help support Ukraine's macroeconomic stability during what will be an extremely difficult year for the global economy. The fund has provided strong backing for the structural reform process, and improvements to the business environment, all benefitting investors.

At the time of writing, the global and domestic outlook is clouded by the international coronavirus crisis, which has injected substantial uncertainty into global markets. Ukraine's open economy, with strong trade ties to Europe and beyond, will not be unscathed. However, once the crisis passes and the global economy starts to recover, Ukraine's large market, ample natural resources, and skilled labour force will continue to attract international investors, and the country will remain one of the most promising M&A destinations in Europe.

KEY FINDINGS

M&A OVERVIEW

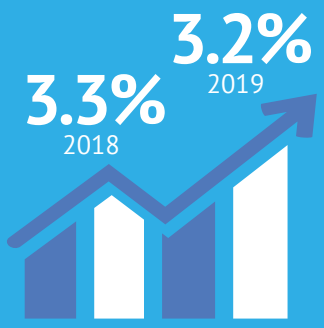
12%

Value in 2019 increased by 12% compared to 2018 to €1.19bn

80

Volume in 2019 dropped by 6% to 80 transactions

ECONOMIC GROWTH



IMF

While the coronavirus pandemic has put a dampener on outlook, the Ukrainian economy was experiencing strong growth before the crisis, growing at 3.2% in 2019 and 3.3% in 2018. Prior to the start of the crisis, it had been projected to grow at 3.5% in 2020.

SECTOR WATCH

TMT

22% Volume

TMT was the best performing sector by both value and volume, taking up 36% of total deal value and 22% of volume in 2018-19

INDUSTRIALS AND CHEMICALS

19% Value

Industrials and Chemicals was the second best performing sector by value, taking up 19% of total deal value in 2018-19

FOREIGN VS DOMESTIC

41% Volume

41% of deals were conducted by foreign buyers, down from 45% in 2018, but still significantly higher than 26% in 2017

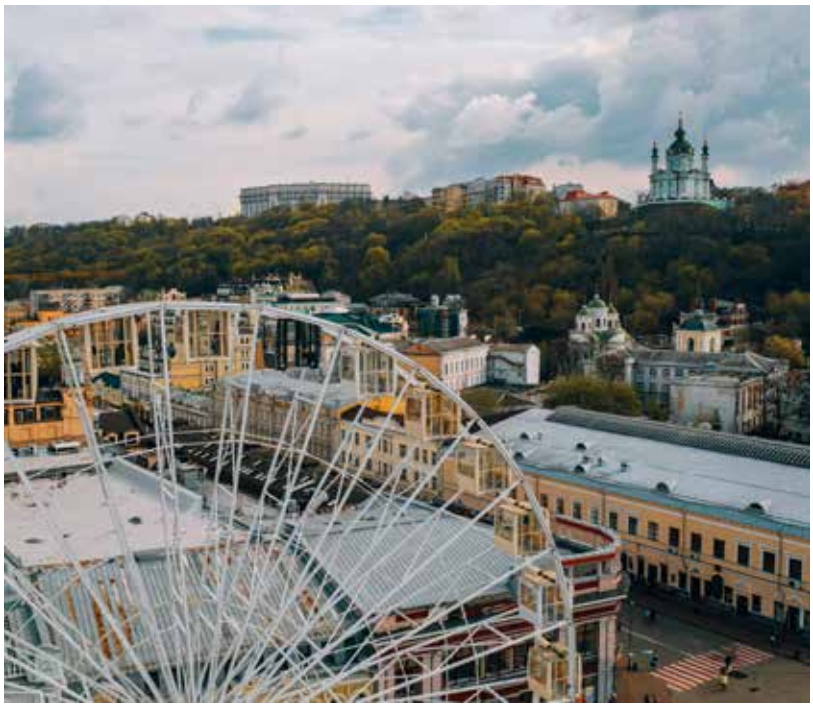
M&A OVERVIEW

Reforms are beginning to show concrete results as Ukraine's economy shows robust growth and foreign investors return to the fold

After a difficult few years, Ukraine's M&A landscape brightened somewhat in 2019, as political and economic developments helped to release pent-up demand and build dealmaking momentum.

Although deal volume fell slightly, from 85 transactions in 2018 to 80 in 2019, total declared deal value, on the other hand, rose 12% to €1.19bn, the highest since 2013. Activity from foreign investors is also on the rise. In 2017, 74% of deals were domestic, with Ukrainian buyers, but in 2018 and 2019, a growing number of deals (45% and 41%, respectively) were inbound, with foreign buyers.

Furthermore, 86% of overall deal value was generated by cross-border deals, up 45 percentage points from 2018, and 66 percentage points higher than in 2017.



STEADY GROWTH

The year's single biggest deal was an inbound transaction: the €770m acquisition of telecoms operator VF Ukraine by Azerbaijan's NEQSOL Holding. The second biggest deal involving a foreign buyer saw Switzerland's Acino International acquire the Ukraine-based primary care portfolio of Takeda Pharmaceuticals, as part of a global deal.

"We saw a big increase in the number of large deals, with some really high valuations," says Anna Babych, a partner at Aequo. "There was a clear pick-up in interest from foreign investors."

Ukraine's growth momentum continued in 2019, with GDP expanding by 3.2%, according to the IMF, much the same rate as in 2018. This was despite domestic uncertainty arising from both presidential and parliamentary elections; growing global headwinds from the trade war between the US and China; a slowdown in emerging markets; and volatility arising from the UK's departure from the European Union.

SHIFTING GROUND

In April, actor and political novice Volodymyr Zelensky won a surprise landslide victory in Ukraine's Presidential election, defeating incumbent Petro Poroshenko. In July's subsequent parliamentary election, Zelensky's big-tent party won the first outright parliamentary majority since the end of the Soviet era.

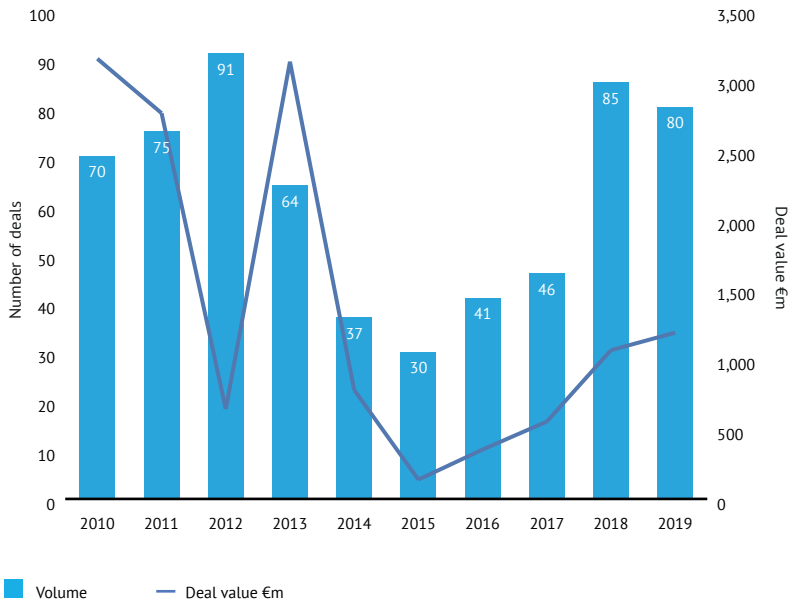
Zelensky appointed a cabinet with a mix of technocrats and experienced ministers from the previous government, promising a degree of policy continuity in key briefs. Markets responded positively to the new administration, which was increasingly seen as reform-minded and having the political space to push anti-corruption and economic liberalisation. In December 2019, the IMF provisionally agreed a new US$5.5bn three-year loan programme for Ukraine, regarded as a vote of faith in the government, and an important bulwark to the reform process, macroeconomic stability, and investor appetite. The IMF deal is particularly significant as it will help unlock a wave of further financing from other international donors, including the European Commission, EBRD, EIB, and World Bank, which have facilities predicated on the Fund's decision.

Under the Zelensky administration and its immediate predecessor, Ukraine has made several major legislative changes associated with IMF conditionality, including launching the new High Anti-Corruption Court and reforms to the Prosecutor General's office.

"There was unexpectedly positive market sentiment in 2019," says Denis Lysenko, managing partner at Aequo. "We saw a significant influx of portfolio investors into Ukrainian sovereign and quasi-sovereign bonds, and several M&A transactions that were either initiated or successfully closed in the second half of the year."

In March 2020, Zelensky ordered a surprise government reshuffle, appointing businessman and former provincial governor Denys Shmygal as prime minister in a move that also saw new finance and economy ministers appointed. The changes raised some concerns among analysts due to the departure of several respected reformers, and because it left some key portfolios temporarily unfilled. The timing was also challenging, given rising economic risk from the global coronavirus pandemic.

Ukraine M&A, 2010-19

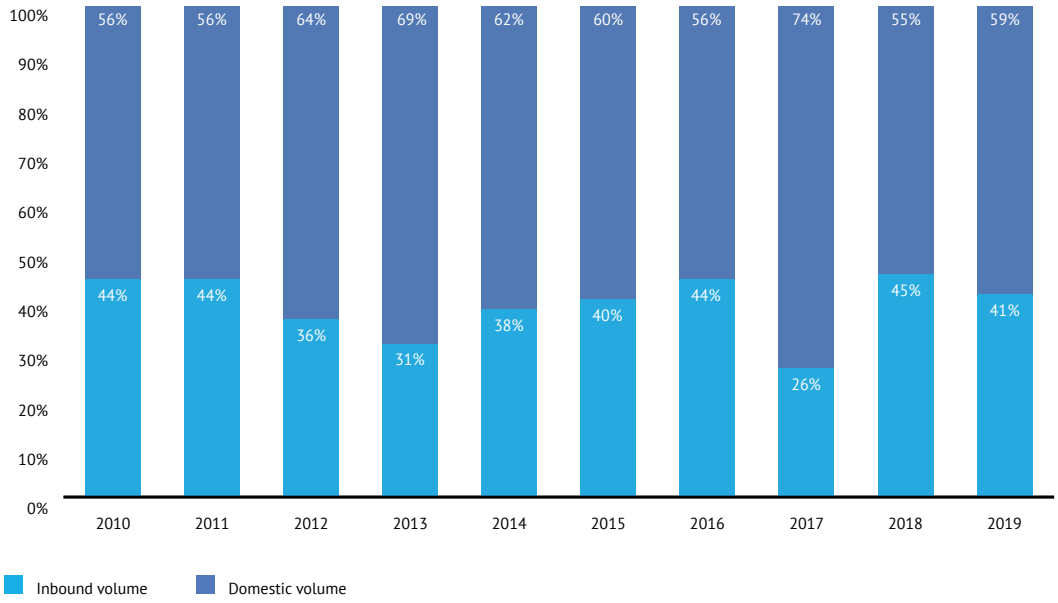


Nonetheless, Shmygal promised "even better and faster reform" and engagement with the IMF, and some analysts feel that the changes will make it easier for the government to push through the legislation required by the fund to finalise its latest financing package. Most notably this includes legislation that would bar former owners of banks nationalised or closed in recent clean-ups from reclaiming the business or being awarded compensation. Fundamentally, the IMF package is a necessity for Ukraine given its external borrowing requirements, and growing risk from the global economic environment. As such, the government is likely to continue with reforms, at least once the immediate pandemic crisis has passed.

UNTAPPED POTENTIAL

A renewed support package from international partners combined with the associated legislative programme should help underscore Ukraine's economic potential in the medium

Share of inbound M&A by deal volume, 2010-19



to long term. Particularly promising sectors include energy, where gas market unbundling has helped Ukraine secure a new transit deal with Gazprom, and where some of Europe's most generous green tariffs were seeing a surge of investment in renewables. The ICT services sector has attracted global R&D investment in recent years to supplement Ukraine's large outsourcing sector and should prove relatively resilient to the Covid-19 crisis. The crisis has also brought to the forefront the importance of maintaining food supply – something which could benefit Ukraine as one of the world's breadbaskets. And in this huge country, infrastructure development is also taking off, with Ukraine now bringing in international investors to develop and manage ports in particular.

"There was unexpectedly positive market sentiment in 2019. We saw a significant influx of portfolio investors into Ukrainian sovereign and quasi-sovereign bonds, and several M&A transactions that were either initiated or successfully closed in the second half of the year."

Denis Lysenko, Partner, Aequo.

UKRAINE M&A: TIMELINE OF THE PAST FIVE YEARS

2015

FEBRUARY 2015
IMF agrees to loan Ukraine US$17.5bn over four years. The deal is predicated on Ukraine cutting spending, restructuring banks, and pushing ahead with anti-corruption measures.

MAY 2015
The National Reforms Council approves the creation of the Comprehensive Program, whose goals include the development of the financial sector, the improvement of regulators' capacity, and protecting the rights of investors.

JULY 2015
Turkcell acquires the 45% stake in mobile operator Astelit owned by Rinat Akhmetov's SCM.

JULY-AUGUST 2015
PJSC Astra is sold to the Deposit Guarantee Fund and NCH Capital in the first sale of an insolvent bank in Ukraine. A month later, PJSC RWS Bridge Bank, which had been created to hold the assets of the insolvent PJSC Omega Bank, is sold to the Deposit Guarantee Fund and Ukrainian Business Group.

2016

JANUARY 2016
George Soros's Ukrainian Redevelopment Fund acquires a stake in technology firm Ciklum, demonstrating investment potential in Ukraine after the crisis.

JUNE 2016
Parliament adopts amendments to the Constitution to reform the judicial system. Changes include the creation of a three-tier court system and new anti-corruption rules for judges.

SEPTEMBER -OCTOBER 2016
Judicial reforms come into force, including the establishment of a new Supreme Court.

OCTOBER 2016
Unicredit Group completes the sale of Ukrsotsbank to Alfa Bank in a €481m deal. Unicredit takes a 9.9% stake in Alfa Bank's owner ABBH.

DECEMBER 2016
The government nationalises PrivatBank, Ukraine's biggest bank by assets, after a US$5.5bn capital shortfall and lending scandal are revealed.

2017

JANUARY 2017
The High Council of Justice, whose responsibilities include the power to nominate judges, is created.

JUNE 2017
Warsaw-listed Kernel Holding, one of the Black Sea region's largest agribusinesses, finalises the acquisition of Ukrainian Agrarian Investments (UAI) for US$155m.

JULY 2017
Ratification of Ukraine's association agreement with the EU, reaffirming ties between Ukraine and the EU and paving the way for "deeper political ties, stronger economic links".

2018

JUNE 2018
New law on limited liability companies comes into effect. The law substantially modernises, clarifies, and strengthens the legal framework governing LLCs. Provisions include the enforceability of shareholder agreements; the lifting of limits of the number of shareholders; and introduces supervisory boards as governing bodies of LLCs.

SEPTEMBER 2018
Saudi Agricultural and Livestock Investment Company (SALIC) acquires Mriya Agro Holding Company, one of Ukraine's largest agricultural companies.

2019

FEBRUARY 2019
Foreign exchange controls relaxed in the first substantive change to forex rules in 25 years. The liberalisation is intended to facilitate the free movement of capital and strengthen the investment environment. The new legislation simplifies processes including cross-border loans and introduces a new risk-based approach for banks dealing with foreign currency transactions.

MAY 2019
Volodymyr Zelensky takes office after a surprise landslide win in presidential elections, beating incumbent Petro Poroshenko with 73% of the vote in the second round.

JULY 2019
Zelensky's big-tent Servant of the People party wins parliamentary elections with the first outright parliamentary majority since the fall of communism.

SEPTEMBER 2019
High Anti-Corruption Court is launched. The long-awaited specialised court is designed to deal with complex and politically charged corruption cases.

NOVEMBER 2019
November 2019: Vodafone Ukraine is sold to Azerbaijan-based diversified holding company NEQSOL for €770m, in one of the largest Ukrainian M&A deals since the 2014 crisis.

DECEMBER 2019
Ukraine and the IMF reach preliminary agreement on a US$5.5bn three-year loan, though differences remain over issues including laws on nationalised banks.

2020

MARCH 2020
Surprise government reshuffle, with Denys Shmygal, a former official and businessman, appointed prime minister, met with mixed reactions from analysts. Shmygal reaffirms commitment to reform and consults IMF on possible emergency package to address the impact of the global coronavirus crisis.

SECTOR WATCH

A look at the industry specifics that make Ukraine's M&A market such an attractive proposition

The sector split by deal volume remained fairly steady from 2016-17 to 2018-19, with the exception of a large drop in financial services transactions, down from 32% of all deals to 10%. A wave of consolidation and sales by foreign and particularly Russian owners in 2016-17 saw dealmaking in the sector surge, but most of these transactions are now completed, and activity has returned to normal levels. Agriculture deals, however, almost doubled their share of volume, from 8% in 2016-17 to 14% in 2018-19.

Overall figures show a surge in TMT's contribution to recorded deal value to 36% in 2018-19, from 2% in 2016-17, largely attributable to the NEQSOL acquisition of VF Ukraine. Financial services M&A dropped even further by value than by volume, from 33% to 3%.

TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS

Big-ticket telecoms transactions and an array of deals in the tech sector make TMT one of the liveliest sectors in Ukraine. In 2018-19, TMT accounted for 22% of overall deal volume, up from 12% in 2016-17. Total recorded value jumped from just €22m in 2016-17 to €810m in 2018-2019, though one transaction accounted for the lion's share of this: the €770m acquisition of telecoms operator VF Ukraine by Azerbaijani diversified holding company NEQSOL Holding.

This was by some margin the largest recorded transaction in 2019, and a landmark for the country's M&A landscape after its difficult past decade. VF Ukraine operates in Ukraine under a brand licence from UK-based Vodafone Group, and is one of the largest mobile network operators in Ukraine with around 20 million subscribers. NEQSOL is fully owned by Azerbaijani oil magnate Nasib Hasanov, and made the acquisition through its telecoms company Bakcell, as part of the group's international expansion strategy. J.P. Morgan Securities and Raiffeisen Bank International financed the deal.

"The VF deal was the largest of the past decade in terms of ticket size," says Babych, who advised on the transaction. "It is also the biggest in TMT we have seen. The sector is the hottest in Ukraine at the moment."

With its relatively low costs, large pool of skilled and multi-lingual tech workers, and a good location, Ukraine has become a favoured business process outsourcing destination. But the TMT sector is now moving up the value chain, with a range of major international tech companies establishing R&D capacity in the country, serving global markets. With the use of online services set to intensify during and after the coronavirus crisis, the industry is likely to perform more strongly than most through 2020.

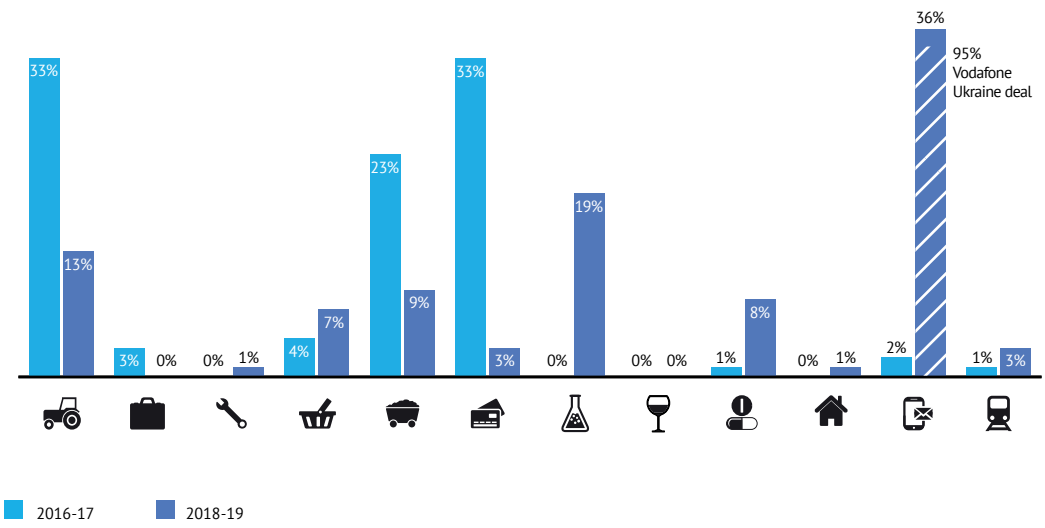
"Most deals in the sector are small to medium, but cumulatively they are very significant," says Babych. "It's a sound and successful industry that is export-oriented and attractive for buyers."

AGRICULTURE

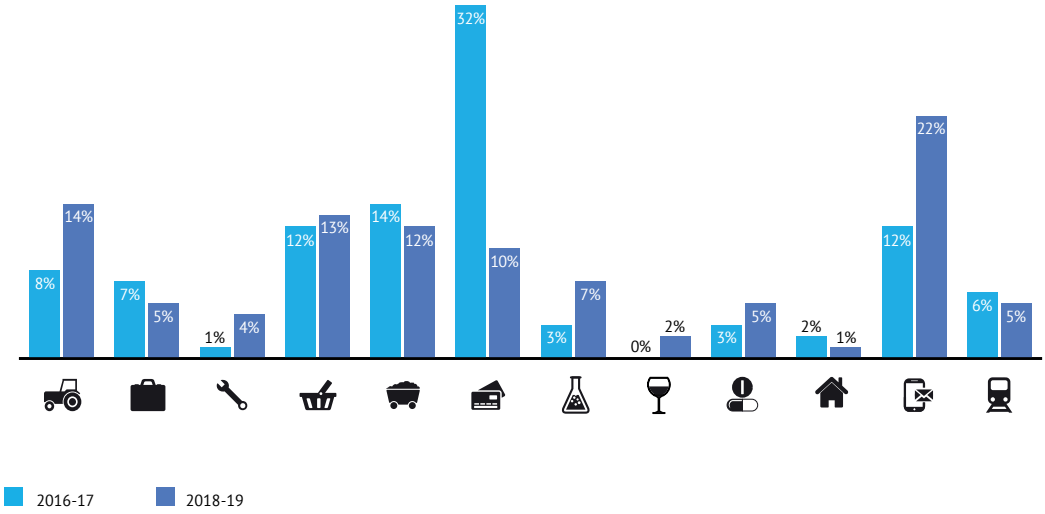
Agriculture accounted for 14% of Ukraine's total M&A volume in 2018-19, almost doubling the number of transactions seen in 2016-17. It made up 13% of reported deal value, down from 33% in 2016-17, when some larger deals contributed to boosting the aggregate amount.

Overall reported value remained fairly steady, however, with reported transactions totalling €290m in 2018-19, from €295m in 2016-17.

M&A value 2016-19, split by sector



M&A volume 2016-19, split by sector



Key:

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

One of the world's ten biggest exporters of both wheat and corn, Ukraine has long been known as a 'breadbasket' of Europe. In the most recent season, ending in 2019, the country produced 75 million tonnes of grain and 19 million tonnes of oilseed crops.

Huge areas of fertile land and access to global markets are obvious competitive advantages. Some 70% of the country's total area is agricultural land – 42 million hectares, with 32 million of that arable land, according to the UkraineInvest agency. Climate and an experienced workforce are also upsides for investors. By some estimates, Ukraine will be one of the world's three biggest food exporters by the middle of this decade. This is set to give Ukraine an advantage to weather the substantial global uncertainty as a result of the coronavirus crisis, as the agrifood industry is expected to be resilient in a downturn.

Agriculture has attracted some of the largest deals in recent years. In September 2018, Saudi Agricultural and Livestock Investment Company (SALIC) acquired Mriya Agro Holding Company, one of Ukraine's largest agricultural companies. SALIC is owned by the Saudi Public Investment Fund, and the transaction is indicative of growing interest from Gulf investors in the agriculture sector in Central and Eastern Europe. The strategic fit is clear: countries in the Middle East are keen to improve their food security and diversify their investment portfolio, while CEE countries including Ukraine are hungry for international capital to boost economic growth, create jobs, and raise exports. Major investments are also helping Ukraine to modernise its farming sector with benefits for productivity and quality.

Nonetheless, Ukraine's agricultural industry was constrained for nearly two decades by a ban on the sale of agricultural land. The ban was imposed to limit speculation in agricultural land but has held back investment by making selling land illegal and stopping owners from using it as collateral. It has also prevented the privatisation of swathes of state-owned agricultural land, some of which is unfarmed. While a long-awaited law legalising the sale of agricultural land was passed by the legislature at the end of March, it still limits the amount of land any person or entity can own to 100 hectares and still bars foreign investors from acquiring land thus restricting them to long-term leases. The new regulations will come into effect in July 2021, and the limit on the amount of land is expected to increase to 10,000 hectares in 2024.

FINANCIAL SERVICES

The financial services sector was the largest single contributor to M&A in Ukraine in 2016-17, accounting for a third of both value and volume. In that period, there was a wave of deals as Russian capital, as well as some other foreign owners, left the market, and domestic

players expanded. In the wake of the 2008 financial crisis, some European banks have retrenched geographically, and sold subsidiaries in Central and Eastern Europe. Meanwhile, local banks, including some owned by leading businesspeople, have looked to increase their market share.

At the same time, the government and the National Bank of Ukraine have pushed for consolidation, and a clean-up of banks, with the market reduced from almost 200 players to around 75. The wake of the global financial crisis and Ukraine's own recession in 2015 left many lenders insolvent in an overbanked sector and revealed malpractice at some institutions. In December 2016, the government nationalised PrivatBank, the country's biggest bank by assets, after a capital shortfall of US$5.5bn was uncovered. The bank had been making the bulk of its lending to companies connected to its owners.

The recent surge in dealmaking activity has now subsided, as remaining players look to integrate recent acquisitions, and take advantage of recovering economic growth. In 2018-19, financial services accounted for 10% of volume and 3% of overall reported value.

The top deal in the sector was the €53m acquisition of Idea Bank Ukraine, a mid-size retail bank based in Lviv, by Dragon Capital, one of Ukraine's largest investment companies, in partnership with an unnamed private investor. The seller was Poland's Getin Holding, owner of Getin Bank, which is facing challenges in its home market; the transaction reflecting similar exits by foreign players and acquisitions by local investors in recent years.

Elsewhere in the sector, Canada-based financial services holding company Fairfax acquired the Ukrainian business of French insurer AXA in 2019.

"We see investors like Fairfax entering the market and consolidating their position," says Lysenko.

"The government is set to prepare major state-owned banks for privatisation, and minority stakes in those institutions will potentially interest foreign investors, primarily international financial institutions (IFIs.)"

ENERGY, MINING AND UTILITIES

With its large coal deposits and strategic location between Eurasia's main oil and gas producers and their major markets, Ukraine has long been a focus for EMU sector investments.

EMU accounted for 12% of deal volume and 9% of overall declared deal value in 2018-19, a drop from 2016-17, when it generated 14% of volume and 23% of value.

The sector has been affected by the conflict in the east of the country, where the coal mining industry is concentrated. Nonetheless,

it has still generated solid dealmaking flow in recent years.

"We've seen quite a significant influx of investors into the energy sector over the past year, particularly into renewables," says Lysenko. "Companies were signing contracts, including pre-PPA, to get the benefit of Ukraine's green tariffs, which are currently still the highest in Europe."

One of the most significant deals in the past year saw strategic energy holding company DTEK take majority stakes in Odesaoblenergo and Kyivoblenergo, electricity distribution system operators in the Odessa and Kyiv regions, respectively. Both have natural monopolies but are not involved in electricity supply. DTEK made the acquisition through two subsidiaries, one based in Ukraine and the other in the Netherlands. The seller was VS Energy group, another big regional electricity distribution market player.

Market liberalisation could boost further activity. In October 2019, parliament approved a law to create an independent gas transmission system operator, a move which is intended to create a competitive local gas market and strengthen Ukraine's position in gas transit negotiations with the EU and Russia. As a result, state-owned Naftogaz was split into production and transportation companies.

This 'unbundling' helped Ukraine secure a new five-year gas transit deal with Russian state-owned giant Gazprom, worth a total of US$7.2bn. Ukraine had not bought gas directly from Russia since 2015, and the new agreement represents a thaw in relations between the two countries and their gas companies. It foresees Gazprom sending 65bcm of gas through Ukraine in 2020, and 40bcm in each of the following four years.

INDUSTRIALS AND CHEMICALS

Ukraine has one of the largest industrial bases in Central and Eastern Europe, leveraging its large skilled workforce, substantial domestic market, and natural resources such as iron ore. Lower costs have also made it competitive on the European market.

As Ukraine's economy recovered gradually from the geopolitical crisis of 2014, the industrials and chemicals sector has seen a rise in dealmaking activity. It accounted for 7% of overall M&A volume in 2018-19, up from just 3% in 2016-17. From a negligible level in 2016-17, it accounted for 19% of total reported deal value in 2018-19, with transactions generating €416m. Nearly two-thirds of this was generated by the acquisition of ZAO Zavod Forge (including its lucrative portfolio of land plots in the Ukrainian capital) by private investor Sergey Tigipko for €236m.

While the hryvnia's appreciation in the second half of 2019 and early 2020 was a sign of rising investor confidence in Ukraine's macroeconomic performance and political outlook, it has also put some pressure on export-oriented industries such as steel by eroding some of their price competitiveness. However, it has also helped make imported inputs cheaper, while market liberalisation in gas in particular is also helping industrial enterprises. As of late Q1 2020, the biggest downside risk was the impact of the coronavirus crisis on the global economy.

"The good news for the chemical sector is that we are seeing more consistent market pricing for major inputs such as natural gas," says Lysenko. "The market seems to be moving slowly in the right direction. There has been some dealmaking activity in steel and heavy industry in the past year. But a decline in global demand may lead to a wait-and-see stance for some time."

CONSUMER

Ukraine's consumer sector benefits from its large domestic market, as well as trade access to major European economies. Although European retailers including Auchan, REWE Group, and Metro are present on the market, as well as a range of international FMCG manufacturers, the market remains under-penetrated by international retailers and products. The economic recovery since 2016 has bolstered consumer confidence and spending power.

The sector accounted for 13% of deal volume in 2018-19, up from 12% in 2016-17, while it contributed to 7% of recorded deal value, up from 4% in 2016-17.

"The trend of currency appreciation in the second half of 2019 played into the consumer

sector as disposable income rose to an extent," says Lysenko. "But a decline in the hryvnia in 2020 may mean that this uptick is slowed."

Indeed, the worldwide coronavirus outbreak in early 2020 has led to a flight to safety among investors, leading to the hryvnia falling again against the dollar. Nonetheless, Ukraine's long-term fundamentals in market size and growth outlook remain strong.

PHARMA, MEDICAL & BIOTECH

The PMB sector has been a significant contributor to M&A activity in Ukraine in recent times, accounting for 5% of deal volume in 2018-19, up from 3% in 2016-17. By reported deal value, the industry is even more significant, accounting for 8% of the aggregate over the past two years.

The domestic market grew at an annual average of 18% between 2010 and 2018, according to Darnitsa, a local pharmaceutical player. The ageing population, growing incomes, and government commitments to healthcare spending have been upsides for the industry.

Local producers have benefitted from rising prices for imported drugs, but also the strength of exports – Ukraine now sells pharmaceuticals to more than 80 countries worldwide. Traditionally focused on CIS states, exporters are now increasingly turning their attention to the affluent markets of the EU. The growth of generics internationally and 'patent cliffs' for leading global firms are also creating opportunities for Ukrainian pharmaceutical companies.

In 2019, Switzerland's Acino International signed a deal to acquire Takeda's primary care portfolio in 30 markets, of which Ukraine is one of the largest. Acino will acquire the rights to selected products from Takeda's prescription pharmaceutical and OTC portfolio.

AN EYE ON PRIVATE EQUITY

Ukraine's PE market remains relatively underdeveloped. Against a backdrop of high multiples in fiercely competitive established markets, the Ukrainian market represents a significant opportunity for returns

Private equity activity has been on the rise across Central and Eastern Europe as funds look to deploy in jurisdictions that offer higher yields than many developed markets, but a lower risk profile than most emerging economies. As one of the largest economies in the region, Ukraine is a locus of this activity. Three decades after the end of communism, there is a growing range of companies of the appropriate size to attract PE investors, as founder-owners look for exits. Both international funds and rising domestic and regional players are on the march.

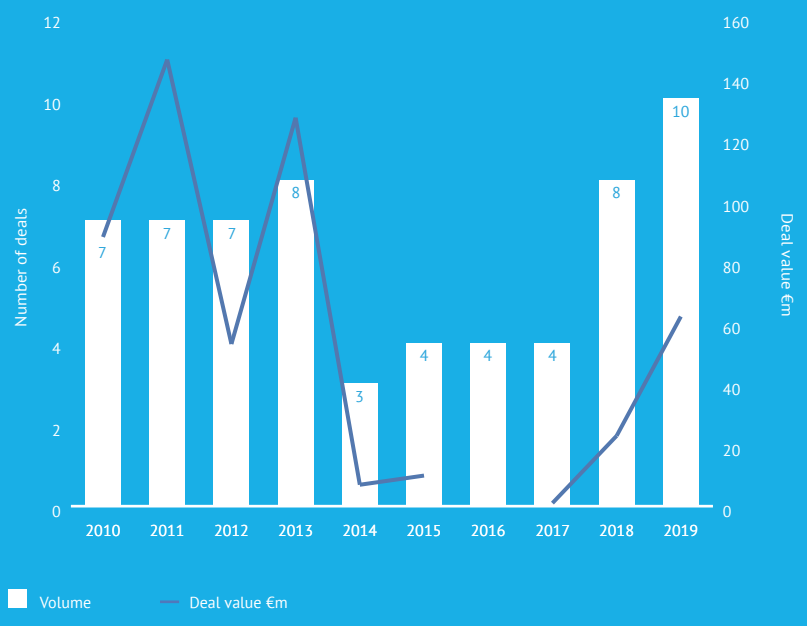
In Ukraine, private equity activity picked up in 2019, reflecting these trends and the country's economic recovery. There were ten PE transactions announced, two more than in 2018, and reported deal value almost tripled from €23m to €62m.

Overall deal value was boosted by the top deal, the acquisition of Idea Bank by Dragon Capital for €53m. The firm also led an investment round in Ciklum, a digital solutions company based in London but originally founded in Ukraine. Co-investors included AVentures Capital, a Ukraine and CEE-focused early-stage R&D-focused fund. Ukraine's lively tech scene is likely to be an area of increasing interest for PE as start-ups come of age and look to expand internationally.

With the global coronavirus pandemic likely to have a significant impact on the economy in 2020, PE players are expected to hold off on transactions not already underway until later in the year, when the outlook is clearer and valuations are more attractive.

"Having spoken to PE clients, they still want to invest, but are waiting for a time when the prices are right," says Babych. "Buyers will close ongoing deals, and then will look for distressed assets."

Ukraine private equity, 2010-2019



There were four private equity transactions in Ukraine in 2016, however, none had disclosed deal values.

THE LONG-TERM OUTLOOK

Ukraine is gaining momentum as a result of the pro-reform agenda it has pushed in recent years. The outlook is bright if it can sustain this progress

Ukraine started 2020 on a positive note, with good growth momentum, a new government, and an encouraging international environment following the US-China trade deal.

The international coronavirus pandemic has put a dampener on the immediate outlook, as the global economy plunges into recession. A flight to safety has once again put the hryvnia under pressure, and cooled dealmaking appetite. It seems unlikely that Ukraine will now achieve the 3.5% economic growth forecast by the National Bank in January.

Ukrainian and international investors alike will be hoping for a V-shaped recovery from any slowdown. The unprecedented fiscal and monetary measures being brought in globally are supportive, and evidence of restored economic activity in China as its protective lockdown was eased in March 2020 suggests that the crisis need not lead to a long slump.

IN A GOOD PLACE

Ukraine is better placed to deal with both a temporary economic shock and to benefit from the global recovery than it has been for some years. The budget deficit was reduced to less than 2% of GDP in 2019, and debt has been cut from 80% in 2016 to just over 50%. Inflation has fallen to 5%. A new IMF deal, or even a short-term emergency package from the Fund, would bolster confidence.

The government of incoming Prime Minister Shmygal remains publicly committed to reform. While the IMF has focused on the problematic legislation around bailed-out and shuttered banks, other pro-business laws have been progressively making their way through parliament.

One of the most important of these is corporate law reform, to bring it in line with international – and more specifically EU – standards. The government has adopted a two-prong approach, both pushing the 'hard' law, and with it 'soft' changes and improvements to the Ukrainian corporate governance code. To avoid a gap between legal changes and implementation on the ground – a pitfall in many reforming emerging markets – the authorities are working with companies to help build their governance according to international best practice.

"I see it as a very positive sign for foreign investors, particularly ones from developed market jurisdictions," says Babych. "They can come to an emerging markets jurisdiction and see that the regulator is not only making the law compliant with international best practice, but also introduces the real instruments and tools for the market, and sets benchmarks which are clear for the international investor."

PRIVATISATION ON THE WAY

The coronavirus crisis may further delay Ukraine's long-awaited privatisation drive, but the direction of travel is clear. In December 2019, the head of the State Property Fund announced that it expected to raise around US$500m in 2020 from the sale of three to five large state-owned companies, including United Mining and Chemical Company and generator manufacturer Elektrotyazhmash. While privatisation remains politically problematic and may face further hold-ups, the potential for boosting M&A activity is considerable.

"We have some large privatisations ahead that could interest international buyers," says Babych. "We also have a large group of state-

owned assets for which local buyers will be the key buyers."

Progress on bringing in private investors for national assets is already being made thanks to the concession law enacted in October 2019. In January 2020, concessions for the ports of Olvia and Kherson were awarded to investors from Qatar and a Georgian-Swiss group, respectively.

These concessions may catalyse further investments in the transportation sector. Although globally the transporation sector is facing considerable pressure globally as the Covid-19 crisis pushes down international trade, longer term, the sector is one of the most promising sectors for Ukraine given its location and size. Looking forward, the TMT sector is set to continue to play a leading role, with tech companies less affected by the global situation than most businesses – and indeed many benefitting. The weaker hryvnia may prove a boost to export-oriented manufacturing, as well as agriculture. And while the consumer sector is likely to experience a cooling due to the economic situation, over the longer term Ukraine's large and under-penetrated market will continue to attract investments.

CONCLUSION

Ukraine's economic recovery and ongoing pro-business reforms have raised the profile of this large and promising European market, leading to a relatively positive outlook for M&A in the face of the global Covid-19 crisis

In the six months to the end of January 2020, Mergermarket was tracking a total of 39 companies being prepared for sale, up from 19 at the same time the year before. The industrials and chemicals sector, long a major economic driver, led the way with 12 'for sale' stories, twice as many as any other sector. Several major industrial companies are being prepared for privatisation, including the United Mining and Chemical Company and electrical generator manufacturer Elektrotyazhmash.

TMT ranked second, with six companies lined up for sale. The sector topped the value charts in 2019 thanks to the VF Ukraine deal, but many transactions in the sector are small and medium-sized, involving growing tech companies that are leveraging Ukraine's technical talent pool, location, and relatively low costs. The growth of innovative tech companies is adding value to an industry that has already become one of Europe's BPO leaders.

The heat map identifies four 'for sale' stories each in the agriculture, consumer, and financial services sector. Ukraine's huge agricultural sector has been attracting bigger-ticket deals for some years but has been held back by the ban on the sale of agricultural land. While the legislature approved some degree of liberalisation of the market at the end of March, this was limited, with the maximum amount of land owned by any person or entity set at 100 hectares. Moreover, it is unlikely that direct foreign acquisitions of land will be permitted in the foreseeable future.

While these sale processes could face interruption and substantial challenges in light of the global economic downturn caused by the Covid-19 crisis, the number of companies for sale being tracked this year compared to the year before demonstrates the health of the market, and offers some degree of hope for a quick recovery once the crisis passes.

In other spheres, Ukraine has made progress in pushing reform. The establishment of the

Ukraine M&A heat chart

Sector	Number of 'company for sale' stories
Industrials & Chemicals	12
TMT	6
Agriculture	4
Consumer	4
Financial Services	4
Energy, Mining & Utilities	3
Business Services	2
Transportation	2
Pharma, Medical & Biotech	2
Grand Total	**39**

*Company for sale stories tracked by Mergermarket between August 1st, 2019 – February 2nd, 2020

High Anti-Corruption Court is significant and is expected to improve the trust of global businesses in the country.

Privatisation has been a slow and politically charged process in Ukraine, and big-ticket sales could be held up in the short term. But smaller-scale sell-offs have gone ahead, and a new IMF package, along with the need to attract FDI in the wake of the likely slowdown in mid-2020, may prove galvanising factors.

Liberalisation of the energy sector has proved a boon, with gas unbundling helping secure a US$7bn-plus gas transit deal with Gazprom in late 2019. Private electricity distributors have been targeted in M&A transactions, and there is rising interest in renewable energy, where Ukraine has some of Europe's most attractive green tariffs.

Further reform is likely to take a backseat to tackling the coronavirus crisis and its economic impact in the first half of 2020. The situation highlights some of the vulnerabilities of the Ukrainian economy and underlines the benefits that would be brought by a new IMF deal. This could provide a much-needed stimulus, underpin recovering investor confidence, and provide new impetus for enhancing macroeconomic stability and the business environment.

NOW-CAST: M&A IN THE POST-COVID-19 ERA

Six months ago, one could hardly imagine that one disastrous event would eventually drag the global M&A market to a sudden rest. Now we see how the Covid-19 pandemic has brought it to a near standstill – hopefully, for just the short term.

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

Since February 2020, Ukraine has faced a sharp slowdown in dealmaking. Investors' activism remains minimal during the lockdown and, hopefully, will pick up after the real stability of the country is restored.

Two significant issues are on the agenda: what if one is in the middle of the deal and how will M&A in Ukraine look like in the post-Covid-19 era?

1. IN OR OUT WHEREABOUTS

Those who found themselves in the middle of a deal as the pandemic spread could pursue two options. Either to hurry up and close as quickly as possible on the same terms (or at least push the deal negotiations to the no-return stage) or to pause and pick different tactics depending on the role.

If each party is still ok with deal pricing and wants to close fast, the only challenge would be regulatory approval (if required). The goal is to get the clearance while each party is still in the game and is not thinking of relying on material adverse change (MAC) or Force Majeure clauses, if those happen to be in the transaction documents. So: full speed ahead to the extent allowed by the overall lockdown to online completion.

If, however, the intention of a party has changed, one must consider the ways out of the deal. The way out depends on whether the pandemic and resulting economic crisis amounts to a MAC or Force Majeure event (again, if in the transaction documents).

Alternatively, the concerned party may wish to re-negotiate price adjustment, pre-completion terms or scope of liability. Since MAC clauses are less common in Ukrainian transactions, we have not seen many transactions where the way out is so straightforward, provided that all other conditions are met.

Finally, for early-stage negotiations, most have been put on hold with no particular timing or even abandoned until better times.

2. REGULATOR'S FACTOR

When the deal requires the approval of the Antimonopoly Committee of Ukraine (AMC), the parties should allow for inevitable delays even though the law provides clear deadlines. First, the quarantine regulation will buy more time for the AMC. Second, conducting necessary inquiries with deal parties and other participants during a pandemic is slow for obvious reasons. Given that, if the deal can be structured so as to circumvent AMC approval legally – and that appears to be the only condition between signing and closing – it is time to explore that opportunity.

3. EXPECTATIONS GAP

It is indeed tough to price deals during the pandemic. Moreover, depending on how quickly the Ukrainian economy will pick up, the expectations of the parties may change even further. We see that price negotiation has re-opened in many pipeline deals. Probably, the now-cast is that those which can be postponed will be postponed due to the buyer's pressure for revenue or change of strategy. Even PE funds that are generally unrestricted to act in turbulent times will probably want to wait until they have a better perspective on valuations or can buy cheaper.

Depending on the case, sellers seeing their valuation assumptions challenged may decide to wait it out until better times are back.

> To outbalance bad news, the pandemic has been a blessing for specific industries. E-commerce and particular FMCG niches seem to be the ones who hit the league table these days."
>
> **Anna Babych, Partner, Aequo**

4. SURVIVING INDUSTRIES

To outbalance bad news, the pandemic has been a blessing for specific industries. E-commerce and particular FMCG niches seem to be the ones who hit the league table these days. We see some activity in M&A in this segment already and will probably see more in the future. Another active M&A segment is biotech and healthcare – all those related to fighting Covid-19. Finally, the world going online has launched an immense shift towards remote-work and remote-life solutions, which is now breeding a new species of unicorns thanks to the transformed demands of customers.

Unlike the lucky ones, such sectors as hospitality, travel, aviation, and tourism have been hit particularly hard by the disruption of the lockdown. However, even those can consider some distressed acquisitions or different types of deals.

5. NEW FORMS, LESS SCALE

Different types of deals will start to come into the pipeline as a result of a troubled and locked economy.

First of all, in the next six months or so, distressed deals are likely to come to market. Those could be supported by restructurings or state aid for strategic industries. We may also see consolidations of some companies that struggle to stand up to the pandemic alone and want to get much-needed cost efficiencies.

Alongside conventional M&A activity, we could see companies pursue recapitalization proposals, various joint ventures, as well as disposals of non-core assets (both distressed or quite sound for a reasonable price).

Lockdown within the country will eventually result in less cross-border and more local deals of a smaller size. That would also be influenced by the need to re-engineer supply chains within the country or particular territory.

Last but not least, the government might decide to protect the worst hit industries, like aviation, through state-aid investments.

6. THE ERA OF VIRTUAL DEALMAKING

We must confess that we have already jumped into the world of virtual dealmaking. After some shock, a business might be surprised to find that dealmaking is in fact possible without offline meetings. Those who grasp and accept that fast will get a huge strategic advantage for themselves and their clients.

Certainly, it will take time to get accustomed to deal processes without high levels of human interaction, offline management presentations, meetings with shareholders, and site visits. All those rituals and actions build trust between the deal parties and bring certainty in the success of the deal. The question of how to build trust in the era of online negotiations is yet to be answered, but the world is already in search of virtual trust-building surrogates.

7. THE BIG WHEN

The now-cast is that the fall-off in activity is likely to continue until there is some greater clarity about the pandemic curve. Many experts believe the answer will come up alongside the answer to when the vaccine will be developed and made available to the population.

In any case, it will take a bit longer for the large cross-border M&A deals to come back to Ukraine again.

8. WHAT'S NEXT

The obvious takeaway from these six months is that MAC and Force Majeure clauses are the new normal in dealmaking. We will see court cases around those events as transactions are terminated or re-formed.

In the medium-term perspective, the non-trivial outcome will be that the companies will try to find liquidity-generating ventures. That means that the seller might think of disposing of some high-value divisions or exiting certain business-segments for a good price. In the long run, those steps will reshape markets and lists of key players in distinct industries.

9. INNOVATIONS

The good thing is that the changes we have faced are forcing us to foster innovation in the legal business and client servicing. The pace for automation, excellent contract management, quick data analytics, Cyrillic machine learning, and AI in M&A transactions is accelerated even further. Online services such as sophisticated legal due diligence tools, efficient contract teamwork solutions, online completion, as well as immense cyber-security back-up, will become the new normal for legal businesses very soon.

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AEQUO

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