cutting through complexity

Russian M&A Review 2014

March 2015

Contents

Foreword

Welcome to the 10th edition of KPMG's annual Russian M&A Review.

The last decade has seen substantial changes in the landscape of Russian M&A, and although 2014 saw the second successive year of decline in value terms, significant opportunities exist for the market to grow and further mature in the years to come. In this edition of the Review we also reflect on the relevance of our key findings from 2005 on today's Russian M&A market.

Political and economic turbulence took their toll on Russian M&A in 2014. Sanctions over the Ukraine crisis led to a sharp decline in inbound M&A from March onwards, while domestic M&A collapsed in the usually strong fourth quarter in the wake of the falling oil price and devaluation of the rouble.

We expect Russian M&A to further contract in 2015, particularly in the absence of the larger transactions which have driven the market in recent years. Recession will undoubtedly see M&A plans reassessed but it will also create opportunities for consolidation and the acquisition of distressed assets with strong market positions at attractive valuations.

Companies will be under increasing pressure to maximise the value of M&A in 2015. Appropriately preparing assets for sale by considering the needs of potential buyers upfront, developing a clear equity story and providing robust and complete information for diligence will be key to achieving this. This edition of the Review includes our insights into how to Buy Right, and provides a road map to help you achieve successful M&A.

Despite the immediate challenges the market faces, we remain convinced that the Russian economy will continue to provide opportunities to create value through M&A over the longer-term.

> **Failing oil prices finally saw the brakes applied to Russian M&A in Q4 2014.**

Headlines

- **Value of M&A down by 38% to USD71.1 billion**
- **Number of transactions announced almost doubled to 595**
- **Average deal value fell by more than two-thirds to USD169 million[1]**
- **Energy and natural resources industry saw a 46% decline in the value of M&A**
- **Domestic deal making collapsed in Q4 to a five year low of USD6.6 billion**
- **Inbound investment fell by 53% to USD8.0 billion**

[1] Based on the number of deals where the transaction value was disclosed

Executive summary

Russian M&A fell by 38% in 2014 to USD71.1 billion driven principally by the impact of two events. First, economic sanctions imposed on Russia in response to the escalation of political tensions over Ukraine resulted in inbound investment falling sharply from March onwards. Second, the value of domestic M&A collapsed in the normally strong fourth quarter, in the wake of falling oil prices, restricted access to capital as a result of sanctions, and a rapidly depreciating rouble.

Confidence amongst Russian corporates concerning the economic outlook began to wane during the latter part of 2014, resulting in both organic and inorganic growth initiatives being put on hold. With many Russian deals priced in hard currency terms, the rouble devaluation exacerbated price expectation gaps between buyer and seller, causing the number of deals to fall in Q4 2014.

The decline in Russian M&A during 2014 was in stark contrast to the global picture where deal making surged by 44% to a staggering USD3.26 trillion.

Overall, we expect Russian M&A to decline further in 2015 buffeted by the economic and political headwinds, which have gathered force in recent months.

Looking back

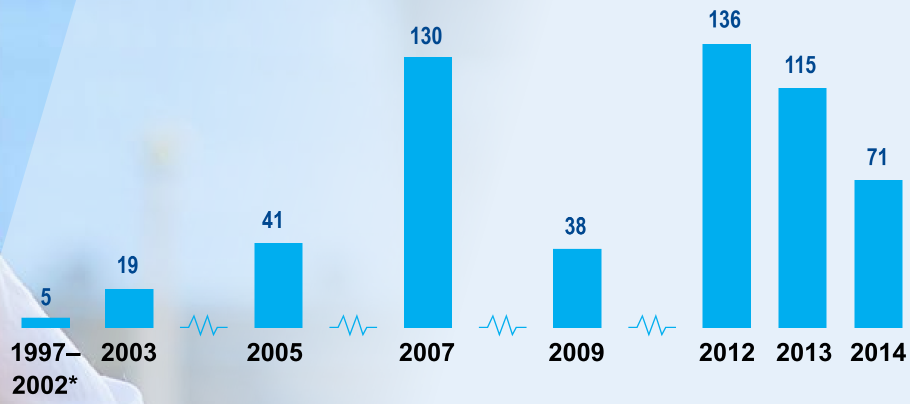
over the last decade

2014 marks the 10th anniversary of KPMG's Russian M&A Review, providing an opportune moment for us to reflect on how the market has evolved over the last decade.

Russian M&A really started to gather momentum from 2003 onwards when the value of deals announced totalled USD18.5 billion fuelled by the USD6.4 billion merger of Tyumen Oil Company (TNK) and British Petroleum's (BP) assets in Russia and Ukraine to form TNK-BP. Prior to this, the market is best described as nascent with the value of Russian M&A announced between 1997 and 2002 averaging just USD5.0 billion per annum.

By 2005, Russian M&A had more than doubled to USD40.5 billion as the market witnessed its first mega deal – Gazprom's acquisition of a 73% stake in Sibneft for USD13.1 billion. The first wave of Russian M&A, like the global market, peaked in 2007, followed by two years of rapid decline in the wake of the global financial crisis. The second wave of M&A turned out to be more of a rollercoaster, hitting a new record in 2012 with the USD56 billion acquisition of TNK-BP by Rosneft; the second largest deal globally that year. In 2015, for the first time, Russian M&A is facing a third consecutive year of decline; the question is whether or not the market will recover in 2016.

Development of Russian M&A deal value (USDbn)



** average annual value of deals*

Source: KPMG analysis

LOOKING BACK

But what has fundamentally changed in Russian M&A over the last decade?

DIVERSIFICATION

- M&A has become more broadly distributed across industry sectors as the Russian economy has expanded: in 2005, 78% (USD31.6 billion) of M&A was focused in the oil and gas, and metals and mining sectors, compared to 37% (USD25.9 billion) in 2014;
- Russian M&A has become less concentrated amongst a small number of large deals: in 2005, the ten largest deals accounted for 72% (USD29.1 billion) of investment, and while large deals still play a key role in the market, the ten largest deals in 2014 only accounted for 36% (USD25.9 billion) of M&A.

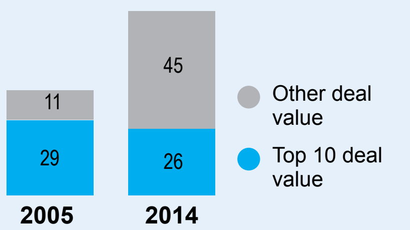
TRANSPARENCY

- When measured in terms of the number of deals with disclosed transaction values, transparency has improved significantly over the last 10 years, from 30% in 2005 (152 deals) to 71% in 2014 (422 deals);
- This trend is likely to result from two primary factors:
  (i) improved corporate governance and disclosure, and
  (ii) improved business media resources.

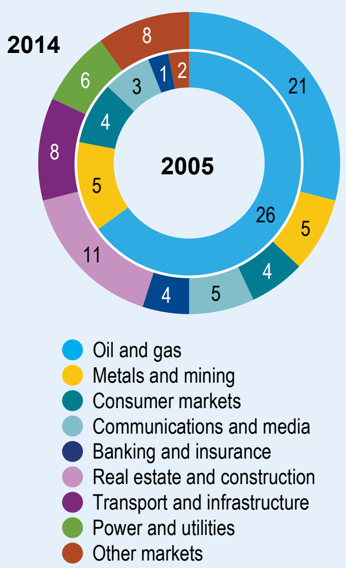
DOMESTICATION

- Russian M&A has become an increasingly domestic affair in recent years, and particularly since 2011, as the share of outbound M&A has fallen.
- Between 2005 and 2014, domestic investment increased from 68% (USD27.7 billion) to 79% (USD56.2 billion) of Russian M&A .

Market concentration (USDbn)

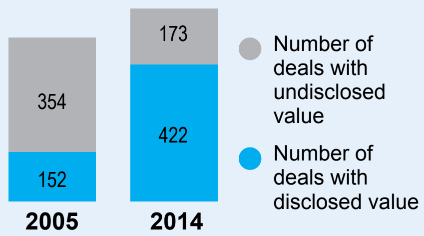


Market mix (USDbn)



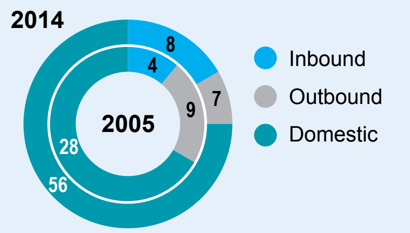
Source: KPMG analysis

Market transparency



Source: KPMG analysis

Market domestication (USDbn)



Source: KPMG analysis

Four key themes stand out when comparing the market in 2014 with 2005

And yet although the market has significantly evolved over the last ten years, **a number of our key findings from 2005, remain as relevant today**, as they did then:

- Russian M&A lags behind developed nations, accounting for only 2.2% of global M&A (2005: 1.7%), with transactions often taking more than a year to close;
- Russian players are frequently reluctant to seek financial advice when undertaking M&A;
- Limited availability of and access to financing (albeit due to different factors in 2005); and
- Poor quality of financial information hinders the deal process and ability to realise value

The Russian economy will continue to provide investors with attractive prospects for value creation over the longer-term. We have seen the market adopt an increasingly more sophisticated approach to M&A in the last decade but significant opportunities remain for further professionalisation to improve efficiency and ultimately the value realised from doing deals.

Russian M&A was in stark contrast to the global picture in 2014.

2014 Review

Despite a surge in the number of transactions announced during 2014, the value of M&A slumped by 38% to USD71.1 billion as the impact of economic sanctions, falling oil price and devaluation of the rouble took their toll on inbound and domestic deal making.

Inbound investment declined from March onwards as political tension over Ukraine escalated and Russia was subjected to economic sanctions. As a result, the value of inbound M&A fell by 53% during 2014 to USD8.0 billion – the lowest level since 2010.

Oil prices went into free-fall during the second-half of 2014 amid slowing demand and rising global production – Russian production hit a post-Soviet record of 10.67 million barrels per day in December. The fall in oil prices and Russia's economic dependence on the energy sector led to a sharp devaluation of the rouble with the CBR[2] swiftly increasing the base rate to 17%. This coupled with constrained access to foreign capital as a result of the economic sanctions saw the brakes firmly applied to domestic M&A during Q4, as the value of deals crashed by 85% to a five-year low of USD6.6 billion.

M&A activity surged in 2014, to 595 deals. Liquidity constraints saw the number of larger deals, those valued in excess of USD2 billion, which have historically driven the value of Russian M&A, dry up with only three such transactions announced in 2014 (2013: 14 deals). Conversely, activity at the lower end of the market exploded, as the number of transactions valued at less than USD100 million almost tripled to 293 (2013: 104 deals).

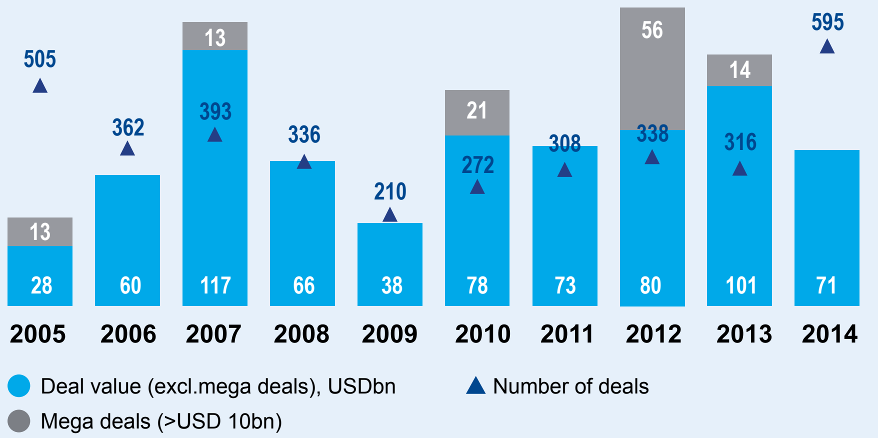
[2] *Central Bank of Russia*

2014 REVIEW

Global M&A (2005–2014)

Source: KPMG analysis

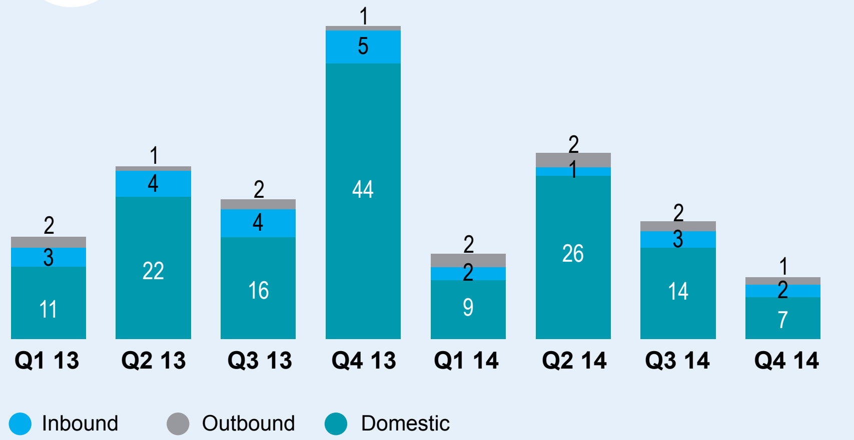
Russian M&A (2005–2014)



2005: Gazprom acquisition of Sibneft
2007: United company RUSAL acquisition of MMC Norilsk Nickel
2010: VimpelCom acquisition of Weather Investments Srl
2012: Rosneft acquisition of TNK-BP
2013: Russian Grids acquisition of Federal Grid Company of United Energy System

Source: KPMG analysis

Russian M&A by type, USDbn (2013–2014)



Source: KPMG analysis

Global deal making surged by 44% to a staggering USD3.26 trillion during 2014; only 11% below the 2007 peak of USD3.67 trillion – with the value of deals in the second half of the year actually 4% higher than the same period in 2007. By comparison, Russian M&A in 2014 was 45% below its 2007 level, while Russia's share of global M&A also fell from 5.1% in 2013 to 2.2%.

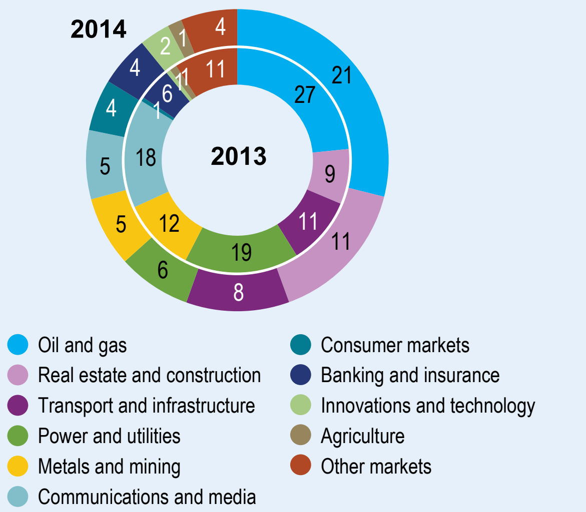
The decline in Russian M&A was largely concentrated in the energy and natural resources[3] industries, and communications and media sector, which together accounted for 90% (USD39.3bn) of the fall in deal value during 2014:

- Stubbornly low commodity prices and restricted access to capital, caused M&A in the metals and mining sector to fall by 56% to USD5.3 billion, as Russian majors focused on the disposal of overseas assets to reduce debt burdens;
- Sanctions and the falling oil price resulted in a 24% decline in the value of oil and gas deals to USD20.6 billion, primarily driven by a lower level of investment by Rosneft
- Restrictions on tariff growth sustained low investor appetite for the power and utilities sector, which saw the value of M&A fall by 71% to USD5.6 billion in the absence of mega-deals such as Russian Grids 2013 acquisition of the Federal Grid Company of Unified Energy System for USD14.4 billion; and
- The change of control in Tele2 and creation of T2 RTK Holding joint venture drove the value of deal-making in the communications and media sector during 2013. In the absence of such larger deals, the value of M&A in the sector fell by USD12.7 billion (71%) in 2014

[3] *Metals and mining, oil and gas and power and utilities*

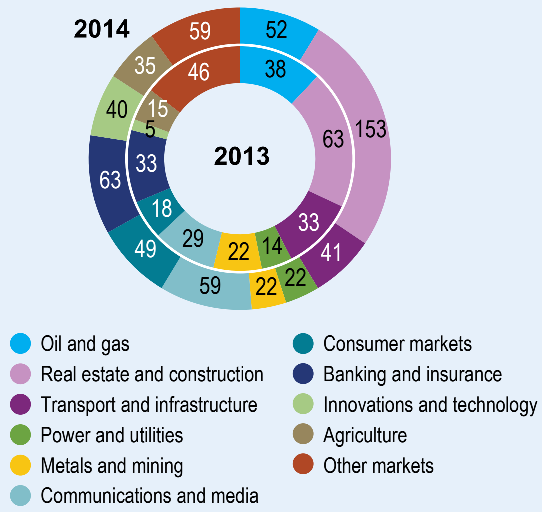
2014 REVIEW

Russian M&A by sector, USDbn



Source: KPMG analysis

Russian M&A volume by sector



Source: KPMG analysis

No Russian mega-deals[4] were announced during 2014 – the first time since 2011. The largest deal of 2014 saw Alliance Group and the Independent Petroleum Company (IPC) form the USD6.0 billion NNK-Aktiv joint venture in April, only for Alliance Group to subsequently sell its 60% stake in the venture to IPC in September for USD4.2 billion.

The second largest deal of 2014 saw businessman Ruslan Baysarov acquire a further 44.1% stake in Stroygazconsulting for USD5.0 billion. The deal increased his holding in the infrastructure construction group to 74.1%, having acquired an initial 30% stake in the company less than six months earlier for USD4.8 billion.

Russian M&A largest deals in 2014

	Target	Sector	Acquirer	Vendor	% acquired	Value USDm
1	**NNK-Aktiv**	O&G	Alliance Group/ The Independent Petroleum Company	Alliance Group/ The Independent Petroleum Company	JV 60:40	6,000
2	**Stroygazconsulting**	T&I	Ruslan Baysarov (private investor)	Ziyad Manasir (private investor)	44%	5,000
3	**NNK-Aktiv**	O&G	The Independent Petroleum Company	Alliance Group	60%	4,200
4	**TGK-9**	P&U	Volzhskaya TGK	KES Holding	n/d	1,844
5	**USM Holdings Limited**	M&M	Management Vehicle	Alisher Usmanov (private investor)	10%	1,800
6	**Yugragazpererabotka**	O&G	SIBUR Holding	Rosneft Oil Company	49%	1,600
7	**Polyus Gold International Ltd**	M&M	Oleg Mkrtchan (private investor)	Halyard Global Limited	19%	1,584
8	**Vkontakte**	C&M	Mail.ru Group Limited	United Capital Partners Advisory	48%	1,470
9	**Altimo**	C&M	LetterOne Group	Gleb Fetisov (private investor)	14%	1,150
10	**Altynalmas Gold Ltd.**	M&M	Polymetal International plc	Sumeru Gold BV; Sumeru LLP	100%	1,119
	Ten largest transactions total					25,767
	As a % of total Russian M&A					*36.2%*

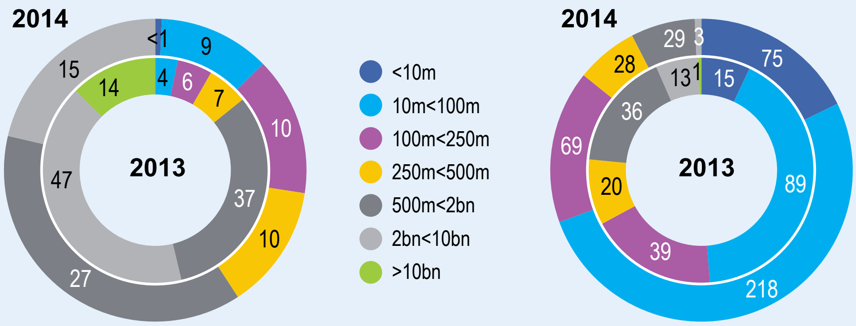
[4] *Deals valued >USD10 billion*

2014 REVIEW

Average deal value fell by two-thirds in 2014 to USD169 million, as the number of transactions valued at less than USD250 million surged by more than two-and-a-half times to 362 deals while the value of deals worth over USD500 million fell by 57% to USD42.1 billion.

Russian deal value by deal size, USDbn (2014 vs. 2013)

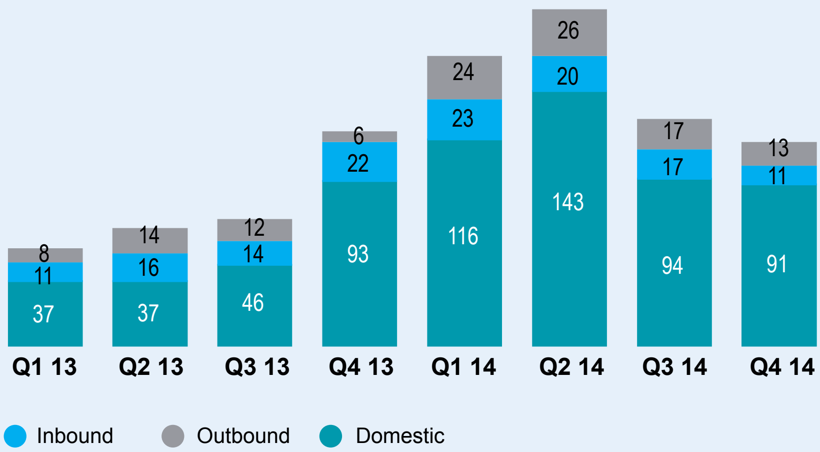
Russian deal volume by deal size (2014 vs. 2013)



Source: KPMG analysis

M&A activity increased almost two-fold in 2014 – despite the decline in deal value – with 595 deals announced during the year, up from 316 a year-earlier. Deal volumes peaked in Q2 2014 (189 deals), following six-straight quarters of growth, before slowing in the second half of 2014, as activity fell to the 2013 level by Q4 (115 deals). Transparency also improved during 2014, with transaction values disclosed for 71% of all announced deals (2013: 67%).

Russian M&A volume by type (2013–2014)



Source: KPMG analysis

Real estate and construction remained the most active sector during 2014 with 153 announced deals (2013: 63), and accounted for 26% of total volume (2013: 20%). Transactions involving state controlled enterprises were the key driver of activity, accounting for 42% of total deal volume in the real estate and construction sector during 2014. Elsewhere, consumer markets, communications and media, banking and insurance, and innovation and technology each contributed 10-12% of the growth in the number of deals.

Domestic M&A

The brakes were firmly applied to domestic M&A in Q4 2014.

Domestic transactions continued to be the focus of Russian M&A, accounting for 79% (2013: 81%) of all deals by value and 75% (2013: 67%) by volume in 2014.

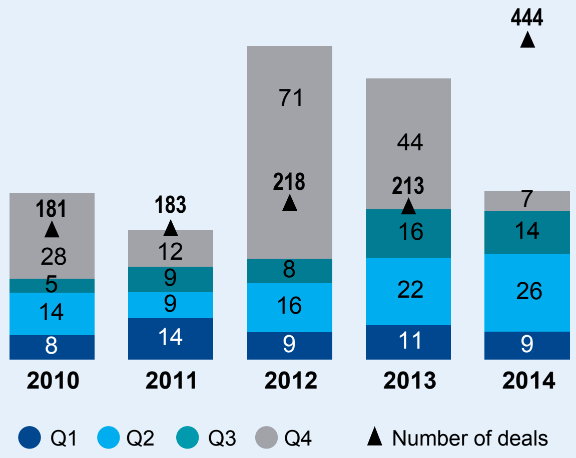
The domestic market remained on par with prior year up to Q3 2014, with USD49.6 billion of deals announced – equalling the post 2007 high – albeit as a result of three times the number of transactions[5] as liquidity constraints made larger deals comparatively harder to fund.

At a sector level the investment picture varied significantly. Oil and gas deal flow increased by 54% in the period to Q3 2014, driven largely by Alliance Group and the Independent Petroleum Company's NKK-Aktiv transactions which totalled USD10.2 billion. Conversely the value of deals in the metals and mining, and power and utilities sectors both slumped by 69% over the same period due to an absence of such large transactions.

The number and value of deals in the real estate and construction sector quadrupled during the first three quarters of 2014, as investors generally perceived real estate as relatively safer investment, attracted to some extent by asset disposals by state controlled enterprises. Infrastructure construction attracted the largest share of investment in the transport and infrastructure segment, with Ruslan Baysarov's acquisition of an additional 44.1% stake in Stroygazconsulting for USD5.0 billion the largest deal in the sector.

Notwithstanding the strength of M&A during the first nine months of 2014, confidence in the economic outlook had already started to weaken amongst Russian corporates. Consequently investment in organic and inorganic growth initiatives started to be put on hold, which, combined with the falling oil price and sharp devaluation of the rouble, led the value of domestic M&A to crash by 85% in Q4 2014 to a five-year low of USD6.6 billion.

Domestic M&A, USDbn (2010–2014)

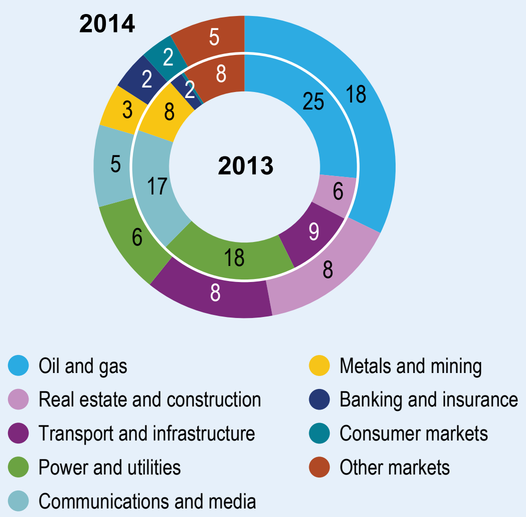


Mega deals:

2012: Rosneft acquisition of TNK-BP
2013: Russian Grids acquisition of Federal Grid Company of United Energy System

Source: KPMG analysis

Domestic M&A by sector, USDbn (2014 vs. 2013)



Source: KPMG analysis

[5] *270 deals with disclosed transaction values were announced to Q3 2014 compared to 87 to Q3 2013*

Inbound M&A

Escalation of the Ukraine crisis saw the value of inbound investment decline from March onwards.

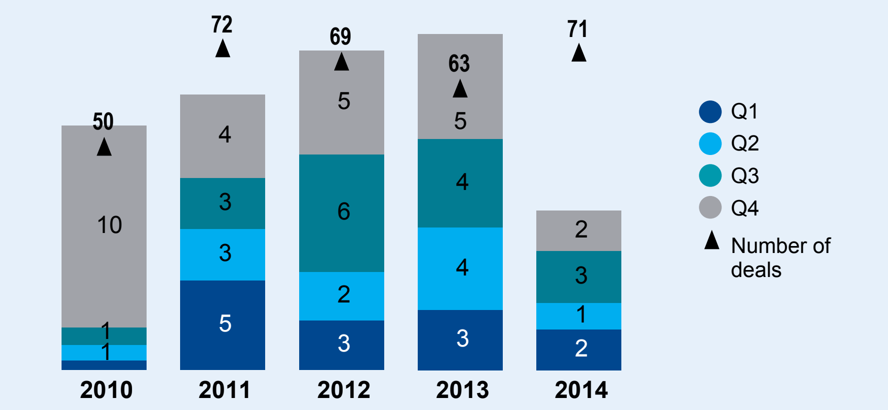
The escalation of sanctions imposed on Russia from March onwards as a result of the political tension over Ukraine saw the value of inbound M&A fall by 53% during 2014 to USD8.0 billion – the lowest level since the 2009 trough.

Predictably given the geopolitical landscape, US and European investment declined by 62% to USD4.0 billion in 2014 – however, it still accounted for two-thirds of the total number of inbound transactions (2013: 65%) and half by value (2013: 62%). Perhaps more surprising, was the fact that investment from the Asia-Pacific region amounted to just USD0.1 billion in 2014, compared to USD3.7 billion in 2013.

Expectations of an influx of investment from Asia-Pacific have run-high for a number of years, despite the region accounting for just 8% (USD5.1 billion) of total inbound M&A between 2010 and 2014. While China has historically been the single largest investor from Asia-Pacific, only two Chinese transactions were announced in 2014 – no deal value was disclosed for either. Chinese investors have been renowned for driving hard bargains, with value expectation gaps between buyer and seller contributing to the lack of completed deals during 2014.

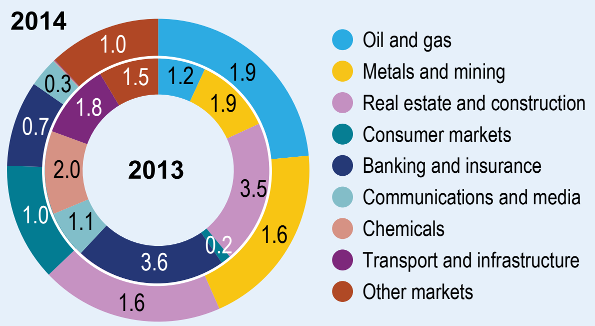
Interestingly, the value of investment into Russia's energy and natural resources industry remained broadly stable at USD3.5 billion in 2014 (2013: USD3.4 billion), with the largest two inbound deals in the sector announced during the last four months of the year – Oleg Mkrtchan acquired an 18.5% stake in Polyus Gold for USD1.6 billion, while North Atlantic Drilling (NAD) acquired 150 drilling rigs together with a five year operating contract from Rosneft in return for a 30% stake in NAD worth USD925 million.

Inbound M&A, USDbn (2010–2014)



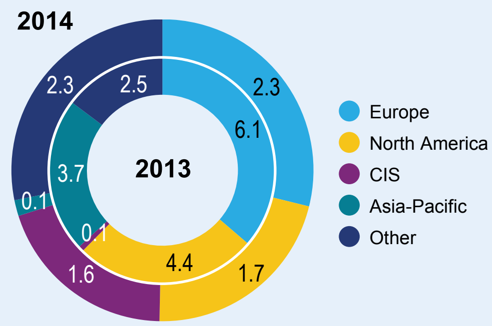
Source: KPMG analysis

Inbound M&A by sector, USDbn (2014 vs. 2013)



Source: KPMG analysis

Inbound M&A by region, USDbn (2014 vs. 2013)



Source: KPMG analysis

Outbound M&A

> **Notwithstanding the sharp devaluation of the rouble, outbound M&A rebounded in 2014.**

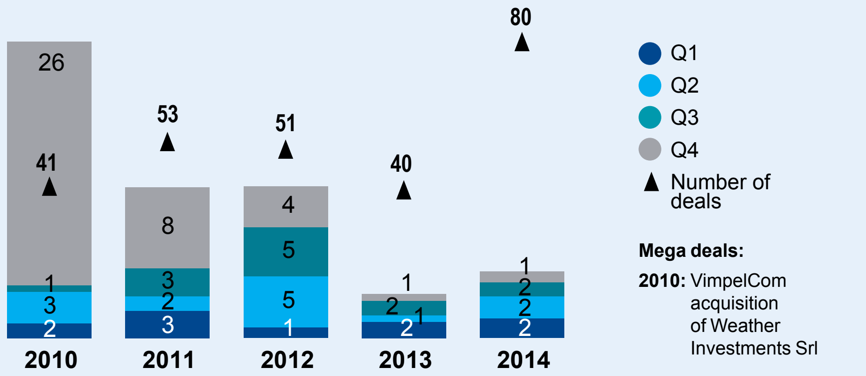
Outbound M&A was remarkably resilient to the sharp devaluation of the rouble, as both the value and number of deals increased in Q4 2014, and remained stable as a proportion of total. Overall, the value of outbound investment increased by 51% to USD7.0 billion, while the number of transactions doubled to 80 deals.

Europe and the CIS remained the most attractive destination for Russian outbound M&A in 2014; accounting for 64% of total investment (2013: 48%) and 66% of total deals (2013: 85%). The largest outbound transaction of the year saw Polymetal acquire Altynalmas Gold for USD1.1 billion to strengthen its position in Kazakhstan and increase its gold reserves by 50%.

Investment was however, much more broadly spread across industry sectors in 2014, unlike the previous year when the energy and natural resources industry accounted for 79% of outbound M&A (2014: 26%). In fact, four of the top five deals in 2013, which accounted for 86% of total value, were in the energy and natural resources sector compared to just the one in 2014.

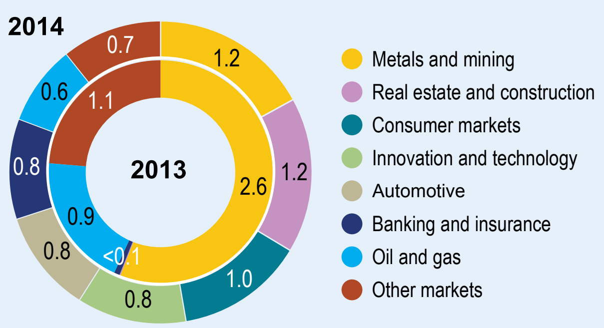
Banking and insurance (USD750 million), consumer markets (USD955 million), innovation and technology (USD819 million), and real estate and construction (USD1.2 billion) accounted for 53% of outbound M&A in 2014 (2013: 1%), and nearly half the total number of outbound deals (2013: 25%).

Outbound M&A, USDbn (2010–2014)



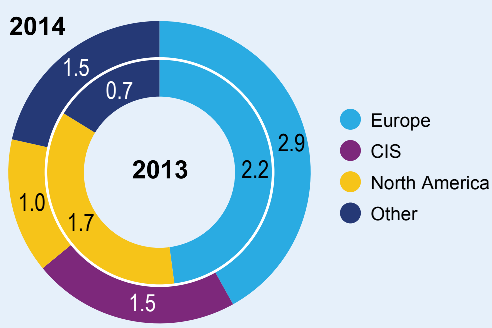
Source: KPMG analysis

Outbound M&A by sector, USDbn (2014 vs. 2013)



Source: KPMG analysis

Outbound M&A by region, USDbn (2014 vs. 2013)



Source: KPMG analysis

Private equity

> **The number of private equity exits increased, as the industry remained cautious about investing large sums of new capital given the deteriorating economic outlook.**

Despite significant levels of uninvested capital, the private equity industry adopted an increasingly cautious investment approach during 2014 as the economic conditions worsened, resulting in the value of M&A falling by USD10.0 billion (54%) to USD8.4 billion.

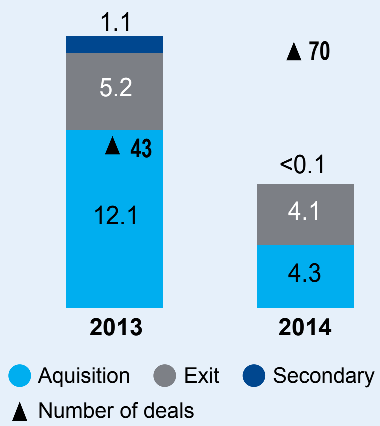
Private equity backed acquisitions increased by 67% during 2014, to 50 deals, although the value of such transactions totalled just USD4.3 billion, down from USD12.1 billion in the previous year. The three largest transactions announced were RDIF and Gazprom Bank's acquisition of the Ust-Luga LPG terminal from Sibur for USD700 million, Millhouse and Pharmstandart paying the same amount to acquire a 70% stake in biotechnology company Biocad, and the acquisition of a 12% stake in the Moscow Stock Exchange by a consortium of investors led by RDIF for USD469 million. In volume terms, private equity focused on acquisitions in the communications and media (11 deals), real estate and construction (8) and innovations and technology (7) sectors.

Although the number of private equity exits increased from 11 in 2013 to 18 in 2014, continuing the trend driven of recent years, the value of such deals fell by 21% to USD4.1 billion. The largest exits saw United Capital Partners sell its 48% stake in the social network Vkontakte for USD1.47 billion, a year after acquiring the stake for USD720 million, and TPG Capital, EBRD and VTB Capital partially exit the supermarket chain Lenta via a USD1.0 billion IPO.

For the second year running, only two secondary private equity deals[6] were announced, although the value of these deals totalled just USD39 million compared to USD1.1 billion in 2013.

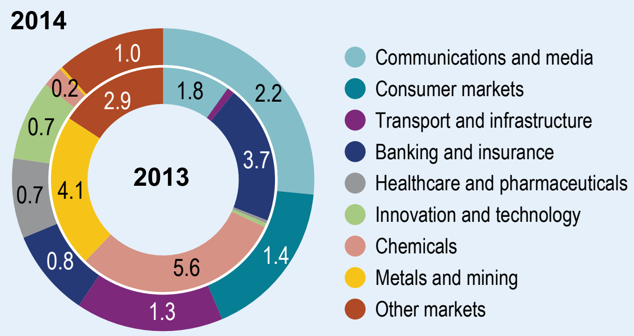
Russian private equity funds deployed a significantly greater level of capital overseas during 2014, announcing 13 deals (2013: 3) with a combined value of USD519 million (2013: USD67 million). The largest of these deals resulted in DST Global acquiring an undisclosed stake in Flipkart Online Services, an Indian e-retailing of consumer products, for an estimated USD210 million.

Private Equity M&A by type, USDbn (2013–2014)



Source: KPMG analysis

Private Equity M&A by sector, USDbn (2014 vs. 2013)



Source: KPMG analysis

[6] *Private equity seller and buyer*

2015 Outlook

As a result of the economic outlook, we expect M&A to decline in 2015, both in terms of the value and number of deals. While it is difficult to predict with any degree of certainty just how far the market will fall, recent history shows us that the impact could be significant.

During the last recession, the value of Russian M&A declined by 71% from the peak of 2007 to the low of 2009. By the end of 2014, Russian M&A had fallen by 48% from the peak of 2012, implying that the market could fall by a further USD20-30 billion in 2015. However, GDP contracted by 7.8% during the last recession, more than twice the decline forecast for 2015[7]. Although the outcome of Russian M&A has historically been defined by deal making in the last quarter, preliminary data indicates that the value of Q1 2015 deal making will be broadly on par with last year[8].

Many of our Asian and Middle Eastern clients are telling us that whilst they are keen to invest in Russia, they are holding off at present until the macro-economic outlook becomes clearer. Nevertheless, recession is likely to see a number of opportunistic transactions during 2015 as corporates with strong balance sheets and private equity houses with uninvested funds take advantage of distressed asset sales.

[7] *The Ministry of Economic Development forecast GDP to contract by 3%, while the International Monetary Fund put the figure at 3.5%*

[8] *Including the USD7.1 billion acquisition of RWE Dea AG by LetterOne Group*

2015 OUTLOOK

Automotive and non-food consumer segments will suffer as the economy weakens; the AEB Automotive Manufacturers Committee expects a 24% decline in new car registrations during 2015[9]. Dislocation in these sectors may well lead to deals as stronger players take advantage of consolidation opportunities.

With access to foreign capital restricted and Russia's sovereign credit rating cut by the world's largest rating agencies – Standard & Poor, Fitch and Moody – the government has shifted its focus to the East, as China's leading rating agency, Dagong, maintained Russia's rating at A, with a stable outlook.

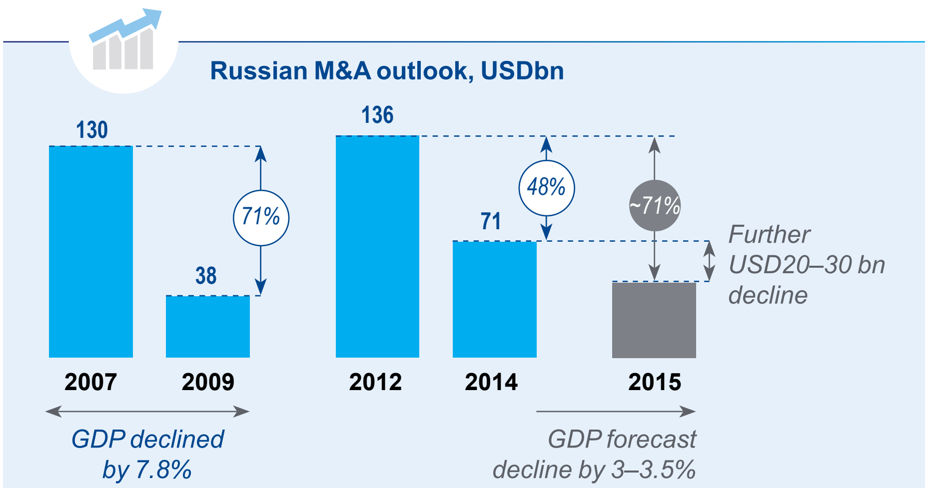
Although China has been by far the largest player from the region, buying USD3.5 billion of assets since 2010, the anticipated gold-rush of investment from the East has yet to arrive. If the level of inbound M&A from China, and the Asian-Pacific region more broadly, is to increase significantly during 2015, we will need to see further contraction of the value expectation gap between buyer and seller.

Trading fundamentals for the Russian agriculture sector improved as a consequence of the ban on Western food imports, which created new opportunities for some players. We expect investment into what is an under invested sector to increase in 2015, with Asian players leading the charge.

Divestments by non-Russian owners, particularly of assets which were underperforming before the current crisis, increased during 2014. We expect to see the number of foreign investors exiting the market to accelerate in 2015 as economic conditions deteriorate, although those with a long track record in Russia may view this as simply part of the country's longer term investment horizon.

We expect disposals of non-core assets and business units to increase during 2015. Based on our experience, there is a need for Russian seller's to better plan and prepare for carve-out transactions, if they are to realise value through such disposals. Buyers need robust historical financials which underpin the business plan of the stand-alone entity, together with a clear operational separation plan for day-1 readiness, as-well-as fully scoped and priced transitional service arrangements.

Overall, we expect to see a decline in 2015 Russian M&A – domestic activity will suffer from the economic headwinds and low oil price, while Western investors are likely to remain cautious for as long as sanctions remain in place. Weakness of the rouble combined with Russian players focusing on disposal of foreign assets to raise capital to service debt repayments will depress outbound M&A.



Source: KPMG analysis

[9] AEB (Association of European Businesses) Automotive Manufacturers Committee press release, 15 January 2015

Buy Right

a road map for successful acquisitions

M&A has long been used as a way to scale up and diversify operations, enter new markets, acquire new customers, obtain new resources, eliminate competitors and more.

M&A transactions have the potential to generate significant shareholder value however, success is not guaranteed. While research shows that Russian deals have historically generated greater value than the global average, half still failed to deliver the value they promised[10]. As Russia enters a more turbulent economic period, companies will come under increasing pressure to Buy Right and maximise the value of their M&A.

KPMG recently discussed the drivers behind successful transactions, and common pitfalls to avoid, with a cross-section of serial Russian M&A dealmakers. The following pages set out KPMG's insights into how to Buy Right and provides a road map to help you achieve successful M&A.

[10] KPMG International survey of global M&A deals completed between July 2009 and December 2011 showed that 30% of global M&A created value, compared to 50% of Russian M&A

Road map
for successful acquisitions

A successful acquisition is typically the product of a robust strategic rationale, a clear understanding of the risks and rewards and the acquirer's ability to take control, capture value and manage risk.

1. **Clear strategic rationale**
   A well defined vision of success, and the assumptions which must hold true to support this

2. **Engaging targets**
   A smart interaction with a target is an important part of the deal management process

3. **Structuring the deal**
   Protect the value of the business and maximise potential net returns

4. **Robust view on synergies**
   Those accountable for delivery must be involved in development of targets and take ownership

5. **Focused due diligence, beyond financial and tax**
   Validate the value hypotheses and understand key operational and commercial drivers and risks

6. **Understand the people and culture**
   Understand and plan for cultural differences and communicate continuously and consistently

7. **Integration and value creation**
   Start post deal planning early, protect business as usual and collaborate to deliver value

8. **Benefits tracking**
   What gets measured gets done – track delivery versus plan

Clear strategic rationale

We are frequently surprised to see buyers who have not rigorously worked through how deals which make sense conceptually will really deliver value.

Sean Tiernan,
Partner, KPMG,
25 years of Deal Advisory experience in UK, Germany, Russia and the CIS

For a deal to be successful it must be supported by a clear strategic rationale that demonstrates how the deal is going to generate value for the acquirer. This is a critical step that underpins the deal – all key decisions can then be referenced back to this strategic rationale.

Having a clear and documented strategic rationale helps retain focus during the deal process, guides structuring and due diligence activities, supports the final price paid, and also provides the discipline to renegotiate or even walk away from the deal if this rationale ultimately no longer holds true.

The approach of private equity (PE) firms is a good benchmark when it comes to acquirers that typically have a well-defined strategic rationale. Under the PE model, investments are made with the end game in mind – a successful divestment. As such they will typically have a clear investment thesis before formally engaging with the target. A well thought out investment thesis will set out how the PE fund plans to make the acquisition, increase value and deliver a strong return on divestment. This in turn helps provide the deal team with a set of discreet hypotheses that can then be validated to support the final investment decision.

A clear vision of success, and the assumptions that must hold true to support this, needs to be understood by the deal team and advisers, and provides a critical reference point against which key deal decisions can be evaluated.

The most important thing is the feeling of understanding whether there is a deal there or not. Everything else is manageable.

Krzysztof Zelicki,
Head of M&A, Rosneft

Engaging targets

Having developed a clear strategic rationale, the challenge is to scan the market and identify, qualify and engage suitable targets for acquisition. There will rarely be a perfect match and targets, once identified, may also be very difficult to qualify and engage. Private companies in particular can be very secretive about the financial performance of their business and hence it is not uncommon for vendors of private companies to reject approaches as they are suspicious as to whether potential acquirers are genuine.

It is important that the process of identifying, qualifying and engaging potential acquisition targets is conducted in a professional manner. Even carefully managed, it is often the case that buyers will need to "kiss a number of frogs, before you find your prince". There are, however, a range of strategies that can be deployed to improve the chances of identifying a better target and ultimately completing a successful acquisition. These include:

- testing the key attributes of the target listing against your strategic rationale to eliminate unsuitable candidates
- utilising intermediaries, particularly advisers, to initially approach targets. This helps lessen the sensitivity that many vendors may have to unsolicited approaches, and sends a strong message to targets that the buyer is serious and prepared to spend money whilst simultaneously presenting buyer anonymity
- approaching targets professionally using Confidentiality Agreements and other documentation to instil confidence with the vendor that the approach is legitimate and well considered
- discussing valuation parameters early to eliminate vendors with unrealistic pricing expectations, and
- creating good documentation around early discussions to clarify what has been agreed and what is yet to be agreed – deals often become unstuck down the track when this is not done.

The objective of a well executed target engagement process is preliminary agreement between a buyer and seller on a deal, built on a trust that both parties will behave appropriately going forward. At the end of the day, all you have in M&A in the absence of a signed binding agreement, is trust.

The more you know about shareholder's priorities and motivations for sale, the greater the likelihood of structuring a sound and successful deal.

Robert Vartevanian,
Partner, KPMG,
28 years of Deal Advisory experience in Europe, Russia and the CIS

Structuring the deal

Try to avoid time pressure situations when drafting complex clauses in sale and purchase agreements, as any subsequent misinterpretations are often a guarantee of expensive and time-consuming disputes post-deal.

John Kallaway, Partner, KPMG,
17 years of Deal Advisory experience in UK, Russia and the CIS

Structuring the deal encompasses a wide range of factors, from the form of the acquisition itself (shares or assets) through to the form of payment structures, funding the consideration and other contractual considerations. Ultimately the objective when structuring the deal is to position yourself as the acquirer to achieve and protect the inherent value you see in the transaction, while also adequately meeting the objectives of the vendor to agree a deal.

Transaction documentation

The sale and purchase agreement needs to accurately reflect the negotiated terms of the deal and include clear definitions and pro-forma examples to avoid misinterpretations in the event of a dispute. An acquirer should seek to incorporate relevant warranties and indemnities from the vendor as protection against key risks or areas of uncertainty (subject to negotiation). In addition, agreed terms regarding whether the business is to be delivered debt free/cash free and with an agreed level of working capital must be documented, together with the approach for preparing the completion documents.

Retention amounts can also play an important part in deal structuring and are useful where there is uncertainty about a vendor's ability post completion to make a payment in the event of a warranty or indemnity claim, or, where there is uncertainty with respect to the quantum of a liability, e.g. environmental remediation.

Think in terms of worst case scenarios. They may not happen very often, but when they do, you will be glad that you built in the necessary protections.

David Gould,
COO, LetterOne Holdings S.A.

Funding the deal

When considering an acquisition target and the anticipated funding required, capital management both across the short to medium term should be well thought through to optimise shareholder returns while managing financial risk within an acceptable level.

Capital providers (both debt and equity) will take confidence from a well thought out and structured capital raising process which will likely result in a lower cost of capital. Early consideration of debt finance and, more importantly, the most appropriate form and structure including terms and conditions (pricing, covenant levels, security, conditions precedent etc.) will allow management more flexibility to operate business as usual and realise synergies post acquisition rather than meeting stringent financier requirements.

Tax considerations

Early assessment of the transaction structure is critical from a taxation perspective to ensure the outcomes for the purchaser, the vendor and the target are appropriate. The form of the transaction structure will be influenced by the decision to carry out an asset or share acquisition.

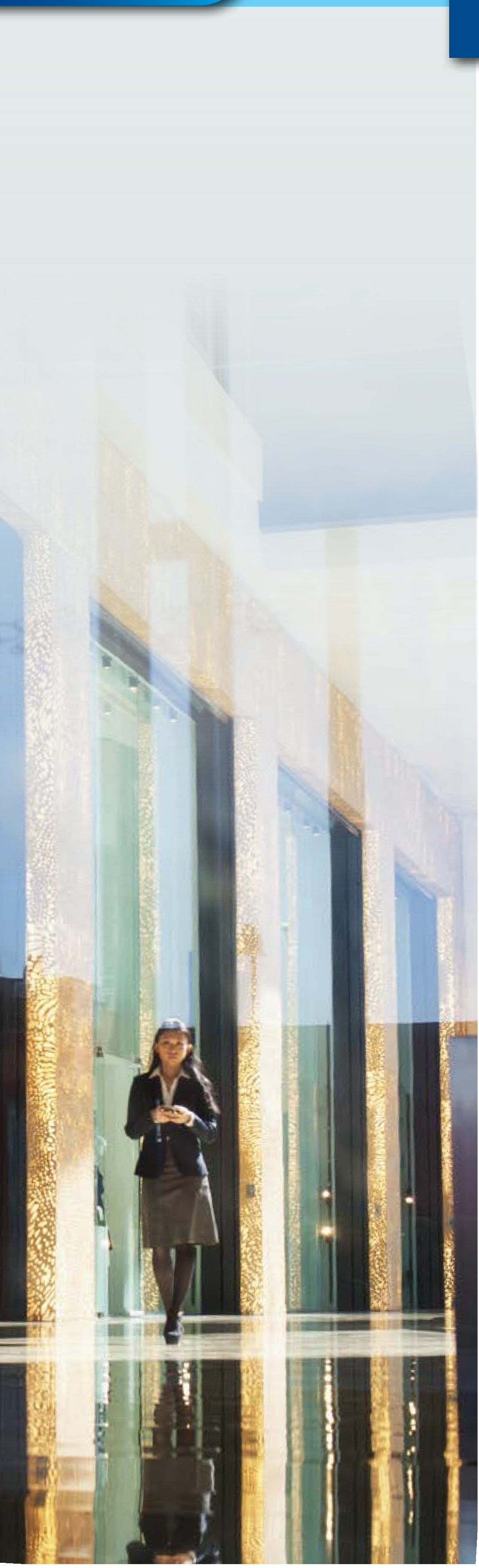
Having a clear understanding of the respective tax attributes, of not only the target business but also those of the vendor and purchaser, are an essential part of planning a transaction. Greater awareness of tax attributes allows for certain transaction structuring opportunities such as pre-transaction dividends so vendors may unlock additional value.

Consideration should be given to tax attributes such as cost base of the target's assets, capital structure of target, tax losses and potential tax leakage resulting from historic tax risks.

Another critical aspect of transaction planning is the impact of transaction taxes. And last but not the least is an assessment of upcoming tax law changes which may have significant effect on the future financial performance.

An assessment of the target's tax profile is essential for maximising the value of the transaction.

Irina Suvorova,
Partner, KPMG,
14 years of Tax M&A experience in US, UK, Russia and the CIS



Robust view on synergies

Our research shows that typically almost half of cost synergies and performance improvements are paid in the purchase price and yet almost half of all acquirers are performing little synergy analysis prior to completion.

A common pitfall is that a high level view on synergies is compiled by the deal team without an appropriate level of operational involvement. This can result in the deal value being underpinned by a set of theoretical synergies and when these are ultimately handed over to an operational team to deliver, some serious operational obstacles are identified, dis-synergies discovered and/or there is no real buy-in from management.

Before committing to the deal, a robust analysis of synergy and performance targets should be completed. Be confident about what is achievable before including them in the purchase price, and plan to exceed the original synergy and performance targets. This reduces the risk of giving away too much of the value upside and this detailed upfront thinking also helps inform subsequent planning around delivery.

The approach to developing the synergies can be aligned to the broader transaction process, i.e. a preliminary top-down view for the indicative offer stage and then a detailed bottom-up build during due diligence prior to a final binding offer.

Forming a view on synergies is not an exact science, revenue synergies in particular are often hard to quantify and as a result buyers are typically reluctant to either pay for these or to announce them to the market as targets. When assessing synergies, we typically recommend forming a view on a base case (high level of confidence) and a stretch case (additional upside with some risk).

From a pricing perspective and public view, the base case becomes your reference point but the stretch case informs your internal management targets. This not only helps ensure you don’t pay for value that can’t be realised, but also keeps upside potential available to offset those inevitable risks and obstacles which will arise during implementation.

> ***Potential synergies matter – as a minimum to create more efficient management and control over the homogeneous assets in your portfolio.***

Tomasz Zamiara,
CFO, O1 properties

Focused due diligence, beyond financial and tax

Due diligence should be targeted to prioritise the validation of the deal rationale and value creation assumptions. If these continue to hold true then the diligence process can continue to cover the broader business risk considerations; if they do not then it helps provide the discipline to walk away.

We are increasingly seeing this played out by way of a phased approach to due diligence. The due diligence is targeted and aligned firstly to testing the investment thesis and only once these are validated does the diligence expand to cover the broader financial and business risks.

A base level of financial and tax due diligence is now the norm on most transactions and considered an imperative from a good governance perspective. However, it's just as important to develop a thorough understanding of the operational and commercial aspects of the target company.

Commercial due diligence can help you understand the market dynamics, competitive landscape and the key drivers of business performance in a particular industry or sector – particularly important if the transaction is being made to diversify into new areas. In addition, developing a good understanding of the target's operations will help you to identify what drives current performance and develop an understanding of the current baseline performance from which synergies and upside opportunities can be assessed.

It is important to involve operational management during the due diligence. Otherwise there is a risk that key operational issues are missed and also you increase the risk of knowledge not being transferred from the deal team to the operational team who, worse still, may be tasked to deliver a value creation plan that they have had no input into.

Due diligence is often seen as a formal box ticking exercise and compliance tool in the CIS. However, when properly focused, due diligence becomes a driver of value, in terms of valuation, future up-side potential and mitigation against value erosion in the SPA.

Lydia Petrashova,
Partner, KPMG,
15 years of Deal Advisory experience in UK, Russia and the CIS

It is not possible to make decisions purely based on internal data of the Target. A consideration of a broader range of factors outside the organization needs to be made in a due diligence process.

Andrey Poluektov,
Head of M&A, Rostelecom

Understand the people and culture

In our experience, developing an informed view of the target's culture and identifying key cultural differences early and planning to overcome them is a key deal success factor. Previous KPMG surveys have found that acquirers that paid attention to these cultural factors were significantly more likely to deliver a successful deal. Also, uncertainty in any transaction typically results in value erosion so the more uncertainty you can remove through regular and consistent communication, the better.

Undertaking a cultural assessment of the target helps to identify gaps where your way of thinking is completely different from the target's – once clear on those gaps you can work out how to manage them and position key communications accordingly. Equally, it helps to identify where there is an alignment between cultures early on and to leverage these to get some momentum and to help bridge the gaps identified.

All interactions with the target throughout the transaction provide opportunities to gain insights into the target's culture, key people and emerging talent. It is important to try and identify these key individuals early and to put plans in place to retain them.

Post completion, an effective communication plan is critical. People do not like uncertainty – an effective communication strategy helps to remove uncertainty and is vital in protecting value.

It is crucial to view any acquisition through the lens of combining corporate cultures of the buyer and the acquired company. The most successful acquisitions happen when the initial approach is integration. They should be marked by internal communication that are appropriate for each culture, reduces uncertainty, and ultimately aligns the needs of both teams and key individuals in those enterprises. That at the end helps to keep and motivate the best employees in the new company.

Yuliana Slascheva, *CEO, CTC Media*

Integration and value creation

Before you sign the deal you need to be comfortable that you have a clear plan of how you will deliver the value post completion.

This provides confidence at the time of committing to the deal that you have a plan to realise the value required to meet your success criteria. This helps in identifying, investigating and factoring into the price any post deal operational issues – these issues could be deal breakers.

In order to be able to develop this integration or value creation plan, your operational team will need to have been involved during the due diligence, or at the very least have received a full briefing and handover from the deal team. You can then use the time between signing and completion to develop a detailed plan to enable you to start delivering value from day one.

An effective integration or value creation plan will begin with some key principles locked down upfront which will serve to keep the plan aligned to delivery of the strategic rationale and end state vision. Ideally these are set with input from senior target management so as to ensure key alignment across both organisations and consistent on-message communication.

When looking at the pitfalls of deals that have failed to deliver shareholder value, a common area of feedback is that companies found that they did not start post-deal planning early enough. Many corporates are now alert to this and will no longer approve a final investment decision unless there is a sufficiently developed integration/value delivery plan in place at time of signing.

Synergy analysis was an important part of our integration program. We identified the long list of value-adding initiatives, quantified each of them, prioritized and implemented them into our 5-year business plan. Prioritization enabled us to focus on those with most significant value potential. Synergy implementation planning helped us to defend the business plan with our shareholders.

Jere Calmes,
Deputy CEO, Tele2 Russia

Deal making is essentially not about "growth" or other vague targets. Deal making is about making money in a form of value creation for shareholders.

Pre-deal synergy analysis is a structured way to make you value creation targets specific, measurable, achievable and timely. Post-deal synergy verification and monitoring is a way to make your chances to succeed as high as possible.

Peter Korolev,
Director, KPMG,
12 years of experience in Deal Advisory in Russia and the CIS

Benefits tracking

One of our observations across many deals is that management teams often fail to track the benefits that are delivered from a transaction effectively. Many times management will only have an indication of whether value has been delivered versus an accurate measure of actual benefits realised and how this compares back to the original investment hypotheses.

Benefits tracking needs to be simple and visual to ensure buy-in across the organisation. There may be a detailed financial model at the heart of this but if the people in the business do not understand what you're trying to achieve it will not be effective. An important part of benefits tracking is determining the operational and financial baseline of the acquired business and the key performance metrics – this provides the base from which to track the impact of your value creation initiatives.

Setting yourself up to track benefits also brings a discipline to the synergy and value creation assumptions themselves – in order to track these you need a good understanding of what drives these benefits and the key assumptions. The discipline of tracking actual benefits versus plan also helps you become better and more informed when it comes to future transactions and value assumptions. Tracking of benefits also means that people are held accountable for the delivery of key value drivers.

From our experience we know of a number of successful examples where companies performed benefits tracking and publicly reported on synergies achieved post-deal. The disclosure of this information enhanced the companies' credibility in the eyes of shareholders and investors and demonstrated the excellence of the management team.

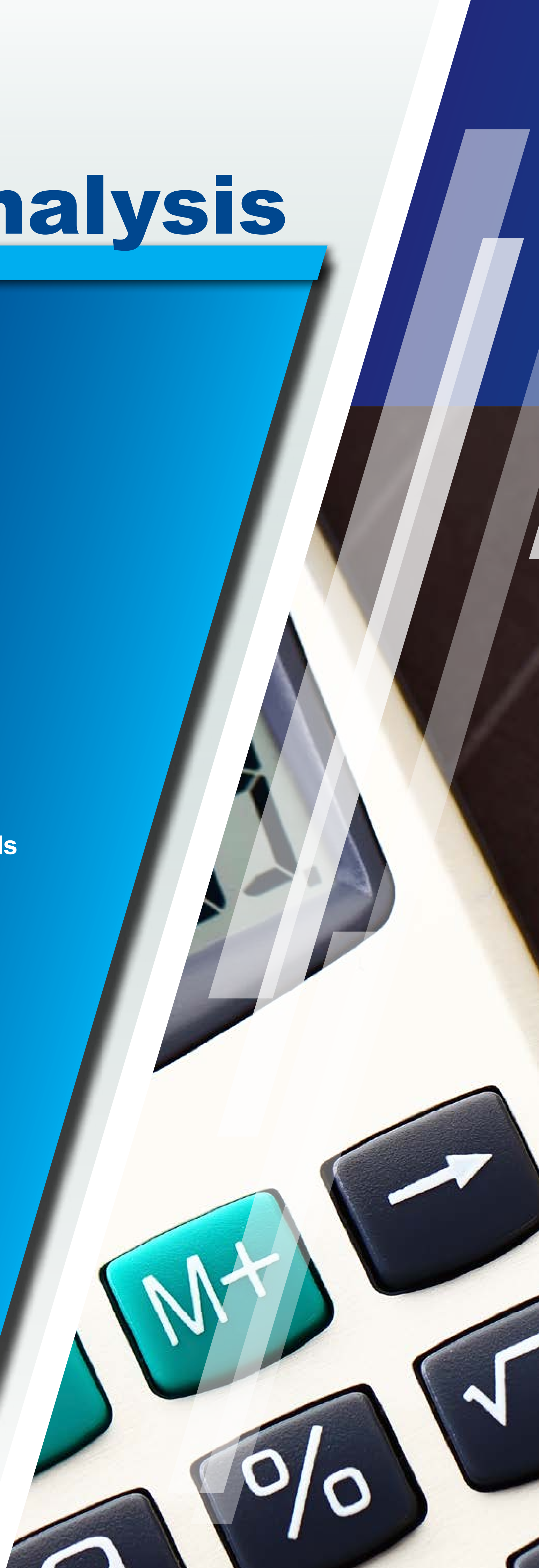
Olga Plevako,
Partner, KPMG,
10 years of experience in Deal Advisory in Russia and the CIS

Value creation remains a core objective of any deal – it might be an immediate synergy or economy of scale reached in one step. In any case continious effort and benchmarking against targeted KPI's post-deal are a must. Competent risk management is an essential ingredient in the recipee of a successful integration.

Ivan Pronin,
Head of M&A Department, InterRAO

Sector analysis

- Agriculture
- Automotive
- Banking and insurance
- Chemicals
- Communications and media
- Consumer markets
- Healthcare and pharmaceuticals
- Innovation and technology
- Metals and mining
- Oil and gas
- Power and utilities
- Real estate and construction
- Transport and infrastructure



Methodology

This report is based on the KPMG Russian M&A database which includes transactions where either the target (inbound) or acquirer (outbound) or both (domestic) are Russian. All data is based on transactions completed between 1st January and 31st December 2014, or announced during this period but pending at 31st December. Historical data may differ from earlier versions of this report as the KPMG Russian M&A database is updated retrospectively for lapsed deals and information subsequently made public.

Data includes transactions valued in excess of USD5 million, as well as transactions with undisclosed deal values where the target's turnover exceeds USD10 million. Deal values are based on company press releases as well as market estimates disclosed in the public domain.

The KPMG Russian M&A database has been complied over a number of years based on information included in the Mergermarket M&A deals and EMIS DealWatch, together with KPMG desktop research of other sources.

Allocation of deals to industry sectors may involve using our judgement and is therefore subjective. We have not extensively verified all data within the KPMG Russian M&A database, and cannot be held responsible for its accuracy or completeness. Analysis of different databases and information sources may yield deviating results from those presented in this report.

Agriculture

2014 DRIVERS

Trading fundamentals improved for the Russian agriculture sector during 2014 following the ban on Western food imports, creating opportunities for some.

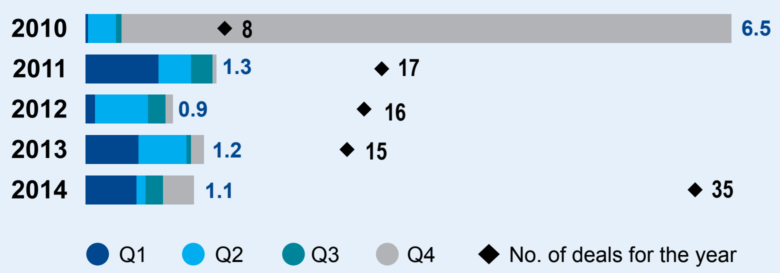
Rising food prices and product substitution saw M&A heat-up in the meat and poultry production segment, with 7 deals (2013: 2) worth a combined total of USD398 million (2013: USD140 million). The acquisition of a 40% stake in Inalca's Russian meat production business by Austrian investment company Knightsbridge, for USD83 million, was the largest inbound agricultural transaction in 2014. Agrokompleks acquisition of 14 agricultural farms with a combined land bank of 170,000 ha from Valinor Group for USD200 million, was the largest deal in the sector in 2014.

2015 OUTLOOK

We expect investment into what is an under invested sector to increase in 2015, driven by further vertical integration, consolidation of distressed assets and an increased level of inbound acquisitions, with Asian players leading the charge.

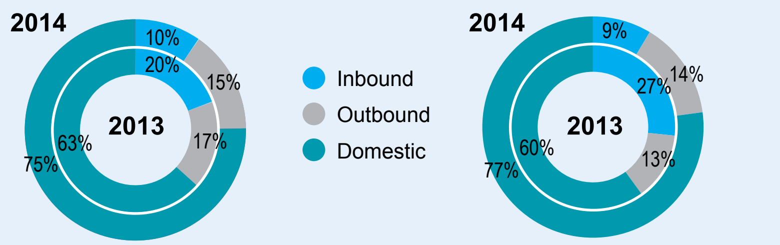
In recent years, state controlled banks have acquired interests in a number of agricultural assets as a result of debt refinancing and enforcement of security pledges. With liquidity constrained in the banking sector, we may see banks looking to raise capital through the disposal of such non-core assets, creating further opportunities for land banks to change hands in 2015.

Agriculture M&A, USDbn (2010–2014)



Source: KPMG analysis

Agriculture M&A value by type | **Agriculture M&A volume by type**



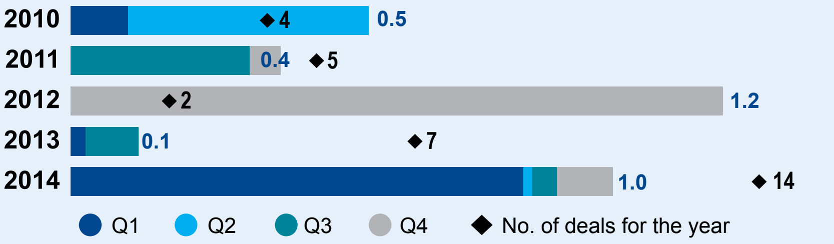
Source: KPMG analysis

Agriculture largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Valinor's agricultural business in Southern Russia**	Firma Agrokompleks	Valinor	100.0%	200
2	**Lisko Broiler**	Agro-Industrial Complex Mikhailovsky	Nikolay Belokonev (private investor)	100.0%	139
3	**Kuzbass Food Plant (KPK)**	KDV Group	Mikhail Vasilyev and Alexander Ivasenko (private investors)	100.0%	99
4	**Agrokultura AB**	Steenord Corp	n/d	51.7%	83
5	**Inalca (business in Russia)**	Knightsbridge Group	Inalca SpA	40.0%	83
	Five largest transactions total				604
	As a % of the total agriculture sector M&A				*55.8%*

Automotive

Automotive M&A, USDbn (2010–2014)

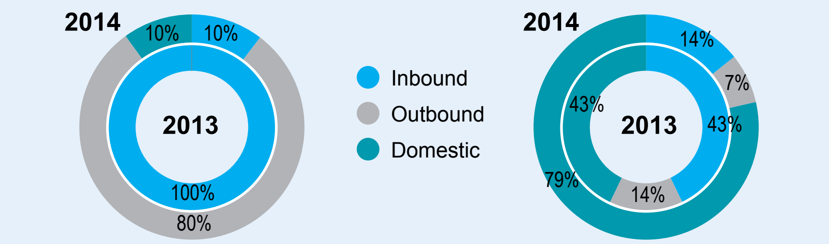


Note: Deal values for domestic and outbound deals in 2013 has not been disclosed.

Source: KPMG analysis

Automotive M&A value by type

Automotive M&A volume by type



Note: Deal values for domestic and outbound deals in 2013 has not been disclosed.

Source: KPMG analysis

Automotive largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Pirelli & C. S.p.A.**	Rosneft Oil Company	Intesa Sanpaolo S.p.A.; Clessidra SGR SpA; UniCredit Group	13.1%	769
2	**KAMAZ Incorporated**	Daimler AG	The European Bank for Reconstruction and Development	4.0%	100
3	**Moscow-based car dealership business of Mega-Auto**	AutoSpecCenter Group	Mega-Auto Group	100.0%	25
4	**Ulyanovsky Avtmobilny Zavod (UAZ)**	VTB Bank	Sollers	11.8%	23
5	**Ulyanovsk Automobile Plant (UAZ)**	Sollers	Minority shareholders	10.1%	18
	Five largest transactions total				935
	As a % of the total automotive sector M&A				*96.9%*

2014 DRIVERS

Acquisitions of minority stakes led to an increase in both the value and number of deals in the automotive sector during 2014. The largest deal in the sector saw Rosneft acquire a 13.1% stake in Pirelli as part of the strategy to strengthen the Italian tyre manufacturer's position in Russia under a 2012 research and development partnership between the two companies. Meanwhile, German automotive group Daimler, increased its interest in truck manufacturer Kamaz to 15% by acquiring a 4% stake from the European Bank for Reconstruction and Development (EBRD) for USD100 million. AutoSpecCenter Group completed the largest domestic deal in the automotive sector with the acquisition of the five car dealerships of Moscow-based Mega-Auto for USD25 million.

2015 OUTLOOK

In January 2015, the Association of European Businesses (AEB) Automotive Manufacturers Committee announced that it expected new car registrations to decline by a further 24% during 2015. We expect this to lead to a number of distressed assets on the market, providing consolidation opportunities for those players with stronger balance sheet positions. Overall though, we do not anticipate a significant increase in the level of automotive M&A during 2015.

Banking and insurance

2014 DRIVERS

The slowing economy and restricted access to international financing, increased the vulnerability of the Russian banking sector during 2014. The Central bank of Russia approved bailout plans for several banks[11] during 2014 and withdrew 94 banking licences (2013: 44) as it sought to prevent bankruptcies and remove the weakest players from the system.

Secondary public offerings of Moscow Exhange Micex-RTS and Otkritie Financial Corporation were amongst the largest deals in sector at USD469 million and USD451 million respectively. Russian players continued to invest in foreign assets, with Alfa Group's USD304 million acquisition of the Ukrainian business of Bank of Cyprus being the largest outbound deal in the sector.

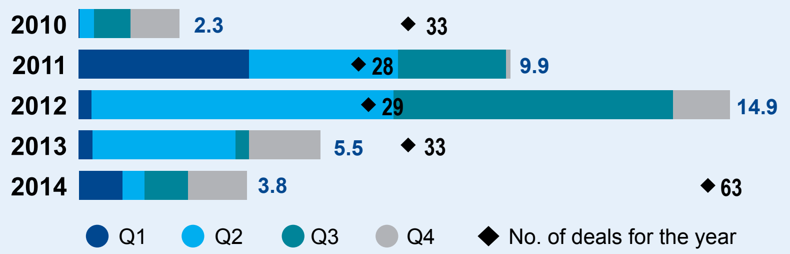
Several foreign players, including Zurich (retail business), Achmea and Home Credit, decided to exit their under-performing Russian insurance businesses during 2014. Changes in legislation drove M&A in the non-state pension fund (NPF) segment. O1 Group, under the control of Boris Mints, acquired NPF Blagosotoyanie OPS, one of the largest NPFs in the mandatory pension insurance sector with USD155 billion of funds under management as of 30 September 2014, in a deal estimated at USD461 million.

2015 OUTLOOK

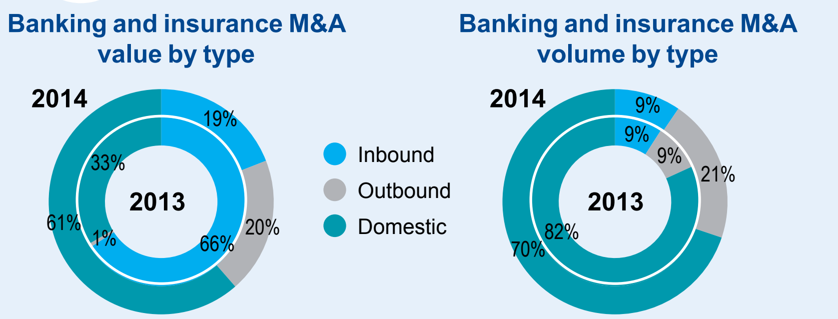
Profitability and asset quality in the banking sector are likely to deteriorate in 2015 driven by macroeconomic factors, leading to an increase in corporate defaults and a higher number of under-performing loans, and ultimately solvency problems.

Russian banks could receive up to 1 trillion roubles (USD16 billion) of aid via the Deposit Insurance Agency (DIA) under a new law approved by the government to support the sector. While low capitalisations and the increased risk of bankruptcy, could see further consolidation in the sector.

Banking and insurance M&A, USDbn (2010–2014)



Source: KPMG analysis



Source: KPMG analysis

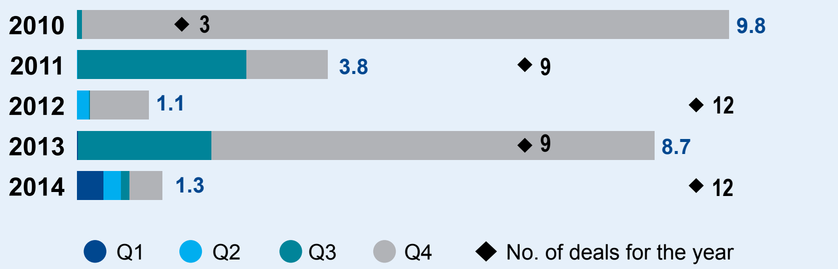
Banking and insurance largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Moscow Exchange MICEX-RTS**	Russian Direct Investment Fund (RDIF); Institutional investors; Private investors; Sovereign Wealth Fund of Qatar; Abu Dhabi Investment Authority; GIC Real Estate; Russia-China Investment Fund	Central Bank of Russia	11.7%	469
2	**Blagosostoyanie OPS**	O1 Group	Blagosostoyanie	100.0%	461
3	**Otkritie Financial Corporation Bank**	Institutional investors; Private investors	not applicable (SPO)	15.1%	451
4	**Bank of Cyprus PJSC**	Alfa Group	Bank of Cyprus Public Company Ltd	99.8%	304
5	**Bank Rossiya**	Ivan Mironov; Tatiana Svitova (private investors)	Gazprom Gazoraspredelenie	12.3%	173
	Five largest transactions total				1,858
	As a % of the total banking and insurance sector M&A				*48.3%*

[11] *Including amongst others, Trust Bank, Mosoblbank, Moscomprivatbank and Baltiyskiy Bank*

Chemicals

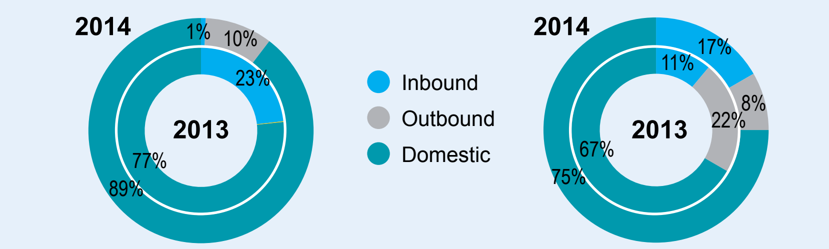
Chemicals M&A, USDbn (2010–2014)



Source: KPMG analysis

Chemicals M&A value by type

Chemicals M&A volume by type



Source: KPMG analysis

Chemicals largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**PhosAgro**	Igor Antoshin (private investor)	Andrey Guriev (private investor)	9.8%	369
2	**PhosAgro**	Vladimir Litvinenko (private investor)	Andrey Guriev (private investor)	4.9%	269
3	**PhosAgro-Cherepovets**	PhosAgro	Minority shareholders	12.4%	194
4	**Verkhnekamsk Potash Company**	Sberbank Investments	Acron	19.9%	186
5	**Delta Advanced Materials Limited**	CIS Acquisition Ltd.	Kleiner, Perkins, Caufield & Byers; Korea Investment Partners Co Ltd	100.0%	124
	Five largest transactions total				1,142
	As a % of the total chemicals sector M&A				*89.3%*

2014 DRIVERS

Minority stakes in several Russian fertilizer producers changed hands during 2014. Private investors Vladimir Litvinenko and Igor Antoshin consolidated their holdings in PhosAgro by acquiring stakes from the company's deputy chairman, Andrey Guriev, in two separate transactions worth a combined USD638 million. PhosAgro bought-out minority shareholders in PhosAgro-Cherepovets for USD194 million. While Acron reduced its holding in Verkhnekamsk Potash Company (VPC) to 51% by selling a 19.9% to Sberbank Investments for USD186 million – in December 2013 Acron repurchased the 10.9% stake in VPC it had sold to Raiffeisen bank in 2012.

The largest outbound transaction in the sector saw Anatoliy Danilitskiy's US listed CIS Acquisition, acquire Chinese speciality chemicals producer Delta Advanced Materials from its private equity owners in a USD124 million reverse takeover.

2015 OUTLOOK

Ageing production infrastructure and out dated technologies mean that Russian chemical producers lag behind their global peers. High prices of raw materials, electricity and rail transport coupled with limited demand for domestically produced chemicals has limited investment in the sector in recent years. The government's strategy for development of the industry to 2030 may stimulate M&A in the sector in the years to come, as players seek to consolidate their market position and take control of a greater proportion of the downstream value chain.

However, the level of M&A in the chemicals sector remains relatively low and has been driven to a large degree by opportunistic activity in recent years. With Russia entering recession, we do not anticipate significant activity in 2015 given the industry's dependence on the wider economy.

Communications and media

2014 DRIVERS

M&A in the communications and media sector was largely driven by activity in the internet and telecommunications segments during 2014.

Mail.RU Group consolidated its holding in the social network Vkontakte to 100% as a result of three transactions with a combined value of USD2.2 billion – Pavel Durov, the founder of VKontakte, and the private equity fund, United Capital Partners, exited the business with the latter realising more than twice the USD720 million it investment in April 2013. Other internet assets, including Headhunter and Auto.ru, changed hands in a number of smaller deals during 2014.

The integration of Rostelecom and Tele2's mobile assets[12] created a fourth federal mobile operator reshaping the industry and establishing a new base for promotion of telecom services in Russia for many years to come. Outside of this, the largest deal in the telecommunications segment saw Gleb Fetisov exit his holding in Altimo for USD1.15 billion.

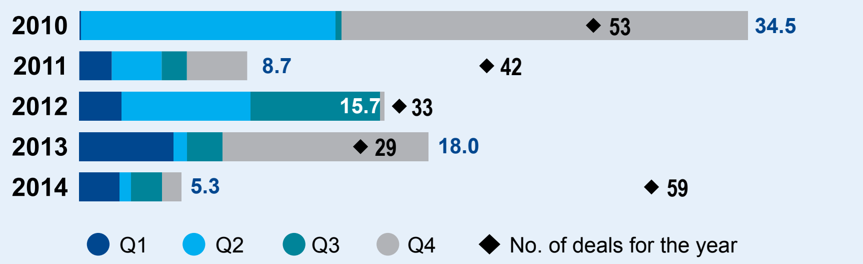
2015 OUTLOOK

Macroeconomic factors will likely see operators reduce organic and inorganic investment, and focus on expansion of data centres, content and subscriber bases given declining fixed line revenues but growing mobile internet traffic.

We expect to see further consolidation of smaller players, as telecom operators and media holdings seek opportunities for strategic partnerships and joint ventures to improve existing and diversify into new channels of content delivery. Alliances will help to deliver revenue growth from existing users, new customers and markets by focusing on delivery and customer service while also promoting media content reach and popularity.

Furthermore, domestic players may also benefit from restructurings and exists of media holdings by overseas owners following the limitations placed on foreign ownership by the mass media law passed in October 2014.

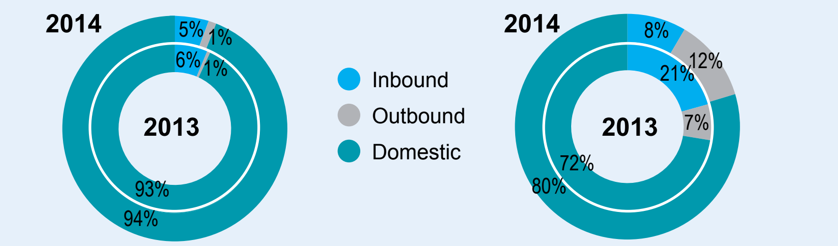
Communications and media M&A, USDbn (2010–2014)



Source: KPMG analysis

Communications and media M&A value by type

Communications and media M&A volume by type



Source: KPMG analysis

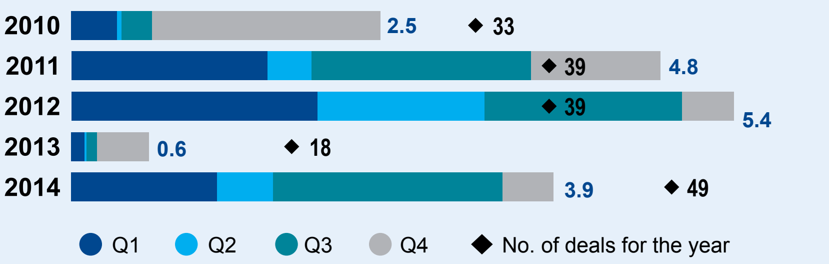
Communications and media largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Vkontakte**	Mail.ru Group Limited	United Capital Partners Advisory	48.0%	1,470
2	**Altimo**	LetterOne Group	Gleb Fetisov (private investor)	14.2%	1,150
3	**Cinema Park**	Said Kerimov (private investor)	Interros Company	100.0%	400
4	**Vkontakte**	Ivan Tavrin (private investor)	Pavel Durov (private investor)	12.0%	360
5	**Vkontakte**	Mail.ru Group Limited	Ivan Tavrin (private investor)	12.0%	352
	Five largest transactions total				3,732
	As a % of the total communications and media sector M&A				*71.1%*

[12] *Three transactions which led to a change of control in Tele2 and creation of the T2 RTK Holding joint venture, accounted for USD12.2bn of M&A in the sector in 2013*

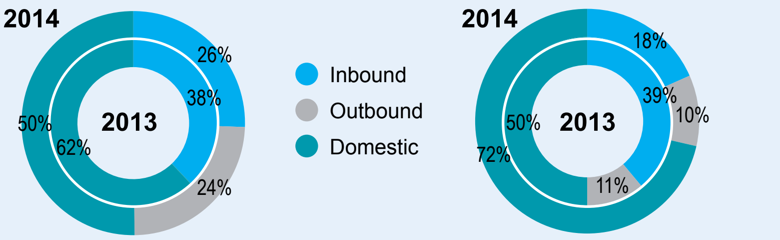
Consumer markets

Consumer markets M&A, USDbn (2010–2014)



Source: KPMG analysis

Consumer markets M&A value by type / Consumer markets M&A volume by type



Source: KPMG analysis

Consumer markets largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Lenta**	Institutional and private investors	TPG Capital 11.1% European Bank for Reconstruction and Development 4.8% VTB Capital 2.6%	22.6%	952
2	**Pabst Brewing Company**	TSG Consumer Partners; Oasis Beverages	C. Dean Metropoulos & Co	100.0%	725
3	**Euroset Group**	MegaFon	Garsdale Services Investment Limited	25.0%	657
4	**Flipkart Online Services Pvt. Ltd.**	DST Global	n/d	n/d	210
5	**United Confectioners**	Guta Group	Moscow City Government	26.6%	187
	Five largest transactions total				2,731
	As a % of the total consumer markets sector M&A				*69.4%*

2014 DRIVERS

Consumer markets M&A rebounded during 2014, due mainly to a small number of comparatively larger deals. In retail, hypermarket chain Lenta completed its long-awaited initial public offering, MegaFon increased its distribution footprint by acquiring a 25% stake in mobile phone retailer Euroset, and DST Global acquired an undisclosed stake in the Indian online retailer, Flipkart, for USD210 million to fund the retailers next stage of development. Russian beer and soft drinks maker, Oasis Beverages with TSG Consumer Partners, acquired US Pabst Brewing Co. for USD725 million, while Guta Group completed the privatisation of United Confectioners by acquiring the governments remaining stake. Outside of the top five, deals focused on consolidation of smaller players in the retail, food and beverage and e-commerce segments, with the average transaction size down by 30% to USD40 million.

Several international brands exited the Russian retail market during the second half of the year as the economic outlook started to further deteriorate. The largest of these exits saw Norway's Orkla sell its Russian confectionery business to Slavyanka for USD125 million and Finland's Oriola-KD sell its Russian pharmacy chain to Pharmacy Chain 36.6 for USD70 million.

2015 OUTLOOK

In recent years the Russian consumer markets sector has been driven by regional expansion, through green and brown-field store openings, and consolidation of small-to-medium sized retailers.

We expect to see the non-food consumer segments suffer as the economy weakens. A number of small-to-medium sized regional players are likely to become insolvent due in part to a lack of access to finance but also the greater economy of scale of larger players with lean operational infrastructure. This will result in further consolidation of federal and national retailers.

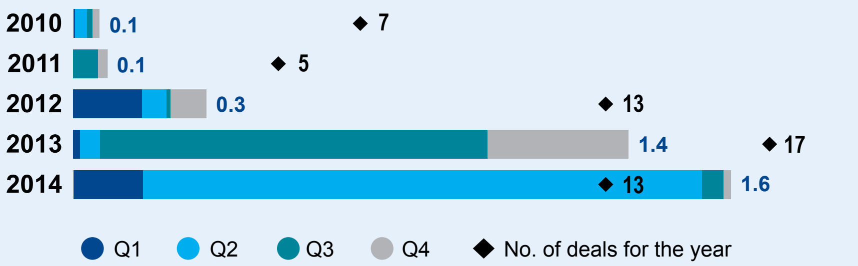
Foreign majors are likely to continue looking for opportunistic acquisitions and greenfield projects given relatively undervalued Russian assets, although we do not expect to see significant levels of activity until the macroeconomic outlook improves. Notwithstanding the economic outlook, certain assets still appear capable of attracting robust valuations, as evidenced by the placing of a 1% stake in Russian retailer Magnit, mainly to UK and US institutional investors, in February 2015 for USD147 million.

Healthcare and pharmaceuticals

2014 DRIVERS

M&A in the healthcare and pharmaceuticals sector during 2014 was defined by three transactions. Investment company Millhouse and listed pharmaceutical company Pharmstandart, agreed to pay Gazprombank USD700 million for the 70% stake it had acquired in Biocad, the Russian biotechnology company, in August 2011. US-listed Abbott Laboratories, established its manufacturing presence in Russia through the USD631 million acquisition of generic and oncology drug producer Veropharm. While R-Pharm continued its international expansion by acquiring Pfizer's Illertissen production plant, in Germany, for USD171 million.

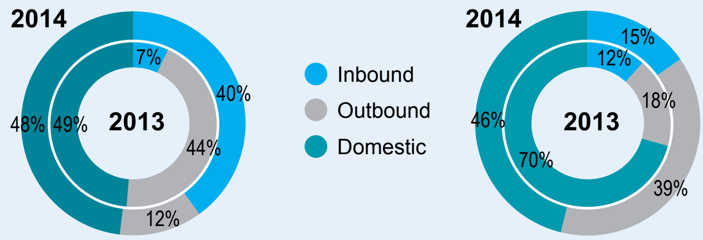
Healthcare and pharmaceuticals M&A, USDbn (2010–2014)



Source: KPMG analysis

Healthcare and pharmaceuticals M&A value by type

Healthcare and pharmaceuticals M&A volume by type



Source: KPMG analysis

2015 OUTLOOK

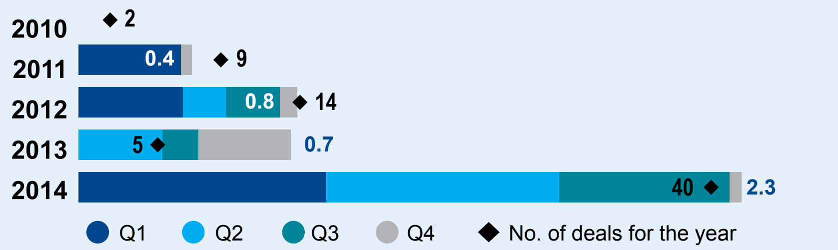
We expect the Russian healthcare and pharmaceuticals sector to continue to attract domestic and foreign investors over the long term driven by population demographics, demand for access to quality healthcare and relative fragmentation of the sector. However, in the short-term at least, macroeconomic factors are likely to weigh down on the level of inbound and outbound investment, although domestic players with strong balance sheets may take advantage of under-priced assets to further consolidate market share.

Healthcare and pharmaceuticals largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Biocad CJSC**	Pharmstandart; Millhouse	Gazprombank	70.0%	700
2	**Veropharm**	Abbott Laboratories	Roman Avdeev (private investor)	100.0%	631
3	**Pfizer Inc (Production plant in Illertissen)**	R-Pharm	Pfizer Inc	100.0%	171
4	**Avicenna Medical Centre**	MD Medical Group Investments Plc	Boris Ayzikovich (private investor)	100.0%	46
5	**Dunes Sanatorium**	Dunes Sanatorium	St Petersburg Property Fund	100.0%	18
	Five largest transactions total				1,566
	As a % of the total healthcare and pharmaceuticals sector M&A				*97.5%*

Innovation and technology

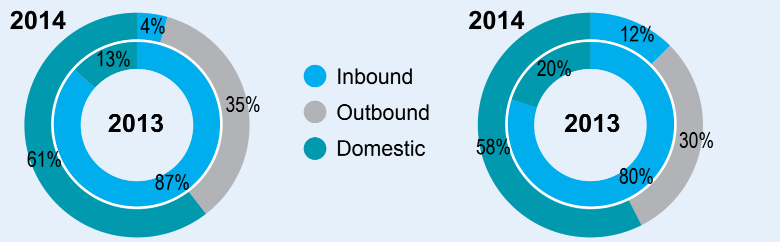
Innovation and technology M&A, USDbn (2010–2014)



Source: KPMG analysis

Innovation and technology M&A value by type

Innovation and technology M&A volume by type



Source: KPMG analysis

Innovation and technology largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Octo Telematics S.p.A.**	Renova Group	Amadeus Capital Partners Limited; Charme Investments S.C.A.; Keensight Capital	100.0%	548
2	**NIIME i Mikron**	RusNano	n/d	25.1%	372
3	**QIWI Group**	n/d	Mail.ru Group and private investors, ADS issued (SPO)	25.7%	319
4	**ST Holding (Space Team)**	Sergey Gushchin; Sergei Smyslov (private investors)	Evgenii Troinin	100.0%	200
5	**Sitronics-Nano**	Research Institute of Molecular Electronics and Mikron (NIIME and Mikron)	Russian Nanotechnology Corporation (RUSNANO)	37.7%	176
	Five largest transactions total				1,615
	As a % of the total innovations and technology sector M&A				*69.4%*

2014 DRIVERS

Acquisitions of overseas assets, and investment into smaller Russian software and technology companies were the main driver of the significant increase in both the number and value of deals announced in the innovation and technology sector during 2014.

Russian players developed a taste for overseas assets in 2014, as outbound investment accounted for 35% (2013: nil) of total M&A in the sector. With the exception of three Israeli investments, outbound M&A was exclusively focused on the US and Europe. In line with its strategy to increase investment in high-tech companies, Renova acquired Italy's Octo Telematics for USD548 million. This was one of three deals in the fast-growing telematics/analytics segment, as businessmen Sergei Smyslov and Sergei Gushchin acquired ST Holding (USD200 million), and Onexim and Sputnik Group acquired a 49.9% stake in collective intelligence company, Witology (USD5 million).

Investment into smaller Russian software and technology companies accounted for 43% of all deals in the sector during 2014, and were the key reason for the average transaction size falling by half to USD70 million – over three fourths of all deals with announced transaction values in the sector were below this level.

2015 OUTLOOK

Given the focus of state-controlled entities such as Rostec and Rusnano, as well as private holdings like Renova, on high-tech and innovative segments of the economy, we expect to see the level of M&A in the innovation and technology sector continue to increase over the coming years. However, it is not only domestic players who will drive M&A activity – Russia has a long history of developing innovative technologies and foreign investors will continue to be attracted albeit that the level of such investment is likely to remain subdued until the current geopolitical situation is resolved.

Metals and mining

2014 DRIVERS

The value of metals and mining M&A declined in 2014 as commodity prices remained stubbornly low and access to capital was restricted, leading Russian players to concentrate on disposals of overseas assets in order to reduce operating costs and service debts – the value of such disposals, which fall outside the parameters of this report, exceeded USD3 billion in 2014[13].

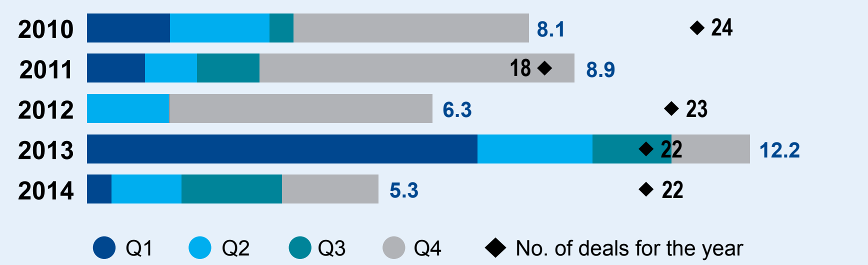
In separate deals management of USM Holding and VSMPO Avisma completed buy-outs of 10% and 15% stakes in each company respectively, accounting for over 40% of the total value of M&A in the sector.

The gold-mining sector remained the most attractive segment supported by increasing demand for gold reserves from the Central Bank of Russia. A total of five deals were announced in the segment with a combined value of USD2.72 billion, including the acquisition of a 18.5% stake in Polyus Gold by businessman Oleg Mkrtchan for USD1.6 billion, and the acquisition of Altynalmas Gold by Polymetal for USD1.1 billion.

2015 OUTLOOK

With the economic outlook worsening, we expect to see players with strong balance sheets take advantage of opportunities to consolidate small to medium sized assets. Russian majors will continue to focus on disposals of overseas assets, such as Mechel's recently announced sale of its US coal mining asset Bluestone. Global players suffering from declining margins as a result of low commodity prices and devaluation of the rouble may look to exit the Russian market, following Alcoa and Arcelor Mittal who recently announced plans to dispose of their foil manufacturing and coal assets respectively.

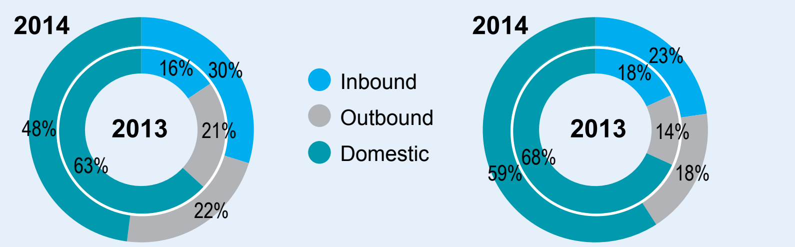
Metals and mining M&A, USDbn (2010–2014)



Source: KPMG analysis

Metals and mining M&A value by type

Metals and mining M&A volume by type



Source: KPMG analysis

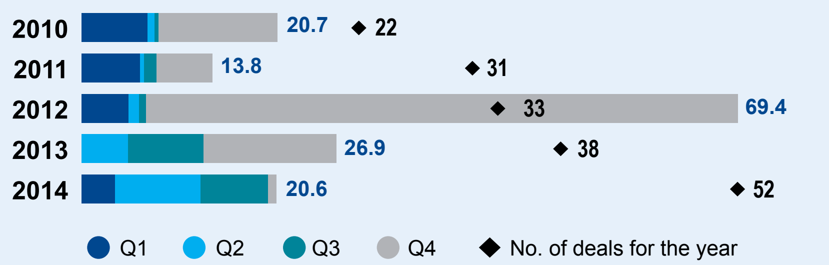
Metals and mining largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**USM Holdings Limited**	Management Vehicle	Alisher Usmanov (private investor)	10.0%	1,800
2	**Polyus Gold International Ltd**	Oleg Mkrtchan (private investor)	Halyard Global Limited	18.5%	1,584
3	**Altynalmas Gold Ltd.**	Polymetal International plc	Sumeru Gold BV; Sumeru LLP	100.0%	1,119
4	**VSMPO Avisma (Verkhnyaya Salda Metallurgical Production Association)**	VSMPO Avisma (management)	Gazprombank	15.0%	405
5	**Pervaya Nerudnaya Kompaniya (PNK)**	Nerudnaya Kompania Berdyaush	Russian Railways	75.0%	141
	Five largest transactions total				5,049
	As a % of the total metals and mining sector M&A				*94.5%*

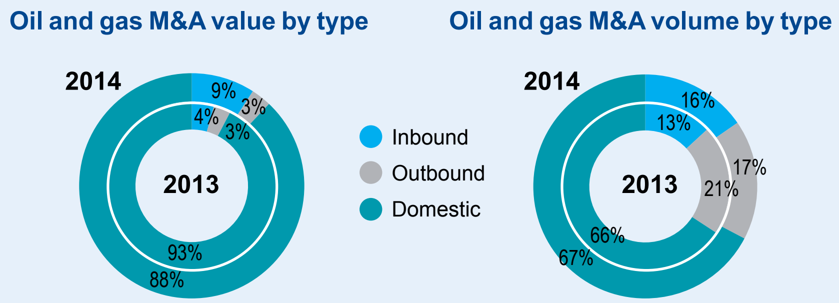
[13] *Including Severstal (Columbus, Dearborn and PBS Coals in North America), Evraz (Vitkovce in Czech Republic, and 34% stake of Highveld in South Africa), and Norlisk Nickel (Nkomati and Tati in Africa, and various gold and nickel mines in Australia)*

Oil and gas

Oil and gas M&A, USDbn (2010–2014)



Source: KPMG analysis



Source: KPMG analysis

Oil and gas largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**NNK-Aktiv**	Alliance Group/ The Independent Petroleum Company	Alliance Group/ The Independent Petroleum Company	JV 60:40	6,000
2	**NNK-Aktiv**	The Independent Petroleum Company	Alliance Group	60.0%	4,200
3	**Yugragazpererabotka**	SIBUR Holding	Rosneft Oil Company	49.0%	1,600
4	**Burneftegaz**	Bashneft ANK	Oleg Burlakov (private investor)	100.0%	1,000
5	**SANORS**	Rosneft Oil Company	SANORS Holding Limited	100.0%	1,000
	Five largest transactions total				13,800
	As a % of the total oil and gas sector M&A				*67.1%*

2014 DRIVERS

The falling oil price coupled with constrained access to capital as a result of the economic sanctions resulted in the value of M&A in the oil and gas sector declining by USD6.3 billion (24%), despite a more than one-third increase in the number of deals.

The oil and gas sector attracted the highest concentration of Russian M&A transactions valued over USD1 billion (5 out of 12) in 2014. The two largest deals saw Independent Petroleum Company form a 60/40 joint venture with Alliance Group in April, only to subsequently buy-out Alliance's stake in September. In November, the Federal Agency for State Property Management nationalised AFK Sistema's stake in Bashneft ANK based on a ruling by the Moscow Commercial Court. AFK Sistema has claimed damages from Ural-Invest, from whom it acquired the Bashneft stake in 2009, although no value is attributed to this transaction in our database as the court case is ongoing.

Gazprom and Rosneft continued to lead the market, announcing 7 and 11 deals in Oil and gas sector[14] respectively in 2014. However, some of these deals have yet to be closed, having been announced before the sanctions and fall in oil prices, and may be put on hold or even postponed.

2015 OUTLOOK

Given the current macroeconomic outlook, we do not expect significant levels of M&A activity in 2015. With restricted access to external financing, key players are likely to focus on funding priority capital investment programs and repayment of debt, ahead of M&A.

Over the next few years we expect to see an increase in production companies selling minority interests to strategic and financial investors as a means to raising finance, as well as further consolidation of oilfield services assets. Opportunistic acquisitions will increase during 2015 as some assets face financial distress as a result of the recession and strong US dollar.

As in previous years, we anticipate further investment from Asian oil majors, as well as financial investors and Middle East players.

[14] Gazprom and Rosneft were also active in other sectors, announcing a total of 12 and 2 deals respectively outside of the oil and gas sector

Power and utilities

2014 DRIVERS

Investor appetite for the power and utilities sector continued to be depressed by restrictions on tariff growth, resulting in the value of M&A in the power and utilities sector falling 71% to USD5.6 billion.

Volzhshakaya TGK, the listed electricity and heat generation company, announced five transactions worth a combined USD4.3 billion, consolidating several generating assets (including TGK-5, TGK-6, TGK-9 and Russian Communal Systems) as part of the restructuring of KES Holding to increase transparency, and potentially facilitating its future sale.

Large industry players including EuroSibEnergy, InterRAO and Rosneftegaz, continued the recent trend of asset consolidation within the sector, with the latter acquiring a minority stake in InterRAO from The Federal Agency for State Property Management during 2014.

Limited future tariff growth and asset valuation gaps resulted in a number of proposed deal not going ahead during 2014, including EdF's proposed acquisition of power generator Quadra from Onexim, and the sale of Teploset by TGK-1.

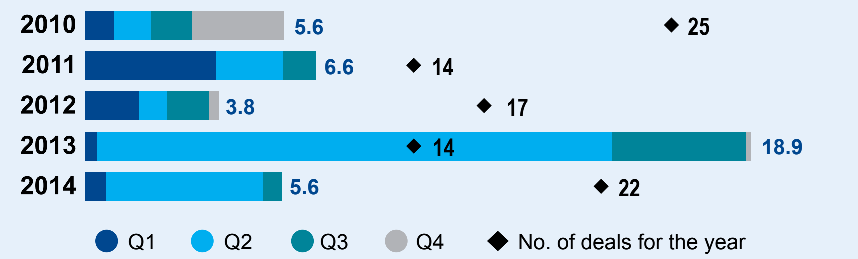
2015 OUTLOOK

Overall we expect M&A in the power and utilities sector to remain subdued during 2015 as domestic players focus on cost reduction and operational efficiency, given continued pressure on tariff inflation. The drive for efficiency may lead to further disposals of non-core assets and, potentially, consolidation in order to achieve greater economies of scale.

The heat generation segment is likely to remain attractive based on recent changes in the alternative boiler method of tariff setting, while auctions of capacity supply agreements will also drive some M&A in the renewables segment.

With Western investment constrained as a result of the sanctions, many eyes will be looking to see whether the sustained interest seen from Asian investors in recent years, and particularly China, results in transactions. Several deals between Chinese and Russian companies have been rumoured for 2015, including the creation of a joint venture between Power China and Rushydro.

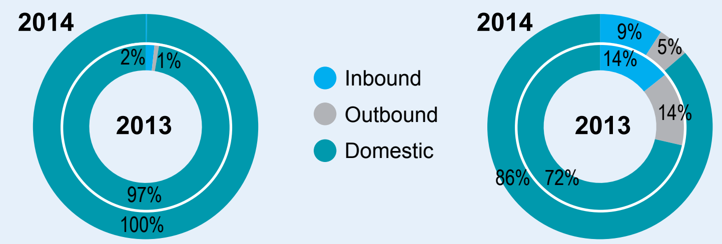
Power and utilities M&A, USDbn (2010–2014)



Source: KPMG analysis

Power and utilities M&A value by type

Power and utilities M&A volume by type



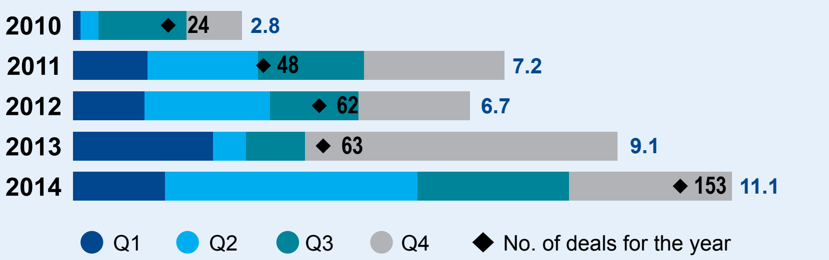
Source: KPMG analysis

Power and utilities largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**TGK-9**	Volzhskaya TGK	KES Holding	n/d	1,844
2	**TGK-5**	Volzhskaya TGK	KES Holding	n/d	869
3	**TGK-6**	Volzhskaya TGK	KES Holding	n/d	680
4	**Russian Communal Systems**	Volzhskaya TGK	Renova Group	n/d	578
5	**INTER RAO UES**	Rosneftegaz	Federal Agency for State Property Management	13.8%	565
	Five largest transactions total				4,536
	As a % of the total power and utilities sector M&A				*81.3%*

Real estate and construction

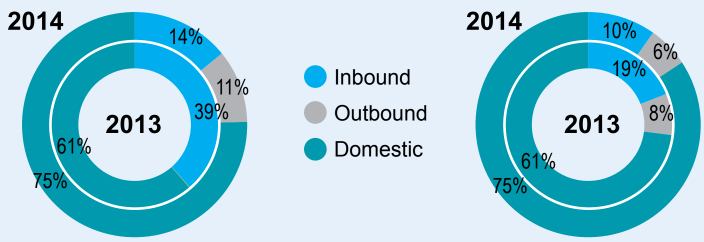
Real estate and construction M&A, USDbn (2010–2014)



Source: KPMG analysis

Real estate and construction M&A value by type

Real estate and construction M&A volume by type



Source: KPMG analysis

Real estate and construction largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Mordovcement**	Eurocement Group	Vita-Line	100.0%	986
2	**Zil Automobile Factory**	LSR Group	City of Moscow	100.0%	797
3	**CA Immobilien Anlagen AG**	O1 Group Limited	UniCredit Bank Austria AG	16.4%	373
4	**Novinsky Passage**	Mikhail Gutseriev; Said Gutseriev (private investor)	Vnesheconombank (VEB)	100.0%	362
5	**Imperia Tower**	Solvers Group	MCG	100.0%	360
	Five largest transactions total				2,878
	As a % of the total real estate and construction sector M&A				*26.0%*

2014 DRIVERS

M&A in the real estate and construction sector increased by 21% in 2014 to USD11.1 billion, as the number of deals rocketed. State controlled enterprises played a key role, acting as either buyer or seller on 64 deals worth a combined USD4.2 billion.

Russian real estate accounted for 77% of deal value, and although inbound investment fell by 60% to USD1.4 billion, domestic players displayed an increased appetite for what was generally perceived as a comparatively safer investment. Russian commercial real estate deals fell by almost half to USD4.2 billion with investors increasingly concerned about the slowing Russian economy.

Eurocement consolidated its hold on the cement and construction materials segment by acquiring Mordovcement from Raisa Tuturina and Sergey Siushov for an estimated USD986 million, while Swiss-listed real estate investment and development fund, Eastern Property Holdings, completed four deals in the Moscow office market during 2014 totalling USD547 million. Nine outbound transactions were announced during 2014, totalling USD1.2 billion (2013: USD7 million), the largest being O1 Group’s acquisition of a 16% stake in the Austrian-listed real estate development and management company, CA Immobilien Anlagen, for USD373 million. While the largest inbound transaction in the sector during 2014 saw Qatar Investment Authority acquire the 207 unit Pokrovsky Hills townhouse development in Moscow for USD350 million.

2015 OUTLOOK

We expect M&A in the sector to fall during 2015. Recession will see demand for commercial real estate soften as unprofitable retail outlets close and companies reassess office leases. Although investors may start to look more closely at B class office space, we do not anticipate a significant number of transactions.

Recent changes in legislation which prevent the sale of state or municipal land for construction may well see some domestic players revisit their investment strategy. The macroeconomic environment is likely to provide opportunities for further consolidation of the construction sector by larger domestic players.

Transport and infrastructure

2014 DRIVERS

Concerns regarding the economic outlook saw the value of M&A in the transport and infrastructure sector fall by 30% in 2014 to USD7.8 billion, as a number of players focused on restructuring existing operations leading to disposals of some non-core assets.

Infrastructure construction attracted the largest share of investment. Ruslan Baysarov increased his holding in Stroygazconsulting to 74.1% with the acquisition of a 44.1% stake for USD5.0 billion, less than six months after paying USD4.8 billion for 30% of the infrastructure construction group. Meanwhile, Basic Element acquired a 48.9% stake in Transstroy, a company specialising in transport infrastructure and heavy construction projects, for USD600 million.

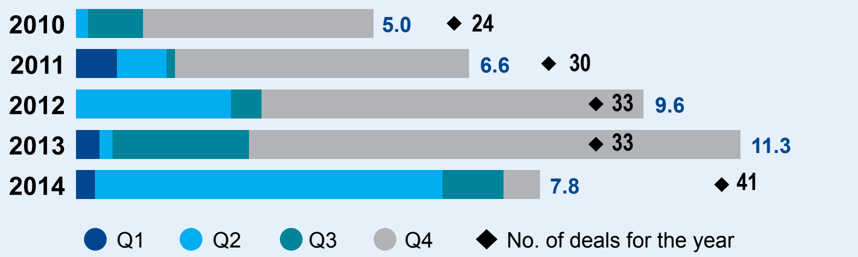
Declining profitability and a generally weak outlook for the transport segment led to a low number of transactions during 2014. The largest deals led to RDIF and Gazprom Bank acquiring the Ust-Luga LPG terminal from Sibur for USD700 million, and state bank Vnesheconombank acquiring a 29% stake in the airplane manufacturer Sukhoi for USD693 million to enable the company to ramp-up production of its Superjet 100 short-range aircraft.

2015 OUTLOOK

With the 2018 FIFA World Cup now three years away, there is a continued need to attract public and private investment into Russia's transport and infrastructure network. We expect to see further consolidation of rail freight, airport, and infrastructure assets during 2015, as well as increased investment in toll roads and development of multimodal transportation services, including door-to-door delivery models.

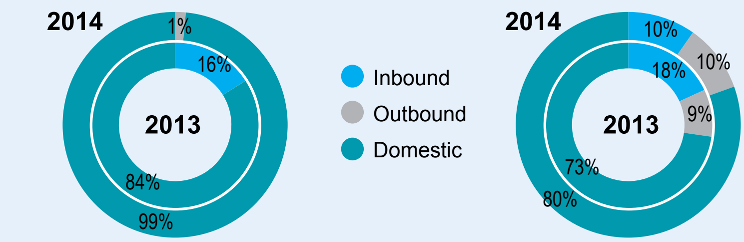
Some companies will seek new investors, with those in the aviation segment likely to be amongst the first due financial pressures of operating in the current economic environment. The road freight segment is also under pressure from declining shipment volumes, implementation of road tolls for heavy vehicles and increase in excise tax on fuel, which may lead to business failures, takeovers and further market consolidation.

Transport and infrastructure M&A, USDbn (2010–2014)



Source: KPMG analysis

Transport and infrastructure M&A value by type / Transport and infrastructure M&A volume by type



Source: KPMG analysis

Transport and infrastructure largest deals in 2014

	Target	Acquirer	Vendor	% acquired	Value USDm
1	**Stroygazconsulting**	Ruslan Baysarov (private investor)	Ziyad Manasir (private investor)	44.1%	5,000
2	**Marine terminal in Ust-Luga**	Gazprombank; A consortium led by Russian Direct Investment Fund	SIBUR Holding	100.0%	700
3	**Sukhoi Company**	Vnesheconombank	n/d	28.6%	693
4	**Transstroy**	Egor Andreev (private investor)	Basic Element	48.9%	600
5	**Neftetransport**	TransOil	Worldwide Invest AS	100.0%	125
	Five largest transactions total				7,118
	As a % of the total transport and infrastructure sector M&A				*90.7%*

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