



# Ukrainian M&A Review 2017

**March 2018**

KPMG in Ukraine

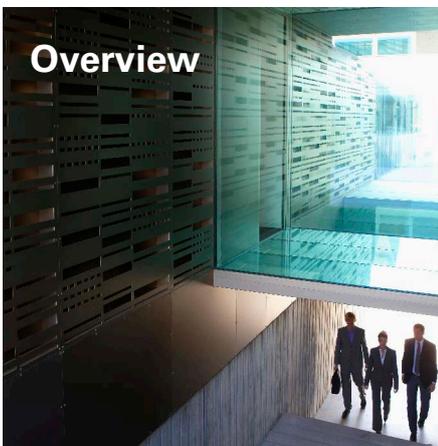
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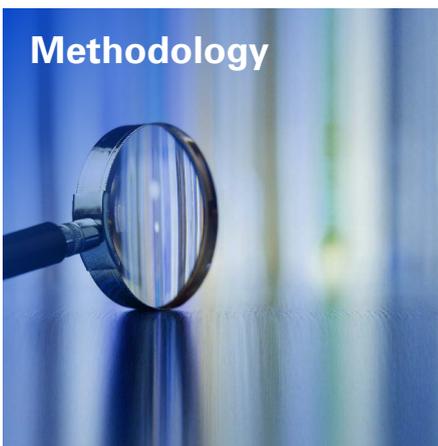
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# Introduction

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We remain optimistic that the year ahead will see further growth in Ukrainian M&A, both in terms of the number and value of deals, driven in part by the increasing appetite of foreign investors, and demand for assets with strong export potential.

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## **Welcome to the inaugural edition of the KPMG's Ukrainian M&A review.**

After successive years of decline, 2017 finally saw Ukrainian M&A return to growth, both in terms of deal flow (22 per cent) and the aggregate value of transactions announced (37 per cent).

However, deal activity remains well below the recent peak of 2013, and at just under one per cent of GDP, Ukrainian M&A<sup>1</sup> is four times lower than the global average and less than one tenth of US or UK deal making. While this is symptomatic of the turbulent economic and political situation the country has faced over recent years, which inevitably impacted the capacity of domestic investors and appetite of foreign investors, it also reflects the low level of transparency in Ukrainian M&A, which is likely to distort the data reported in this review.

While positive steps have been made towards reforming the economy, there is still a long road ahead if the conditions imposed by the IMF and EU as part of their multi-billion dollar loan packages are to be achieved. Notwithstanding this, given the underlying trends and market sentiment we remain optimistic that the year ahead will see further growth in Ukrainian M&A, both in terms of the number and value of deals, driven in part by the increasing appetite of foreign investors, and demand for assets with strong export potential.

KPMG has an important role to play in the Ukrainian M&A market, not only as an advisor to those seeking to engage in transactions but also as independent source of insights into the market, associated opportunities and risks. We believe it is our duty to responsibly promote Ukraine as an investment destination to our clients, and believe that the M&A review is a helpful starting point for such insights.

## **Peter Latos**

### **Partner, Head of Deal Advisory Ukraine**

<sup>1</sup> From 2014 to 2017, deal values were only disclosed for less than half of all transactions announced



# Overview

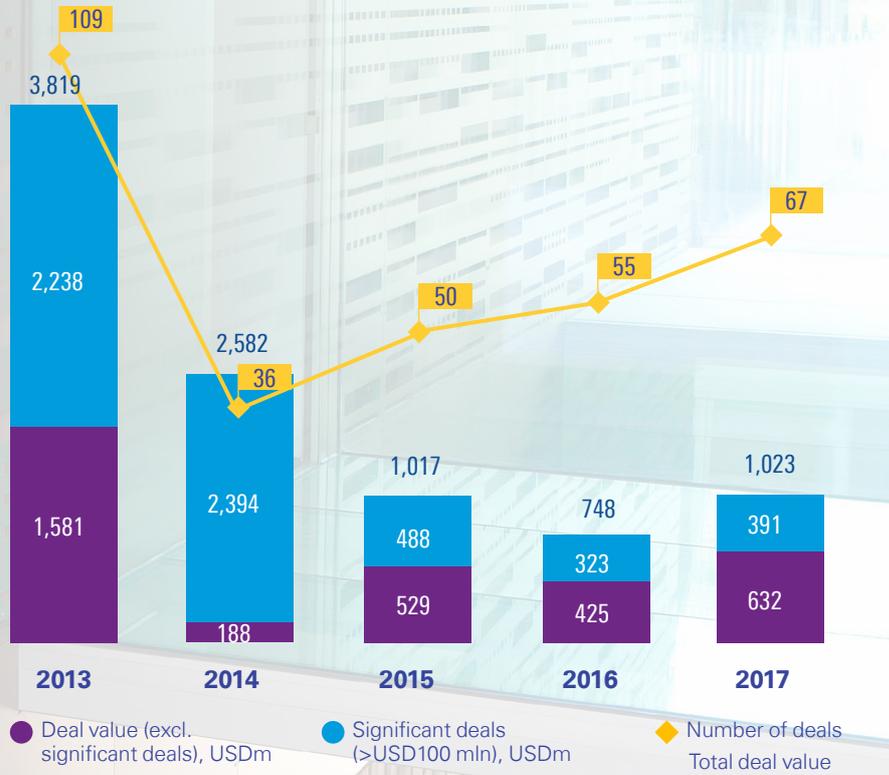
Although Ukrainian M&A remains relatively modest by comparison to other Central Eastern European (CEE) countries, and is still well below the recent peak of 2013, we continue to see a number of positive indicators for the country's deal activity.

Overall, Ukrainian M&A recorded double-digit growth in both the number and value of deals announced in 2017: activity increased by 22 per cent to 67 deals, with a combined value of USD1 billion, 37 per cent higher than the previous year.

37% USD 1 bn

67 deals

Ukrainian M&A (2013–2017)



The value of 2017 Ukrainian M&A was driven to a large extent by three deals each valued in excess of USD100 million. In June 2017, Kernel, Ukraine's largest agricultural business, used part of the proceeds from its January Eurobond raising to acquire Ukrainian Agrarian Investments from Russia's Onexim Group for USD155 million. A group of international investors acquired a 13 per cent stake in Ferrexpo from CERCL Holdings in January for USD126 million, while in May Evraz Group sold its Ukrainian iron ore mine and beneficiation plant (ESB) to DCH Group for USD110 million.



### Ukrainian M&A largest deals in 2017

	Target	Sector	Acquirer	Vendor	% acquired	Value USDm	
 <p>10 largest deals in period USD 714 million</p> <p>As % of total transactions in 2017 70%</p> 	1	Ukrainian Agrarian Investments	Agriculture	Kernel Holding	ONEXIM Group	100%	155
	2	Ferrexpo	Metals and mining	BlackRock; TT International; Institutional investors	CERCL Holdings	13%	126
	3	Evraz Sukha Balka	Metals and mining	Berklemond Investments (DCH Group)	Evraz Group S.A.	100%	110
	4	Druzhba Narodiv Nova; Druzhba Narodiv; Crimean Fruit Company	Agriculture	Undisclosed	Myronivsky Hliboproduct	100%	78
	5	10 agricultural companies of Glencore	Agriculture	Epicentre	Glencore	75%	55
	6	IntroPro	TMT (IT)	Luxoft Holding		100%	53
	7	Agro Invest Ukraine	Agriculture	Kernel Holding SA	MK Group	100%	43
	8	Astarta Holding	Agriculture	Fairfax Financial Holdings	Aluxes Holding Limited; Albacon Ventures Limited (Valery Korotkov - private investor)	10%	37
	9	Kyivenergo	Power and utilities	System Capital Management/Ornex	State Property Fund	25%	30
	10	DTEK Dniproenergo	Power and utilities	System Capital Management/Ornex	State Property Fund	25%	28

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We expect to see more deals across a wider range of sectors in 2018, and spread through more regions of the country.

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A number of key factors and emerging trends influenced Ukrainian M&A in 2017, that will also have some effect in 2018 and beyond:

- Increased dealmaking in the agricultural sector owing to high crop yields and profitability in recent years, together with improved debt raising capabilities of the largest players;
- Renewed interest from Dragon Capital in commercial and logistics real estate owing to low purchase prices and anticipated high return on investments in relatively lower-risk assets.
- Higher volume of investments into the IT industry driven by foreign capital and the export orientation of the sector;
- The first steps in promising and long-awaited state privatization program, following the sale of minority stakes in regional oblenargo (power distribution companies);
- Exit of Russian banks from Ukraine due to significant limitations being imposed on their operations;
- Ukrainian businesses forced to sell operations in Crimea.



21 deals worth  
USD 0.4 bn  
of inbound M&A  
announced in 2017

While the value of inbound M&A fell by just over one-third in 2017 to USD351 million, the number of deals has remained broadly stable over the last three years. This reflects investors continued confidence in the medium-to-long-term prospects of the country, and, although progress has been sluggish at times, government's efforts to implement reforms to transform the economy. Likewise, Foreign Direct Investment (FDI) has recovered sharply from the nadir of 2014, with a number of investment funds returning to Ukraine. US-based Overseas Private Investment Corporation (OPIC) for example has quadrupled its investment portfolio in the country since 2014, across a range of sectors, from financial services, to agriculture and energy.



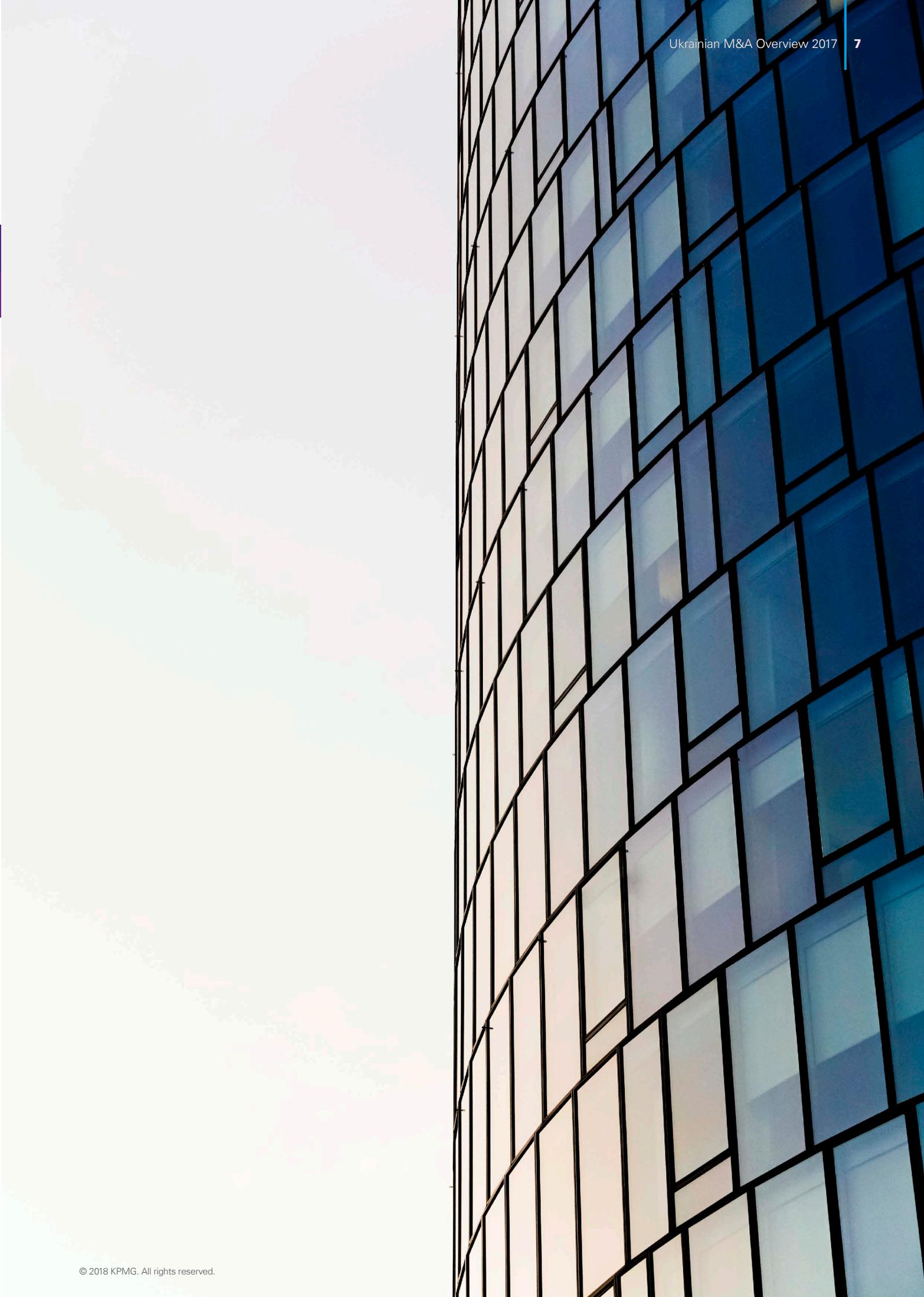
Key expectation  
for 2018

The number of transactions and the aggregate value of deals **will continue to grow and show a strong gain over 2017.**



Our outlook for 2018 remains upbeat, and overall we expect to see further growth in both the activity and value of Ukrainian M&A. This will in part be driven by a higher level of inbound M&A, and we have seen strong levels of interest since the last quarter of 2017 but also increased domestic activity from both strategic and financial investors, as the economy improves.





# 2017 in Review

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Despite the the escalation in the dispute in the East, Ukraine has demonstrated a positive albeit moderate economic growth, and growing dealmaking activities.

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The year started with renewed optimism that economic growth would pick up and broaden out; instead most agencies cut their growth forecasts several times as the optimism failed to materialize. At the start of 2017 the International Monetary Fund (IMF) forecast growth at 2.5 per cent and was optimistic that this would be upgraded further during the year. But, at its October review, the IMF reduced its forecast to 2 per cent and warned that tough economic conditions were likely to persist into 2018. One of the reasons cited for the slower growth was the escalation in the dispute in the East which resulted in various types of coal and steel products being cut-off, and some power supply disruption from Donbass to the rest of the country. That disruption reduced output from such industries as steel, coal and coking coal and forced the country to significantly increase thermal coal supplies from other countries.

**The dispute in the East has affected predominantly metals and mining sector**



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**Agriculture accounted for almost half of M&A activities in 2017 owing to the Ukraine's natural conditions and export orientation.**

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Escalation of the dispute in the East had some influence on M&A in the metals and mining sector during 2017. The sale of Evraz Sukha Balka (ESB) iron ore and beneficiation plant, as one of the key drivers of an almost three-fold increase in the value of M&A in the sector, from USD90 million in 2016 to USD251 million in 2017. Some of the largest industrial holding companies in Ukraine are either restructuring or selling assets in the Donbass region, following the complete ban on transportation of industrial products across the disputed line.

The power and utilities sector also experienced a significant increase in M&A, as the value of deals rose almost five-times, from USD27 million in 2016 to USD122 million in 2017 following the privatization of DTEK's (Systems Capital Management) minority stakes in five regional power distribution companies (Oblenergo). These

transactions accounted for the majority of all funds raised by the state from privatisations during 2017.

Agriculture was the hottest sector in 2017, attracting USD452 million of deals, or 44 per cent of total Ukrainian M&A; a three-fold increase on the previous year. Investors see agriculture as a 'safe haven', with a natural hedge against ongoing hryvnia devaluation and a competitive advantage in terms of geography. The sector is also particularly interesting because of the International Monetary Fund's (IMF) desire to push through industry wide reforms. The hope is that once completed, reforms will make it easier and more attractive for new domestic and foreign participants to enter the sector, and turn it into a major source of future growth for the economy.

The government has accelerated privatization by selling state-owned minority stakes in 5 regional power distribution companies.



USD122 million



Elsewhere, the banking and insurance sector saw higher levels of deal activity but with a lower level of invested funds. In 2016, Unicredit's USD323 million sale of Ukrsofsbank to Alfa Group, accounted for 43 per cent of the total deal value in the country. In 2017 a total of 14 deals were announced with a combined value of USD40 million, driven mainly by the sale of Ukrainian subsidiaries of Russian banks due to limitations imposed by the National Bank of Ukraine (NBU) in March 2017. As a result of the NBU's limitations, which include a ban on dividend distribution and repayments of intrabank loans abroad, most Russian banks operating in Ukraine have either already exited or are in the process of doing so.

But apart from the increasingly attractive agriculture sector and the almost must-do upgrades in the utilities and mining sectors. Investor activity in Ukraine was not so extensive last year. It was more a case of wait-and-see as the country continues to deal with the conflict in the East and manages both the economic and political transition that started in early 2014.



### Inbound M&A

As noted earlier, while the number of inbound deals has remained broadly stable over the last three years, averaging around 20 per annum, the combined value of investment was much lower in 2017 than either of the previous two years. Notwithstanding this, the level of foreign investor interest in Ukraine remains strong, and we expect to see the value of investment grow in 2018.

In 2017, the CIS, North America and Europe were the most active foreign investors in Ukraine. CIS-based investors focused primarily on the acquisition of assets in Crimea from Ukrainian shareholders, as it is no longer practicable to continue operations under such shareholder structures given the ongoing dispute.

The acquisition of IntroPro, an IT company, by Swiss-based Luxoft for USD53 million, was the sole inbound deal from Europe, while there were deals involving North American investors: the acquisition of a 13 per cent stake in Ferrexpo from CERCL Holdings by a group of investors led by BlackRock, for USD126 million, and the acquisition of a 10 per cent stake in Astarta, an agricultural holding, by Canada's Fairfax Financial Holdings for USD37 million.

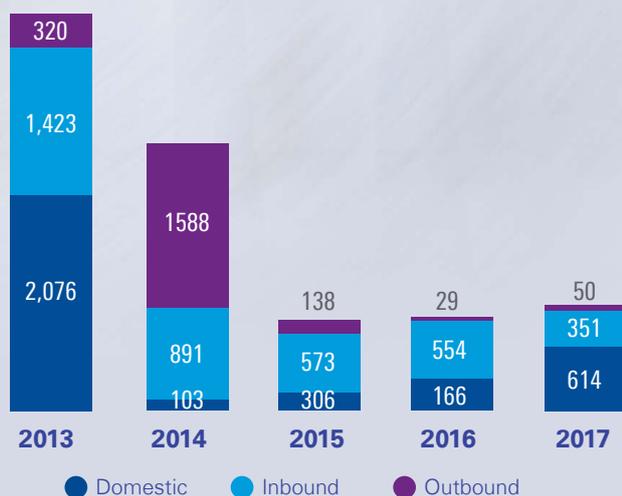
### Outbound M&A

Outbound M&A was principally focused on the CIS and North America. In particular, in 2017 IDS Borjomi group, headquartered in Ukraine, acquired Kompaniya Chistaya Voda for USD26 million, and Ukrainian confectionary Konti acquired Krasnaya Zarya Confectionery Factory for USD17 million in order to get access to the wider Russian consumer market.

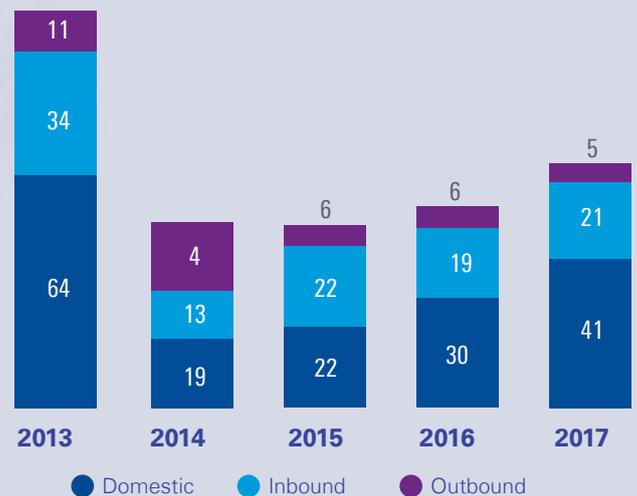
North American outbound M&A represented the fund raising activities of two US-based software developers with Ukrainian roots, Petcube and Allset Technologies. Both companies secured capital from Ukrainian and international venture capital funds.



Ukrainian M&A deal value by type (2013–2017), USDm



Ukrainian M&A deal number by type (2013–2017)





# Ukraine's advancements over 2017



# 2018 Outlook



Investors will continue to carefully monitor progress of reforms, and economic development, when assessing M&A opportunities in Ukraine.



## Concern over the delayed IMF loans and reforms

Another area of continuing concern for investors is the apparent slow pace reforms imposed as conditions to the loan packages negotiated with the IMF and European Union (EU). Both institutions have complained about the rate of progress in tackling such contentious issues as high-level corruption and a failure to continue reducing utility subsidies. Such criticism has also resulted in continuous delays in the loan schedule and uncertainty over when advances will resume, and on what schedule. In 2015 the IMF agreed to loan Ukraine a total of US\$17.5 billion, in quarterly instalments and the EU up to EUR6 billion, also in stages, with both agreements linked to timely progress of identified reforms and the privatization program. To date, the IMF has loaned only USD8.7 billion, including the first tranche of USD5 billion in March 2015, and only USD1 billion in 2017. Similarly, the EU has, to date, loaned EUR2.8 billion, including EUR600 million in 2017. Both the IMF and the EU say they will not make further payments without specific reform progress. The fear for investors is that the government will not be willing to push through unpopular reforms ahead of the presidential and parliament (Verhovna RADA) elections, both of which are scheduled for 2019.

Although the suspension of IMF and EU loans is a concern for investors and will slow economic progress, the country is not expected to experience a financial crisis in 2018. In September 2017 the Ukraine government was able to return to the international debt market and raised USD3 billion from investors. The bond was issued with a coupon of 7.4 per cent.



One of the areas which the IMF is also critical of, is the slow pace of the privatization program. Selling equity in state assets was a key condition of the 2015 loan agreement. And while the state did sell 83 separate assets in 2017, raising circa USD120 million, the list of assets to be privatized numbers some 3,400. This will be a significant source of future M&A and will attract a lot of investor interest owing to the recently adopted law on privatization, but only when the program picks up pace. The fear is that the privatization program in 2018 will not be much different to that of 2017, because of the lack of support across political parties, and may not actually gather pace until after the 2019 elections.

## What's next?

Politics and economics will again be investor's primary concerns in 2018. The IMF and other agencies continue to warn of a risk of another year of sluggish growth, partly because of the disruption in materials from Donbass to the rest of the country and partly because of the expected continued suspension of IMF and EU loan disbursements. The continuing sluggish trend across most areas of the economy is also impacting consumer and business confidence and the real danger is that major consumption and investment decisions will be further postponed until after the election cycle is completed.



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**The National Bank of Ukraine (NBU) is keen to keep inflation under control and reduce lending in the market by raising the benchmark rate.**

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Currently the IMF forecasts growth to accelerate to 3.2 per cent in 2018 but only if the problems affecting the economy in 2017 are resolved quickly. Otherwise it warns that it may cut the forecast to somewhere between 2 – 2.5 per cent, at its spring review.

There is also concern over monetary policy. The parliament has approved a full time Governor to the National Bank of Ukraine (NBU). The NBU was forced to raise its benchmark rate by 100 basis points in December 2017, 150 basis points in January 2018 and 100 basis points in March 2018 to 17.0 per cent, because inflation is running higher than it was expected. By the end of November 2017, the rate was already at 12.7 per cent, ahead of the NBU's yearend target of 12.2 per cent which, itself, was up from the 10 per cent target set at the start of 2017. The higher interest rate and double-digit inflation are likely to have resulted in some investors adopting a more cautious stance in 2017.

Above all else in 2018, investors will pay close attention to the interaction between the IMF and the government. If the IMF continues to delay payments and complain about either the slow pace of reforms or the lack of any initiatives to deliver on the agreed program, then this will keep investors sidelined or will invest only slowly. IMF statements will, therefore, be very important for investment activity this year.

If the IMF resumes payments and expresses satisfaction with progress then a broader pick up in investment activity can be expected.

The other area which will impact investments will be politics. Ukraine faces both presidential and RADA elections in 2019 so the hope is that parties will be clearer with policy priorities and can rebuild public support to ensure a smooth election cycle. Investors are always sensitive to any risk of political instability.

Furthermore, the NBU's decision to repeal the prohibition on the repatriation of dividends abroad that was in place until June 2016, will provide investors with additional confidence. In 2017 foreign investors repatriated USD1.8 billion in dividends, and are allowed to repatriate USD5 million per month.

The outlook for 2018 is that the number of transactions and the aggregate value of deals will continue to grow and show a strong gain over 2017. This is predicated on the economy continuing to recover as a result of the government's process of structural reform, supported by International Financial Institutions (IFI), which will drive greater competitiveness and stabilization of the economy, and, which in turn, will fuel further growth and an improved investment climate.

# Preparation is everything

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**Investing time upfront to appropriately prepare a business for sale is a critical step in any sales process, whether the key objective of shareholders is to maximize value from the disposal, achieve a clean exit, or speed of deal execution.**

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Sellers have a limited window of opportunity to maximize value before marketing their business to potential investors. Preparation is key, and a pre-sale review from a buyer's perspective is often a cost effective way to identify potential risks and mitigating actions, and frequently unearths latent value potential, which can often be captured, rather than being left on the table for the purchaser.

While preparation is, key for any disposal, cross-border deals often present a greater level of execution risk. Such risks arise from many factors including country risk (political, economic and currency), cultural and social challenges, and of course language barriers. However, differences in approach to and expectations of the M&A process can also play a significant part.

Although inbound deal-making in Ukraine is still significantly below the recent peak of 2013 (34 inbound deals (31 per cent) worth USD 1.4 billion), international investors continue to demonstrate their confidence in Ukraine, with around one-third of M&A being driven inbound acquisitions in recent years, and a total of 21 deals (31 per cent) worth a combined USD0.35 billion announced in 2017.

We see ongoing interest from foreign investors in Ukraine, both through M&A and direct investments, and believe that this trend will continue to accelerate in 2018 and beyond. This interest is explained by several factors, including the improving business environment and resumed economic growth, driven in part by the Ukrainian authorities' economic and structural reforms, supported by international donors. This combined with the attractiveness of certain industries, and particularly those with export potential, is gradually helping to overcome the negative perception of Ukraine, and increasingly encourage international investors back into the market.

But what do international investors look for in a target business, and what factors can influence deal value?

While the investment rationale varies from deal-to-deal, investors are typically looking for a robust business model, with clear growth opportunities, a strong management team, and established governance systems and controls – and where the latter are not yet established, a clear path to do so. Beyond this, the principal consideration is whether an acquirer can operate the business more efficiently than the existing owner, which combined with synergy realisation, will generate a greater return for shareholders. This essentially boils down to the ability of the seller to articulate a clear equity story to investors.



**Oleg Neptyakh**  
Director, Deal Advisory



**Dmytro Shchur**  
Associate Director,  
Deal Advisory

Failing to adequately identify, evaluate and quantify potential risks, and opportunities, before engaging with investors is one of the key drivers of value erosion during the deal process, while failure to execute the process in a timely manner can often kill a deal. To maximise value from disposal it is important to do your homework and assess the proposed deal from a buyers perspective. This includes evaluating all potential operational, financial, legal and tax risks, quantifying them and either implementing, or at least, identifying mitigations to address them.

Not being able to readily provide clear and robust management information, that will stand up to the scrutiny of due diligence is often a key cause of delay in the deal process, which can lead to a loss of investor confidence and ultimately impact deal value. Not only is it important to provide a clear historic financial track record that demonstrates the value of the business but also realistic financial projections built on a well-grounded strategy. And there should also be a clear line of sight from the key drivers to historic performance to the key assumptions on which the projections are built. While such projections will be subject to scrutiny and challenge from investors they will form a basis for price negotiation and evaluation of the synergy benefits by a potential buyer.

Separation of the business is also a key factor to the deal closing, and requires looking at the business through several different lenses to identify key touch points with the seller, such as assets, contracts, people, processes and technology. This is particularly true where either the selling shareholder, group or other related parties are actively involved in day-to-day operations as customer, supplier or support functions, with the level of complexity further increased if the disposal will require the business to be carved out from an integrated group. Separation may necessitate transitional service arrangements for a finite period of time or until the business can become fully standalone, which require careful consideration by both parties. And it is important not to overlook the more obvious issues, such as change of control clauses, and cross guarantees and pledges between group companies.

The seller should also evaluate the business's tax and regulatory compliance in the jurisdictions it operates; remedy tax reporting practices if needed, and even consider initiating a tax audit of the business, in the course of preparation to sale.

A disposal process requires significant time investment and expertise, to navigate a successful outcome, particularly if the process includes numerous potential bidders. Insufficient marketing activities and delays in the subsequent process may cause a loss of interest from prospective investors. Seller's should objectively assess their ability and capacity to manage and execute the process in-house or hire an experienced M&A advisor, with a proven track-record of completions, who will be responsible for streamlining the transaction process and managing interactions with all the stakeholders involved.

KPMG in Ukraine and the CIS acts as an integrated team of professionals experienced in all M&A-related services from origination to execution, financial, tax and legal due diligence, and operational improvement, combined with deep sector knowledge. This combination will help you capture and maximize the value of your business on disposal.



# A ticket to success



There are good reasons to believe that Ukrainian companies will increasingly look to public markets as a means of raising capital over the next few years.



## After successful bond sales in 2017, should Ukrainian companies consider an initial public offering (IPO)?

During 2017, Ukraine returned to capital markets for the first time in a number of years. In January, Kernel the Warsaw-listed producer and exporter of sunflower oil raised USD500 million via a Eurobond issue, excluding debt restructurings, was the first corporate bond issued by a Ukrainian company since 2013. Then, in September, the government raised USD3 billion from a 15-year sovereign bond, its first since the 2015 debt restructuring. Following this, Horizon Capital, the Ukrainian private equity fund, turned to the Bucharest stock exchange for the initial public offering of CEE focused Purcari Wines to exit a 40.9% stake in the company.

Does this mark the start of a new wave of Ukrainian public offerings, or simply the ability of a select few to raise money from capital markets? In the case of Kernel, it is fair to say that the company has lower debt levels than many others, and benefits from a high volume of exports, making it less exposed to hryvnia volatility, nonetheless it successfully raised more than six times the amount of the last Ukrainian corporate bond issue. Meanwhile, the government's bond was the largest open market debt issuance in the country's history, and with the longest maturity ever seen. While Purcari Wines is a Moldovan business, it does at least demonstrate that Ukrainian financial investors are once again viewing public markets as a viable exit route.

Furthermore, IPO's could form a key part of the government's ongoing privatization program, and have already been put forward as an option for some of the larger state-owned enterprises. For example, the corporate development strategy for Naftogas presented to the government in June 2017 included a possible IPO, while the Ministry of Finance has suggested that an IPO could be an option for Oschadbank in 2021.

Whether private or state-owned, any company considering an IPO should align such a decision with its long-term strategic objectives. Listing is a complex process, and one that requires careful preparation and planning to ensure that management and the business itself are ready for life as a public company.

There are many reasons why companies turn to public markets – from succession planning to crystalizing value for current investors, accessing capital to fund acquisitions or paying down existing debt. Whatever the reason, the consequences of going public are similar for most businesses. Life as a public company inevitably means greater scrutiny and accountability, the need to explain decisions made and actions take, while constantly striving, at a minimum, to meet market expectations for earnings growth. At the same time, major decisions will require board, and potentially shareholder, approval making it important to consider the impact of going public on dilution of ownership and voting rights in advance. All of which means that additional resources, time and money will need to be allocated to meet these demands post listing.



**Dmitry Musatov**  
Partner, Deal Advisory

The costs of going public require careful consideration, with the underwriters' commission, typically negotiated as a percentage of the value of the offering, the largest single cost. After this, legal fees for preparing the offer document and costs of auditing financial information to be disclosed, which vary depending on whether pro-forma and/or forecast financials are required, are likely to be the most significant costs of the process itself.

As well as costs, the timeline for an IPO process can vary significantly, and will depend on several factors. In addition to assessing the readiness of your company for public markets, it is important to consider the experience of your chosen advisors, prevailing market conditions and regulatory requirements.

### **Which companies should consider a potential IPO?**

Firstly, any company considering an IPO needs to choose where to list. Unfortunately, the Ukrainian stock market is still relatively immature, with a weaker legal and regulatory environment, and simply a lack of investors to provide sufficient liquidity for most companies. As such, without further government intervention to implement a functioning public market, a foreign stock exchange is likely to be the most realistic option for most companies seeking to list in the immediate future.

Secondly, export-oriented businesses are more likely to be of interest to potential investors, and more often in those geographies in which the company is operating. While sentiment for Ukraine has certainly improved over the last year or two, there is still much for the government to do in order to raise investor confidence in the long-term prospects of the economy.

**Agriculture and technology are two sectors where we perceive potential investor interest for IPO's.**

Despite past difficulties, the Ukrainian technology sector has become one of the largest in European software development, with an abundance of talent and worldwide market recognition. Many Ukrainian technology companies are already well known and beloved by international investors, and as evidenced by 2017 deal-making, remain in demand. The potential exists for early seed investors to look to capital markets to realize value from start-up technology companies in the years ahead.

The agriculture sector was one of the first to venture into public markets. Despite concerns regarding the outcome of the Orange Revolution, Ukrporoduct, a leading Ukrainian dairy producer, successfully listed on the London Alternative Investment Market (AIM) in 2005. Ultimately, investors put their trust in the investment proposition and quality of the business. While the sector has suffered in recent years due to the economic downturn, Ukraine remains a global leader in agricultural commodity exports, which raises the prospect for potential future IPO's.

While a number of Ukrainian companies have recently been rumoured to be preparing to go public, the prospect for a run of initial offerings seems a little way off. However, there are good reasons to believe that private and state-owned companies will increasingly look to public markets as a means of raising capital over the next few years.

KPMG is well positioned to help companies assess whether an IPO is the most appropriate source of funding available, and if so, to help guide them through the process itself, and beyond to support them as they operate as a public company. We advise the issuer and compliment the work of the underwriter. Our team in Ukraine have deep local market experience but can also draw upon the knowledge of colleagues across our network of member firms in 155 countries, to help you consider your options.

# The tip of the iceberg

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**The sheer volume of distressed assets combined with legislative changes to encourage new entrants into the debt collection industry, provides renewed optimism that a fully functioning NPL market will evolve in Ukraine.**

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Ukraine has one of the highest non-performing loan (NPL) ratios in Europe, and with an estimated 70 per cent of banks in the process of being restructured, consolidated and deleveraged, we can expect to see further assets for sale, and opportunities for investors.

The financial crisis of 2008 and political crisis of 2013-2014 resulted in sweeping changes to the Ukrainian banking landscape, with over 94 banks declared insolvent. In addition to curing liquidity and capital adequacy problems, the banking system required widespread reforms, and a renewed effort to tackle pockets of fraud and related party lending.

Ukrainian authorities, including the National Bank of Ukraine (NBU), have initiated a series of economic and structural reforms to revive the financial sector, partly as a condition of the International Monetary Funds (IMF) Extended Fund Facility (EFF) arrangement. However, a broad range of international donors, such as the World Bank, the European Bank for Reconstruction and Development (EBRD) and the US Department of Treasury (USDoT), are supporting these reforms by providing technical assistance.

The Deposit Guarantee Fund (DGF), originally established to protect Ukrainian deposit holders, had its mandate expanded in 2014 to become the resolution authority with responsibility to clean-up insolvent banks. Loans (mainly corporate), account for almost 80 per cent of DGF's portfolio, with the remainder being real estate and moveable property. Consumer loans are a key feature of the NPL market in many European countries however, such loans have historically accounted for a significantly smaller proportion of loan portfolios in Ukraine. Although consumer debt in the form of mortgages are an increasing issue in the country, homeowners have significant legal protections, and as such, we do not expect to see any significant development in this segment of the market in the near future. However, we continue to see growing interest in corporate loans, mainly secured, as well as real estate, and expect these two segments to be the main driver of the NPL market development in Ukraine.

All assets managed by DGF are sold through the electronic trading system ProZorro.sale, which is overseen by Transparency International (TI). The trading system ensures transparency, reliability, and integrity of the sale process via auctions, without risk of third party influence, providing greater confidence for investors. KPMG Ukraine has set up its own electronic platform for DGF auctions which is an integral part of the ProZorro trading system. It is expected the KPMG e-platform will allow potential investors to participate in auctions shortly. While the DGF collected UAH5 020 million (circa USD190 million) and around UAH1 billion (circa USD35 million) from the sale of NPLs and foreclosed assets in 2017 and January 2018, respectively, this is a tiny fraction of the UAH500 billion (USD18 billion) of assets managed.



**Yuriy Fedoriv**  
**Director, Deal Advisory**

Previous efforts to establish an NPL market in Ukraine have come to little. Ukrainian banks hold an estimated UAH561 billion (USD20 billion) of non-performing loans on their books, yet the market is still in its infancy as the majority of banks prefer to service NPLs in-house. The existing market is highly concentrated, with the ten largest agencies accounting for 70 per cent of debt collections.

During 2018 the DGF plans to recover UAH10 billion (USD360 million) via all means: accelerated disposal of both single large asset and portfolio sales, as well as loan repayment by the borrowers in the ordinary course. The sheer volume of distressed assets combined with legislative changes to encourage new entrants into the debt collection industry, provides renewed optimism that a fully functioning NPL market will evolve in Ukraine. So far investors have only seen the tip of the iceberg.

International investors are already entering the Ukrainian market, attracted by the prospect of higher recovery levels from distressed assets following legislative changes intended to improve the efficiency of the enforcement process. While foreign investors do not require a license to service local currency loans, they are required to either register with the NBU as a new creditor, or set up a licenced Ukrainian entity to service foreign currency loans.

However, any investor, whether domestic or foreign, should ensure that they have a solid understanding of the legal aspects of the market, which is developing rapidly, and have thoroughly evaluated the risks and opportunities associated with NPLs, whether these are being sold directly by Ukrainian banks or the DGF.

KPMG is well placed to advise lenders on their options to realise value from NPLs, and to help investors navigate the acquisition process. We understand the local market specifics, including debt collection and enforcement procedures, having led a number of large restructuring cases for both lenders and borrowers.

We can provide comprehensive support during the transaction process, from valuation and due diligence of loan portfolios, through to advice on deal structuring and strategy to drive value realisation. KPMG has strong relationships with local debt collection agencies and can provide a full range of services to support NPLs: from legal and tax structuring, and valuation services upon NPLs purchase to assistance in out-of-court and court enforcement activities. Our international network of member firms provides access to knowledge and investors from all of the major global NPL markets.





All data is based on transactions completed between **1<sup>st</sup> January and 31<sup>st</sup> December 2017**, or announced during this period but pending at **31<sup>st</sup> December 2017**

# Methodology

## KPMG Ukrainian M&A database

This report is based on the KPMG Ukrainian M&A database which includes transactions where either the target (inbound) or acquirer (outbound) or both (domestic) are Ukrainian. All data is based on transactions completed between 1st January and 31st December 2017, or announced during this period but pending at 31st December 2017. Historical data may differ from earlier versions of this report as the KPMG Ukrainian 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 Ukrainian M&A database has been compiled over a number of years based on information included in the Mergemarket M&A deals database, EMIS DealWatch database and S&P Capital IQ database, together with KPMG desktop research of other sources.

Allocation of deals to industry sectors may involve using our judgment and is therefore subjective. We have not extensively verified all data within the KPMG Ukraine 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.

Classification of the deal type between inbound, outbound or domestic was made based on information in the used sources and the public domain about the dominant geography of the acquirer's major shareholders and/or headquarter, as well as dominant geography of the target (in turnover or asset terms).

## Macro trends and medium term forecasts

Information presented in this report on macro trends and medium term forecasts are based on data from Macro-Advisory Ltd., an independent macroeconomic and political strategy firm specialising in the Eurasia region, including Ukraine and the CIS.

Due to comparably low openness (transparency) of Ukrainian M&A market, values of over 50 per cent of M&A deals are not publicly disclosed that may distort comparability of deal values by period

# Appendixes

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**1**

› Macro trends and medium term forecasts

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**2**

› Cross-border M&A highlights

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**3**

› Sector highlights

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## Appendix 1

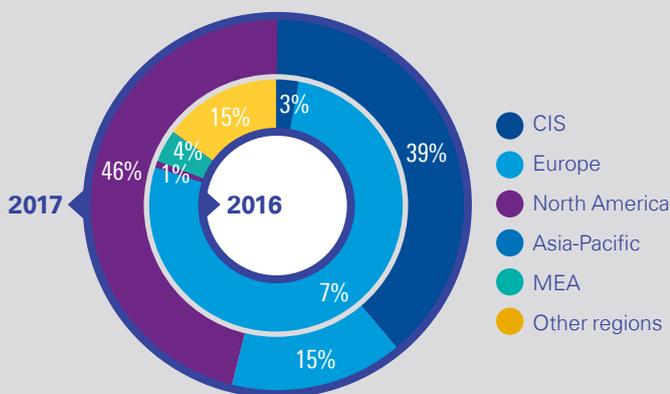
# Macro trends and medium term forecasts

	2013	2014	2015	2016	2017	2018F	2019F	2020F	2021F	2022F
GDP, UAH bln, nominal	1,465	1,587	1,989	2,383	2,912	3,375	3,911	4,381	4,857	5,412
GDP, USD bln, nominal	183	134	91	93	110	119	130	141	152	167
<i>Growth, real % YoY</i>	(0.0%)	(6.6%)	(9.8%)	2.3%	2.1%	1.9%	2.4%	1.8%	2.1%	2.4%
CPI - average, % YoY	(0.3%)	12.1%	48.7%	13.9%	14.5%	11.1%	8.3%	7.9%	7.3%	6.7%
CPI - year-end, % YoY	0.5%	24.9%	43.3%	12.4%	13.8%	8.9%	8.7%	7.2%	6.7%	6.7%
<i>Gross fixed investment, real % YoY</i>	(8.4%)	(24.0%)	(9.2%)	20.1%	12.0%	2.0%	5.5%	5.0%	6.0%	5.0%
<i>Industrial production, real % YoY</i>	(4.3%)	(10.1%)	(13.0%)	2.8%	0.5%	0.8%	3.0%	2.6%	2.9%	2.9%
Agricultural output, % change YoY	13.0%	2.3%	(4.4%)	6.0%	2.7%	2.6%	2.5%	2.6%	2.4%	2.5%
Bank average lending rate, %	16.6%	17.7%	21.8%	19.2%	15.5%	14.5%	14.0%	13.0%	12.5%	12.0%
Real disposable income, % YoY	6.9%	(9.4%)	(19.1%)	(6.4%)	(6.3%)	2.6%	8.4%	3.7%	(0.2%)	(0.1%)
<i>Unemployment, % EOP</i>	7.2%	9.3%	9.1%	9.3%	9.0%	8.8%	8.4%	8.0%	7.8%	7.7%
<i>Budget, balance % of GDP</i>	(4.3%)	(4.2%)	(1.4%)	(2.2%)	(2.9%)	(2.7%)	(2.6%)	(2.2%)	(2.1%)	(1.7%)
<i>Current account, % GDP</i>	(9.0%)	(3.4%)	(0.2%)	(3.7%)	(3.9%)	(6.9%)	(3.9%)	(3.6%)	(3.6%)	(2.8%)
UAH/USD, year-end	8.0	15.8	24.0	27.2	26.8	30.0	30.3	31.8	32.2	32.6
UAH/USD, average	8.0	11.9	21.8	25.6	26.6	28.4	30.2	31.0	31.9	32.4

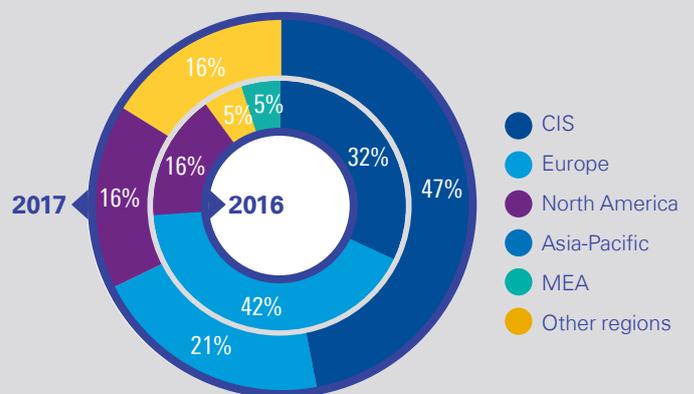
Appendix 2

# Cross-border M&A highlights

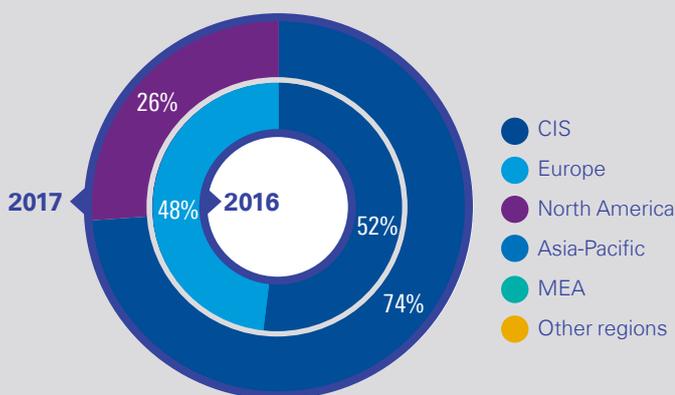
Inbound M&A deal value by region, (2017 vs. 2016)



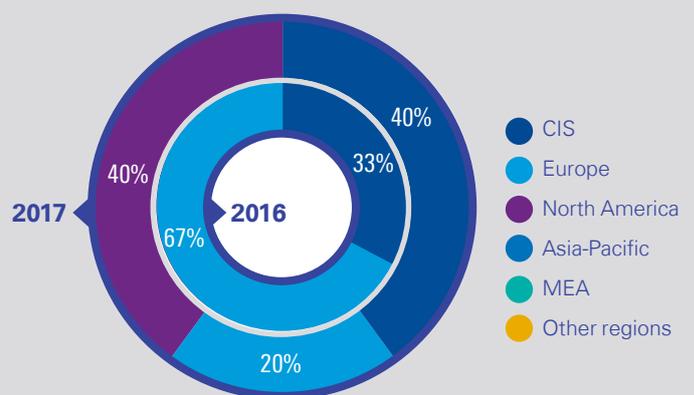
Inbound M&A deal volume by region (2017 vs 2016)



Outbound deal value by target's region, (2017 vs. 2016)

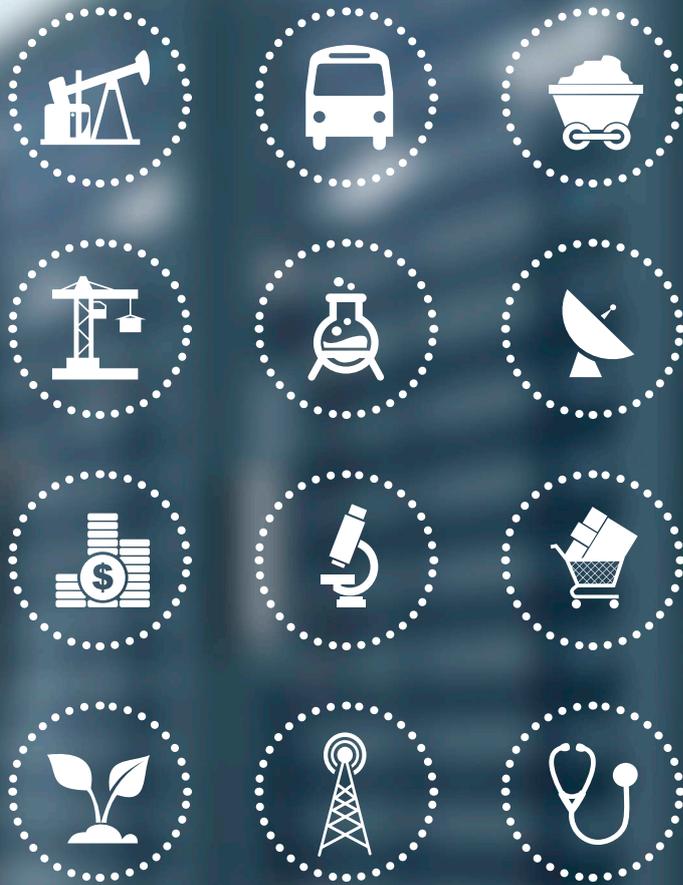


Outbound deal number by target's region, (2017 vs. 2016)

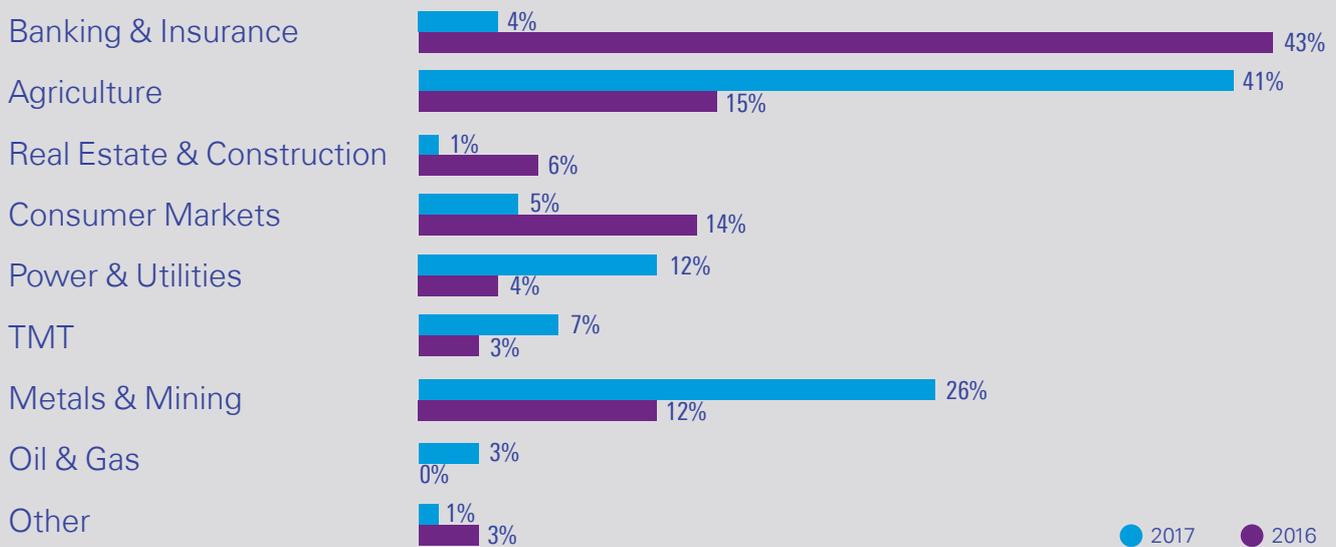


## Appendix 3

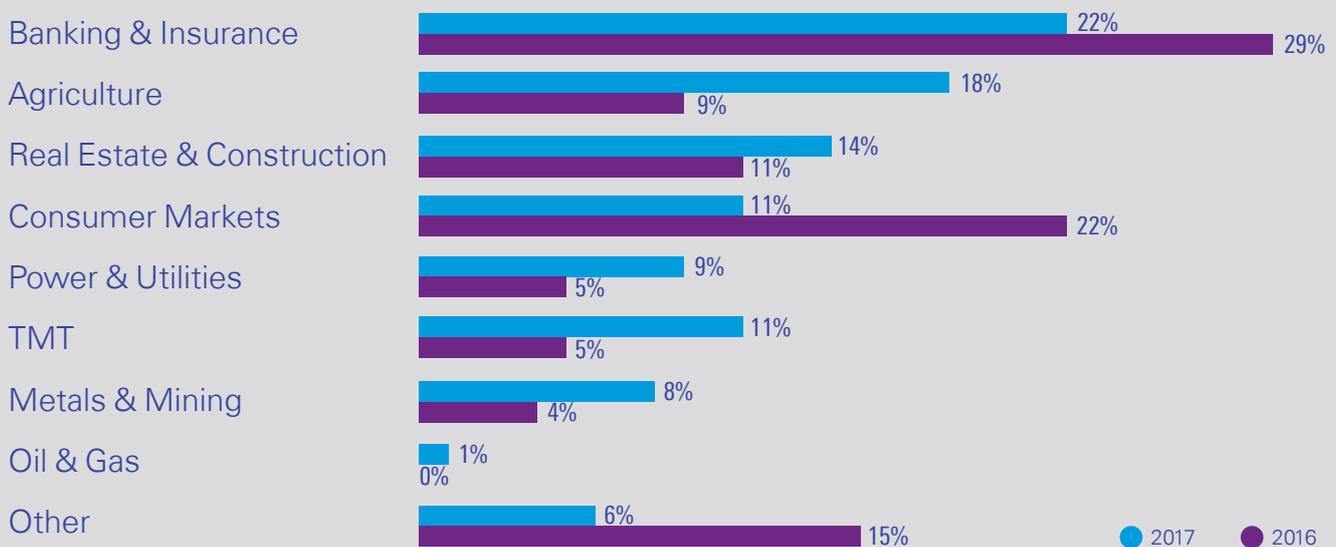
# Sector highlights



## M&A deal value by sector in 2016–2017



## M&A deal number by sector in 2016–2017



Note: Other sectors include (i) Transport and Infrastructure, (ii) Chemicals, (iii) Healthcare and pharmaceuticals, (iv) industrial products.



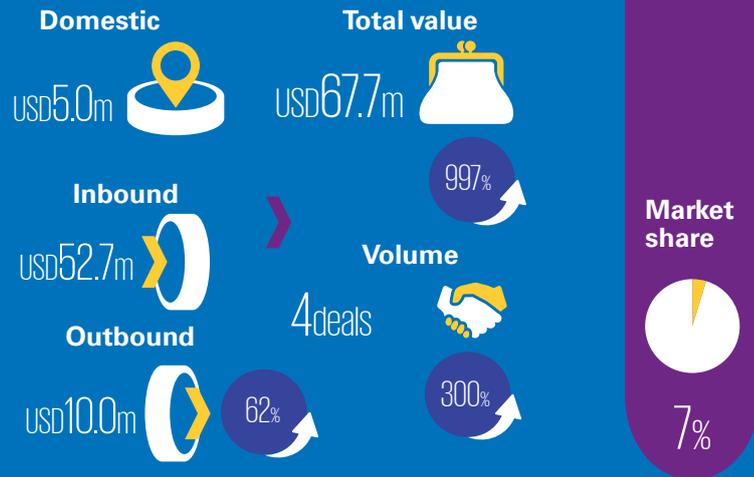
# Innovations and technology

Ukraine is recognized globally for the strength of innovation and technology sector, and in particular its coders, and accounted for USD3 billion of exports in 2016, of which 80 per cent were to the US. The sectors export orientation provides strong appeal for investors, from venture capitalists to private equity funds and strategic investors alike.

Deal making in the innovation and technology sector totalled USD68 million in 2017, and was dominated by Luxoft's USD53 million acquisition of the Ukrainian software engineering consultancy IntroPro, further deepening its expertise in product development, engineering and software development for telecoms, media and technology companies.

Elsewhere, mobile app businesses Petcube, completed a USD10 million equity funding round to bankroll new product development, marketing and sales across global markets, while the drone services company DroneUa, was subject of a USD5 million acquisition by an undisclosed bidder.

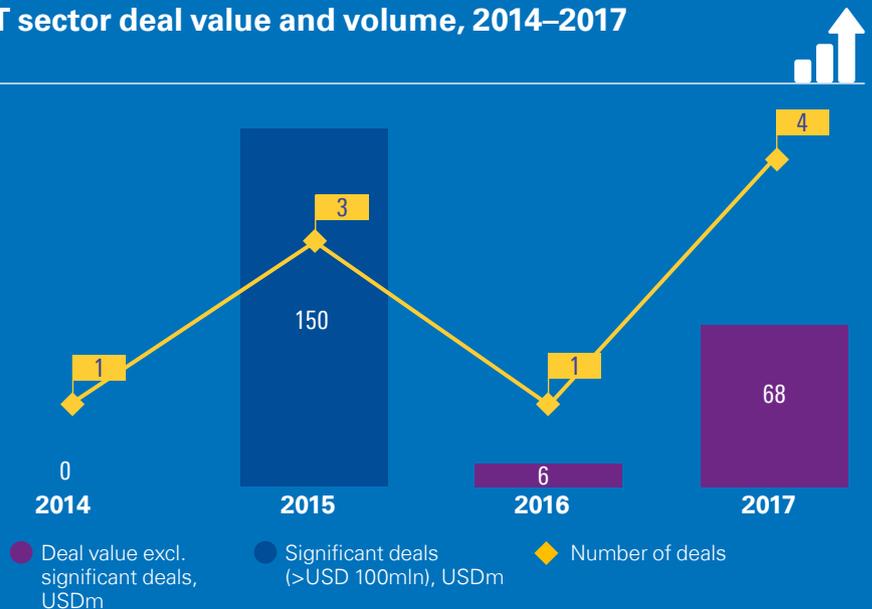
Although not included in our database of Ukrainian M&A due to the current residency of the company, Grammarly, the start-up and writing-enhancement platform established in Ukraine, raised USD110 million of equity funding in May 2017 from a pool of investors including General Catalyst, Breyer Capital, IVP, SignalFire, and Spark Capital, reinforcing the export potential of such companies.



## Innovations and Technology largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	IntroPro	Luxoft Holding, Inc.		100%	53
2	Petcube Inc	AVentures Capital; Almaz Capital Partners; Y-Combinator			10
3	Drone.UA	Undisclosed bidder			5

## IT sector deal value and volume, 2014–2017



## Outlook

The sector will continue to attract both domestic and foreign investors, as the race to secure talent and leading edge technologies as the drive for innovation heats-up globally.

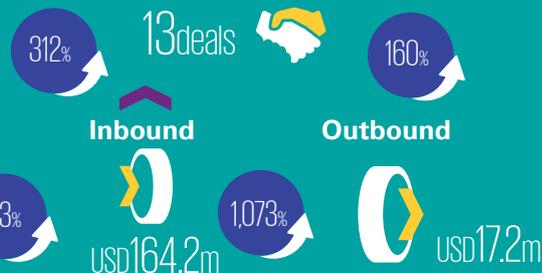
We expect to see an increased level of dealmaking in 2018, especially in e-commerce, fintech, and blockchain-based technologies, including crypto currencies, during initial fundraising and at a more maturity stages of investment.

# Agriculture

## Total value



## Volume



## Market share



### Agriculture largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	Ukrainian Agrarian Investments Ltd.	Kernel Holding SA	The ONEXIM Group	100%	155
2	Druzhba Narodiv Nova; Druzhba Narodiv; Crimean Fruit Company	Undisclosed	Myronivsky Hliboproduct	100%	78
3	10 agricultural companies of Glencore	Epicenter Ltd	Glencore International AG	75%	55

Agriculture accounts for over 40 per cent of Ukraine’s export revenues, and has accounted for an ever increasing share of the country’s M&A since 2014. Much of this deal-making has been focused on the ongoing consolidation of land banks by key market players such as Kernel and Epicentre.

During 2017, Kernel acquired Ukrainian Agrarian Investments (190,000 hectares) and Agro Invest Ukraine (28,000 hectares) for a combined consideration of USD200 million, financed via a USD500 million Euro bond issued in January 2017. Meanwhile, Epicentre acquired Glencore’s agricultural business in Ukraine for USD55 million, as well as Obolon Agro (11,000 hectares).

High yields and profitability of export-oriented agricultural products in recent years have seen increased competition for agribusinesses, and consequently higher valuations for agricultural land (from USD500-700 a year ago to around USD1,500 per hectare), especially in regions with climates more suited to primary crop production.

At the same time, some large agricultural producers were still focused on debt restructuring, including ULF, Milkiland and Mriya. During 2017, Milkiland group sold its heavily indebted real estate development division, Krai Property, to Dragon Capital and disposed of its Magellan trade centre in Kyiv, to Sberbank to satisfy a collateral enforcement. Mriya’s shareholders are considering disposal of the business once the going debt restructuring has been completed.

### Agriculture deal value and volume, 2014–2017



### Outlook

The Ukrainian agriculture sector is still highly fragmented, with further consolidation expected once the long awaited abolition of the moratorium on the sale of agricultural land is passed into law. The switch from a leasehold to freehold model of land ownership is expected to aid well performing business in finance raising both, locally and abroad, and boost M&A activity, with foreign investors keen

to get use of better security for their investments in the rich fertile lands of Ukraine. Limited access to financing and high debt burdens will be a particular constraint for smaller producers, who in turn are likely to be consolidated into regional clusters or by the larger players in the sector.

# Consumer markets

Despite the fact that wholesale and retail trading accounts for a significant part of Ukraine's GDP, M&A activities in consumer market was comparable low during 2017.

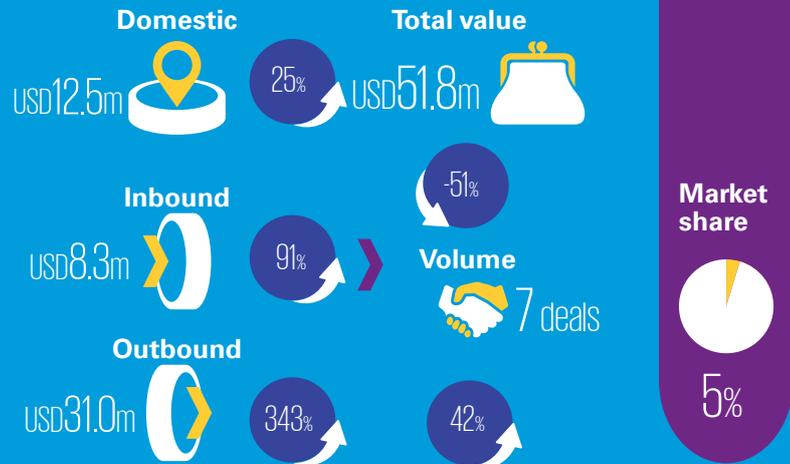
In June 2017, regional producer and distributor of mineral water IDS Borjomi, headquartered in Ukraine, acquired Russian mineral water producer Chistaya Voda for USD26 million. This deal was motivated by the company's strategy of expansion to the Russian market.

In January 2017 Auchan Ukraine has acquired Karavan, a Ukraine-based hypermarket retailer chain (nine hypermarkets with combined area of 58,000 m2) for USD13 million. The transaction will strengthen Auchan's presence in Kiev and provide for expansion of its services in four new regions - Kharkiv, Dnipro, Zhitomyr and Chernivtsi.

In November 2017 Agrokompleks Imeni Tkacheva has acquired Crimea's leading supermarkets chain, Produkty u Doma (legal entity OOO PUD) operating 63 supermarket stores. Until May 2014, Produkty u Doma was managed by Ukrainian retailer ATB-Market.

## Outlook

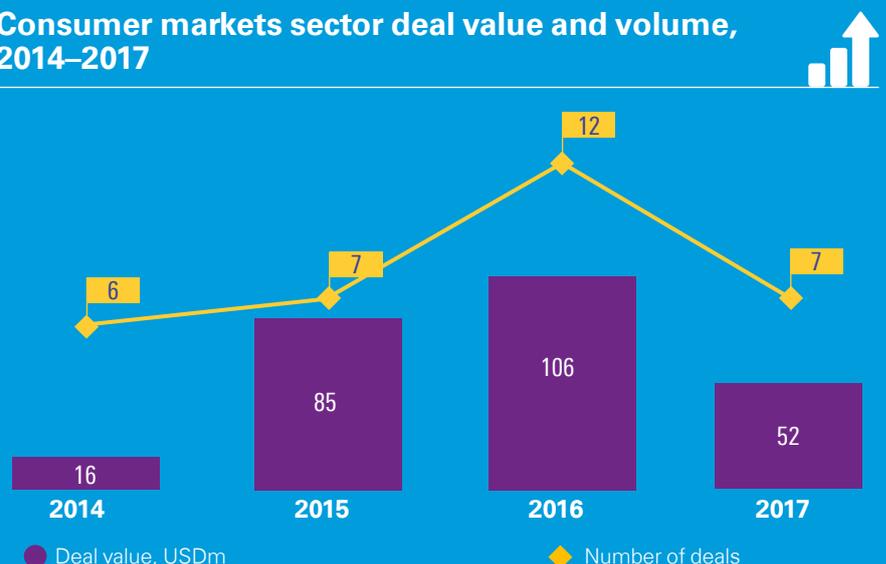
Activities in consumer markets may be stimulated by growing purchasing power of consumers as the EIU forecast real wages growth by 8 per cent in 2018, 6.2 per cent in 2019, 5.7 per cent in 2020.



## Consumer markets largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	Chistaya Voda	IDS Borjomi Russia; IDS Borjomi International	Andrei Sharkov (Private Investor)	100%	26
2	Karavan	Auchan Ukraine	Retail Group of Ukraine	100%	13
3	Produkty u Doma (PUD)	Agrokompleks Imeni Tkacheva	Russky Prodtorg	100%	8

## Consumer markets sector deal value and volume, 2014–2017



# Banking and insurance

The Ukrainian banking sector has seen a substantial period of transformation during the last four years. Over 90 banks have been declared insolvent, with their assets and loan portfolios falling under the administration of the Deposit Guarantee Fund (DGF), in an attempt to clean-up the industry and improve the overall transparency and health of the banking sector.

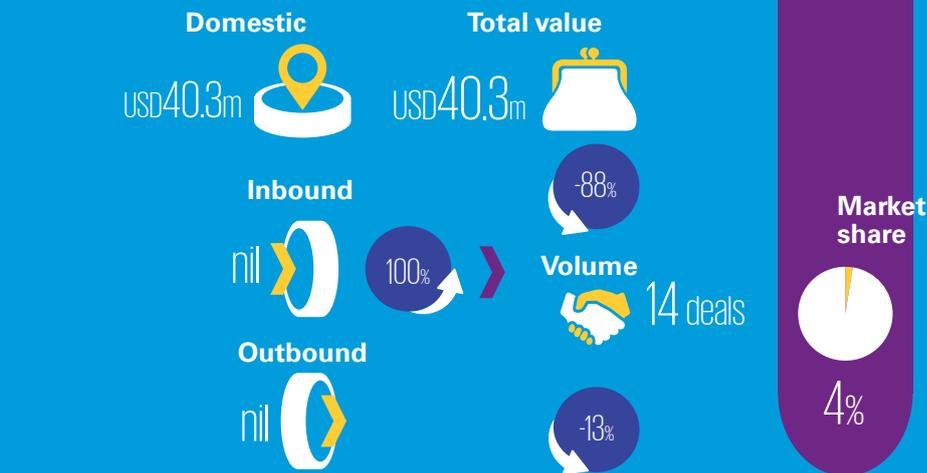
Furthermore, the ongoing conflict in the east of Ukraine has seen several Russian banks exit the market, with others expected to follow. In September 2017, TAS Group acquired Sberbank's VS Bank for USD16 million.

Elsewhere, Ukraine's space technology research company, Yuzhnoye State Design Office, obtained antitrust approval for the acquisition of more than a 50 per cent stake in local lender Commercial Bank Noviy for USD6.7 million, and DCH Group of Mr Alexander Yaroslavsky acquired insurance company Ingo Ukraine for USD18 million from Russian insurance group.

## Outlook

As highlighted on page 18 what remains of the banking sector is suffering from a high level of non-performing loan (NPL) portfolios, which combined with the need to drive operational improvements and reduce costs, including branch closures, continues to put the industry under pressure.

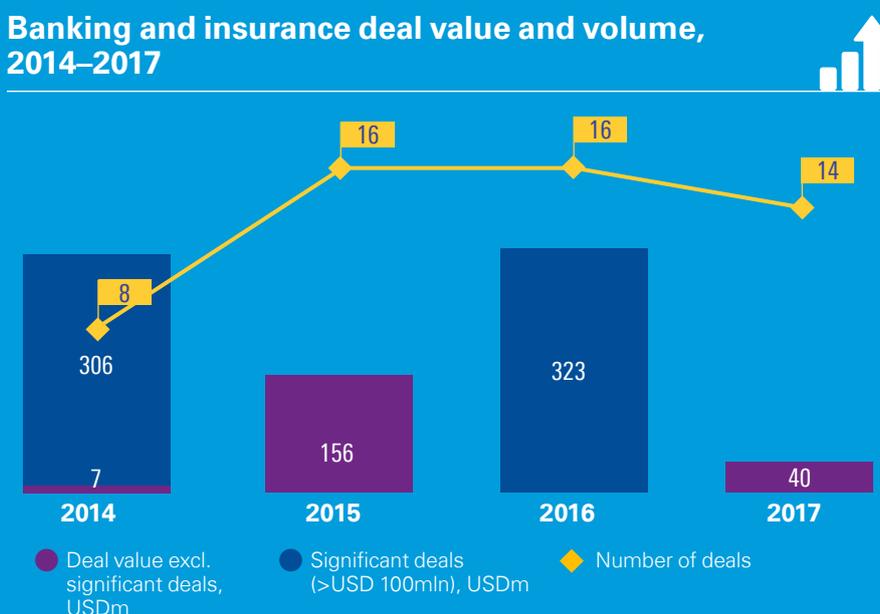
During the first quarter of 2018, the National Bank of Ukraine (NBU) will perform stress testing of commercial banks, including evaluation of capital adequacy and quality of assets held. It is widely expected that some players will require further capital



## Banking and insurance largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	JSIC INGO Ukraine	Development Construction Holding LLC		75%	18
2	VS Bank	PJSC Tascombank Yuzhnoye State	Sberbank OAO	100%	16
3	Commercial Bank Noviy	Design Office		55%	7

## Banking and insurance deal value and volume, 2014–2017



injections from shareholders as a result, and could drive M&A in the sector.

In addition, the government is expected to initiate the partial privatization of the largest banks that

were taken into state ownership, including Oschadbank, Privatbank, Ukreximbank and Ukrgazbank, over the coming year.

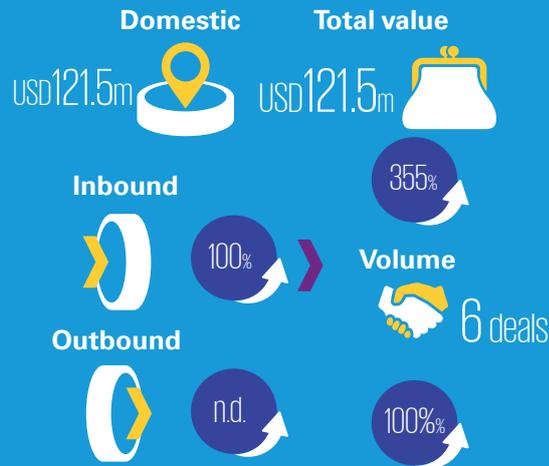
# Power and utilities

In 2017 deal making in P&U sectors was chiefly attributable to the privatization of minority stakes in five regional power distribution companies by their majority shareholders, DTEK Group (part of System Capital Management).

## Outlook

The sector will see an increasing volume of M&A activities owing to the development:

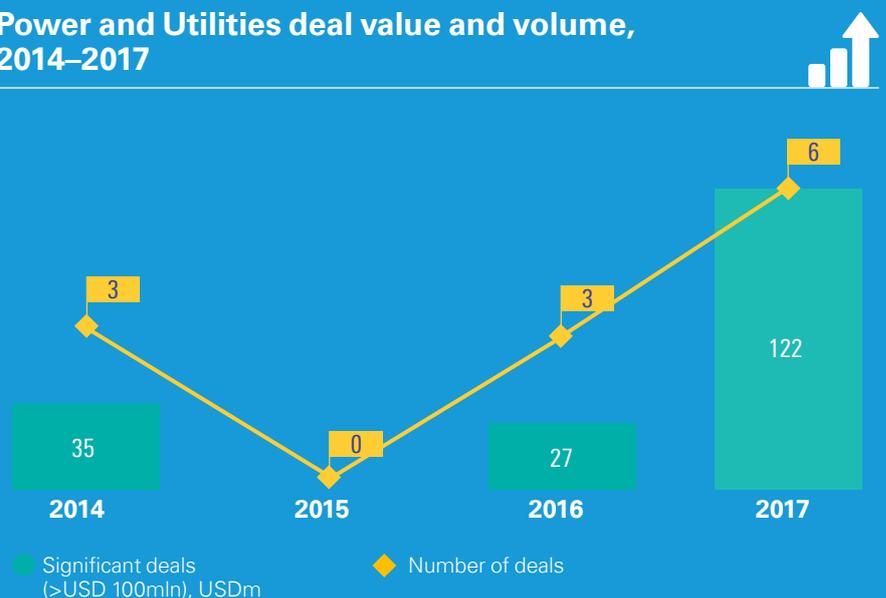
- Anticipated liberalization of the electricity market, including tariff setting mechanism, and connection to the EU power grids system;
- Started privatization of Centrenergo operating three thermal power plants in Ukraine, to be followed by privatization of majority stakes in several regional power distribution companies;
- Growing share of power generation from renewable resources in Ukraine' power generation balances to 12 per cent by 2025 and 25 per cent by 2035 declared in the Ukraine's Energy strategy till 2035. This requires construction of large power generating facilities in Ukraine. Green tariffs to be earned by renewable power plants are secured in the EUR till 2030, and depend on the year of respective plant commissioning. Respective tariffs will be lowered in 2020. This provides incentive to complete new construction of the power plants by then, and we see a lot of deal making activities in these first months of 2018.



## Power and Utilities largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	DTEK Dniiproblenergo	System Capital Management	State Property Fund	25%	39
2	PJSC Kyivenergo	System Capital Management	State Property Fund	25%	30
3	DTEK Dniiproenergo	System Capital Management	State Property Fund	25%	28

## Power and Utilities deal value and volume, 2014–2017



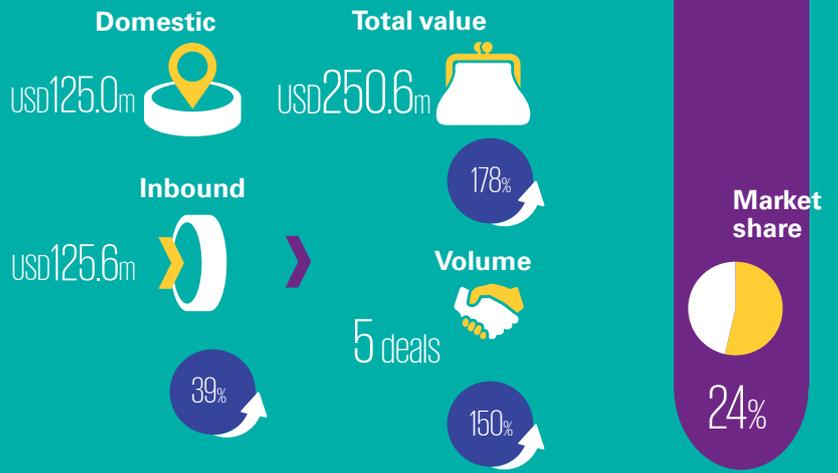
# Metals and mining

Ukraine's steel output decreased by 6 per cent in 2017 as compared to 2016, to 21.3 million tonnes, owing to seizure and closure of steelmaking facilities in the Donbas region in early 2017, as well as lower steel demand at domestic market. This has thrown Ukraine out of 10th place in global steel making ranking, where Ukraine stayed during 2012-2016 (8th place during 2007-2011).

In January 2017, CERCL Holdings, joint venture between the BXR Group and the family of Czech entrepreneur Zdenek Bakala, sold its 13.2 per cent stake in iron pellets producer Ferrexpo Plc through a secondary offering on the LSE to several institutional investors, including BlackRock and TT International among them. Ferrexpo is the less affected M&M producer in Ukraine due to its location on the territory controlled by Ukrainian government and export of the absolute majority of the extracted iron pellets to Europe and Asia.

In May 2017 Russian Evraz Group divested its iron ore enrichment factory Evraz Sukha Balka to DCH Group USD126 million.

In July 2017 control over Novogrodovskaya and Rossiya coal mines has been transferred from Mr Yanukovych to Ukrainian businessman Mr Kropachev for USD15 million. This is a continuation of a series of divestment of coal assets by former president. These assets are vertically integrated coal production group, which supplied thermal coal to state-own thermal power plant Centrengo.



## Metals and Mining largest deals in 2017

	Target	Acquirer	Vendor	% acquired	Value USDm
1	Ferrexpo Plc	BlackRock Inc; TT International; Institutional investor(s)	CERCL Holdings	13%	126
2	Evraz Sukha Balka	Berklemond Investments Ltd (DCH Group)	Evraz Group S.A	100%	110
3	Rossiya coal mine	Vitaly Kropachev (Private Investor)	Viktor Yanukovych (Private Investor)		15

## Metal and Mining sector deal value and volume, 2014–2017



## Outlook

Given that no indicators of recovery of the situation in the Donbas region and resumption of goods movement to the territory controlled by Ukraine are observed, this sector will remain deprived throughout 2018.

# M&A in Ukraine by sector

M&A in Ukraine by sector										
	Deal value, USD m					Deal number				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
Agriculture	927	218	112	110	452	19	2	6	5	13
Banking and insurance	585	313	156	323	40	18	8	16	16	14
Chemicals	7	–	–	8	–	2	1	–	1	–
Communications and media	556	57	205	15	–	8	5	4	2	3
Consumer markets	364	16	85	106	52	19	6	7	12	7
Healthcare and Pharmaceuticals	17	13	7	16	–	3	3	2	3	1
Industrial products	288	15	31	–	–	9	3	1	1	1
Innovations and technology	71	–	150	6	68	5	1	3	1	4
Metals and mining	108	1,588	180	90	251	3	1	3	2	5
Oil and gas	179	305	45	–	25	7	2	2	–	1
Power and utilities	258	35	–	27	122	4	3	–	3	6
Real estate and construction	195	–	40	48	6	6	–	4	6	10
Transport and infrastructure	212	22	6	–	8	4	1	2	3	2
Other	51	–	–	–	–	2	–	–	–	–
<b>Total</b>	<b>3,819</b>	<b>2,582</b>	<b>1,017</b>	<b>748</b>	<b>1,023</b>	<b>109</b>	<b>36</b>	<b>50</b>	<b>55</b>	<b>67</b>



# KPMG Deal Advisory Ukraine

**League of M&A advisors in mid-cap market  
(deals up to 500 USDm) for 2016 and 2017**

**Key contacts in Deal Advisory**

**KPMG**



481 deals

**PricewaterhouseCoopers**

2 350 deals

**Rothschild & Co**

3 339 deals

**Ernst & Young LLP**

4 273 deals

**Deloitte**

5 243 deals

**BDO**

6 238 deals

Source: Thomson Reuters

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