Baltic M&A Monitor

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RAIDLA LEJINS & NORCOUS

Contents

Foreword

Welcome to the Baltic M&A Monitor, a comprehensive review of M&A activity in the Baltic region published by Raidla Lejins & Norcous in association with Mergermarket. This report provides detailed insights into M&A deals in Estonia, Latvia and Lithuania in 2014, including sector and country-specific trends, and forecasts for the year ahead.

Optimism in the Baltic M&A market prevailed in 2014, with the region taking a cue from the burgeoning global M&A market. The combined deal volume of Estonia, Latvia and Lithuania climbed 4% year-on-year (YoY) while maintaining relatively stable deal value amounting to €1.02bn, down 7% on the previous year.

However, in the second half of the year, tensions between the Ukraine and Russia began to have a significant impact on European export-oriented industries and dampened investor enthusiasm. The three Baltic countries showed remarkable resilience and were able to resist much of the impact of geopolitical tensions in the region, partly due to strong trade links with each other. Nevertheless, an oversupply of export commodities in the Nordic markets also caused further difficulties for Baltic producers and exporters. On the other hand, Nordic inbound investment into the Baltics proved to be a boon amid a slowdown in the German economic recovery halfway through the year. In comparison, the GDP growth for the Baltic region remains robust in 2014 and is forecasted to be above the Eurozone average in 2015, which bodes well for the coming 12 months.

While deal volume continued to be evenly spread throughout the Baltics, Lithuania still attracts the biggest deals in terms of value. Lithuania's adoption of the euro in January 2015 also concludes the integration of all three economies into the Eurozone and is expected to improve investment flows into Lithuania itself.

In terms of sectors, FS and energy, mining and utilities (EMU) accounted for the largest share as ongoing reforms and recapitalisation efforts spur M&A activity in the Baltics. This trend is likely to continue into 2015. In a bellwether deal, German energy company E.ON Ruhrgas divested its Lithuanian natural gas transmission business Amber Grid for €50m, which foreshadows the utility's likely exit from Latvia in 2015. The largest deal in 2014 took place in the FS sector with RSA Insurance Group's sale of its Lithuanian business Lietuvos Draudimas to Polish insurer PZU for €180m.

Meanwhile, domestic and foreign private equity (PE) funds look likely to continue to support investments in small and mid-cap enterprises, particularly in the technology, media and telecommunications and industrial and chemicals sectors, as domestic banks remain reluctant lenders. A slew of exits are also expected over the next 12 months as PE cycles are winding down, resulting in attractive targets for strategic buyers looking to expand in a region buoyed by growing domestic demand. All this augurs well for Baltic M&A in 2015. However, much of the growth will nevertheless depend on avoiding a contagion of the Russia-Ukraine crisis and a stable Eurozone.

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Baltic M&A review

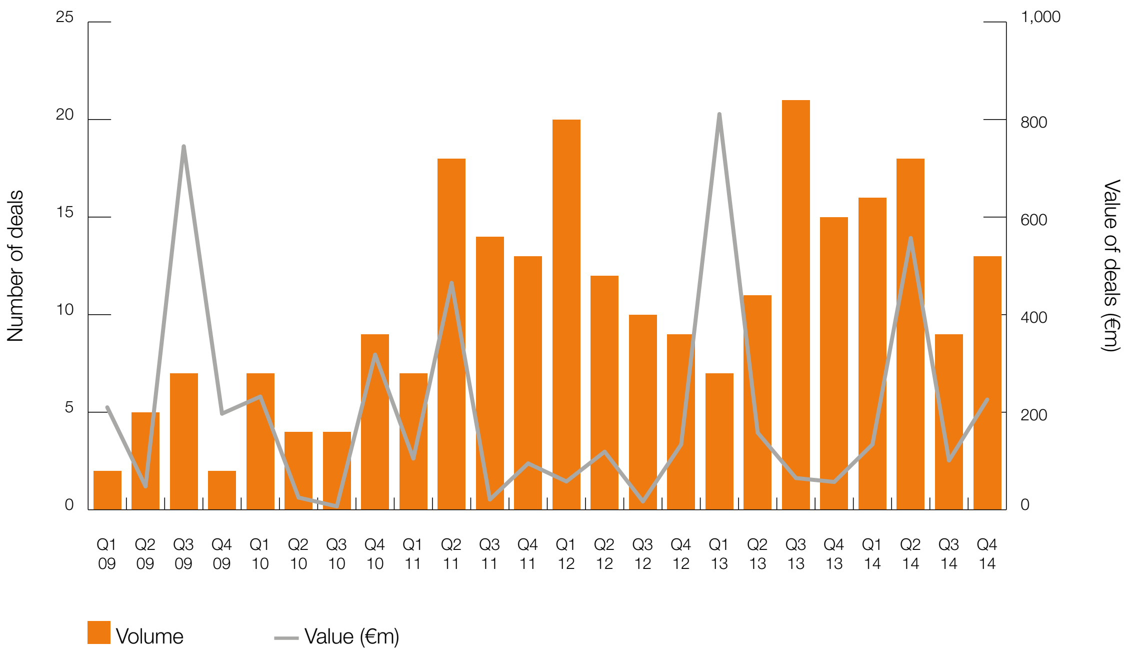
Introduction

Baltic Resilience

Estonia, Latvia and Lithuania experienced a remarkably resilient M&A market in 2014 compared to many of their Eastern European peers. Baltic M&A volumes, in accordance with Mergermarket deal qualifications, climbed up 4% YoY to 56 deals from 54, amid relatively stable deal value, down only 7% YoY to €1.02m. This is in spite of a tepid recovery in the Eurozone economy and geopolitical tensions in neighbouring Ukraine.

The Baltic countries have emerged among the fastest growing economies in Europe. GDP growth for Lithuania has been estimated at 2.7%, Latvia at 2.6% and Estonia at 1.9%, which far exceeds the overall Eurozone forecast of 0.8% for 2014, according to the European Commission (EC).

Baltic M&A, 2009–2014



Baltic M&A review

In addition, the region has provided a safe haven for investors despite its geographical proximity to Russia and the Ukraine. The fallout of tensions in the neighbouring countries appears to only have a mild effect on the Baltics, partly due to domestic demand, strong trade links with each other and the high-performing Nordic countries.

However, the trade embargo with Russia began to weigh heavily on both the Baltic and the Nordic export markets in the second half of the year. Goods produced in Nordic countries for the Russian market never found their way to Russia due to sanctions, which caused oversupply and a reduction of prices in Nordic markets. This in turn caused significant difficulties for Baltic exporters to place their products. The Russian-Ukrainian crisis, a weak euro and the aforementioned difficulties on export markets force local businesses to keep their expectations low for 2015. Even greater pressure on companies with exposure to the Ukraine and Russia, especially Lithuanian export-oriented businesses such as those in the agriculture and consumer goods sectors, which are already part of an ongoing consolidation drive aiming to make these sectors more internationally competitive, may result in further M&A.

Top Baltic M&A Deals, 2014

Announced Date	Target Company	Target Sector	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value* (€m)
17/04/2014	Lietuvos Draudimas AB	Financial Services	Lithuania	Powszechny Zaklad Ubezpieczen SA	Poland	RSA Insurance Group plc	180
20/02/2014	Agrowill Group AB	Agriculture	Lithuania	Vretola Holdings Limited; Baltic Champs Group UAB	Switzerland		92
21/05/2014	AB Lietuvos Dujos (40.03% stake)*	Energy, Mining & Utilities	Lithuania	Lietuvos Energija, UAB group	Lithuania	Gazprom OAO	76
05/11/2014	Citadele Bank (75% stake)	Financial Services	Latvia	Ripplewood Advisors LLC, a group of investors	USA	VAS Privatizacijas agentura	74
21/05/2014	AB Lietuvos Dujos (38.9% stake)*	Energy, Mining & Utilities	Lithuania	Lietuvos Energija, UAB group	Lithuania	E.ON Ruhrgas International GmbH	63
22/12/2014	Cgates UAB	TMT	Lithuania	Starman AS	Estonia	SEB Venture Capital; Advanced Broadband Ltd	56
20/08/2014	SIA Ventamonjaks serviss	Transportation	Latvia	Uralchem Freight Limited	Russia	Transmar Holding SA	55
28/05/2014	AB Amber Grid (39.96% stake)*	Energy, Mining & Utilities	Lithuania	UAB EPSO-G	Lithuania	Gazprom OAO	54
21/05/2014	AB Amber Grid (38.92% stake)*	Energy, Mining & Utilities	Lithuania	UAB EPSO-G	Lithuania	E.ON Ruhrgas International GmbH	50
17/04/2014	AAS Balta	Financial Services	Latvia	Powszechny Zaklad Ubezpieczen SA	Poland	RSA Insurance Group plc	48

*Deal shares and percentages calculated in accordance with data published by NASDAQ OMX Vilnius.

Baltic M&A review

In the Zone

Baltic deal value, which reached a low point of €325m in 2012, has remained relatively stable since then as economic growth is robust in all three countries with GDP growth rates above the euro area average. Since Lithuania joined the Eurozone in the beginning of 2015, all three Baltic countries have finally become part of the currency union. As seen with Estonia in 2011 and Latvia in 2014, entering the common currency gives a general boost to the business environment as it reduces risks and costs associated with foreign exchange volatility and regulations for European investors. Following Latvia's entry last year, deal value increased 150% to €215m YoY, reaching a seven-year high despite a 12% dip in volume to 15 deals.

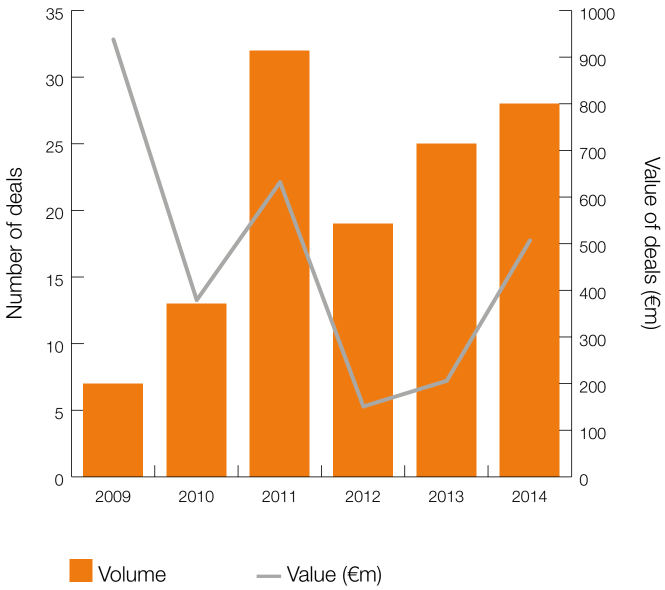
Inbound Influx

In the aftermath of the financial downturn, deal volume returned to pre-crisis levels in 2011 and has since maintained a stable level around 50 deals. In addition, inbound M&A has been increasing steadily over the past three years. In 2014, volume increased four percentage points YoY to 50% of total M&A. Meanwhile, inbound value increased from 19% of total M&A in 2013 to 50% in 2014.

Much of this was due to the Nordic economies. Inbound deals from Denmark, Norway, Sweden and Finland lifted dealmaking activity in the Baltics by 71% YoY to 12 deals and accounted for 43% of total inbound M&A, compared to 28% in 2013.

Lithuania accounted for the biggest share at 55% (or €277m) of total inbound value. The highest value deals last year were made by strategic buyers from Poland and Switzerland.

Inbound M&A, 2009–2014



Baltic Blues

The story is a little gloomier for domestic M&A. In 2014, deal value dipped 40% YoY from €885m to €511m, while volume slipped from 29 to 28 deals. Tight credit lines persist in the Baltic countries making it difficult for small and medium-sized enterprises to raise funds. Despite a significant share of the Baltic financial system being under the ownership of well-capitalised Nordic banks, lending is still restrictive. In Lithuania especially, a high number of non-performing loans is putting a strain on balance sheets. The same is true, to a lesser extent, in Estonia and Latvia.

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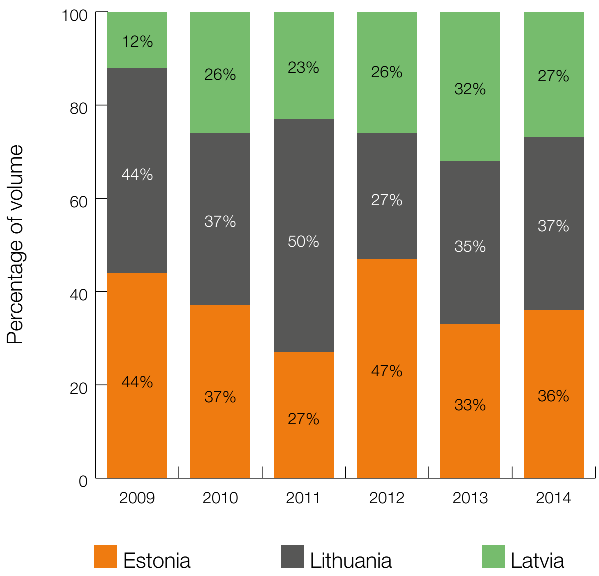
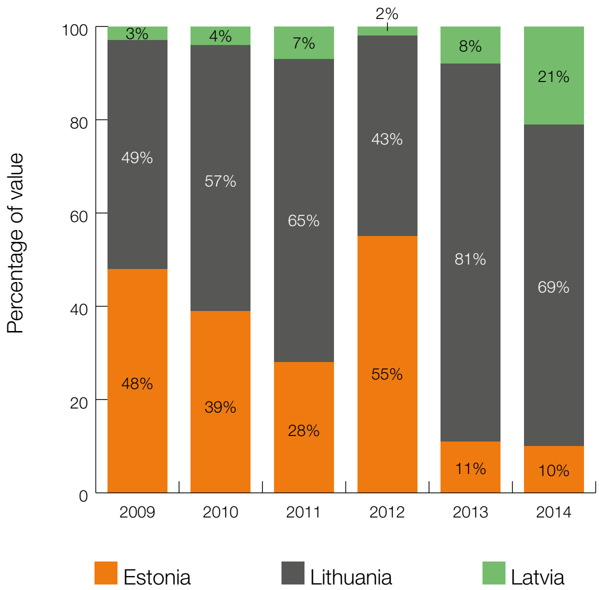
Baltic M&A review

M&A Trends Split by Geography Volume, 2009–2014



M&A Trends Split by Geography Value, 2009–2014



Regional Divides

As in the previous year, the number of deals in 2014 was distributed relatively evenly across the three countries. Lithuania had the highest number of deals in the Baltics with 21, followed closely by Estonia with 20 deals.

Lithuania, the region's largest economy, also accrued the most value with 69%, or €697m, of total deal value. In a similar pattern to 2013, when Lithuania's Central Bank sold Ukio Bankas to Siauliu Bankas for €782m, big ticket deals in the FS and energy sectors, such as the sale of insurance company Lietuvos Draudimas for €180m, boosted value considerably. Meanwhile, Estonian deal value remained stable at 10%, while Latvian deal value jumped by 13 percentage points to 21% of total M&A.

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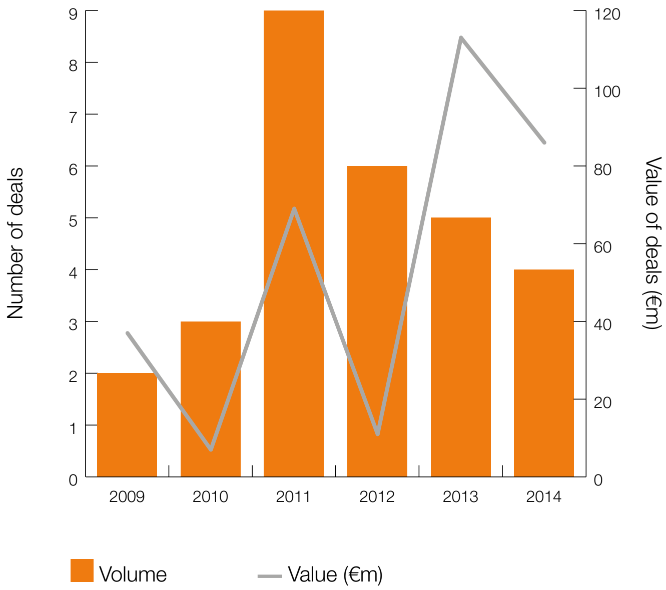
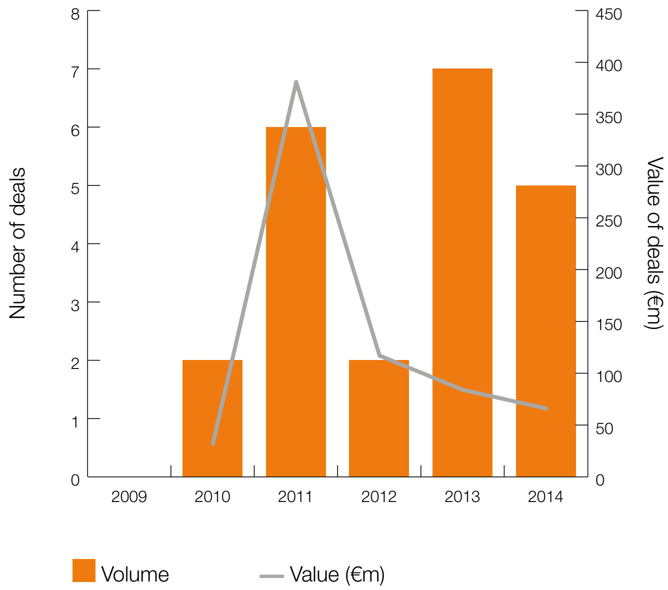
Baltic M&A review

Baltic Buyout Trends, 2009–2014



Baltic Exit Trends, 2009–2014



Private Equity Performance

Attracted by the Baltic economic growth story, PE and venture capital (VC) have long contributed to the investment landscape. However, while the number of buyouts remained stable, deal value dropped off by 24% to €86m. This is partly due to uncertainty over the impact of sanctions on Russia. Many investments are still spearheaded by EU funds such as the Joint European Resources for Micro to Medium Enterprises (JEREMIE) and the Baltic Innovation Fund (BIF), in cooperation with the European Investment Bank, aimed at jump-starting small and medium-sized enterprises. In the past, these ventures have consistently produced a slew of exits which make attractive targets for local and regional strategic buyers.

For example, local PE fund BaltCap exited Latvian concrete flooring specialist Primekss after four years for €10m in a deal with Russia-based Green Gateway Fund. In another deal Latvian electronics manufacturer Hanzas Elektronika, which has its main export markets in the Nordics and the UK, was bought out by its management from BaltCap after 12 years.

However, generally, exit opportunities remain limited in more modestly sized capital markets, leaving only strategic buyers as the main exit strategy. In 2014, exits declined 29% from seven to five, and dropped 21% in deal value to €66m. Nevertheless, exits from PE firms can represent appealing targets, particularly for Nordic companies, if they can acquire a sizeable market share and show potential for more regional and product expansion.

In better news, US PE investment in the region rose in 2014, amid increasing cash reserves and risk appetite. For example, one such acquisition took place when Ripplewood Advisors LLC and a group of international investors bought commercial bank Citadele Bank for €74m.

Baltic M&A review

Sector Splits

Overview

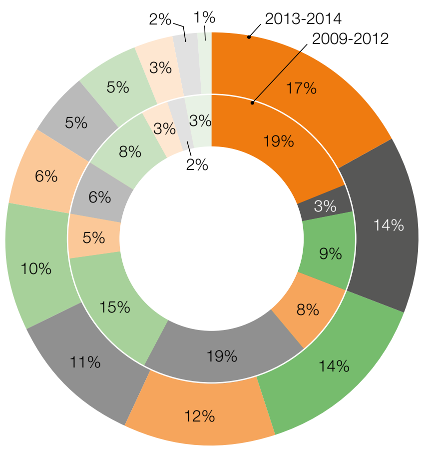
In 2014, the EMU, and FS sectors accounted for 66% of deal value between them (an even split of 33% each). Over the past two years the FS sector alone has accounted for 56% of total deal value, an inexorable rise, considering it only accounted for 1% in the period 2009-2012. In 2013, for example, values were boosted by the blockbuster sale of debt-ridden commercial Lithuanian bank Ukio for €782m to corporate Lithuanian Siauliu Bankas. In 2014, while far from the heights of 2013, the sale of Latvian Citadele Bank for €74m already accounted for 22% of total sector value.

In 2014, the top contributor in terms of volume was the EMU sector (21%), followed by the consumer and industrial & chemicals sectors, each accounting for 16% of total deal volume. Between 2009 and 2012, the industrial & chemicals and the consumer sectors had the highest deal volume with 19% each. The trend in EMU sector-related deals over the past two years largely stems from the ongoing energy market liberalisation. Meanwhile, finance sector contribution has grew from 3% to 14% in 2013–2014.

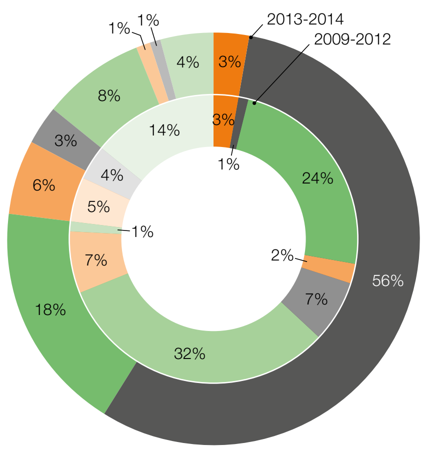
Energy

Almost half of the top 10 deals in 2014 took place in the energy space. All three Baltic countries are fully immersed in energy market liberalisation, aiming to align with the EC's Third Energy Package, which seeks to create an internal EU energy market. This includes regulations mandating the break-up of state monopolies, diversifying supply and separating gas and electricity suppliers from distributors. In 2014, the latter contributed to M&A in the sector with the retreat of German utility company E.ON Ruhrgas from Estonia and Lithuania. It sold its 33.66% stake in Eesti Gaas AS to the Russian subsidiary of Finnish utility Fortum, and in Lithuania its 38.9% stake in natural gas supply company Lietuvos Dujos for €39m (€63m without a Net Cash consideration), as well as an 11.76% stake in electricity distributor LESTO for €34m, to Lithuanian operator Lietuvos Energija. In addition, E.ON disposed of its 38.92% stake in Lithuanian natural gas transmission company Amber Grid in a sale to state holding company EPSO-G for €93m (€50m without a Net Debt consideration). A similar exit by E.ON is also ongoing in Latvia with the tender for a 47.2% stake in Latvijas Gaze, expected to be concluded in 2015.

M&A Volume 2009–2014, Split by Sector



M&A Value 2009–2014, Split by Sector



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

Baltic M&A review

Unbundling rules laid out in the EC's reform package also led to Russian oil and gas company Gazprom and minority stakeholders selling Lithuania's Amber Grid to state holding company EPSO-G for a total of €54m. The Russian corporate and minority shareholders also sold a combined approx. 40% stake in natural gas company Lietuvos Dujos to state-owned utility Lietuvos Energija for €76m. Similar developments are also ongoing in Latvia and may result in a reduced presence of Gazprom as a distributor in the Baltics.

Financial

As global insurance companies emerge from the financial crisis, many are still endeavouring to strengthen their balance sheets and are aiming to refocus their portfolios. In a large-scale recapitalisation effort, UK-based general insurer RSA Insurance divested its Baltic assets in all three countries. These were acquired almost entirely by Polish financial services provider Powszechny Zaklad Ubezpieczen (PZU) for a total of €258m. Only part of the RSA's Estonian portfolio under subsidiary Codan Forsikring, namely the agricultural insurance branch, was sold to Denmark-based general insurer TrygVesta Forsikring for an undisclosed sum.

The acquisition of Vilnius-based insurance company Lietuvos Draudimas for €180m was the top Baltic deal of 2014, and is likely to spark further dealmaking as the Lithuanian Competition Council has made the acquisition conditional on PZU selling stakes in some of its existing businesses in Lithuania.

Meanwhile in the banking segment, Latvian Citadele Bank had to be privatised according to an agreement with the EC, resulting in the sale of a 75% stake by the country's privatisation agency to US-based PE firm Ripplewood Advisors LLC and a group of international investors for €74m. The European Bank for Reconstruction and Development (EBRD) will hold on to the remaining 25% stake.

Consumer and Agriculture

Strategic buyers looking to attain market share in the Baltics – and the wider region – made up much of the M&A landscape in the consumer sector.

However, some markets have been subdued by the trade embargo between Russia and the EU. Lithuania suffered from a slowdown in off-take in some of its most important markets such as Russia and the Ukraine. In the wake of this scenario, there was a strategic merger between Lithuanian agricultural and dairy producer Agrowill Group and investment holding company Vretola Holdings and mushroom cultivator Baltic Champs Group UAB for €92m, which will enable Agrowill to upgrade from raw agricultural materials to value-added food products.

Another example of strategic expansion was the acquisition of Lithuania-based ice cream and frozen foods businesses AB Premia and Russian OOO Khladokombinat by Latvian dairy and ice cream company Nordic Foods Holding for €27m from Estonia-based Premia Foods. After the sale Premia Foods will maintain its fish products business and use the money from the sale to repay loans. Meanwhile, Nordic Foods aims to grow its ice cream business in the Baltics, and is also now aiming to expand to the Chinese market. If sanctions continue and suppliers seek to branch out to new markets, such as Nordic Foods' expansion into China, this is likely to spark more M&A in the sector.

Transportation

The ice-free Baltic Ports still present a strong draw for logistics companies – particularly Nordic buyers looking for synergies and geostrategic advantage. One such deal was Finnish transportation company Kiitosimeon's buy-in into Finland-based container and Estonia-based transportation logistics business by Finnish company Kuljetusliike Ilkka Huttunen in January for an undisclosed sum. In another deal, Russian Uralchem Freight, a subsidiary of fertiliser producer Uralchem, acquired a majority stake in SIA Ventamonjaks, an operator of Latvian liquid ammonia transshipment terminals, from Swiss holding company Transmar for €55m in August. The acquisition will create synergies for Uralchem's distribution logistics.

TMT

The Baltic cable and broadband services space continued to support M&A activity in 2014 and will likely result in more deals in the coming year as cable and telecommunications companies vie for market share. Estonian cable TV operator Starman AS took a first step to regional expansion by buying its Lithuanian equivalent Cgates for €56m. This move follows the capital injection Starman received through the €84m buy-in of a majority stake in 2013 by Swedish investment firm East Capital Explorer.

In the TMT sector, small-scale computer software and internet service platforms continued to provide a number of targets for foreign buyers wanting to expand their services. For example, two Norwegian IT companies looking to create synergies and expand their footprints made acquisitions in the Baltics. PSI Group ASA bought Lithuania-based retail-focused application provider New Vision Baltija UAB for €5m. In the second deal, Visma AS acquired Latvian Enterprise Resource Planning and Business Intelligence provider FMS Group for an undisclosed sum, and thereby gained more than 30% market share in the country.

While TMT has spearheaded global M&A values, in the Baltics the sector only accounted for 8% of total deal value in 2013–2014, compared to 32% between 2009 and 2012. Nevertheless, the steady number of transactions – 11 over the past two years – shows that the Baltics continue to be productive incubators for nimble technology companies and software applications developers.

Outlook

The Mergermarket Heat Chart (see next page), which logged 'companies for sale stories' for the past 12 months, shows that the industrial products, TMT and FS sectors are generating the highest amount of potential M&A targets. For the FS sector this is likely to mean that consolidation will continue in the wake of last year's successfully concluded deals. Banks and insurance companies are strengthening their capital base and will seek to take advantage of growth opportunities for their services portfolios and customers in the region. For example, Polish insurer PZU has been mandated by the competition authority to divest its existing business in Lithuania as a precondition of the acquisition of insurance company Lietuvos Draudimas. This will enable other companies to stake out market share. The banking segment will also become more competitive as Lithuania joins the Eurozone, which may lead to consolidation activity in the future.

Energy market liberalisation across all three countries will also continue to result in asset swaps, particularly for utilities, as already seen over the past two years. Other sectors benefitting from the strong economic fundamentals and competitive advantages of the region, such as TMT, business services and consumer goods, will also continue to bring forth attractive targets for strategic buyers.

Baltic M&A review

Heat Chart

Sector	'Company for Sale' Stories
Industrials & Chemicals	17
TMT	16
Financial Services	13
Energy, Mining & Utilities	10
Transportation	8
Business Services	8
Consumer	6
Pharma, Medical & Biotech	4
Construction	2
Leisure	2
Real Estate	1
Defence	1
Grand Total	88

Hot
16
12
10
8
4
2
1
0
Cold

The Mergermarket Heat Chart is based on "company for sale" stories tracked by Mergermarket over 01/01/2014 to 31/12/2014. Deal opportunities are captured according to the dominant geography and sector of the target company.

In the fourth quarter, Baltic deal volume and value bounced back from a low in the third quarter, with a 44% increase in volume and a 124% spike in value quarter-on-quarter, indicating resilience in the face of external pressures. The increase in inbound M&A may also be a confidence boost for investors still contemplating deals in the region.

Equally, local PE funds such as BaltCap II, which raised €100m in 2014, and Poland and Estonia-based BPM Capital's €70m BPM Mezzanine Fund closed in early 2015, which intends to target businesses in the €3m–7m range, will contribute to maintaining a healthy PE investment cycle in the region. In particular, funds in Estonia are growing at a fast pace with investors in 2014 committing €341m in addition to assets already under management.

While most of Europe is occupied by a sluggish Eurozone recovery, all three Baltic countries continue to offer attractive targets and safe investment havens for foreign buyers. Domestic demand will counter some of the adverse impact of sanctions on consumer-oriented industries and the general downside risk stemming from Russia and, going forward, this resilience paired with a stable regulatory environment amid robust GDP growth should continue to result in solid deal flow.

About Raidla Lejins & Norcous

Raidla Lejins & Norcous is a leading pan-Baltic provider of legal services with independent offices in Vilnius, Riga, Tallinn and Minsk. With a total staff of 155 professionals, of whom over 120 are lawyers, it renders comprehensive legal services to local, regional and international legal entities, including multinational enterprises, international banks and financial institutions.

Raidla Lejins & Norcous has a well-developed network of relationships with leading law firms both in the West and in the East. The firm is a member of Ius Laboris, the leading global alliance of labour and employment law practitioners with 2,500 lawyers specialising in all areas of law relating to human resources.

The firm has a very strong local client base and international ties. Its clients include many leading regional and international companies, banks and financial institutions. The firm's substantial domestic and international practice focuses on mergers and acquisitions, banking and finance, corporate advisory, dispute resolution, competition, real estate and construction, intellectual property and employment law.

Clients are offered solutions based on premier legal expertise in each jurisdiction, uniform quality and best practices of international standard and a "one-stop concept" – coordinated assignment handling. The firm's core values reflect utmost attention to responsiveness, dedication, efficiency and care for clients in all aspects of its work.

Raidla Lejins & Norcous is consistently top ranked by all major global directories: Chambers Global, Chambers Europe, The Legal 500, as well as IFLR1000, the guide to the world's leading financial and corporate law firms, and the specialised international transactions directory Mergermarket.

According to Mergermarket, the law offices Raidla Lejins & Norcous are one of the leading M&A advisers in the Baltics and No.1 M&A adviser by the number of M&A transactions advised in Lithuania in 2014.

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MERGERMARKET

Mergermarket is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

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