M&A IN UKRAINE

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What trends are you seeing in overall activity levels for mergers and acquisitions in your country during the last year or so?

Dmytro Fedoruk & Zoryana Sozanska-Matviychuk: M&A activity levels have risen in Ukraine since the financial crisis. According to EMIS, M&A deals in Ukraine were worth more than €4.7 billion in 2013. However, the M&A market has not picked up after the turbulent events of 2014. The number of M&A deals and their size, have shrunk compared to pre-2014 activity levels. While, according to EMIS, there were more M&A deals in 2015 compared to 2014, M&A deals in Ukraine these days tend to be smaller in value.

As far as foreign investment goes, we have witnessed a few exits by foreign investors but have not seen a lot of new foreign investment into the country, with the exception of financing provided by the likes of the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund (IMF) and the European Investment Bank. The role of the international financial institutions in supporting the Ukrainian economy has been critical, and at the same time we would like to (finally) see some private money being invested into Ukrainian businesses. A renewed cooperation between Ukraine and the IMF and the latest tranche in September 2016 is expected to give a positive signal to all potential investors. In addition, there is a shared hope that foreign investment will begin to flow into Ukraine again once there has been good progress with the various reforms that are currently underway. The reforms, first and foremost a judicial reform and changes in how the public prosecution authorities operate, should improve the investment climate in Ukraine. An improved investment climate and the abundance of undervalued assets could lead to a significant increase in dealmaking. Assets in Ukraine should generally be cheaper to buy because of a major depreciation of the Ukrainian hryvna (from around 13 hryvnas per US dollar in September 2014 to around 26 hryvnas per US dollar in September 2016).

Privatisation of Ukraine’s many state-owned enterprises (SOEs) is one area where interest from foreign investors, and eventual dealmaking, are anticipated. The list of SOEs to be privatised in 2016–2017 has recently been expanded and now includes over 400 enterprises. The government is particularly hopeful about attracting investment into some large infrastructure, chemicals and energy-producing companies. The ‘crown jewel’ on the list of SOEs to be privatised is the Odesa Portside Plant (OPP). It is a major producer of ammonia and other chemicals, and also operates a sea terminal for transhipment of chemicals. Unfortunately, the first attempted auction of the OPP (with a starting price of approximately US$20 million) that was scheduled for July this year was cancelled because of a lack of interest. A second auction is planned to be held in November 2016, with a significantly reduced starting price of approximately US$150 million.

Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

DF & ZS-M: Generally speaking, Ukraine’s natural and human resources and, to an extent, its existing production facilities, make it an attractive for investments in areas such as agriculture, energy, IT and heavy industries.

The most active sectors have been finance and technology and telecommunications. Some deals took place in agriculture and pharma. A number of exits by foreign investors from their struggling Ukrainian subsidiaries took place in the banking sector and this trend is expected to continue. The value of the Ukrainian banks has dropped dramatically so banking M&A deals tend to be low-value as a result. In insurance, there was an acquisition by Canada’s Fairfax of 100 per cent of shares in QBE Ukraine, an acquisition by the Bulgarian Euroins Insurance Group of almost all of its shares in HDI Ukraine and a very recent (yet to be completed) acquisition by TAS Insurance, a Ukrainian insurance company, of 100 per cent of shares in Aegon Life Ukraine from its Dutch parent.

Ukraine’s IT sector has been quite active, although most deals are relatively small (ie, up to US$5–10 million). Recent examples of larger deals in IT were Snapchat Inc’s purchase of a Ukrainian start-up Loosery Inc for an estimated price of approximately €130 million, acquisition...
by Horizon Capital (a regional private equity fund manager) of a minority stake in Rozetka (a Ukrainian e-commerce business) for an estimated price of US$30–50 million and a sale by Horizon Capital of its stake in Ciklum (a Ukrainian software developer) to George Soros for an estimated value of US$40–60 million.

What were the recent keynote deals? What made them so significant?

DF & ZS-M: A large keynote deal was EBRD’s investment into Raiffeisen Bank Aval in late 2015. This acquisition was very high-profile and, perhaps, signalled to the investment community that things may not be as bad in the Ukrainian banking sector as previously thought.

Another very positive deal was the investment by George Soros into Ciklum, which also took place in late 2015. This investment should encourage other investors to venture into the Ukrainian IT industry.

A recent deal that must be noted is Turkcell’s acquisition of 45 per cent in Astelit (a Ukrainian mobile operator) in July 2015. It was one of the largest M&A deals in Ukraine, with a value of approximately US$100 million. Before the acquisition, Turkcell held 35 per cent in Astelit so it became the sole owner of Astelit after the deal. We have recently seen an increased interest in Ukrainian assets from Turkish investors, which could become a trend in Ukrainian dealmaking in the near future.

Had the first attempted auction of the OPP been successful, the deal would have been closed by now. An eagerly anticipated second auction is expected in November this year. The government’s preference is for the OPP to be made private by a foreign investor. A successful sale of this flagship SOE could prompt more foreign investment into Ukraine. In particular, there is a number of energy producing and energy distributing companies (including various ‘oblenergo’ SOEs (energy distributors)) up for grabs within the privatisation process.

In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your country primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

DF & ZS-M: Vendors commonly prefer cash consideration. Share transactions are less common. There still are certain regulatory restrictions that make it difficult for Ukrainian residents (both individuals and companies) to invest abroad by way of acquiring shares of foreign issuers.

First, there is a requirement to obtain a licence from the National Bank of Ukraine (the central
bank) (NBU) to invest abroad. There are very limited exceptions to that rule. In the past, there have been examples of consideration being paid by way of issue of shares in the foreign holding company, in exchange for shares in the Ukrainian target. Such structures require cautious planning.

Second, there are certain additional restrictions that have been imposed by the NBU in response to the fiscal instability of the post-2014 period, aimed at preventing an outflow of capital. Though some of these restrictions have been relaxed, a few remain. Most notable in the M&A context is the ban on repatriation of proceeds from the sale of shares in Ukrainian companies, and also of dividends (with limited exceptions). These are temporary measures that should be removed once the Ukrainian financial market is in a better shape.

We expect to see many more debt-to-equity conversions by overleveraged Ukrainian companies and their shareholder lenders.

**How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your country?**

**DF & ZS-M:** There have been quite a few new laws and regulations introduced in the past couple of years. These are part of the government’s ongoing reform efforts so more regulatory changes are expected. Some laws were mandated by the IMF and other laws were passed in accordance with the Ukraine-EU Association Agreement, which was (finally) signed in 2014. The Association Agreement requires harmonisation of Ukrainian laws with those of the European Union.

Worth noting are some important changes in corporate governance and in merger control. From 1 May 2016, a few new statutory protections became available to minority shareholders. These include more stringent rules regarding related party transactions, the right to bring a derivative action (that is, an action by a shareholder of a company on behalf of that company against its officers) and the requirement to have at least two non-executive board members on boards of public companies. In merger control, there was a long-awaited revision of the antitrust clearance thresholds in May 2016. Also, a fast-track procedure (of 25 calendar days in total, as opposed to 45 calendar days for the standard procedure) is now available to clear transactions with limited impact on the relevant market.

From 1 January 2016, the process of registration and maintenance of companies in Ukraine became more user-friendly. There are now more authorised persons who can process registrable changes (eg, private notaries), and more information about Ukrainian companies is publicly available (including, certain basic details of their ultimate beneficial owners and copies of the organisational documents).

The registration of foreign investments with local authorities in Ukraine, commonly seen as a useless bureaucratic procedure, was cancelled in July this year. Accordingly, the statutory guarantees for foreign investors (eg, protection against expropriations) are also available for those foreign investments that have not been so registered.

Certain measures have been taken in the regulatory landscape to combat corruption, which is perhaps Ukraine’s single biggest problem and a major deterrent to foreign investors. For example, liability for bribery has been increased and the National Anti-Corruption Bureau has been established.

**Describe recent developments in the commercial landscape. Are buyers from outside your country common?**

**DF & ZS-M:** The continuing support of the Ukrainian economy by international financial institutions sends a positive message to private investors. Combined with a significant depreciation of the hryvna and falling prices for Ukrainian assets, a further improvement of the investment climate should encourage more foreign investment. Removal of the NBU’s capital controls would also help but is unlikely to happen until 2017.

Overall, foreign buyers have not been common in the past few years. Instead, there have been a few exits by foreign investors, particularly in the banking sector. Some larger recent transactions have been between Ukraine’s oligarchs.
THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

The legal and economic environment in Ukraine is challenging. Though we are seeing improvement, there is red tape even for the implementation of high-profile projects.

It is certainly an interesting feature of mergers and acquisitions practice that virtually all large and medium-sized M&A transactions in the country are completed under English law (though this may not be unique to Ukraine). The shared love of English law in Ukraine (which is a civil law jurisdiction) must have been prompted by the rigidity of Ukrainian corporate and contract laws.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

When choosing a Ukrainian counsel, a client should look for someone with good practical experience that goes beyond technical knowledge. That person should understand how things are done in more developed jurisdictions and should preferably have worked abroad or at least with an international firm so that he or she can place himself or herself in the shoes of the foreign client, despite cultural differences. Finally, transactional work can be challenging and requires a lot of stamina so it almost takes a special breed of lawyers who are responsive, quick and determined, to get the deal done for the client.

What is the most interesting or unusual matter you have recently worked on, and why?

Perhaps the most interesting matter that we have worked on in the past few months was (and still is) the OPP privatisation. The fate of other SOEs could depend on whether the privatisation of the OPP is successful. This project is very high-profile and is being closely watched. We are looking forward to the second auction of the OPP, which is scheduled to take place later this year.

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Are shareholder activists part of the corporate scene? How have they influenced M&A?

DF & ZS-M: Put simply, no. Shareholder activism could, in theory, increase; there are still many companies that were created in the course of the earlier privatisation of the 1990s when employees were issued small stakes of shares, and that today have thousands of minority shareholders. There is no statutory squeeze-out mechanism at the moment (though a number of attempts have been made to introduce this into Ukrainian law).

As a general rule, such minorities are not active, and only a small portion of those ever attend the annual shareholders’ meetings. So there are no Western-style activist campaigns funded by hedge funds or other third parties.

The reintroduction of the derivative action could lead to minority shareholders joining forces (the law requires holding at least 10 per cent of all shares to be able to bring a derivative action) and becoming more active.

Take us through the typical stages of a transaction in your jurisdiction.

DF & ZS-M: A typical M&A transaction will have the following timeline. After preliminary discussions between management teams (with or without involvement of intermediaries), a term sheet or a similar, largely non-binding, document would be signed. The obligation to maintain confidentiality of any information about the target, and of the negotiations themselves, would normally be in a separate confidentiality or non-disclosure agreement, though it could be a part of the term sheet. Due diligence process will then start. The process of provision of due diligence information has become more structured and virtual data rooms are used in larger deals. Negotiations will continue in parallel but can often be protracted, especially where a foreign investor is negotiating with a potential local partner who is not represented by experienced advisers. Often the signing of the transaction documents will be preceded by some pre-acquisition restructuring so that the target group is investor-ready.

Typically, there is a split signing and closing of the transaction, so once the transactions documents are agreed and signed, the parties will work on satisfying the conditions precedent (such as regulatory approvals, in particular). The time it takes to complete a transaction will depend on many factors and usually the involvement of experienced advisors on both sides makes things easier and quicker.

A private company acquisition (especially an acquisition of a limited liability company, which is the most common corporate form in Ukraine) is not extensively regulated by the law so the parties are largely free to determine the process. It will be necessary to take care of statutory registrations after closing so that any changes in the ownership of the company or its management are validly registered with the government authorities.

Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your country?

DF & ZS-M: More reforms and liberalisation of regulation are expected to follow, resulting in a better investment climate. The Ukrainian economy is now poised to (slowly) recover; the Economic Development and Trade Ministry of Ukraine assessed the growth of GDP to be 0.7 per cent in January–July 2016 and predicted this would increase to 1-1.2 per cent by the end of 2016. According to the IMF’s 2017 forecast, Ukraine’s GDP will grow at 2.5 per cent.

Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your country?
As regards specific legal changes that are anticipated in the near future (which are relevant to M&A transactions), there are draft laws under discussion in the Ukrainian Parliament that, if passed, would allow for debt-to-equity conversions in Ukrainian limited liability companies (this is currently restricted by the law), conclusion of Western-style shareholders’ agreements under Ukrainian law (such agreements in respect of Ukrainian companies have been predominantly completed under English law) and a minority squeeze-out by a 95 per cent shareholder (no such mechanism is available at present). Out of those three draft laws, the first (regarding debt-to-equity conversion) is likely to be passed soon.

What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

DF & ZS-M: 2017 is expected to be the year when the government’s big privatisation programme will be implemented. Many large SOEs, including the OPP, are scheduled to be auctioned this year; however, we think that, realistically, most are likely to be sold in 2017. The State Property Fund of Ukraine (the government agency in charge of the privatisation) has taken a number of preparatory steps with the help of external advisors, whose involvement has been sponsored by the United States Agency for International Development and other donors. But we think that changes to Ukraine’s outdated privatisation laws are critical for privatisation to be successful, which could be a big boost to the economy and would encourage more foreign investment.

We are also cautiously optimistic that dealmaking will start picking up in 2017. Again, any increase in the activity will probably depend on the successful implementation of ongoing reforms, particularly in the anti-corruption area.

As regards sectors, we expect most activity to be in agriculture, energy and IT.

Deal size and activity should increase provided that the geopolitical situation is relatively stable and predictable, and further provided that the economy continues to recover with the help of the IMF and other international financial institutions. The IMF recently provided a new aid tranche of US$1 billion, which resulted in Ukraine placing a US$1 billion eurobond guaranteed by the US government. This was a very positive development.