March 2009

Deal Drivers Russia

A survey and review of Russian corporate finance activity

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Contents

Introduction

2008 was a momentous year for M&A in Russia with the first decline in the number of deals concluded for at least four years. The bull market was never going to last forever, but the decline was much sharper than many had considered. In 2007 deals were concluded at a rate of almost one a day, with a combined value of close to €80bn. In 2008 the number of deals was down a quarter, whilst the value of those deals collapsed by half. Indeed the decline is even more stark when you consider that in Q1 and Q2 of 2008, the deal flow was up on the same period in the preceding year – with the second half of 2008 showing a dramatic fall.

It is against this backdrop that at the end of 2008, CMS commissioned mergermarket to interview 100 Russian M&A and corporate decision makers. We wanted to find out what they thought of the current situation and what their views on the future are. We also wanted to test our own view that Russia remains an attractive jurisdiction in which to invest.

The Russian M&A market has taken a hit in the current environment - of that there is no doubt. However, what was discovered during the research is that despite the gloomy headlines, there remains a stronger level of optimism, and overall the message is clear that, the Russian market has a positive future.

In particular, the research revealed that over half of the respondents expect the overall level of M&A activity, and the level of private equity buyouts to increase over the next 12 months, with only a quarter anticipating a fall. Furthermore, whilst over three quarters of decision makers expect Russian economic growth to decrease in the next 12 months, only a fifth of them believe the economy will be the biggest challenge facing the Russian M&A market this year. With half of the respondents anticipating the funding environment will improve during 2009, we believe the year will be more positive than others might have you believe.

The research also includes forecasts for the next 12 months, provides insight into M&A market by sectors, and analyses trends in the IPO market, Private Equity and Alternative Investments. Finally, it has been underpinned by mergermarket's historical M&A data.

Russia remains a place of great opportunity and the next couple of years will see a return to more realistic prices and a shift from a seller's to a buyer's market, which offers a healthier environment for business.

We hope you find this report interesting reading, and if you are interested in discussing the Russian market, we'd love to hear from you.

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In December 2008, mergermarket interviewed 100 Russian M&A and corporate finance decision makers in order to garner their views on various aspects of the present Russian M&A environment.

In addition, mergermarket journalists supplemented this research with deal type and sector analysis. Finally the report has been underpinned by mergermarket's historical M&A data.

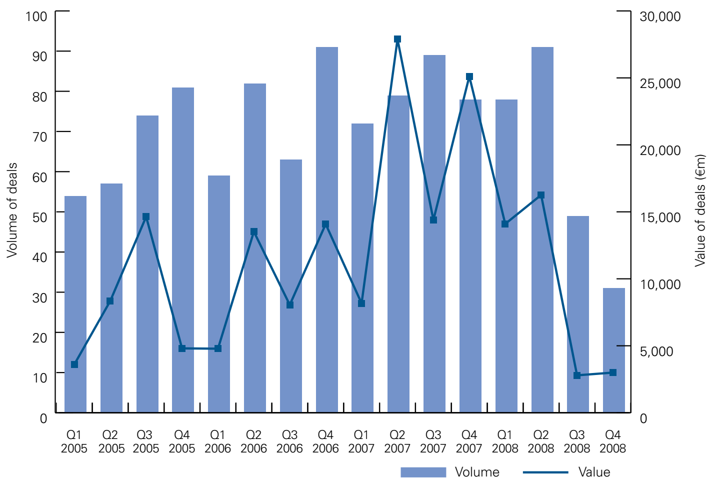
01
M&A Survey & Review

Deal Trends

Over the 2005-2008 period, domestic and inbound M&A activity in Russia was robust with 1,100 deals valued at €183.7bn taking place.

Domestic deals comprised the bulk of total transactions, accounting for approximately 70% of both deal volume and value over the period while inbound deals accounted for the remaining 30% in both volume and value terms.

Overall M&A trends in Russia



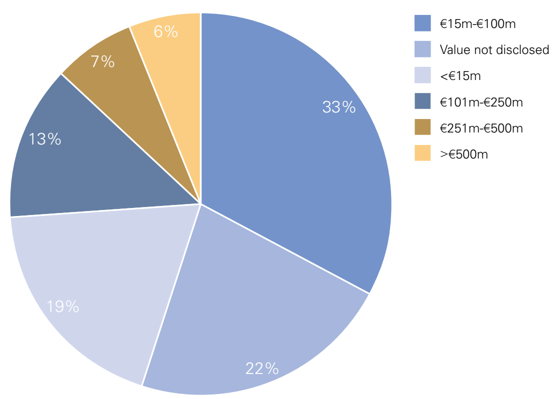
In 2008, M&A activity in Russia experienced a sharp deceleration following a three-year bull market culminating in some 317 deals worth €75.6bn coming to market in 2007. However, in 2008, the volume of M&A transactions fell by just over one quarter and deal values by over one half compared to 2007 figures. Furthermore, as the credit crisis worsened over the course of 2008, it's not surprising that the M&A slowdown quickened in the second half of the year. Notwithstanding the fallout from the financial crisis, Russia's deal-making environment had already begun to worsen in the preceding month as the Georgian conflict sparked heightened investor bearishness.

In this regard, mergermarket's data on quarterly M&A activity is most revealing. While transaction volumes in Q1 were only up by a meagre 4.2% year-on-year to 75 deals, deal valuations rose by an incredible 72% to €14bn, reflecting ongoing resilience to the credit crunch. This trend continued in Q2 with deal flow up by a surprisingly brisk 12.7% year-on-year. However, the second quarter marked the starting point of a pattern of dwindling deal valuations. Indeed, by the final quarter of the year, deal flow dropped to just 22 transactions worth a mere €2.8bn, down by over 70% and 85% respectively from Q4 2007 levels.

As the economic and political situation in Russia worsened in the second half of the year, both domestic and foreign investors became increasingly reticent to conduct M&A transactions. Domestic transactions numbered 47 deals worth €4.6bn in H2 2008, a comparatively large decline from the 109 deals, valued at €18.8bn, made in H1. Similarly, inbound deals stood at just 22 transactions with a total deal valuation of €1.8bn in the second half of the year, marking a significant fall from the 55 deals worth €11.2bn in H1 2008.

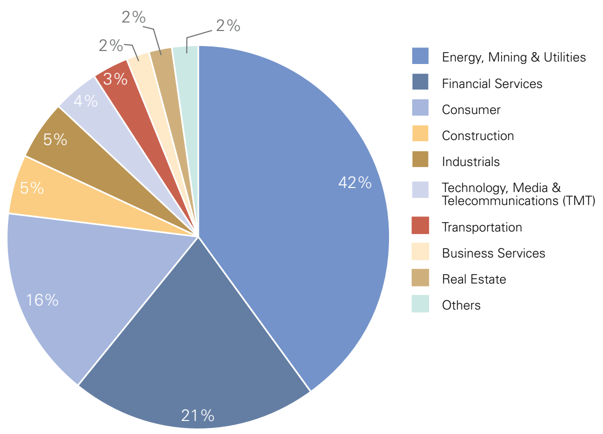
Companies from the UK comprised the largest group of foreign investors making acquisitions in Russia in 2008, accounting for 16.9% of total inbound investments by volume, which was followed closely by firms from the US at 15.6%. Notably, the proportions of UK and US investments made in 2008 to total acquisitions that year are slightly above trend levels for the 2005-2008 period. However, this is also the case with Cyprus and Finland, the third and fourth most active investors in Russia, underscoring the tendency for increasing concentration of inbound investment by country. By deal value, Finland and the US led the way, each contributing around one fifth of total deal valuations in 2008.

Deal size split of Russian M&A activity 2008



Energy, Mining & Utilities M&A activity remained the leading sector by M&A activity in 2008, with deal flow comprising slightly more than 25% of the total number of transactions and just over 40% of total deal values over the year. The Consumer space was the next most active with just under 20% of total deals and about 15% of total deal valuations, while the Technology, Media and Telecommunications (TMT) sector accounted for about 15% of deal flow, but only an approximate 4% of total value. Notably, the Financial Services sector, which accounts for around 12.5% of total deal volumes, was the second largest sector by deal value after Mining, Energy & Utilities in 2008, accounting for just under one quarter of total deal valuations over the year.

Russian M&A sector split by value

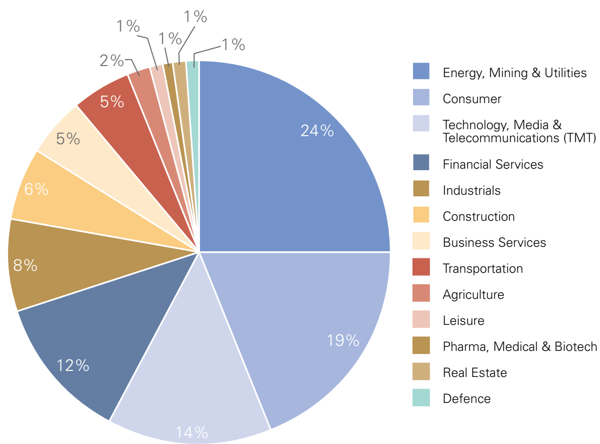


By deal size, small-cap deals (<€100m) accounted for just over 50% of total transaction volume in 2008, but only 11% of total deal value – figures not dissimilar to the overall trend for 2005 to 2008 as a whole. In 2008, deal volume and values in the mid-market (€101-€500m) comprised 20% of the overall market, compared to just 15% over the 2005-2008 period, while the share of such deal values accounted for about 30% of the market (compared with roughly 20% for the 2005-2008 period). Large-cap deals (>€500m) numbered 17 with a value of €21.4bn in 2008, accounting for approximately 7% of deal volume and 60% of deal value in the year.

Perhaps unsurprisingly, Mining, Energy & Utilities transactions accounted for seven of the top 10 Russian M&A deals announced in 2008. However, the largest transaction announced in the year was financial investment firm Interros Company's purchase of a 50% stake in KM Invest for some €4.6bn in May. In the Energy sphere, the Finnish utility company Fortum's acquisition of a 29% stake in TGK-10 – a Russian power generator and distributor – from Unified Energy Systems of Russia (UES) in July was the second largest deal carried out, valued at €2.3bn. Meanwhile, UES' announced sale of a 77% stake in TKG-7 to Berezville Investment Ltd. was the third largest deal announced in 2008 with a value of €1.9bn. The deal, pending completion, would give Berezville complete control of TGK-7 as it already owns 23% of the Russian listed power generating company.

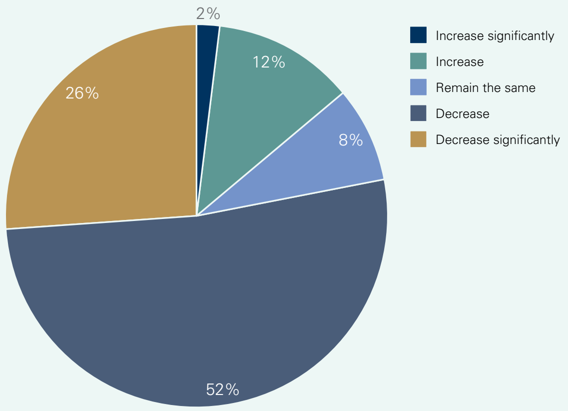
Lastly, while fear and uncertainty drove down the number of announced M&A transactions in 2008, the Initial Public Offering (IPO) market was also severely hit by the global financial crisis. Indeed the Russian market stalled to such an extent that not one single IPO was announced in Q4, compared to some 12 offerings in the final quarter of 2007. Aborted listings and a general lack of activity in the IPO space is unsurprising given the hit that the equity markets have taken across the globe in recent times. Russian firms are now looking to raise capital through alternative means such as stake sales with Ecowave Technology, the manufacturer of emergency protection for pipelines and other equipment, being a case in point having recently cancelled its planned Q4 2008 IPO. Moreover, the IPO market in its current state is not a viable exit route for private equity houses, this has served to act as a further depressant on listing volumes. 2009 will arguably see an uptick in the number of delistings with advisers already reportedly being engaged on this issue by Russian corporates.

Russian M&A sector split by volume 2008



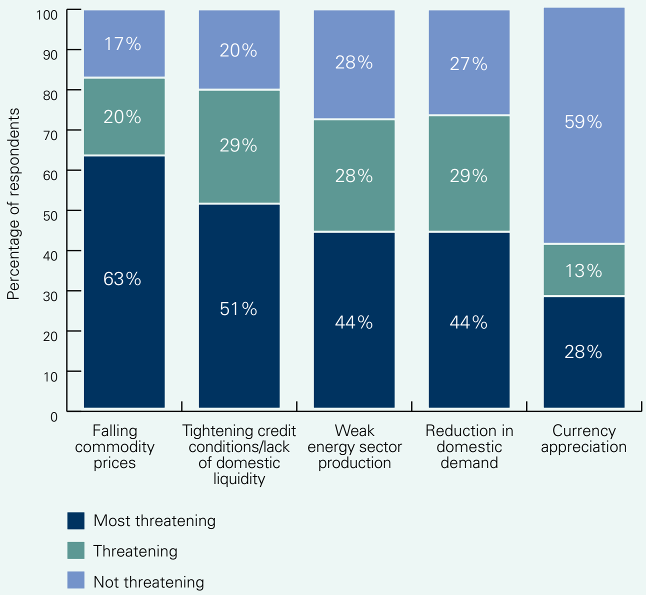
The majority of respondents expect Russian economic growth to decrease over the next 12 months

What do you expect to happen to the level of economic growth in Russia over the next 12 months?



Falling commodity prices are considered most likely to stall economic growth

Please rate the following in terms of their influence on economic growth for Russian businesses over the next 12 months.



- A combined majority of respondents (78%) expect the level of economic growth in Russia to decrease (52%) or decrease significantly (26%) over the coming year. Most consider that growth will decelerate sharply "especially when compared with the past few years," one respondent notes, while another highlighted that next year's economic performance "really is dependent on oil prices."
- Meanwhile, others are more sanguine. Of this group, 8% expect growth will remain the same, while another, more optimistic group, believe that it will either increase (12%) or increase significantly (2%).

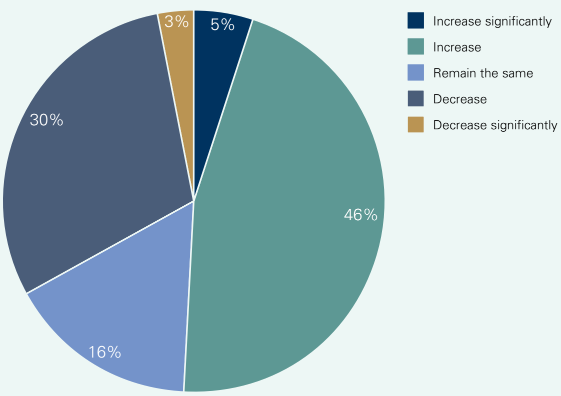
- Falling commodity prices are viewed by a considerable 63% of respondents as likely to be very threatening to Russian economic growth over the next 12 months. Elsewhere tightening credit conditions and a lack of domestic liquidity is viewed as very threatening by 51%. One respondent states: "When you take out the combination of high commodity prices and credit availability, you have taken away two of the biggest supporters of the Russian economy."
- Furthermore, weak energy sector production, closely related to falling commodities prices, is viewed by a combined 72% as at least threatening to economic growth in Russia over the course of 2009. Unsurprisingly, currency appreciation is not widely regarded as a key influence with 59% considering it not threatening, this sentiment reflects the general weakening of the rouble in recent times.

"It is not a surprise to us to see over half of respondents expecting to see an increase in activity – we have been very busy in the corporate department throughout the last year and our pipeline remains very strong."

Irene Engel, Head of Corporate

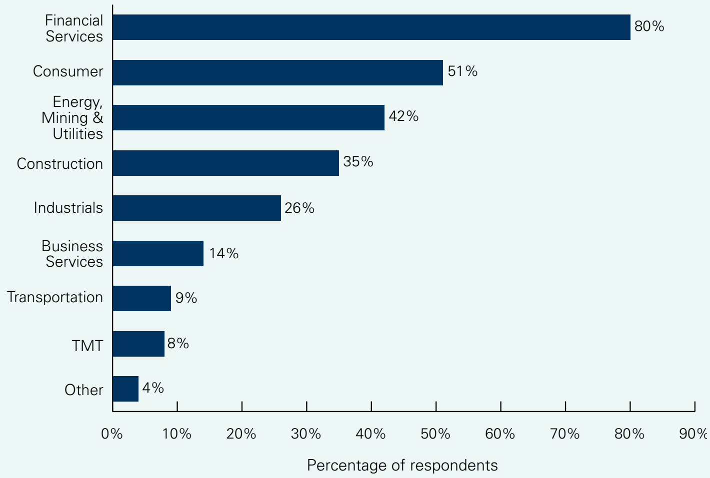
51% of respondents expect Russian M&A activity to increase over the next 12 months

What do you expect to happen to the overall level of M&A activity in Russia over the next 12 months?



Financial Services is most likely to generate the greatest levels of Russian M&A activity over the next year

Which three sectors do you believe will witness the most M&A activity in Russia over the next 12 months?

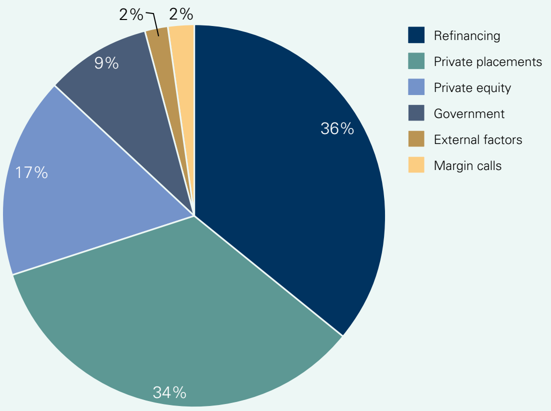


- A combined 51% of respondents expect the overall level of M&A activity in Russia to increase (46%) or increase significantly (5%) over the next 12 months. One respondent states: "I believe this will be a busy year for consolidation, particularly for Banking, Retail, Construction and Real Estate – so overall activity will increase." Another respondent agrees that consolidation will drive activity but adds that, "the level of deals will increase, but the value of deals will go down."
- On the other hand, one-third of respondents expect M&A activity to decrease (30%) or to decrease significantly (3%) over the next 12 months. "Although asset prices are very attractive, funding is very limited, which presents a problem," writes one respondent. Lastly, 16% of respondents expect the level of activity to remain the same. A number of respondents among this group note that a projected drop in activity in the first half of 2009 will be offset by an increase in the second half of the year.

- The Financial Services sector is regarded by 80% of respondents as one of the industries most likely to witness the greatest level of M&A activity over the next 12 months. One respondent highlights one of the reasons behind this: "There is a direct correlation between the incidence of problems and the number of players in a sector. There are almost 1,000 banks in Russia – a number that will need to be trimmed down."
- Meanwhile, 51% of respondents believe the Consumer sector will experience the greatest level of M&A over 2009, while 42% believe it will be Energy, Mining & Utilities transactions. Just under one tenth of respondents cite Transportation (9%) and the Technology, Media & Telecommunications sectors (8%) as the most likely to experience the greatest level of M&A activity over the next year.
- "Not all sectors are affected by the financial crisis. For example, I would not expect much activity in the TMT sector. But the ones that are most affected by liquidity (i.e. Banking, Retail, Manufacturing and Construction) will be most active in M&A", one respondent writes.

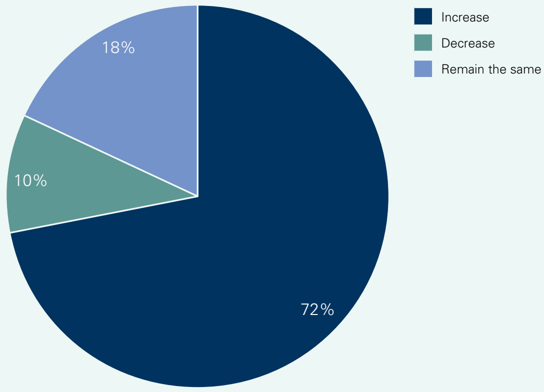
Refinancing and private placements are identified as being the most likely source of distressed situations

What do you believe will provide the most likely source of distressed situations in Russia over the next 12 months?



Russian distressed situations are expected to increase according to 72% of respondents

What do you expect to happen to the number of distressed M&A situations in Russia over the next 12 months?



- Re-financing is regarded by around 40% of respondents as the most likely source of distressed situations for firms in Russia over the coming year. "Nobody will step in now to help out companies going into distress – perhaps there is some hope of being saved with state money," writes one respondent.
- Private placements are also viewed by 38% of those surveyed as the most likely source of distressed situations over 2009, while another smaller share (19%) view private equity portfolio companies as the most likely source. Notably, a sizable number of respondents are uncertain as to where distressed situations will arise.

- Nearly three quarters of respondents (72%) expect the number of distressed M&A situations in Russia to increase over the next 12 months. Others believe that the number of distressed M&A situations will remain the same over 2009, while a small share of respondents (10%) expect that it will decrease.

Domestic M&A

2008 saw domestic transactions continue to dominate the M&A landscape in Russia. Indeed over this timeframe, such deals accounted for around two thirds of overall deal flow, both in terms of volume (67%) and value (64%). Moreover, these figures swell to above 70% when looking at data over the last four years.

Domestic trends followed those seen in the wider M&A market in Russia as deal making largely dried up when the global financial crisis hit in the third and fourth quarters of the year. This is borne out by the fact that 70% of 2008 domestic deal flow was announced in the first half of the year and this figure swells to 80% when looking at deal valuations. Somewhat unsurprisingly, full year 2008 activity was significantly down on deal flow over the previous 12 months both in terms of volume (29%) and value (56%).

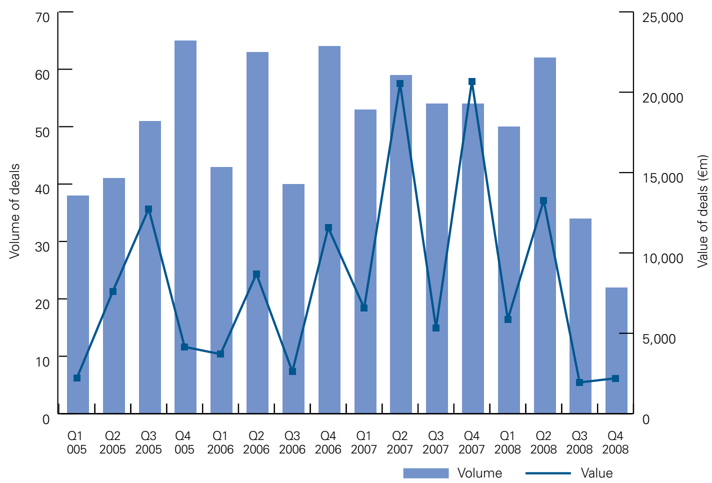
Despite the significant fall in the value of domestic M&A deals, a notable number of home-grown large cap transactions were announced in 2008 with three out of the top five announced deals in Russia being domestic in nature. The largest deal was seen in April in the investment fund niche of the Financial Services sector when the Interros Company acquired the remaining 50% stake it didn't already own in KM Invest for €4.6bn from Onexim Group. Elsewhere, other significant domestic transactions include the €1.9bn acquisition of a 32.18% stake in TGK-7, the listed Russian power generating company, by Berezille Investment, the subsidiary of holding company Integrated Energy System.

This deal was part of the wider privatisation of Unified Energy System of Russia (RAO), the electricity producer and distributor, which led to the creation of, amongst other things, 13 Territorial Generation Companies (TGKs) and five thermal Wholesale Generation Companies (OGKs). The privatisation of RAO was one of the principal drivers of M&A deal flow in Russia in 2008. The process led to several other sizeable domestic transactions coming to the market such as oil giant Lukoil's acquisition of an 82.3% stake in TGK-8 for €1.5bn from IFD Kapital, the financial group which offers insurance, banking and investment banking services.

Looking at the deal size split of domestic M&A in 2008, in spite of the abovementioned bumper deals, 85% of transactions with an announced deal value occurred in the €5m-€250m range. This increased emphasis on deal making in and around the mid-market space is undoubtedly symptomatic of the credit crunch and the cyclopean effect it has had on the debt markets. Banks' reluctance to lend in the current climate has made financing large scale deals very difficult and, where possible, very expensive. In turn this has led to a refocus on smaller cap transactions with an increased emphasis on value creation and operational efficiency.

In terms of the sector split of domestic deal-making in 2008, the Energy, Mining & Utilities sector continued to lead the way, accounting for 28% of deals with regard to deal volume and 42% of deal value. Elsewhere, the TMT and Consumer sectors have both witnessed a significant number of deals, accounting for 17% and 14% of activity respectively. 2008 figures loosely mirror overall domestic M&A since 2005 – over this timeframe, the Energy, Mining & Utilities sector has had a 22% share of the volume of deals and a 55% value share.

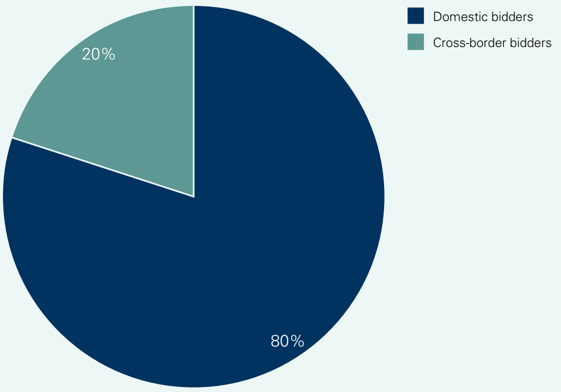
Domestic M&A trends in Russia



Indeed, mergermarket intelligence suggests that some domestic deals are in the pipeline with Transmashholding, the rail stock producer, reportedly considering acquiring a 50% plus one share stake in competitor Tverskoy Vagonostroitelnyi Zavod. Elsewhere, Probusinessbank is set to undertake an acquisition spree in the Financial Services space. It is reported that the company has already considered around 30 targets since the start of the financial crisis.

Respondents expect domestic bidders to dominate M&A activity in Russia over the next 12 months

Where do you believe the acquirers of Russian assets will predominantly originate from over the next 12 months?



- Over three quarters of respondents (80%) assess that domestic bidders will be the primary acquirers of Russian assets over 2009, compared with 20% who believe acquisitions in the country will be carried out by cross-border bidders. "Cross-borders investors will be lower owing to the evaluation of higher risks and the inability to raise financing," one respondent writes, while another says that: "When the capital markets open up again, the international investors will come back."

Cross-border M&A

Between 2005 and 2008, Russia witnessed the acquisition of 330 businesses by foreign buyers worth a total of €53.9bn. This represents around 30% of overall M&A in Russia over the time period in question both in terms of the volume and value of transactions.

Inbound M&A activity

Perhaps unsurprisingly, the bulk of this activity came at the height of the M&A boom in 2007 with the sale of 97 Russian businesses valued at a total of €22.4bn to foreign buyers – some 29% of overall volumes and close to half (42%) of total values for the four year period.

2008 was nevertheless a rather different year for Russian inbound transactions. However, there were 77 announced acquisitions worth a combined €13bn, representing a not insignificant amount of deal flow considering the global financial crisis that continued to unfold over the course of the year. Unsurprisingly, the bulk of this activity – some 55 transactions worth €11.2bn – took place in the first half of the year with just 22 deals worth €1.8bn taking place in H2 2008. Typical quarterly inbound valuations are now around levels last seen in Q4 2005 while Q4 2008 saw just eight inbound acquisitions. To put into context the current lull in cross-border inbound deal flow, before the fourth quarter of last year, announced deal volumes had never dipped below 16 acquisitions per quarter.

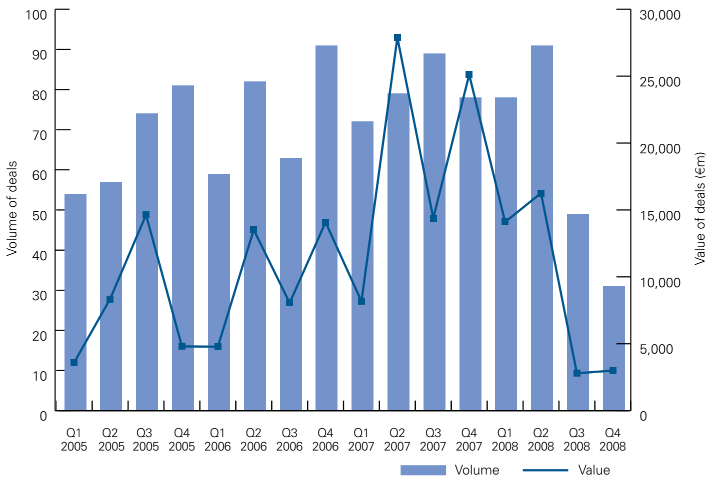
The UK, US and, somewhat intriguingly, Cyprus stood out as the most acquisitive countries in 2008, having undertaken 13, 12 and 10 purchases in Russia respectively over the course of 2008. In terms of deal values, neighbouring Finland accounted for over 20% of overall valuations, while the US made up 19% and the UK 14%.

Looking at the sector split of inbound cross-border M&A, between 2005 and 2008, one-quarter of inbound acquisitions and over half of total valuations (56%) were focused in the Energy, Mining & Utilities sector. At the same time, foreign acquirers have also been interested in the Consumer niche, having made 70 purchases worth €7.8bn over the past four years – some 21% of overall volumes and 14% of valuations. Buys in the Industrials space also accounted for more than a 10% share (13%) in terms of volume, yet made up just 6% of total values.

However, a look at inbound acquisitions by sector in 2008 alone paints a quite different picture to the above. From 2008 data, it is clear that the Energy and Mining boom is over with the sector accounting for only around one fifth of deal volumes and 38% of valuations – declines of 4.1% and 18% respectively on similar figures from the 2005-2008 period. At the same time, where Energy, Mining & Utilities M&A activity has declined, overseas interest in the Russian Business Services sector has picked up. M&A deals in the sector made up 29% of deal volumes in 2008 compared to 21% over the 2005-2008 period, while valuations accounted for 29% of overall flows in 2008 – against an overall figure of just 14%.

And while Russian inbound market share is gravitating away from the Energy, Mining & Utilities sector and towards the Business Services space, so inbound deals are getting smaller. Between 2005 and 2008, 68% of inbound transactions were worth less than €500m. The corresponding percentage for 2008 alone was 73%, indicating that inbound valuations are increasingly heading south.

Inbound M&A trends in Russia



The largest inbound deal since the beginning of 2005 saw E.ON AG, the German Energy, Mining & Utilities company win the auction to acquire a 47% stake in JSC OGK-4, the Russian electricity company, from Unified Energy System of Russia, for €5.9bn in the third quarter of 2007. E.ON subsequently acquired a further 23% in JSC OGK-4 taking its overall holding in the company to 76.1% in early 2008.

Earlier on in 2007, EniNeftegaz, the subsidiary of ENI SpA, the Italian oil and gas exploration firm, and Enel SpA, the Italian electric utility company, won a closely-fought auction for the gas assets of NK Yukos OAO, the Russian oil company, namely the Arctic Gas Company, OAO Neftegaztechnologia, ZAO Urengoil and a 20% stake in Gazprom Neft, for €4.4bn, making it the second largest Russian inbound transaction over the period. EniNeftegaz saw off competition from a wide field of prospective buyers including Nefttradegroup, a subsidiary of Russian oil firm Rosneft, Unitex, GroupInvest, Sever-Zapad Invest and Trans-Nafta, a gas-trading firm. Having won the auction, EniNeftegaz retained Arctic Gas, OAO Neftegaztechnologia and ZAO Urengoil while parent company Eni retained the 20% stake in Gazprom Neft.

Outbound activity

Russian businesses undertook 213 outbound transactions between the beginning of 2005 and the end of 2008, spending €38.5bn in the process. As a percentage of overall Russian M&A activity over that period, outbound deals accounted for 19% of all volumes and 21% of total deal values.

Outbound deal flow trends show a general expansion over the period 2005-2007, from around 38 transactions worth a total of €6.5bn in 2005 to around 62 purchases worth some €13.4bn in 2007. Since then however, annual Russian outbound deal flow has shown a modest decrease, with just 58 acquisitions worth €11.8bn taking place over the course of 2008.

The majority of outbound deal flow in 2008 was concentrated in the first half of the year, with 41 of the total number of 58 transactions and €9.4bn of the total of €11.8bn of deal activity over the year taking place. H2 on the other hand, saw just 17 outbound transactions worth some €2.4bn – with just two outbound deals worth a paltry €181m occurring in Q4.

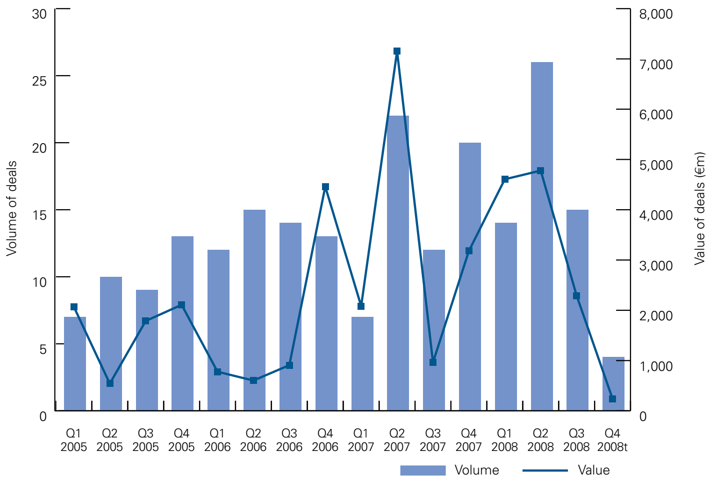
The US established itself as the pre-eminent country for Russian businesses to do M&A in 2008, accounting for just over 10% of overall outbound Russian deal flow. Russian buys of Cypriot and Ukrainian businesses totalled 8.6% apiece while Germany, Italy, Kazakhstan and the UK all comprised 5.2% of overall transaction volumes. In terms of deal values, Canadian purchases made up close to one quarter (24.5%) of overall outbound deal values last year, a large part of which was no doubt due to the €3.8bn acquisition of LionOre Mining, a Canadian mining concern, by Norilsk Nickel, the diversified mining company. US buys accounted for a further 15% while Italian acquisitions made up another 12.3%.

Over the 2005-2008 period, Russian buyers spent €33.4bn targeting foreign Industrials, Energy, Mining & Utilities and TMT acquisitions – a total of 87% of the total amount paid out for overseas businesses. Industrials buys made up 40.4% of this, Energy, Mining & Utilities an additional 34% and TMT, 12.5%. A similar picture emerges when examining outbound deal flows in terms of volume – the three sectors accounted for a combined 65.4% of overall transactions, with Industrials M&A plays accounting for 29.9%, TMT, 20.6% and Energy, Mining & Utilities, 15%.

However, looking at 2008 sector data alone, it would seem that the Russian penchant for TMT buys is fading fast. Percentage M&A volumes in this particular sector have fallen by 5% while valuations have also declined 1.7% compared to figures for the 2005-2008 period. Instead, Russian M&A buyers are increasingly focusing their attentions on the

Business Services space – 2008 deal volumes and values have risen 3% and 3.7% respectively.

Outbound M&A trends in Russia



Outbound deal trends have also shown that deal sizes have remained fairly constant over the period, with the proportion of deals worth less than €500m making up around 70%. In fact, if anything, deal sizes are getting slightly larger, with 10% of all transactions valued at over €500m in 2008 alone, compared to a figure of 8% for the 2005-2008 period.

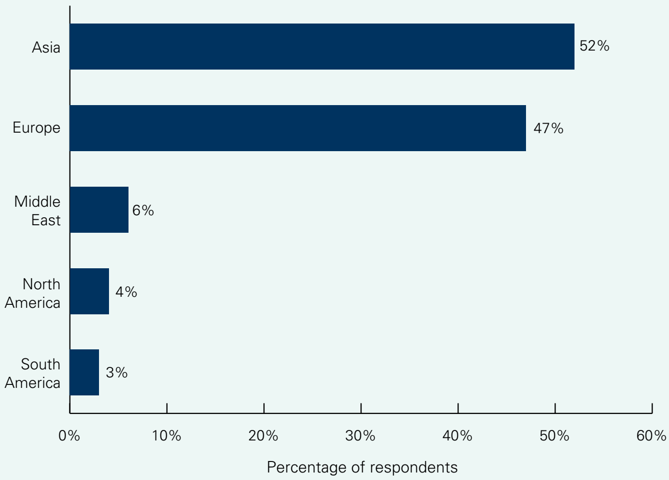
The largest outbound transaction in 2008 was the aforementioned acquisition by Norilsk Nickel of LionOre Mining, for €3.8bn. In second place was a consortium bid by the Evraz Group, the Russian steel manufacturer, and Trubnaya Metallurgiczeskaya Kompaniya (TMK), the Russian steel pipe manufacturer, to acquire the North American tubular operations of SSAB, the Swedish based steel producer, for €2.2bn. Evraz faced competition for the assets from the John Maneely Company, the New Jersey pipe manufacturer, as well as ArcelorMittal, the world's largest steel producer.

Prospective outbound deal flow looks likely, especially within the CEE region, according to mergermarket intelligence. Center-Invest, the Russian private banks, recently announced that it is interested in acquiring within Central and Eastern Europe. However, it is unlikely that such acquisitions would happen in 2009. Similarly, at a recent presentation, Sberbank, the commercial Russian bank, outlined its strategy for the next five years, which included acquisitions in external markets sometime in the near future.

> ***"Our decision to upgrade CMS' commitment to the Russian market whilst other firms look to downgrade is supported with these findings. With Europe accounting for almost half of all inbound bidders and over half of all outbound targets in the next year, CMS' unique, distinctively European, proposition means we are ideally placed to support Russian M&A."***
>
> **Elena Zhigaeva, Partner**

Over half of respondents believe the majority of cross-border bidders will originate from Asia over the next 12 months

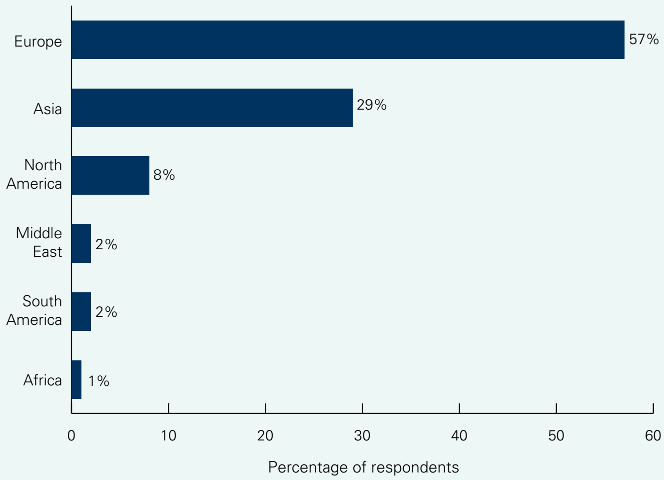
Where do you believe the majority of cross-border bidders will originate from over the next 12 months?



- Over half of respondents (52%) believe the majority of cross-border bidders will originate from Asia over the next 12 months. Respondents point to China, Japan and India as the Asian countries where cross-border bidders will predominately originate. However, a sizeable portion of those surveyed (47%) believes that the majority of bidders will originate from Europe. Respondents single out Germany, France and, to a lesser extent, the UK, as the main countries in Europe where cross-border bidders for Russian assets will originate.
- Comparatively smaller portions of respondents believe the majority of cross-border bidders will come from the Middle East (6%), North America (4%) and South America (3%). Several respondents believe that deals originating from North America will come from Canada, while others comment that bidders are unlikely to originate from the US.

Europe is identified as the region Russian bidders will most aggressively target for acquisitions over the next year

Which regions do you believe Russian bidders will most aggressively target over the next 12 months?



- 57% of respondents believe Europe will be the primary target market for Russian bidders over the next 12 months. Respondents note that Russian bidders will target acquisitions in Central and Eastern Europe and particularly in countries within the Commonwealth of Independent States, which includes several former member countries of the Soviet Union.
- Just under one third (29%) of those surveyed believe Asia will also be aggressively targeted – Australia, China and India are cited as the main target markets in this regard. Only 1% of those surveyed believe Africa will be the primary market targeted by Russian bidders over 2009, a share marginally below that for South America and the Middle East (2% apiece).
- A number of respondents point out that rather than seeking outbound M&A opportunities, Russian companies are more likely to concentrate on acquisitions in the domestic market over the coming year. In addition, several believe that outbound acquisitions will be mainly dependent on sectoral considerations such as where there is complementarity – for example, the Mining sector in Australia and Canada.

Acquisition Financing

Like most areas of the M&A market in both Russia and beyond, acquisition financing has been severely affected by the global financial crisis.

With the debt markets likely to remain static in the foreseeable future, it would appear that cash rich companies are best placed to strike deals and take advantage of falling valuations. Heading into 2009, cash would appear to be king in the Russian M&A market.

Securing debt from increasingly risk-averse banks to finance M&A deals in Russia remains an expensive and unattractive proposition. Consequently, it is almost a certainty that debt to EBITDA multiples will continue to fall on Russian M&A transactions in 2009. Any firms which are looking to finance deals fully or wholly through bank debt will likely move to carry out thorough due diligence in order to be sure that the transaction will create sufficient value in the long term to justify the initially unappealing lending terms. Moreover, the majority of acquirers will also look to assemble water-tight financing arrangements in advance of their M&A bid announcements.

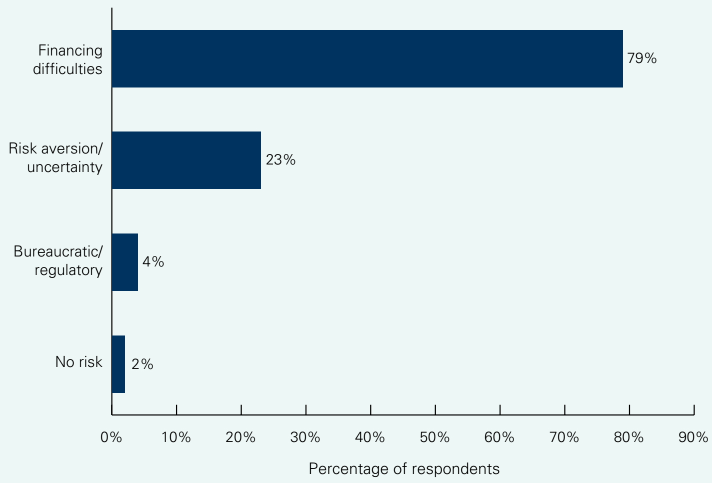
However, it should be noted that a small number of domestic state sponsored banks are still deploying capital, albeit generally not to corporates who are looking to make an M&A play. Principally through their private equity arms, state banks such as VTB and VEB have been opportunistically acquiring stakes in distressed companies across a number of core and non-core sectors including Industrials & Chemicals, Construction and Financial Services.

Indeed, in September 2008 VEB moved to acquire a 98% stake in Sviaz-Bank for an undisclosed consideration. The deal materialised as a result of the liquidity squeeze which resulted in Sviaz-Bank being unable to meet its commitments to customers and counterparties. Banks are set to remain relatively reluctant to finance acquisitions, preferring to prop up struggling organisations and refinance foreign debt. In other words, the political motivations of state-sponsored banks will likely act as a hindrance to M&A activity in Russia as traditional debt financing for deals set to remain scarce into the second half of 2009.

With the Russian government seemingly opting to place the country's macroeconomic well-being ahead of the acquisitive aspirations of domestic firms, an uptick in the number of non-cash M&A transactions is also expected in 2009. This is a trend which has already started to materialise, principally involving companies who are entering distress and as a result are forced to move quickly. In terms of the sectors where non-cash deals will materialise in the coming months, niche sectors such as Consumer Retail, Construction and Financial Services are set to witness these types of transactions, primarily due to their acute exposure to the financial crisis.

Over 75% of respondents identify financing difficulties as the greatest constraint to M&A activity over the next 12 months

What do you believe will be the greatest constraints to M&A activity in Russia over the next 12 months?

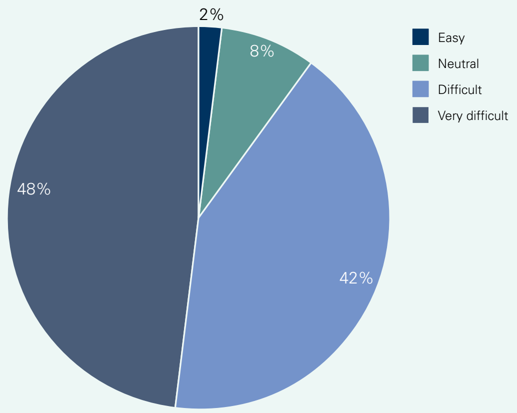


Respondents were able to chose more than one answer

- Over three quarters (79%) of respondents identify financing difficulties as the greatest constraint to M&A activity over the next 12 months. One respondent says: "Financing will be the biggest problem for conducting M&A. Even if companies can get the funding, the cost will be very high."
- Risk aversion and uncertainty due to poor market conditions are also identified by 23% of respondents as the greatest constraints to M&A activity over the next year. One respondent says that deal flow will be constrained by "the overall slowdown in economic growth coupled with growing uncertainty over future market conditions." Lastly, bureaucratic and regulatory issues are cited by 4% of respondents as posing the greatest constraints to M&A activity over the next year, while 2% do not foresee any constraints to conducting M&A activity in 2009.

The overwhelming majority of respondents believe it will be difficult for Russian companies to secure deal financing

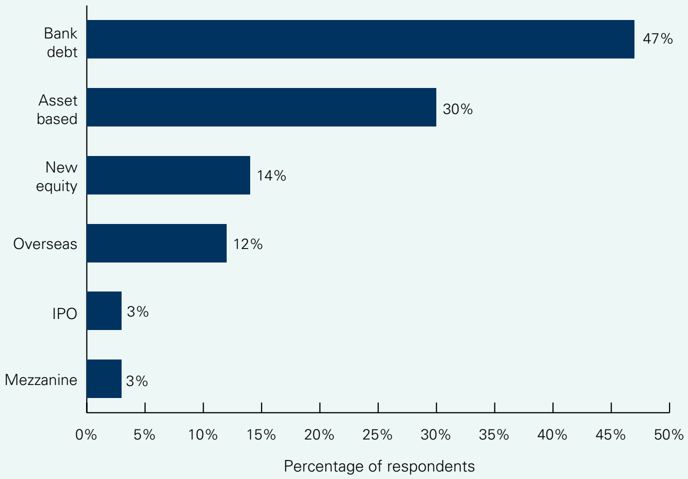
How easy or difficult do you expect Russian companies to find securing financing for deals over the next 12 months?



- A combined 90% of respondents believe that it will be difficult (42%) or very difficult (48%) for Russian companies to secure financing over 2009. One respondent writes: "The functioning of credit markets has been hampered in response to the near closure of bond markets and a local bond market recovery is unlikely in 2009. The government will be providing emergency funding where the survival of businesses and entire sectors depends on such support."

Bank debt to finance the bulk of Russian M&A, while recourse to IPOs and mezzanine capital will remain minimal according to respondents

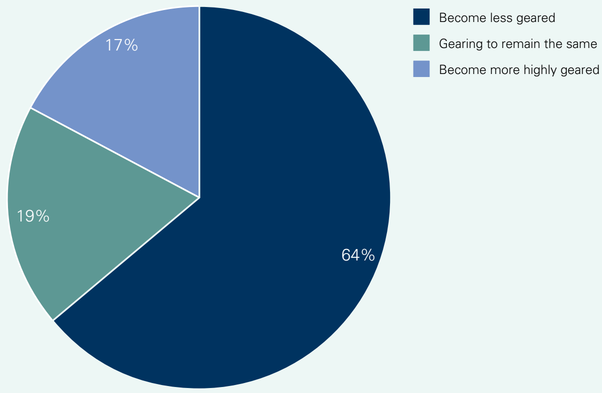
How would you expect Russian companies to finance M&A activity in current market conditions?



- Nearly half of respondents (47%) expect bank debt to account for the bulk of Russian deal financings. While many of these respondents say bank credit will be difficult to obtain, they believe that credit from public banks and government funding will play a bigger role, albeit only for large companies with viable business models in strategic sectors. One respondent writes: "It will mostly be state or government funds providing financing through state-owned banks – perhaps, through direct injections in the case of key oil or gas companies."
- Nearly one third (30%) expect M&A deals to take place through asset-based transactions. In this regard, one respondent notes: "There will be more 'non-money' deals such as equity swaps." Others note that companies might collateralise assets for financing or in some instances use it as a method of payment.
- Other respondents view new equity (14%) and overseas capital (12%) as possible financing sources for Russian companies to conduct M&A, while smaller numbers cite IPOs and mezzanine capital (just 3% for each) as likely sources of financing.

A large majority of respondents expect Russian companies' debt:equity ratio to become less geared over the next 12 months

What do you expect to happen to the level of Russian companies' debt/equity ratio over the next 12 months?

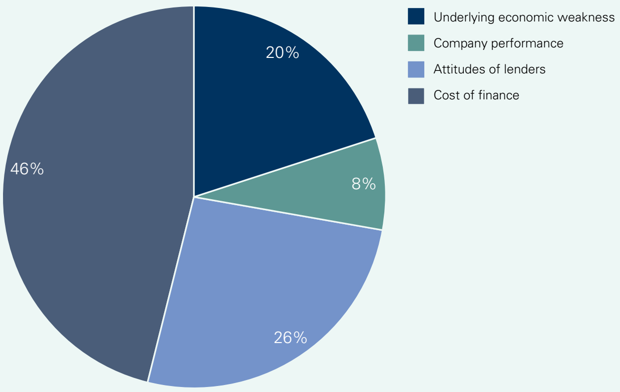


- A combined 83% of respondents expect Russian companies' debt:equity ratio to become less geared (64%) or to remain the same (19%) over 2009. One respondent believes that: "By default they should become less geared – companies are facing restructurings, and need more equity at the moment. Balance sheets will be looked at very differently from now on." The remaining 17% of respondents foresee that Russian companies will become more highly geared over the next 12 months.

> *It is clear that the majority of decision makers are looking to the end of 2009, or the start of 2010 for the funding environment to improve – given the fundamental opportunity of the Russian market, we are anticipating a strong rebound in debt financing of M&A.*
>
> **Grant Williams, Head of Banking and Finance**

46% of respondents believe the cost of financing will be the biggest challenge facing Russian bidders in 2009

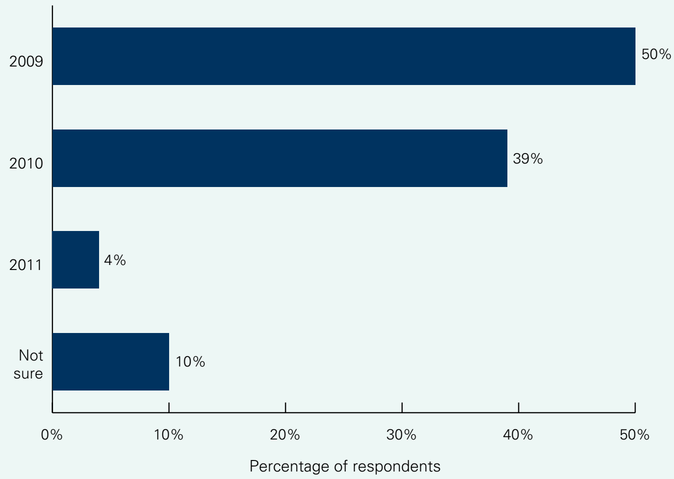
What do you envisage will be the biggest challenge to Russian firms initiating transactions over the next 12 months?



- Nearly half of respondents (46%) foresee the cost of financing to be the biggest challenge facing Russian firms looking to initiate deals over the next 12 months, while just over one quarter (26%) expect the attitude of lenders to pose the greatest challenge. Underlying economic weakness is viewed by 20% of respondents as the greatest challenge over the period, while just 8% believe that company performance is the greatest challenge.
- Many companies are looking for investment opportunities, but they will find it very difficult to finance their M&A transactions. The real problem is that around six months ago, companies started working with less and less capital and significantly increased inherent risk. The perception of the quality of assets has changed dramatically. "Companies need to pledge a lot to get financing – pledging against their controlling stakes and their production assets" one respondent states.

Half of respondents feel the funding environment will begin to improve in 2009 – albeit only toward the end of the year

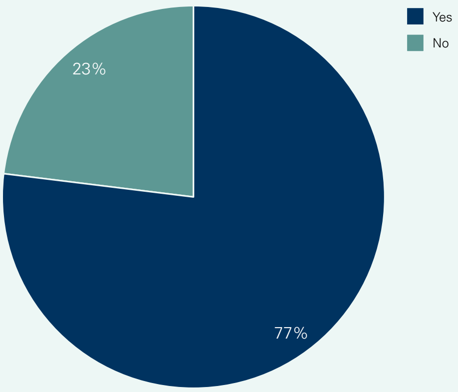
When do you feel the funding environment in Russia will improve?



- Half of respondents expect the funding environment to improve in 2009, though the overwhelming majority go on to say that this will only occur from the second half of the year. "It should become 'considerably better' in the middle of 2009," writes one respondent, while another states: "The first half of 2009 will be bad, but in the second half, problems will be sorted out and we will see improvements in the M&A space."
- A further 39% expect that the recovery in credit markets will not occur until 2010 and a small share (4%) foresee it occurring in 2011. One tenth of respondents are not sure, but some point out that it will be dependent on the recovery in the global economy and the success or failure of the monetary and fiscal policies carried out by the Russian government.

77% of respondents believe Russian firms are under pressure from lenders to alter their capital structure

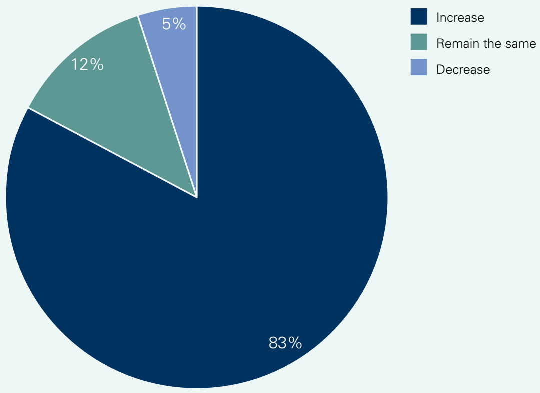
Do you believe Russian firms are under pressure from lenders to alter their capital structure?



- Over three quarters of respondents (77%) believe that Russian firms are under pressure to change their capital structure by lenders, "especially for construction and retail firms as they accrued high debt levels over the recent economic boom," writes one respondent. On the other hand, just under one quarter (23%) of respondents do not believe that Russian firms will come under pressure from lenders to alter their capital structure.

Corporate defaults and restructurings will increase over the next year, according to a large majority of respondents

What do you expect to happen to the number of corporate defaults and restructurings in Russia over the next 12 months?



- A large majority of respondents (83%) expect the number of corporate defaults and restructurings in Russia to increase over 2009. "There was a large amount of borrowing in a very short period of time from 2004 to mid-2008 – so there was a big building up of debt. This sudden cut-off of finance will, of course, result in an increase in defaults," says one respondent. Among this group of respondents, some identify the Retail and Construction sectors as areas where corporate defaults and restructurings will rise more markedly than others over the coming 12 months.
- 12% of respondents expect the level of corporate defaults and restructurings will remain the same in 2009, while a smaller group (5%) hold a more optimistic outlook and expect the number of companies entering into these distressed situations will decrease.

Private Equity

The credit squeeze reigned in private equity activity across Russia and Europe in 2008. Compared to 2007 numbers, mergermarket data shows that financial investor activity in Russia fell by a significant 37% last year in terms of deal volume and 25% with regard to deal valuations.

The decline in the number of transactions was more severe than that witnessed in the wider European market which witnessed a 27% drop. This is relatively unsurprising given that doing business in Russia is almost viewed as an alternative investment strategy in itself by many private equity houses. Indeed private equity investment in Russia in 2008 accounted for less than 2% of overall private equity activity in Europe in terms of both deal volume and value.

Over the last 12 months private equity activity in Russia on both the buy and sell side has been hit. 2008 witnessed eight exits worth €793m, the fewest number of such deals in Russia since 2005. Remarkably, buyouts totalled 17 deals worth €1.7bn last year, fewer deals than witnessed in any of the preceding three years although deal valuations remained relatively robust.

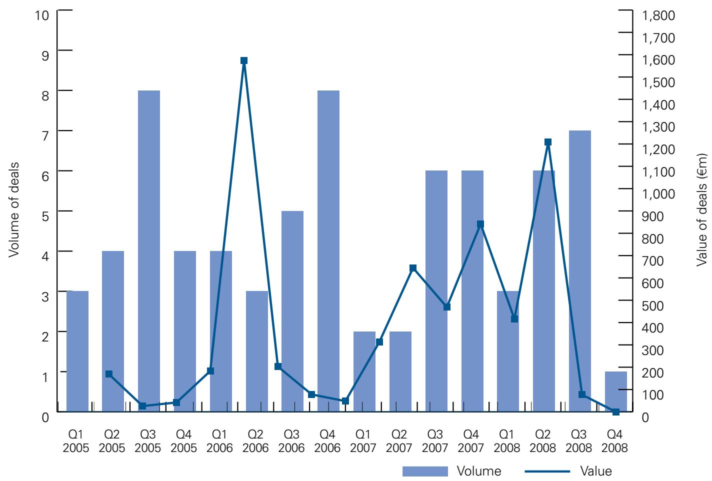
Indeed, a number of sizeable private equity transactions were brokered in Russia in 2008. The largest such deal was the €509m buyout of SIA International, the distributor of pharmaceutical products, by TPG in April. Like a number of deals announced pre-financial crisis, the transaction was underpinned by TPG's desire to expand its presence into Central and Eastern Europe (CEE). Looking forward, this rationale is unlikely to drive private equity activity in the short- to medium-term. This is due to several collaborating factors, namely worsening economic conditions in Russia and private equity's need to focus on a more risk-averse investment strategy with renewed focus on value creation in portfolio companies.

The flight of private equity capital away from Russia has already been seen over the second half of 2008 with none of the top 10 deals in the asset class being announced later than the end of July. Elsewhere, only one of the eight announced exits in Russia in 2008 was a secondary buyout with trade players emerging as the primary exit route for private equity practitioners, especially given current undesirable conditions in the Initial Public Offering (IPO) market. Tellingly, Russia did not witness one IPO over the fourth quarter of 2008, compared to seven offerings over the same time period 12 months earlier.

While this is cause for concern, it should be noted that Russia is not alone in its troubles with other developing economies such as China, Brazil and India also witnessing a similar decline in IPO activity.

Tiger Global Management, the US private equity firm, was involved in the largest announced exit last year in Russia, selling a 14.6% stake in Mail.ru, the provider of free email services, to Digital Sky Technologies, the investment fund owned by Yury Milner and Grigory Finger, for €218m. Elsewhere, the second largest such deal involved Itella, the Swedish information logistics solutions firm, acquiring a 90% stake in National Logistics Company, the logistic services firm, from Citigroup Venture Capital Equity Partners and RosEvroGroup, the Russian consortium, for €200m.

Private equity buyout trends in Russia

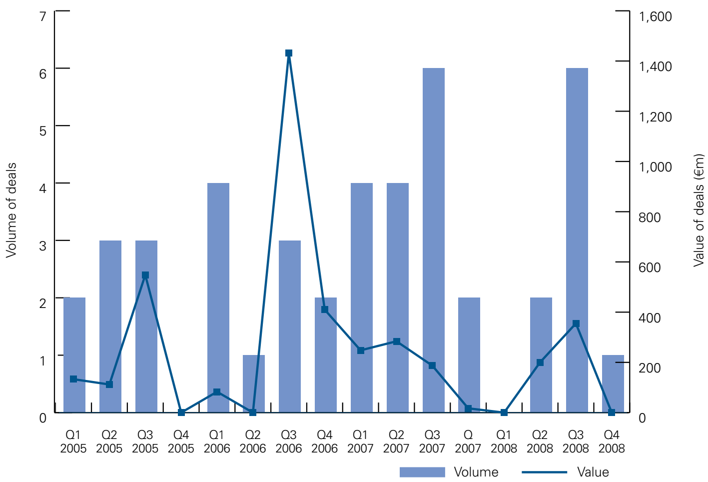


Looking at the sector split of buyouts in 2008, activity was centred predominantly in three sectors; Financial Services, Consumer and TMT which collectively accounted for 71% of such deals. The Consumer sector (38%) also led the day with regard to deal values, thanks in part to the €381m acquisition of Russian Alcohol Group by Central European Distribution Corporation, Lion Capital and Goldman Sachs from Industrial Investors Group, the industrial investment company. Despite

> *"I can't think of another market in the world that has this level of optimism surrounding private equity buyouts in 2009."*
>
> **Irene Engel, Head of Corporate**

these larger transactions, the vast majority (85%) of buyouts with a disclosed deal value in 2008 took place in the lower mid-market space or below (<€250m). This closely mirrors the longer term trend seen since 2005 where buyouts valued at €250m and below have accounted for 88% of overall disclosed value activity in Russia.

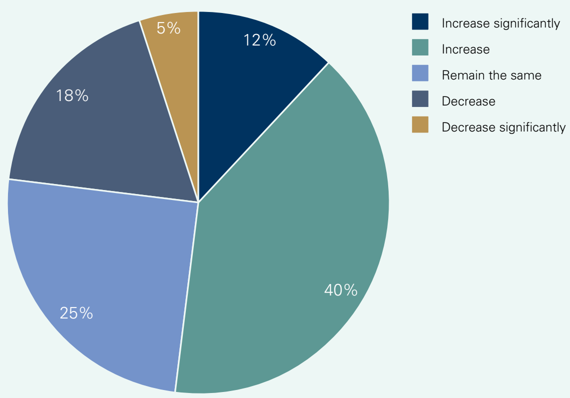
Private equity exit trends in Russia



The short-term outlook for future private equity investment in Russia remains somewhat bleak. Investing in Russia is a capricious task at the best of times, let alone in a period when the domestic economy is struggling due to falling commodity prices, weak equity markets and general uncertainty. With private equity still feeling the fallout from the global financial crisis and debt still difficult and expensive to come by, the asset class looks set to return to safer, more mainstream investment activity. As a result, financial investors may well view Russia as a geography where the current risks vastly outweigh any potential rewards. However, the impact of declining private equity investment on overall Russian M&A activity will perhaps not be as severe as felt elsewhere; since 2005 investment from the asset class has only accounted for around 10% of the overall M&A market in terms of deal volume and 6% of deal value. Trade buyers have always been the principal driver of Russian M&A activity although the current balance sheets of several traditionally cash-rich corporates have undoubtedly seen better days.

Over half of respondents expect the level of Russian private equity buyouts to increase over the next year

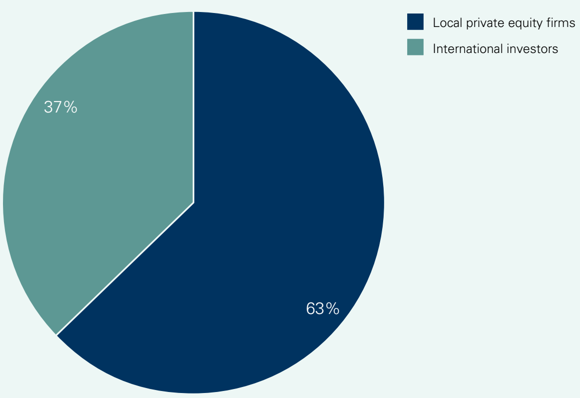
What do you expect to happen to the level of private equity buyouts in Russia over the next 12 months?



- A combined 52% of respondents expect that the level of private equity buyouts in Russia will either increase or increase significantly over 2009, with 40% making up the former and 12% the latter. "Activity will definitely be increased – it is time to buy at these lowered prices", writes one respondent, while another states that, "this increase is already happening – there are plenty of private equity firms asking us for recommendations for targets."
- One quarter of those surveyed believe the level of private equity buyouts will remain the same in 2009, while 18% of respondents expect that it will decrease and 5% expect it will decrease significantly. One respondent simply states that, "companies cannot get financing."

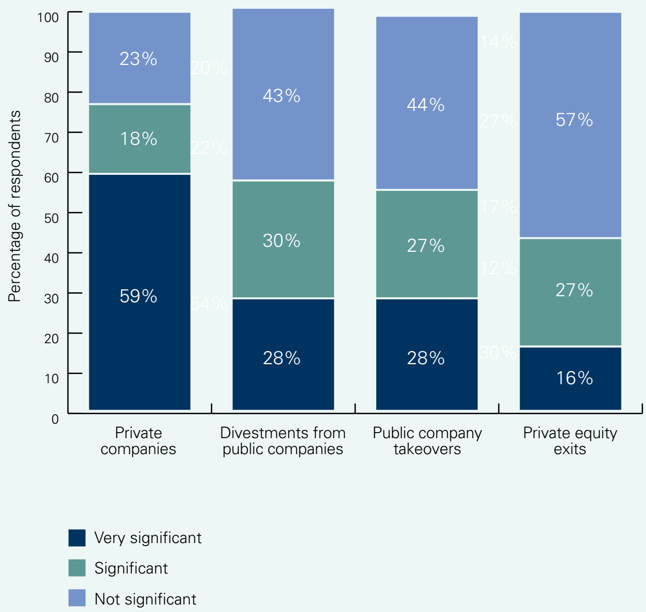
Local private equity firms are expected to conduct the majority of Russian private equity activity over 2009

Do you expect the majority of private equity activity in Russia over the next 12 months to be conducted by local private equity firms or international investors?



Private companies are the most likely deal source in 2009 for private equity buyers

Where do you expect private equity firms to source their acquisition targets in Russia over the next 12 months?

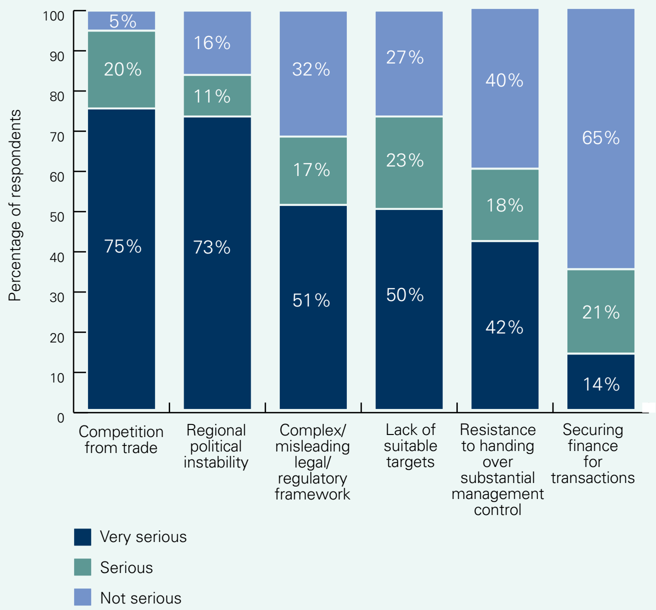


- A majority of respondents (63%) expect the majority of private equity activity in Russia to be carried out by local firms over the next year. One respondent highlights that: “Local private equity firms with cash will definitely continue with acquisitions, but buyouts will have to be non-leveraged since financing isn’t available. Firms might also want to wait until the credit markets bounce back, but then they might just want to take advantage of today’s low prices.”
- The remaining 37% of respondents foresee the majority of private equity activity in Russia being carried out by international firms over the coming 12 months. One respondent notes: “For international investors, there are excellent opportunities now as valuations are at a quarter now of what they were only a few months ago.”

- Over half of respondents (59%) expect private equity firms to mainly source acquisition targets through private companies over the next 12 months. 28% believe that divestments from public companies and public company takeovers will provide a very significant source of deal flow for financial investors.
- Respondents remain downbeat on the number of secondary buyouts that will come to the Russian market in 2008 with 57% citing other private equity exits as an insignificant source of deal flow for the asset class.

Competition from trade buyers is the most serious obstacle facing private equity firms conducting acquisitions in Russia

What are the most serious obstacles that private equity firms face when conducting acquisitions in Russia?



- Competition from trade buyers emerged as the principal threat that private equity firms face when conducting acquisitions in Russia with 75% of respondents labeling this issue as very serious. Only a marginally smaller share of respondents (73%) believe that political instability in the region is a very serious obstacle to financial investor activity in Russia. On the other hand, 65% of respondents believe that securing financing for transactions is not a serious obstacle to private equity investment.
- One respondent highlighted that: "Russia is also party to legal instability because there isn't a guarantee that capital restrictions will not be imposed in Russia – so those willing to make investments should be willing to be long term investors. At the same time, Russia does not have a legal system that is friendly for investors (corruption/ political issues) - but this would not be a problem that has increased because of the financial crisis – these are issues that have always been persistent."

Valuations

Mirroring global trends, valuations of M&A deals in Russia have been falling in recent times. mergermarket data shows that over the last two years, the average deal size of announced deals in Russia has fallen by 34%, from €238m in 2007 to €156m in 2008.

This trend was particularly pronounced over the second half of 2008 where, in the midst of the global financial crisis, the average deal size of an M&A transaction in Russia shrank to only €92m.

This trend can be seen across most sectors in the Russian M&A market although blue chip firms and commodity companies are particularly undervalued. This is largely attributable to the hit that the global equity markets and oil prices have taken over the last six months and is a reflection of the systemic fear and uncertainty that currently exists in Russia. This level of fear has been exacerbated by the speed with which the economy has nosedived towards recession, subsequently driving the general apprehension that currently underpins undertaking M&A in Russia.

While dubious corporate governance could be masked at times when the economy was witnessing commodity-fuelled growth, it is now acting as a further depressant on M&A valuations. Moreover, as average deal sizes continue to fall and smaller transactions become more commonplace, the level of complexity on such deals increases. Indeed the large scale deals that were more commonplace during the M&A boom are often less complicated than deals that occur in the mid-market space and below. Such transactions tend to be intricate as they generally include terms like earn out periods and tax deferrals.

Looking forward, not only will valuations remain depressed in the short term but it is also likely that M&A deals in Russia will take substantially longer to complete. This is set to materialise as firms place a greater emphasis on warranties and indemnities in M&A deals, issues which had been almost eschewed during times of cheap leverage and rising multiples over the last couple of years. Therefore, not only is the average value of an M&A deal in Russia falling, transactions are also likely to close over a longer time period. Furthermore, as the pricing mechanism on deals becomes keener, negotiations on Russian deals in 2009 will likely be dominated by parties on the buy side of a transaction. This is in direct contrast to what had developed during the M&A boom where the seller was king and could almost name their price in deals.

It should not be forgotten that a notable minority of Russian corporates have cash on their balance sheets that they are looking to deploy, borne out by the fact that a number of potential deals are in the pipeline and a bottleneck of transactions may start to form. This is being principally driven by firms who are looking to acquire undervalued assets, as well as stressed or distressed competitors who are undergoing a period of corporate restructuring. Forced sellers in the coming months are likely to include businesses owned by Oleg Deripaska. At the end of 2008, Deripaska's diversified holding company Basic Element had a net debt of around US$6.3bn and as a result it is under pressure to dispose of underperforming assets. According to mergermarket intelligence, Basic Element is looking to sell its stake in insurer Ingosstrakh in addition to seeking investment in UC Rusal, the aluminium producer, and automotive manufacturer GAZ.

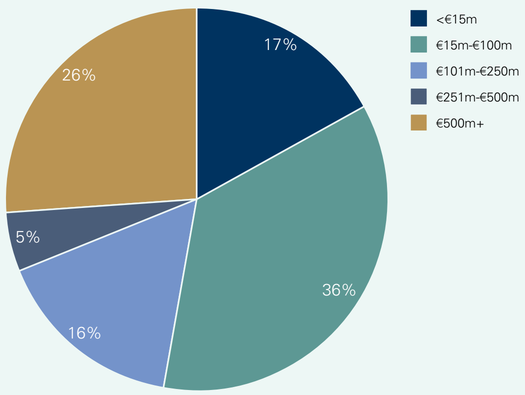
Elsewhere, deal values may be pushed up towards the end of 2009 as buyer confidence starts to return and firms look to broker significant transactions once more. The challenging issue that cash-rich Russian corporates face is identifying the time when valuations bottom out. It may well be that firms are currently waiting for their peers to move and a small raft of initial acquisitions could kick start a significant round of consolidation in Russia, driven by firms eager to broker deals while valuations are low. Intriguingly, this could lead to increased competition for attractive targets, especially in the second half of 2009, and create auction situations for undervalued assets which could drive up average deal values.

However, the issue of when deal valuations will start to level out is impossible to exactly predict, such is the volatility in the Russian economy at the moment. It is relatively safe to assume that company valuations in Russia had been pushed artificially high and are now significantly undervalued. In the medium- to long-term, deal values will tend towards a middle ground although where the exact equilibrium lies is very difficult to ascertain, especially given the current fear in the markets.

> ***"Falling valuations are just a reflection of the new economic reality. We are now in a buyers market and if sellers want to get their deals done, they have to alter their perceptions about price. But I think this is a healthy development and certainly 'good for business'."***
>
> **David Cranfield, Managing Director**

Over half of respondents expect bulk of M&A activity to be valued at €100m or less over the next 12 months

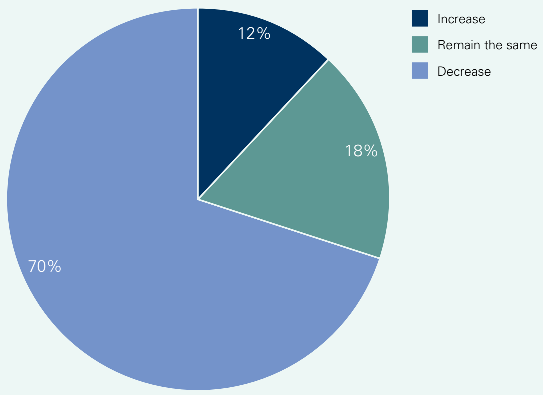
What deal size range do you expect to witness the most M&A activity in Russia over the next 12 months?



- A combined 53% of respondents expect M&A activity to be greatest for deals valued at or less than €100m over the next 12 months. Of this proportion, 36% believe that most transactions will occur in the €15 - €100m deal size range, while 17% believe that deals valued at less than €15m will comprise the largest number of total M&A deal flow.
- While a number of respondents comment that there will be little scope for large-cap deals over 2009, over one-quarter (26%) believe that deals valued above €500m will comprise the greatest level of overall M&A transactions in the year. 16% and 5% respectively expect the €101 - €205m and the €251 - €500m deal size ranges will be the most active spaces for M&A activity.
- One respondent explains the rationale behind his answer, saying: "I think there will be deals all across the board! It is hard to pinpoint a single range because everything is so unclear. You cannot say that small companies have fewer problems than large companies."

70% of respondents expect company valuations to fall over the coming 12 months

What do you expect to happen to company valuations in Russia over the next 12 months?

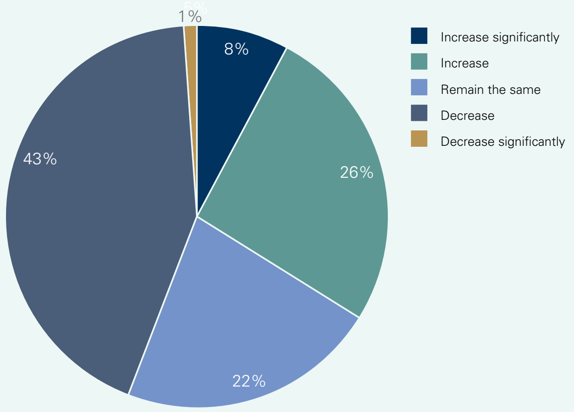


- The majority of respondents (70%) believe that company valuations will fall over the coming 12 months, while 18% expect valuations to remain the same and 12% believe valuations will increase. Among those expecting lower valuations in 2009, respondents cite the ongoing global financial crisis, lack of liquidity and slowing Russian economic growth as the principal causes.

IPOs and De-listings

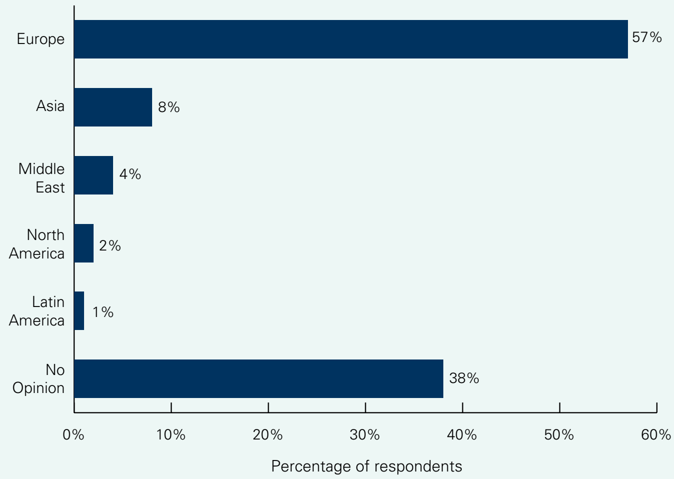
Just under half of respondents predicted a fall in IPO levels during 2009

What do you expect to happen to the number of Russian firms listing over the next 12 months?



Respondents identify Europe as the most attractive listing location for Russian companies

What do you believe is the most attractive listing location for Russian companies?

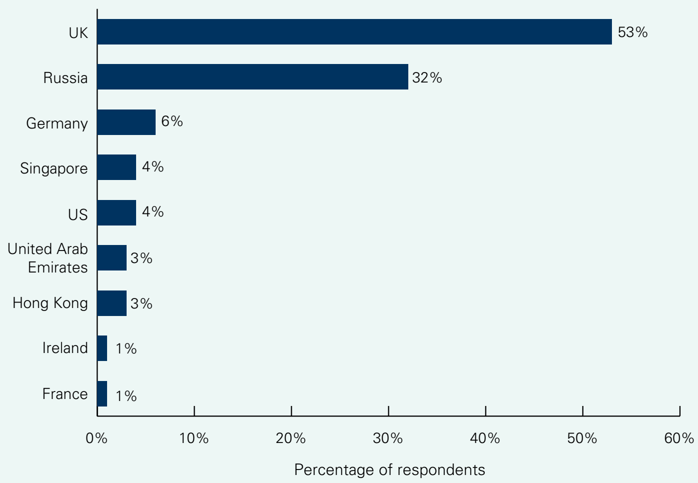


- A combined 44% of respondents expect the number of Russian companies listing to at least decrease over the next 12 months. One respondent expects there will be no IPOs over the next six months, while another more bearish respondent states "The frozen IPO market will not recover earlier than 2010."
- Just under one quarter of those surveyed (26%) expect the number of listings to remain the same, while a combined 34% of respondents take a more positive view and predict increase.

- Over half of respondents (57%) identify Europe as the most attractive region for listing Russian companies, followed by Asia, which garnered a much lower 8% of respondents' replies. Of those who did not select Europe as their answer, a number cited the collapse of European IPO markets, such as London or Moscow, as a reason to not list there. However, one respondent regards the UK or Russia as the most likely listing countries, but says: "After this financial crisis who knows what the face of global finance will be like. Perhaps Shanghai and Dubai will emerge as major players."
- Incidentally, a sizeable portion of respondents (38%) did not have an opinion on the issue.

53% of respondents who cite a specific IPO market to list say the UK is the most attractive destination for Russian companies

What do you believe is the most attractive listing location for Russian companies?

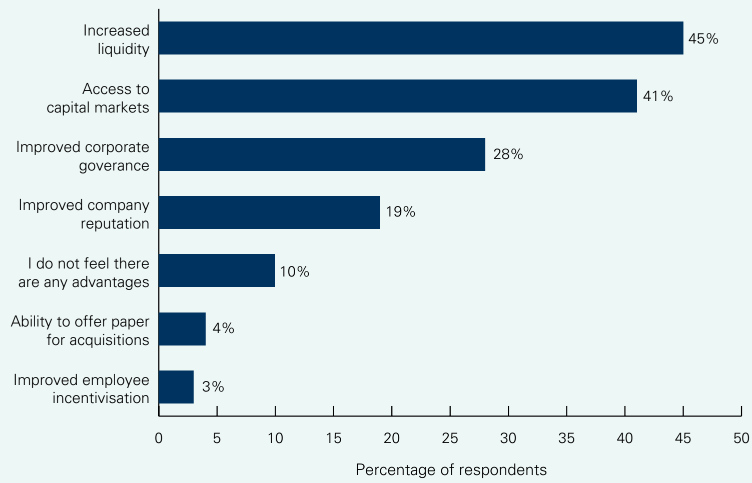


Respondents were able to chose more than one answer

- Over half of respondents (53%) identify the UK as the most attractive location for Russian companies listing, while nearly one third believe Russia is the most attractive location to go public. With respect to the benefits of each location, one respondent says: "The Moscow Stock Exchange is simpler, cheaper, and easier to list on – while the London Stock Exchange is much more expensive. However, with the London Stock Exchange, the company gains a broader opportunity, and will receive a higher valuation."

Increased liquidity and access to capital markets are seen as the main advantages of being a listed public company

What do you feel are the advantages of being a publicly listed company?

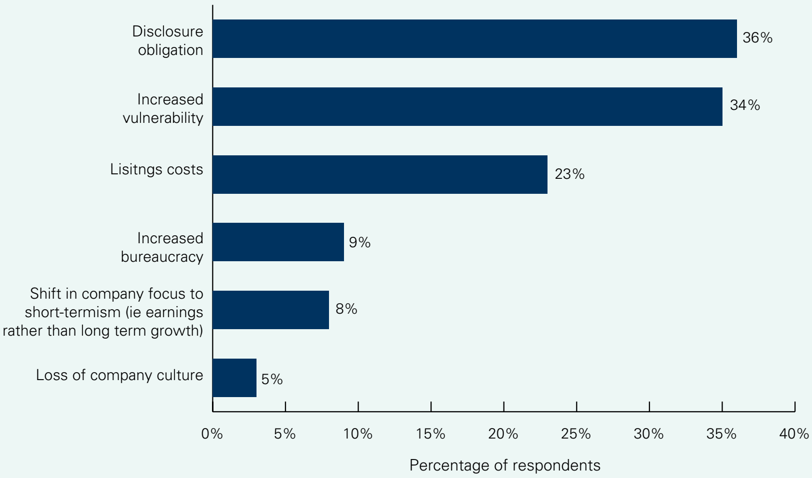


Respondents were able to chose more than one answer

- Increased liquidity is identified by the largest portion of respondents (45%) as being the main advantage of being a listed public company, while a slightly smaller portion (41%) identifies access to capital markets as the main advantage. One respondent highlights that, "life for investors is easier, having more liquidity is a good thing and listing publicly really forces the company towards better corporate governance – there is some degree of structure/standardised transparency."
- A more bearish respondent adds: "At the present time, I really see no advantages - public equities are trashed. But in the past, for example in 2006-2007, listing really maximised the value of future revenue streams, and listed companies got preferential access to financing, which also created a stronger position for companies in their home market."

Disclosure obligation is regarded as the main disadvantage of being a publicly listed company

What do you feel are the disadvantages of a being a publicly listed company?



Respondents were able to chose more than one answer

- Disclosure obligation garners the largest share of responses at 36%. One respondent writes that: "It is rather costly to live up to corporate governance and transparency regulations. It involves not only higher costs but also more discipline and diligence on the part of managers," while another says: "In a financial crisis such as this one, private companies will not be as greatly affected as public companies, for which market capitalisation is so transparent – private companies can pretend they are okay even if profits are down 90%."
- Just over one third of respondents (34%) also highlight the increased vulnerability to takeovers for publicly listed companies. "Many of the Russian Oligarchs that own publicly-listed companies have used their equity stakes as collateral for loans. The probability that they will lose their holding in the companies, as they are unable to re-pay their debts, is now very high," says one respondent.
- Notably, a number or respondents also comment that listed companies remain vulnerable to market conditions. One respondent says: "The market is currently not reflecting the true value of the company and share price performance is collapsing with no new opportunities for increasing share value."

Alternative Investments

Always considered a somewhat niche and specialist product in which to invest, the Russian alternative investment space could come into its own in 2009. Indeed as global financial markets continue to crumble, it is likely that savvy investors will increasingly look to non-standard methods of revenue-generation.

Over the course of the year, opportunities for buying cheap Russian assets look set to increase while distressed situations will undoubtedly become more commonplace. Interestingly, as financing M&A becomes increasingly troublesome, dealmakers are increasingly turning to non-cash transactions in order to keep costs down as well as alleviate any stress caused by exchange rate fluctuations. For example, earlier this year, Nizhny Novgorod Fats & Oils, the Russian fats and oil producers and two Singaporean companies formed a joint venture, valued at $136m, which involved no initial cash exchange.

In today's volatile financial climate, brevity is also key with the time taken to complete transactions expected to fall in 2009. This trend already manifested itself in 2008 with the approximate average time taken to complete an M&A transaction in Russia totalling 62 days, down from around 85 in 2007. This will be especially prevalent in alternative investment M&A transactions, such as Real Estate fund activity, which have suffered disproportionately over the past year and are therefore likely to see fire sale-type situations.

Infrastructure funds

The development of Russia's infrastructure is a pressing concern for the Russian Government and one with which they aim to press ahead over the next decade and a half, spending over €650bn in the process. This year alone, the authorities will spend $420bn, the majority of which will go towards modernising the railway network. Such expenditure will arguably lead to an increase in foreign investment which is expected to top $55bn in 2008, a 77% increase on 2006 numbers. Going forward, an increase in the number of public-private-partnership (PPP) projects is also likely and this will positively impact on levels of M&A activity in this particular universe.

Indeed, Basic Element's purchase of the remaining 50% stake that it did not already own in Proektno Stroitelnaya Kompania (PSK), the Russian construction and infrastructure business, in late November 2008 is testimony to this. The private equity firm announced that it would help PSK to develop its existing and future projects which include PPP as well as its Western High-Speed Diameter and Pulkovo airport reconstruction projects. Basic Element previously bought the other half of PSK in October 2007 for €138m.

Interest in the sector is also largely being driven by its fundamentals. Infrastructure investments benefit from predictable cash flows, typically strung out over very long timeframes, as well as highly regulated markets. Perhaps because of this, prospective deal flow in the space looks strong, with MOL, the Hungarian oil company, examining smaller Russian oil and gas mining companies if they become available at the right valuation. Elsewhere, Abu Dhabi National Energy Company and Gazprom announced the signing of a Memorandum of Understanding to partner in Europe's largest new gas storage project in the Netherlands, the Bergermeer Gas Storage Project. The new gas storage facility will enhance the security of energy supply to European consumers and contribute significantly to the liquidity of the North-West European gas markets

Real Estate funds

Another area in which deal flow has thrived recently has been the Russian Real Estate Fund sub-space, in which a number of deals have been completed in the past year. Chief among these was the €4.6bn purchase of a 50% stake in KM Invest, the Russian investment fund, by Interros, its domestic counterpart, from the Onexim Group, a Russian investment & real estate fund. At the same time, Onexim acquired a 27.5% stake in JSC Open Investments that was previously owned by KM Invest. Another notable deal was the €170m purchase of a 50% stake in IVI-93 by the A1 Group, the Russian real estate investment arm of the Alfa Group Consortium, the financial and industrial conglomerate.

It must be said however, that with the Russian Real Estate market now suffering heavily due to the credit crisis, it remains to be seen whether real estate fund activity in the sector will remain buoyant, or whether distressed sales will start to dominate. The market saw a very sharp decline in the last quarter of 2008, with real estate prices falling 10% in November and December and the outlook in 2009 appears to be bleak with prices tipped to fall by as much as 30%.

Free-falling prices have already begun to affect the wider sector, with the November 2008 sale by Investbuilding, the Russian real estate development firm, of a 49% stake in Masshtab, a local construction business specialising in residential development, for €1.2bn, primarily being attributed to the credit crisis. Similarly, it has been reported that Sibir Energy may not be able to fully fund its proposed $340m real estate transaction of assets from Chalva Tchigirinski without a rights issue, according to a JPMorgan note cited in the press, while Kemi Finans, a privately-owned Russian investment company, is reputedly looking to sell Yuis-Stroibeton, a Sochi-based real estate developer, for around $30m, for undisclosed reasons.

However, investors have been quick to note the apparent shift from a sellers' to a buyers' market. According to mergermarket intelligence, shareholders of Mirax Group, the Russian real estate company, plan to acquire cheap real estate companies on the post-credit crisis real estate development market in 2009. For these purposes, Mirax plans to establish an investment fund of between $300-400m to invest in the market as soon as March 2009.

Summary

Alternative investments in Russia could witness a lucrative 2009, with infrastructure investments looking particularly strong due to sound fundamentals and relatively high public spending. Real estate funds could suffer over the course of the year with the wider sector beginning to show some significant weakness. Nonetheless, potential buyers have made it known that they are on the sidelines waiting for valuations to bottom out before stepping back into the market.

Pre and Post-Deal Issues

Conducting an M&A transaction is never an easy task and simply put, doing a deal in Russia can be especially problematic.

It is a well-known fact that the majority of M&A acquirers, whether in Russia or abroad, do not fully achieve their target synergies upon completion of a deal. This shortcoming, however, can be overcome by plenty of preparation before closing the deal, as well as implementing a solid integration process once the ink has dried on any tie-up.

Doing a deal in Russia

With M&A timeframes growing ever shorter, particularly in the current volatile climate, it is now even more imperative to effectively prepare for post-deal integration. In doing so, one of the most important points potential buyers of Russian businesses must pay heed to is what they are actually buying – are they purchasing a stake in an overseas subsidiary, domestic joint venture or their original targeted business? Difficulties typically arise due to the fact that Russian businesses' legal and corporate structures tend to be complicated, resulting in a large number of offshore entities. This is driven primarily by the desire to create tax efficient mechanisms as well as acting as a safe haven against political and/or financial upheaval. Indeed the 1998 financial crisis still looms large in many Russians' minds while the recent conflict between Russia and Georgia has done nothing to boost potential Russian M&A deal flow.

Buyers looking at Russian businesses should also be wary of the length of time it takes for Russian regulators to approve a deal. In July 2008, Hapoalim, an Israeli bank announced that it wanted to acquire a 78% stake in Russian counterpart SDM bank, for around €90m. Three months later, the bid was put on hold, and subsequently withdrawn when the Russian regulatory authorities had notified Hapoalim that it would take a year before a conclusion would be reached. In comparison, French energy firm Total's attempt to acquire a 25% plus one share stake in Novatek, the Russian gas business, for €1.2bn also proved ultimately futile. The bid, which was announced in late September 2004, had still not been approved by Russian regulators just under a year later, at which point Total withdrew its bid.

As in any M&A transaction, communication plays an important role in determining the outcome of a bid, and in Russia, personal rapport still counts for a great deal. Russian vendors tend to be self-made entrepreneurs and are used to managing all aspects of the business. Therefore, it is vital to ensure that contact with the correct person has been made. Furthermore, it has been noted that trust is an integral component of any relationship – it is vitally important that promises are kept to otherwise deals can, very abruptly, go sour.

Once the formalities are over, some measure of due diligence can go ahead. Caution should be exercised at this point in the proceedings as some Russian sellers dislike the notion of due diligence – it is, at best, considered an exercise that must be completed for the buyer, at worst, a possibly hazardous endeavour which risks the exposure of confidential information to the public.

At this point in the deal, the buyer should also be considering the post-deal integration process. The bulk of acquirers neglect formulating any sort of integration process until after an offer is made, which is, to some extent, impractical considering that with an accurate idea of the synergies to be gained from the proposed transaction, a more realistic bid can be made. At the same time, vendors who come up against a bidder who can present hard-and-fast explanations behind a bid valuation will have less room to manoeuvre, ultimately speeding up the transaction.

However, focus on completing the acquisition should not be lost – advice that should be well remembered by one Russian bidder. This bidder had previously attempted to acquire an 80% stake in a local competitor for €18m and was finalising integration procedures when the M&A team realised that the firm had failed to submit the correct deal documentation, resulting in the transaction lapsing. The firm lost $0.5m to the target as per the termination agreement.

Closing a deal

Once a bid has been made, it is in the buyer's best interest to complete the deal as soon as possible. On a number of occasions, prospective buyers have found themselves losing out to a competitor who tables a higher bid at the last minute, so timing is crucial once a bid has been accepted.

Buyers should also aim to begin controlling the target's finances as soon as possible. This is especially vital if the target is a listed company where cash flow is not a particular concern. If projected synergies are going to be realised, control over cash is a first priority. Following this, other integration measures such as dealing with organisational structures, integrating IT and reporting systems as well as ensuring robust communication channels with employees are established should all take place.

02
Sectors

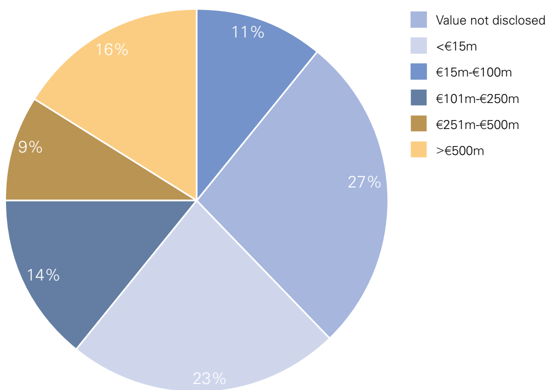
Energy

Over the past four years, the Russian Energy M&A market has proven to be particularly vibrant, witnessing 182 transactions take place, with a combined market value in excess of €79bn.

Activity in the sector has been led by the Gazprom's €10.9bn acquisition of a 73% stake in Sibneft JSC, the Russian integrated oil company, from Millhouse Capital UK Limited, the UK-based holding company controlled by Roman Abramovich, announced in H2 2005. The acquisition also includes assets not directly owned by Sibneft, which comprise of a 49.5% stake in Slavneft and Slavneft's subsidiaries; a 36.84% voting shares in Moscow NPZ, the Russian oil and gas company, and a 49% stake in the Sibneft-Yugra oil venture.

In order to finance the deal, Gazprom borrowed approximately $12bn from a syndicate of banks, including ABN AMRO, Dresdner Kleinwort Wasserstein, Citigroup, Morgan Stanley, Goldman Sachs and Credit Suisse.

Energy volume split by deal size



The second largest transaction in the sector saw EON AG, the German company involved in energy, utilities, chemicals manufacturing, oil and gas production, win the auction to acquire a 47% stake in JSC OGK-4, the Russian electricity company, from Unified Energy System of Russia for €5.9bn, in late 2007. EON faced stiff competition for the asset from the likes of Russian aluminium player Rusal, Russian energy company Surgutneftegaz and Italian energy firm Enel.

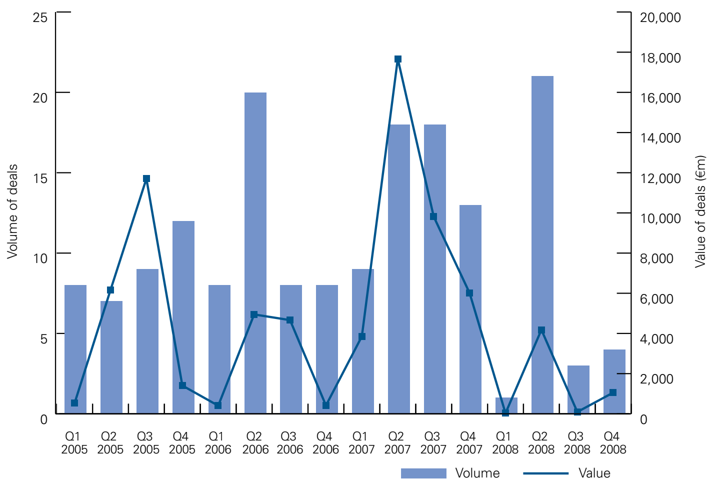
Looking at overall deal trends, Russian deal flow in the Energy, Mining & Utilities space has seen peaks and troughs over the four year period, with the bulk of activity occurring in 2007. During the year, 59 acquisitions took place, worth a total of €37.4bn, accounting for close to half (47%) of overall deal valuations and 32% of total deal volumes.

In comparison, 2008 M&A trends in the Russian Energy sector remained comparatively resilient in spite of the wider global economic downturn, registering 43 such acquisitions worth a total of €11.9bn. These figures represent a relatively modest decline on the previous year's volumes of around 27% and a much larger 68% fall in terms of annual deal valuations.

Looking at last year's M&A trends in more detail, it is clear that the bulk of transactions came in the first half of the year – 74% of them to be precise, accounting for 90% of the year's total deal valuations. In stark comparison, Q3 2008 sectoral deal flow saw just three transactions worth a miniscule €93m come to market – quarterly M&A transactions over the period typically average 11 deals worth a total of around €5bn.

With both sellers and buyers finding it difficult to transact in the current market climate, it is perhaps unsurprising that deal valuations have fallen in the past year compared to figures for the 2005-2008 period. The proportion of deals taking place in the €0-100m space in 2008 alone accounted for 51.2% of all transactions while the same figure for the whole four year period was just 42.3% - an increase of 8.9%.

Energy M&A trends in Russia



In the 2005-2008 period, close to half (49%) of total Russian Energy deal volumes comprised Oil and gas exploration and production transactions, which were also worth 65.4% of overall valuations. Electrical power generation and transmission acquisitions made up a further 55.5% of volumes, as well as accounting for an additional 47.9% of valuations.

However, looking at 2008 subsector data alone, it is interesting to note that Electrical power generation and transmission deals made up a very large 90.7% of overall deal volumes and 89.3% of valuations. Meanwhile, the share of Oil and gas exploration and production deals as a percentage of values and volumes equated to just 20.9% and 18.1% respectively.

Private equity interest in the Russian Energy sector is conspicuously absent, with just three private equity buyouts worth a combined €813m taking place in the past four years. The largest of these saw Urals Energy, the Cypriot oil exploration and production company, along with Ashmore Investment Management, the UK private equity and fund management firm, acquire stakes of 35.3% and 10.5% respectively in OOO Taas-Yuriakh Neftegazodobycha (Tass), the Russian oil exploration and production company, for a total of €515m, in January 2008. Other notable buyouts include a minority stake purchase by the European Bank for Reconstruction and Development in TGK-9 (Territorial Generation Company No 9), the Russian company engaged in the generation, transmission and distribution of heat, energy and electricity, for €140m, as well as the €158m buy of a 25% plus-one-share stake in ITERA Group, the Russia based independent producer and trader of natural gas, by Sun Capital Partners, the Indian private equity group.

Top 10 Energy deals in 2008

Announced Date	Status	Target Company	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
29-Feb-08	C	TGK-10 (Territorial Generating Company No 10)	Fortum Oyj	Finland	Unified Energy Systems of Russia	2,283
15-May-08	P	Volzhskaya TGK OAO (TGK-7 OAO) (77.00% stake)	Berezville Investments Ltd	Russia	Unified Energy Systems of Russia	1,886
11-Feb-08	C	TGK-8 (Territorial Generation Company No 8)	OAO Lukoil	Russia	Financial Group IFD Capital	1,508
17-Feb-08	C	NK Alliance OAO	West Siberian Resources Ltd	Bermuda	Bazhaev family (private investor)	1,026
7-Apr-08	P	JGC TGK-4 (The Fourth Territorial Generating Company)	Onexim Group	Russia	Unified Energy Systems of Russia	1,019
14-Mar-08	P	TGK-2 (The Second Territorial Generating Company)	Kores Invest	Russia	Unified Energy Systems of Russia	902
14-Mar-08	P	Territorial Generating Company No 6 (80.14% stake)	Integrated Energy Systems	Russia	Unified Energy Systems of Russia	746
13-Oct-08	C	Rusia Petroleum OAO (25.00% stake)	JSC OGK-3	Russia	Jarford Enterprises Inc	424
2-Oct-08	P	OAO Severneftegazprom (25.00% stake)	E.ON AG	Germany	Gazprom OAO	362
23-May-08	C	Bashkirenergo OAO (21.27% stake)	Unitrade OOO	Russia	Unified Energy Systems of Russia	296

C = Completed; P = Pending

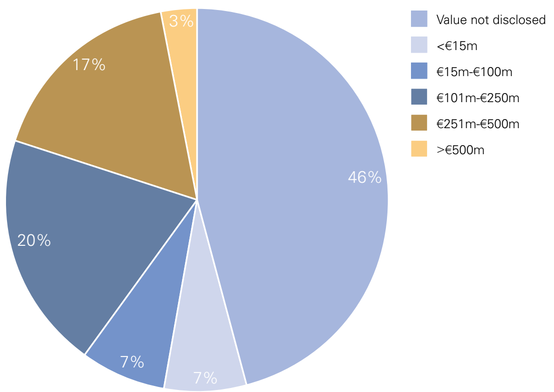
Financial Services

Financial Services M&A activity in Russia over the past four years has amounted to 115 transactions worth a total of €17.9bn, accounting for around 10% of total Russian M&A activity over the period by both deal value and volume.

Interestingly, annual Financial Services deal valuations have continued to grow over the period despite the onset of the credit crisis, from €765m worth of deals in 2005 to over €8.4bn in 2008 – a growth rate in excess of 1000% over the past four years. At the same time however, Russian Financial Services volumes over the past four years have remained virtually static at around 20-30 acquisitions taking place annually.

However, a closer look at 2008 deal flow will show that 2008 wasn't all good news for the Russian Financial Services M&A market. First-half deal valuations totalled some €6.6bn while H2 2008 saw just €363m of deals come to market – a drop of around 95%. Admittedly, the apparent collapse of deal valuations in the second half of the year could be due to the fact that only one M&A valuation was actually announced over the period – the €163m stake purchase by Zurich Financial Services Group, the Swiss provider of Insurance-related financial services, of the remaining 34% stake it did not already own in Zurich Retail Insurance Company, the Russian insurance company, in November 2008. The fact that half-yearly deal volumes in 2008 showed only a very small slide (15 transactions in H1 2008 compared to 13 in H2 2008) adds credence to this.

Financial Services M&A split by deal size



Since the beginning of 2005, Financial Services transactions have mainly been made up of Banking M&A deals, with the sub-sector accounting for around 54% of overall Financial Services volumes and 48% of valuations. Fund management accounted for a further 8% of volumes and 22% of valuations while Insurance-related M&A flows made up another 17% of volumes but just 7% of total values. However, a look at 2008 sub-sector activity shows a very different picture. Fully 88% of 2008's total M&A valuations were made up of Banking deals at the expense of every other sub-sector in the Financial Services space – Insurance-related valuations accounted for just 9% of total values while Principal financing deals made up the remainder. Nonetheless, the proportion of deal volumes attributed to each sub-space remained roughly similar to percentages covering the 2005-2008 period.

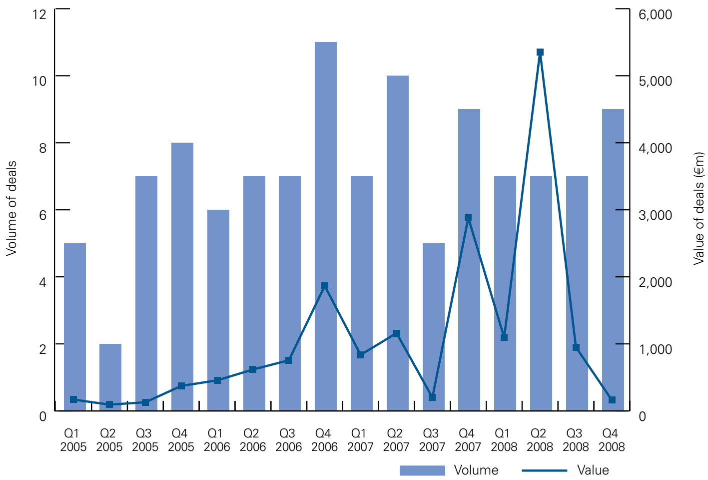
Russian Financial Services M&A valuations have also shown a tendency to rise over the course of 2005-2008. Over the period, 54% of Russian Financial Services deal flow has been focused in the €0-100m space, while of the remainder, 35% has taken place in the €101-500m range, and 11% in the €500m+ space. However, 2008 deal flow in the first of these was just 24%, while activity in the €101-500m range accounted for 65%. The proportion of large-cap (€500m+) deals remains relatively stationary at 12%.

Deal flow in the Russian Financial Services sector mostly took on the form of domestic transactions over the 2005-2008 period, with 66% of transactions being purely Russian plays. However, in terms of value, domestic and inbound transactions were roughly balanced with total domestic acquisitions representing 52% of the total and inbound deals making up the remainder.

Inbound transactions were led by French and Cypriot buys, accounting for 15% of overall volumes apiece, while German purchases in the Russian Financial Services sector amounted to 13% of the overall figure. In terms of valuations, French acquisitions led, with 33% of the total, followed by German (15%) and Austrian (11%) acquisitions. Given French dominance in this respect, it is unsurprising that the largest inbound transaction into the sector since the beginning of 2005 was the €1.2bn bid by Société Générale, the French asset management, private banking, retail banking and investment banking services provider, to acquire a 30% plus two shares stake in Rosbank JSCB, the Russian bank, in late 2007.

Meanwhile, the largest overall transaction in this space since the beginning of 2005 saw Interros, the Russian investment fund acquire the remaining 50% stake it didn't own in KM Invest, its domestic counterpart, from the Onexim Group, for €4.6bn. Under the terms of the agreement Onexim will also buy a 27.5% stake in JSC Open Investments for €517m, as well as a 91% stake in the Soglasie insurance company, a deal whose value was undisclosed, both from KM Invest.

Financial Services M&A trends in Russia



Another notable transaction valued at €1.1bn, just €100m less than the aforementioned Société Générale transaction, saw Sergey Popov and Martin Andersson, two private investors, acquire a 50% stake in MDM Bank, the Russian bank, from Andrei Melnichenko in late 2006. As a result of the transaction, Mr Popov increased his stake-holding in the bank to 90%, while Mr Andersson gained control of 10%. As part of the deal, Mr Popov sold his entire stake in the EuroChem Mineral and Chemical Company, the Russian agrochemical company, to Mr Melnichenko.

Potential M&A activity in 2009 could include a sale of the MFK Trust, the factoring subsidiary of the Trust banking group, to VTB, the Russian bank. VTB's press spokesman reportedly announced that the two parties had signed a MOU on the sale of the trust to VTB for a valuation of no more than €7m. At the same time, it has been reported that Agrokhimbank, the private Russian bank, is seeking an investor. The bank is supposedly in talks with a number of banks and considers Russia's Deposit Insurance Agency as one of the possible investors.

Foreign interest in Russian Financial Services assets is also robust, with Standard Bank, the Johannesburg Stock Exchange-listed entity, looking to acquire a Russian bank. The bank is interested in buying a Moscow-based bank with a regional network in order to strengthen its position in Russia, as well as take advantage of cheap valuations caused by the credit crisis. Standard Bank reportedly has around $1bn to invest in overseas acquisitions.

Top 10 Financial Services deals in 2008

Announced Date	Status	Target Company	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
17-Apr-08	C	KM Invest ZAO (50.00% stake)	Interros Company	Russia	Onexim Group	4,641
3-Mar-08	C	Expobank Commercial Bank	Barclays Plc	United Kingdom	Petropavlovsk-Finance	487
26-Jun-08	C	Uniastrum Bank (80.00% stake)	Bank of Cyprus Public Company Ltd	Cyprus		366
25-Aug-08	C	Insurance Group Kapital	Syneron Holdings Ltd	Cyprus	Financial Group IFD Capital	339
22-Sep-08	P	Renaissance Capital (50.00% stake)	Onexim Group	Russia	Renaissance Group	338
3-Mar-08	C	Rosbank JSCB (7.50% stake)	Societe Generale de France SA	France		287
14-Apr-08	C	Bank VTB North-West	JSC VTB Bank	Russia		207
2-Jul-08	C	ZAO Spasskiye Vorota Insurance Group (SVIG) (75.00% stake)	Stolichnaya Strakhovaya Gruppa (SSG)	Russia		194
21-Nov-08	C	Zurich Retail Insurance Company (34.00% stake)	Zurich Financial Services Group	Switzerland		163
28-Feb-08	C	Interros Company	Vladimir Potanin (Private investor)	Russia	KM Invest ZAO	145

C = Completed; P = Pending

Consumer & Retail

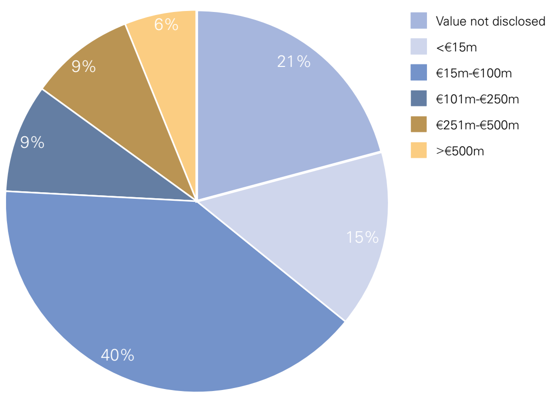
In the period from January 2005 to the close of last year, there were 219 announced Consumer transactions worth €17bn. This represents 20% and 10% of total deal volume and value respectively which makes the sector the second most active niche within the Russian M&A market after the Energy, Mining & Utilities sector.

Amongst the Consumer sub-sectors, the Retail space is the most active, accounting for almost 45% of total deal volume and roughly 60% of total deal value from 2005-2008. Consumer foods accounted for roughly 30% and 20% of deal volume and value over the period, while other Consumer areas account for the outstanding M&A activity.

These trends generally remain when looking at 2008 alone. Retail remained the leading area in terms of both deal volume and value with 24 deals worth a combined €3bn. Although the Consumer: Other space witnessed one more transaction than the Foods niche, food related M&A saw twice as much activity in terms of deal valuations, with €1.7bn worth of announced transactions.

Despite overall deal volumes in the sector falling by around 40%, deal valuations totalled €5.6bn and remained relatively robust, down by just 2% from 2007 numbers. After peaking

Consumer volume split by deal size



in Q2 with 17 announced deals, 2008 deal flow slowed precipitously thereafter to the lowest quarterly levels experienced over 2005-2008. Indeed, there were just 11 deals announced in the second half of 2008 worth a total of €715m, down from 32 deals worth €4.9bn in the first half of the year. Of course, this fall in Consumer sector deal flow was not particularly surprising and largely mirrored M&A trends in most other industry sectors. This deceleration was driven by two principal factors: firstly, the deepening of the global financial crisis from late September onward; and secondly, weakening investor confidence as a result of the military conflict with Georgia in August.

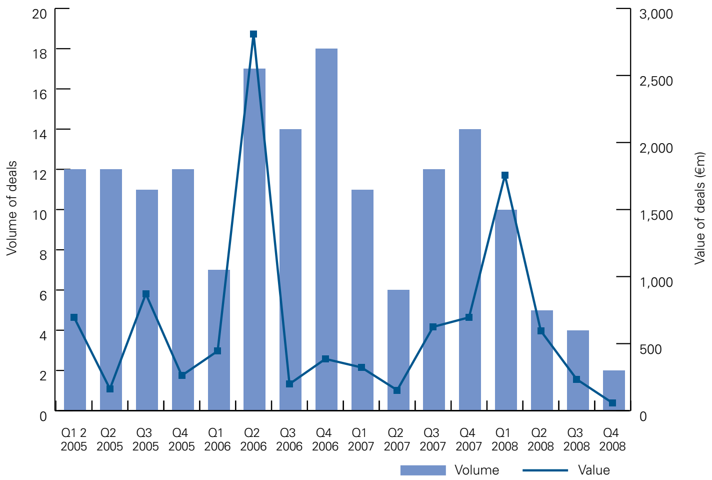
However, as mentioned above, deal valuations remained relatively buoyant in 2008. The split by deal size is revealing in this regard as it shows that last year saw three large cap deals (>€500m) which accounted for approximately 45% of total deal value in the year. Notably, these were three of only seven Consumer deals since 2005 which had a deal value greater than €500m. Elsewhere, the mid-market (€101- €500m) remained solid with transactions in this space valuing €2bn in 2008.

The most noteworthy deal in the Consumer sector in 2008 was the €1.3bn acquisition of an approximate 75% stake in Russia's leading juice company, JSC Lebedyansky, by PepsiCo and the Pepsi Bottling Group. The acquisition of Magistral, a retail network of petrol stations also offering engineering services, for €601m through a joint Cypriot and Russian venture was the next largest deal made in the year. Elsewhere, other significant transactions include the acquisition of Formata Holding BV by X5 Retail Group NV, the listed company engaged in development and operation of grocery retail stores, for a consideration of €582m. Notably, all three of the aforementioned deals were announced in the first half of the year, before the global financial crisis and the onset of hostilities between Russia and Georgia.

The tightening of the debt markets and the systemic fear that enveloped the Russian economy in the second half of the year will no doubt have the most profound and lasting significance for M&A activity. These issues not only sap investor confidence but in effect also undermine the core rationale for deal making as such. This is in spite of the fact that depressed share prices have led to undervalued assets in the sector which potentially represent a good value for money, especially in defensive areas with companies focussed on staple consumer goods. That said, a flagging domestic economy will likely result in Russians cutting back on discretionary spending and there will be a concomitant knock-on effect on the profitability and thus valuation of some companies at the sharper end in the Consumer space.

As such, there is plenty of scope for cash rich companies to make cheap acquisitions. Looking forward in terms of likely future transactions, TNK-BP is set to acquire a 25% plus one share stake in STMP Holdings to complete its 100% control of the company. STMP, with a total value of £180m, is a petrol retailer with 56 stations in the Moscow area.

Consumer M&A trends in Russia



Top 10 Consumer & Retail deals in 2008

Announced Date	Status	Target Company	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
20-Mar-08	C	Lebedyansky JSC	Bidco for Lebedyansky	USA		1,288
22-Feb-08	C	Magistral	Baltia Oil; Novy Investments Ltd; TEYA AZS	Cyprus		601
11-Apr-08	C	Formata Holding BV	X5 Retail Group NV	Russia		594
24-Apr-08	C	Musa Motors Group	Inchcape Plc	United Kingdom	Bradholm Networks Ltd; Brightport Merchants Ltd; Broadzone Ltd; Harnley Experts Ltd	446
5-Feb-08	C	ZAO Association Grand	Lukoil Tsentrnefteprodukt; OAO Lukoil	Russia	Longhill Trading Ltd; Lorston Trade Ltd; Orest Ltd; Rionet Finance Ltd; Sterra Ltd; Trade Systems Inc	396
22-May-08	C	Russian Alcohol	Central European Distribution Corporation; Goldman Sachs; Lion Capital LLP	United Kingdom	Industrial Investors Group (promyshlennoye investory)	381
22-Sep-08	C	Euroset Group	ANN Investment Company	Russia	Timur Artemyev (private investor); Yevgeny Chichivarkin (private investor)	271
13-Mar-08	C	Copecresto Enterprises Ltd (85.00% stake)	Central European Distribution Corporation	Poland		194
26-May-08	C	Whitehall Group (75.00% stake)	Central European Distribution Corporation	Poland		178
9-Apr-08	C	Nezavisimost Group (49.95% stake)	A1 Group Ltd	Russia		177

C = Completed; P = Pending

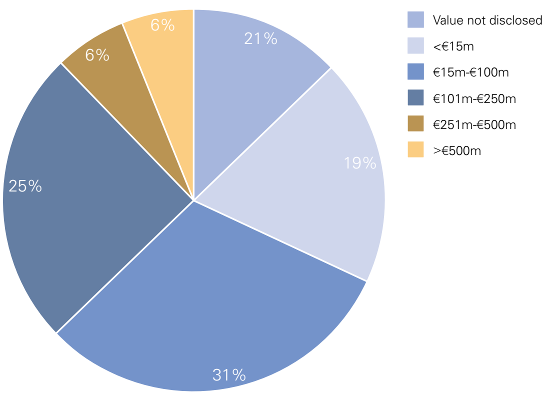
Mining

In recent years, the Mining sector has been an active space for M&A activity in Russia – a country which, endowed with vast mineral resource wealth, has benefitted significantly from the elevated prices for hard commodities that persisted until recently.

In the 2005-2008 period, total domestic and inbound M&A transactions in the sector numbered 69 with an overall value of €22.2bn. Of these deals, roughly 70% were carried out by domestic bidders and the remaining 30% were carried out by foreign investors. Total domestic and inbound deal flow remained buoyant over the period with between 16 to 18 transactions announced per year between 2005 and 2008.

However, there was a clear slowdown over the course of 2008 with just three deals being announced in the second half of the year, compared to 14 in the first half. And although the total number of transactions in 2008 was down by only one deal compared to the 18 deals announced in 2007, valuations for deals fell markedly to €2.8bn in 2008 from €11.4bn the year before. Unsurprisingly, the slump in Mining deals in the second half of 2008 mirrored the deceleration in Russian M&A activity as a whole. That said, the extent of the annual fall in deal valuations in 2008 seemed greater owing to the announcement of the €8.5bn acquisition of a 25% and one share interest in MMC Norilsk Nickel by Russian Aluminium (RusAl) in late 2007.

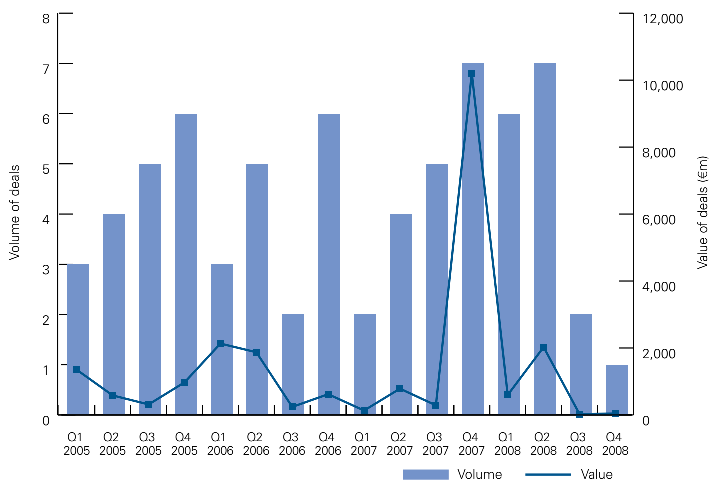
Mining volume split by deal size



This slowdown in the second half primarily reflected the worsening global financial crisis in September and its effects on Russia, but also the eruption of military conflict with Georgia the month prior. In addition to the negative effect that scarce credit access may have had on Mining firms wishing to conduct M&A, companies' profitability may also have suffered from falls in metals prices – particularly for those mining for industrial metals, which have fallen since the global economic situation worsened. Precious metals, such as gold and silver, on the other hand, have not experienced the same falls given that such metals are seen as safe haven investments during downturns and as a hedge against inflation.

By deal size, small-cap transactions (<€100m) dominated M&A activity over the 2005-2008 period, accounting for just over one half of total deal volumes and 5.1% of reported deal valuations. Mid-cap deals (€101m - €500m) accounted for roughly one fifth of deal volumes and 15% of reported deal valuations. Finally, large-cap deals (>€500m) made up 13% of total deal volumes, but represented nearly 80% of total reported deal valuations. In 2008, deal size proportions were comparable to 2005-2008 trends, with around half of transaction volumes in the small-cap range, a slightly higher 30% in the mid-market and 6% in the large-cap range. Notably, the mid-market share of total deal values stood at roughly 40%, while the deal value share for large-cap deals was 47% in 2008.

Mining M&A trends in Russia



Among the notable deals in 2008 was the acquisition of a 68% stake in Polymetal, the Russian silver and gold producer, through a joint purchase by Inure Enterprises Ltd., PPF Group NV and Quotan International Limited for a consideration of

€1.3bn, in June. The deal was by far the largest undertaken in the year and saw PPF gaining a near 25% stake, Quotan holding a near 24% stake and Inure holding just over 19% of Polymetal. ArcelorMittal, the world's largest steel producer, was also prominent in Russian Mining circles in 2008, having undertaken two transactions: the acquisition of two coal mines and related company and plant operations from Severstal OAO for €437m in April, as well as the acquisition of coal mining assets from the Anzherskoye Mine for €47m in the same month. The Italian company Coeclerici Coal & Fuels SpA also carried out two deals in Russia last year, snapping up the mining firm OAO Kuznetskaya Investitsionno-Stroitelnaya for €35m in February and secondly, the coal mining firm Korchakolsky for €22m in April.

The outlook for deal making in the Mining sector will be impacted by the current scarcity of credit, and the effect that falling commodity prices will have on Mining firms' balance sheets. Nonetheless, deal-churn will continue to bring activity to the sector. For example, Nuclear Power Corporation of India (NPCIL), a state-run entity, reportedly plans to acquire 40%-50% stakes in Russian uranium mines in the near future in order to ensure an uninterrupted supply of nuclear fuel. At the same time, Russian tycoon Vladimir Potanin may soon sell his 35% stake in the Russian gold producer Polyus Gold to businessman Suleiman Kerimov. Mr Kerimov has supposedly offered $1.6bn for the stake. In other Mining news, Mr Potanin is reputedly looking for funds to acquire $1.5bn worth of debt of Russian aluminium player UC RusAl. Mr Potanin wants to use this debt to release his 18% stake in the Russian metals miner Norilsk Nickel from collateral held by the listed Russian bank VTB.

Top 10 Mining deals in 2008

Announced Date	Status	Target Company	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
16-Jun-08	C	Polymetal (68.03% stake)	Inure Enterprises Ltd; PPF Group NV; Quotan International Ltd	Russia	Aniketa Investments Ltd	1,306
31-Jan-08	C	Berezovskaya Mine (97.59% stake); Pervomayskaya Mine (99.35% stake)	ArcelorMittal	Luxembourg	Severstal OAO	437
15-Apr-08	P	Belon Group JSC (17.39% stake)	Onarbay Enterprises Ltd	Cyprus		197
11-Jun-08	C	Razryez Yuzhnyi	JSC Ural Mining and Metallurgical Company	Russia	Novosibirskenergo OJSC	193
29-Apr-08	C	Malo-Elginsky (coal deposit)	Sakha Ugol	Russia	Yakutnedra	175
4-Apr-08	C	Metallurgich. zavod im.A.K. Serova OAO	ENRC NV	Netherlands	Blackmore Holdings Ltd; Chesswood Holdings Ltd; Cretown Corporate Advisory BV; Industrial Metals Technology Ltd; International Mineral Resources AG; Prentice Holdings Ltd	133
17-Jan-08	C	OAO Vanadium Tula (79.00% stake)	Siberian Mining and Metallurgical Company	Russia	Koks OAO	68
31-Jan-08	C	Anzherskoye Mine	ArcelorMittal	Luxembourg	Frontdeal Ltd	47
3-Nov-08	P	New Mining Company	Central Asia Gold AB	Sweden		43
13-Feb-08	C	OAO Kuznetskaya Investitsionno-Stroitelnaya Kompaniya	Coeclerici Coal & Fuels SpA	Italy		35

C = Completed; P = Pending

Technology, Media & Telecommunications

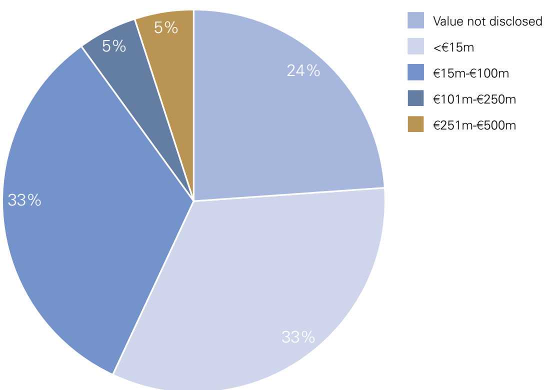
M&A transactions in the Russian Technology, Media and Telecommunications (TMT) sector numbered 161 with a total value of €11.4bn over the 2005-2008 period, at the same time, making up 14.5% of overall Russian M&A activity and 6.2% of total deal valuations.

Within the sector itself, transactions in the Telecommunications Carriers and Media sub-space were the most active with respective shares of roughly 40% and 35% of total deals by volume and 25% and 60% by value.

2008 TMT deal trends remained broadly similar to levels throughout the 2005-2008 period. That said, while the number of announced TMT deals increased marginally in 2008 (by one deal up to 34 transactions), valuations for these deals were down to just €1.5bn from the €4.5bn worth of deals completed in 2007.

Focusing in on 2008 deal flow, the bulk of deal making took place in the second and third quarters, with M&A transactions remaining particularly brisk in Q3 when 16 deals (the highest level since Q4 2006) worth €702m took place, despite the slowdown in overall Russian M&A deal flow. In the final quarter of the year, however, deal flow dropped to a meagre three announced deals worth just €24m – the lowest level in volume and value terms of any quarter over the entire 2005-2008 period. However, the slowdown in deal making occurred across the Russian economy as a whole and as such, was not unique to the TMT space. This slowdown primarily resulted from the worsening of the global financial crisis from late September onward and to a lesser extent, the military conflict with Georgia that began the month prior.

TMT volume split by deal size

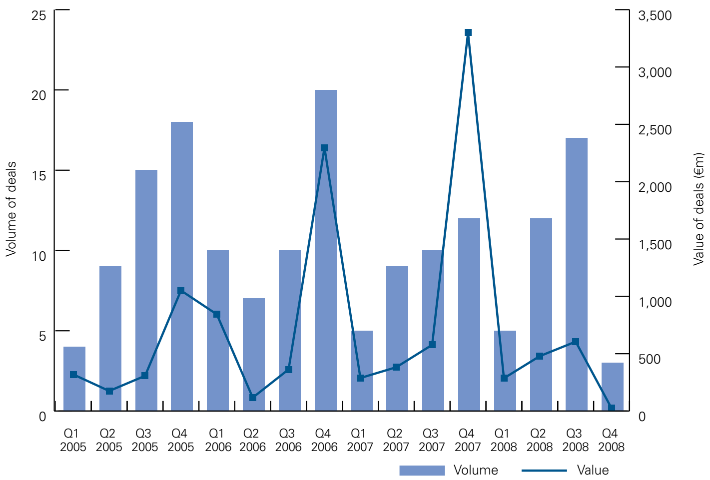


Elsewhere, the breakdown of total TMT transactions within Russia by deal size shows that acquisitions were firmly in the small-cap (<€100m) and mid-market (€101m - €500m) range in 2008, with the combined share for both accounting for slightly less than 70% of total deal flow and nearly 35% of total deal value – levels not too dissimilar to the 2005-2008 period as a whole. There were only four deals with valuations over €500m during the 2005-2008 period, none of which were announced over the past year. That said, the last large-cap (€500m+) deal to be completed – mobile phone provider VimpelCom's €3bn acquisition of Golden Telecom – was announced in 2007, but actually completed in February 2008. The aforementioned deal was one of three domestic transactions carried out in the large-cap range between 2005 and 2008 with the remaining one being an inbound acquisition. In fact, these proportions are roughly analogous to overall Russian TMT deal flows as a whole. Over the 2005-2008 period, around 75% of the market tended to comprise domestic transactions while the remainder consisted of inbound deals – levels fairly consistent with 2008 trends.

Meanwhile, between 2005 and 2008, acquisitions of TMT assets abroad by Russian firms numbered 44 with a total value of €4.8bn. Half of these outbound TMT acquisitions were directed towards Telecommunications Carrier companies, and associated deal valuations accounted for nearly 70% of the total at €3.3bn. The Media subsector was also active with 10 deals, albeit worth a comparatively low total of €131m – much lower than the €857m invested in Computer Semiconductors or the €332m in Telecommunications Hardware. At the same time, outbound TMT acquisitions by Russian firms were solidly focussed on the small-cap and mid-cap markets; in fact, only one deal was worth more than €500m.

The abovementioned acquisition of Golden Telecom by VimpelCom was the most notable deal in recent years by virtue of its value alone. Indeed, among TMT deals in Russia, it stands as the largest transaction undertaken since 1999. VimpelCom continued its acquisitive streak into 2008, conducting the year's largest buyout through its acquisition of the remaining 49% stake in the telecommunications operator Corbina Telecom for a consideration of €262m – VimpelCom owns the other 51% of Corbina through its wholly owned OOO EDN Sovintel subsidiary. Another noteworthy deal from 2008 was Russian television network CTC Media's acquisition of DTV Group for €258m. The deal, completed in April 2008, complements DTV's strategy to increase its presence in the Russian advertising market and to increase its audience base.

TMT M&A trends in Russia



The outlook for M&A within the TMT space will be influenced by the performance of the Russian economy, which has exhibited intense volatility in recent months. For instance, the slide in the value of the rouble in the second half of 2008 increased balance sheet pressure on some of the largest Russian TMT firms with large foreign-currency denominated debts – this includes VimpelCom and MTS, market leaders in the Russian wireless telecommunications market. With this in mind, TMT firms are forecast to continue to see downward pressure on the top line as economic activity slows over the short term, which may subsequently lead to an increased reluctance to conduct deals. But with asset prices depressed across much of the Russian market, there remain good opportunities for cheap acquisitions of distressed assets for firms that have sufficient cash at hand.

Potential deals in the pipeline include the Czech financial company PPF Group's bid for the Russian retailer of computer accessories, Sunrise, for an undisclosed amount – Sunrise had revenues of £417m in 2007. Elsewhere, the Russian antitrust regulator recently gave approval to MTS for the acquisition of the mobile retailer, Telephone.Ru – though MTS is still mulling whether to complete the transaction. Lastly, a subsidiary of The Walt Disney Company and the Russian television broadcaster Media One is to form a joint venture company to provide family entertainment television programming for the Russian market. Disney will hold a 49% stake in the new company and provide programming, marketing and acquisition support in return for a cash investment.

Top 10 Technology, Media & Telecommunications deals in 2008

Announced Date	Status	Target Company	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
3-Jun-08	C	Corbina Telecom (49.00% stake)	VimpelCom	Russia	Inure Enterprises Ltd	262
11-Mar-08	C	DTV Group	CTC Media Inc	Russia	Modern Times Group AB	258
25-Jul-08	C	Mail.ru (17.16% stake)	Digital Sky Technologies (DST)	Russia	Tiger Global Management LLC	218
27-May-08	C	OAO ARCTEL	Rosweb Telecom	Russia	Flex Welt Finance Ltd; Leader Asset Management	127
18-Jul-08	P	ZAO Begun	Google Inc	USA	Rambler Media Ltd	88
15-Jul-08	C	K - Systems (50.00% stake)	Eduard Voronetsky (private investor)	Russia	Georgy Gens (Private Investor)	63
18-Jul-08	C	OJSC News Media (50.00% stake)	National Media Group (NMG)	Russia	UFG Private Equity Fund	50
17-Jul-08	C	Buka Entertainment Company	1C Company	Russia	Finam Investment Holding Company; Norum Private Equity Advisors Ltd	50
3-Apr-08	P	RTComm.RU OJSC (68.40% stake)	OAO Rostelecom	Russia	Synterra CJSC	42
7-Jul-08	C	CJSC Ural Telephone Company	OAO Comstar United TeleSystems	Russia		31

C = Completed; P = Pending

Top-deals tables

Top 10 overall deals in 2008

Announced Date	Status	Target Company	Target Sector	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
17-Apr-08	C	KM Invest ZAO (50.00% stake)	Financial Services	Interros Company	Russia	Onexim Group	4,641
29-Feb-08	C	TGK-10 (Territorial Generating Company No 10)	Energy, Mining & Utilities	Fortum Oyj	Finland	Unified Energy Systems of Russia	2,283
15-May-08	P	Volzhskaya TGK OAO (TGK-7 OAO) (77.00% stake)	Energy, Mining & Utilities	Berezville Investments Ltd	Russia	Unified Energy Systems of Russia	1,886
11-Feb-08	C	TGK-8 (Territorial Generation Company No 8)	Energy, Mining & Utilities	OAO Lukoil	Russia	Financial Group IFD Capital	1,508
16-Jun-08	C	Polymetal (68.03% stake)	Energy, Mining & Utilities	Inure Enterprises Ltd; PPF Group NV; Quotan International Ltd	Russia	Aniketa Investments Ltd	1,306
20-Mar-08	C	Lebedyansky JSC	Consumer	Bidco for Lebedyansky	USA		1,288
18-Nov-08	C	Masshtab (49.91% stake)	Construction	Avgur Estate	Russia	Investbuilding Group	1,189
17-Feb-08	C	NK Alliance OAO	Energy, Mining & Utilities	West Siberian Resources Ltd	Bermuda	Bazhaev family (private investor)	1,026
7-Apr-08	P	JGC TGK-4 (The Fourth Territorial Generating Company)	Energy, Mining & Utilities	Onexim Group	Russia	Unified Energy Systems of Russia	1,019
14-Mar-08	P	TGK-2 (The Second Territorial Generating Company)	Energy, Mining & Utilities	Kores Invest	Russia	Unified Energy Systems of Russia	902

C = Completed; P = Pending

Top 10 domestic deals in 2008

Announced Date	Status	Target Company	Target Sector	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
17-Apr-08	C	KM Invest ZAO (50.00% stake)	Financial Services	Interros Company	Russia	Onexim Group	4,641
15-May-08	P	Volzhskaya TGK OAO (TGK-7 OAO) (77.00% stake)	Energy, Mining & Utilities	Berezville Investments Ltd	Russia	Unified Energy Systems of Russia	1,886
11-Feb-08	C	TGK-8 (Territorial Generation Company No 8)	Energy, Mining & Utilities	OAO Lukoil	Russia	Financial Group IFD Capital	1,508
16-Jun-08	C	Polymetal (68.03% stake)	Energy, Mining & Utilities	Inure Enterprises Ltd; PPF Group NV; Quotan International Ltd	Russia	Aniketa Investments Ltd	1,306
18-Nov-08	C	Masshtab (49.91% stake)	Construction	Avgur Estate	Russia	Investbuilding Group	1,189
7-Apr-08	P	JGC TGK-4 (The Fourth Territorial Generating Company)	Energy, Mining & Utilities	Onexim Group	Russia	Unified Energy Systems of Russia	1,019
14-Mar-08	P	TGK-2 (The Second Territorial Generating Company)	Energy, Mining & Utilities	Kores Invest	Russia	Unified Energy Systems of Russia	902
14-Mar-08	P	Territorial Generating Company No 6 (80.14% stake)	Energy, Mining & Utilities	Integrated Energy Systems (IES)	Russia	Unified Energy Systems of Russia	746
11-Apr-08	C	Formata Holding BV	Consumer	X5 Retail Group NV	Russia		594
17-Apr-08	C	JSC Open Investments (27.50% stake)	Real Estate	Onexim Group	Russia	KM Invest ZAO	517

C = Completed; P = Pending

Top 10 inbound deals in 2008

Announced Date	Status	Target Company	Target Sector	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
29-Feb-08	C	TGK-10 (Territorial Generating Company No 10)	Energy, Mining & Utilities	Fortum Oyj	Finland	Unified Energy Systems of Russia	2,283
20-Mar-08	C	Lebedyansky JSC	Consumer	Bidco for Lebedyansky	USA		1,288
17-Feb-08	C	NK Alliance OAO	Energy, Mining & Utilities	West Siberian Resources Ltd	Bermuda	Bazhaev family (private investor)	1,026
29-Feb-08	C	AvtoVaz OAO (25.00% stake)	Industrials	Renault SA	France	Russian Technologies State Corporation (Rostechnologii)	768
22-Feb-08	C	Magistral	Consumer	Baltia Oil; Novy Investments Ltd; TEYA AZS	Cyprus		601
8-Apr-08	P	SIA International Ltd (50.00% stake)	Business Services	TPG LLP	USA		509
3-Mar-08	C	Expobank Commercial Bank	Financial Services	Barclays Plc	United Kingdom	Petropavlovsk-Finance	487
24-Apr-08	C	Musa Motors Group	Consumer	Inchcape Plc	United Kingdom	Bradholm Networks Ltd; Brightport Merchants Ltd; Broadzone Ltd; Harnley Experts Ltd	446
31-Jan-08	C	Berezovskaya Mine (97.59% stake); Pervomayskaya Mine (99.35% stake)	Energy, Mining & Utilities	ArcelorMittal	Luxembourg	Severstal OAO	437
22-May-08	C	Russian Alcohol	Consumer	Central European Distribution Corporation; Goldman Sachs; Lion Capital LLP	United Kingdom	Industrial Investors Group (Promyshlennoye Investory)	381

C = Completed; P = Pending

Top 10 outbound deals in 2008

Announced Date	Status	Target Company	Target Sector	Target Country	Bidder Company	Bidder Country	Seller Company	Deal Value € (m)
14-Mar-08	C	SSAB (North American tubular operations)	Industrials	Canada	Evraz Group SA; Trubnaya Metallurgiczeskaya Kompaniya (TMK)	Russia	SSAB	2,233
24-Jun-08	C	ISAB refinery (49.00% stake)	Energy, Mining & Utilities	Italy	OAO Lukoil	Russia	ERG SpA	1,348
26-Mar-08	C	Oriel Resources Plc	Energy, Mining & Utilities	United Kingdom	Mechel OAO	Russia		1,013
30-May-08	C	Esmark Inc	Industrials	USA	Severstal OAO	Russia		758
22-Aug-08	C	PBS Coals Ltd	Energy, Mining & Utilities	Canada	Severstal OAO	Russia		671
21-Mar-08	C	Sparrows Point LLC	Industrials	USA	Severstal OAO	Russia	ArcelorMittal	525
28-May-08	C	Altis Semiconductor	TMT	France	AK Invest Group	Russia	IBM Corporation; Infineon Technologies AG	500
4-Apr-08	C	Austrian Hotel Company	Leisure	Austria	Azimut Hotel Group	Russia		400
25-Jan-08	C	Naftna industrija Srbije A.D. (NIS) (51.00% stake)	Energy, Mining & Utilities	Serbia & Montenegro	Gazprom Neft	Russia	Government of the Republic of Serbia	400
7-Jul-08	C	Limnotex Developments Ltd (25.00% stake)	TMT	Kazakhstan	VimpelCom	Russia	Crowell Investments Ltd	357

C = Completed; P = Pending

Top 10 private equity buyouts and exits in 2008

Announced Date	Status	Target Company	Target Sector	Bidder Company	Bidder Description	Seller Company	Deal Type	Deal Value € (m)
8-Apr-08	C	SIA International Ltd (50.00% stake)	Business Services	TPG LLP	US based private equity firm		IBI	509
22-May-08	C	Russian Alcohol	Consumer	Central European Distribution Corporation; Goldman Sachs; Lion Capital LLP	UK based private equity firm; US and Poland based importer of beers wines and spirits, and distributor of domestic vodka; US based investment banking, securities and investment management firm	Industrial Investors Group (Promyshlennoye Investory)	IBI	381
25-Jul-08	C	Mail.ru (17.16% stake)	TMT	Digital Sky Technologies (DST)	Russia based investment fund interested in media sector	Tiger Global Management LLC	Exit	218
10-Jan-08	C	Transcontainer OAO (15.00% stake)	Transportation	European Bank for Reconstruction and Development; GLG Emerging Markets Special Situations Fund; Moore Capital Management LLC; Troika Dialog Group	Russia based private investment bank; UK based investment fund managed by GLG Partners LP; UK based investment institution providing project financing for banks, industries and businesses, both new ventures and investments in existing companies. It also works with publicly owned companies to support privatization, restructuring state-owned firms and improvement of municipal services; US based private investment management firm	OJSC Russian Railways	IBI	217
28-Apr-08	C	National Logistic Company (NLC) (90.00% stake)	Transportation	Itella Corporation	Finnish provider of mail delivery and logistics services	Citigroup Venture Capital Equity Partners Ltd; RosEvroGroup	Exit	200
9-Apr-08	C	Nezavisimost Group (49.95% stake)	Consumer	A1 Group Ltd; Alfa Capital Partners	Russia based investment company; Russian private equity firm		IBI	177
26-Jun-08	C	AKB Investtorgbank OAO (39.98% stake)	Financial Services	JCF FPK Sarl; Starr Russia Investments III BV	Russia based investment holding company; Russia based private equity fund of J.C Flowers & Co		IBI	136
21-Feb-08	C	Vozrozhdenie Bank (9.90% stake)	Financial Services	Brysam Global Partners	US based private equity firm		IBI	103
12-Mar-08	C	Unimilk Ltd Liability Company (10.00% stake)	Consumer	Capital International Private Equity Fund III	US based fund of Capital International focusing on investments in Asia, Europe, Africa and Latin America		IBI	96
18-Jul-08	C	OJSC News Media (50.00% stake)	TMT	National Media Group (NMG)	Russia based media holding company	UFG Private Equity Fund	Exit	50

C = Completed; P = Pending

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