

# Déjà vu the Ukrainian way

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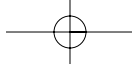
THE GLOBAL FINANCIAL CRISIS TOOK THE UKRAINIAN ECONOMY UNAWARES. THE CURRENT ACCOUNT BALANCE DEFICIT, GROWING DEBT VOLUME AND INCREASE OF OVERDUE LOANS WERE THE MAIN REASONS FOR THE FINANCIAL CRISIS IN UKRAINE. NO SOONER HAD WE ENJOYED THE ADVANTAGES OF BORROWED FUNDS USED FOR BUSINESS DEVELOPMENT, THAN WE FULLY EXPERIENCED THE IMPACT OF EXTERNAL INVESTOR CAPITAL OUTFLOW SEARCHING FOR MORE RELIABLE CAPITAL SAVING MARKETS, WHICH ONLY WORSENERD THE CURRENT ACCOUNT OF THE COUNTRY. ACCORDING TO THE NATIONAL BANK OF UKRAINE, IN THE FIRST QUARTER OF 2009 THE VOLUME OF OVERDUE LOANS INCREASED BY MORE THAN 55% TO US\$3.6BN; PRIMARILY THAT WAS THE RESULT OF NATIONAL CURRENCY DEVALUATION BY TWICE AS MUCH IN A FOUR MONTH PERIOD. THIS SITUATION IS BEING COMPLICATED BY THE POLITICAL CRISIS AND DOWNFALL OF INDUSTRY DYNAMICS. THE FACT THAT SINCE APRIL 2009 THE HRYVNIA'S (UAH) EXCHANGE RATE HAS RAPIDLY INCREASED TO UAH/US\$7.4 REPRESENTS THE FIRST SIGN OF STABILISATION IN THE COUNTRY.

The above mentioned figures confirm that Ukraine is an emerging market, which severely felt the lack of liquidity, but has a chance for recovery by the end of 2009. In its report (April 2009), the World Bank predicted that gross domestic product (GDP) in Ukraine will decrease by the end of the year to 9%. In 2010 Ukraine will be able to increase its GDP to 1%, and by 2012 will reach a level of growth of 4%-5%. We have observed practically the same average annual growth over the past five years. According to the World Bank, inflation in 2009 is estimated at 16.4% which could be improved to 10% in 2010 and to 8% in 2011. This was discussed in the report as part of the negotiations on the next US\$3bn payment. On November 5, 2008 the International Monetary Fund reached a decision to allocate a stabilisation loan of US\$16.43bn to Ukraine, with gold-currency reserves of the country at that time totalling around US\$32bn. According to the agreement, two payments of US\$4.5bn and US\$2.8bn have been received.

## Financial crisis measures

Realising the importance of the financial sector, the government in cooperation with international organisations has undertaken a package of measures to support the banking system. The European Bank for Reconstruction and Development is ready to allocate €500m this year with the first loan of US\$250m to be issued to Ukrainian Export-Import Bank. The Government of Ukraine plans to recapitalise a number of major banks accordingly.

The crisis caused difficulties for all parties involved in banking relations and led to the situation where all the banks almost went bankrupt. They stopped paying out deposits and started to increase the interest rate in credit contracts that resulted in mass non-payments. These circumstances meant that banks had to reach compromises with clients, for example, people sold their deposits at



discount or tried to sell their mortgages. Before the Ukraine government developed and adopted regulations, this process had not been controlled. The first step was the introduction of the Anti-Crisis Law on October 31, 2008 to avoid the collapse of the banking system by restructuring and capitalisation; it also provides protection and assistance to the local banking sector. The next step was making alterations to several laws and the Civil Code concerning the prohibition of unilateral changing of banks' contracts to protect rights of depositors and debtors against banks. Thus, one more legal deficiency was liquidated.

## Mergers and acquisitions (M&A)

M&A market capitalisation in 2008 amounted to US\$3.6bn with 36 deals. The following industries have the largest transaction share: finance (51.9%), retail (16.2%), metallurgy (15.9%), food (15.5%) and mining (8.1%). In 2007 the amount of deals totalled around US\$21.5bn with 87 deals. It is expected that the capitalisation of M&A transactions in 2009 compared to 2008 will increase by at least double providing that owners are prepared to sell assets at such low prices. If in 2008, Ukrainian banks were sold for between two and three balance values, in 2009 the price is less than one. Insurance companies' prices are estimated at a rate of three quarters of gross written premiums. The average price of the retail chain can be evaluated as half of annual sales, besides debt deals are typical for this sector. Other markets displayed a similar trend, the biggest drop being observed in the construction market where the main developers have been forced to sell their assets at huge discounts amounting to 90%. 2009 will be marked as the year of property redistribution as it will enable the acquisition of assets at prices substantially lower than seen in previous years.

From the above, we assume that the most active M&A periods will be observed in four enterprises' categories which are of interest to investors:

1. Companies that experience a serious shortage of both domestic financial resources and borrowed funds are

forced to actively seek new sources of financing. This is especially when the global economy is in the active process of reducing the debt burden on stockholders' equity (deleveraging).

2. Businesses most vulnerable to the impact of the crisis include durable goods sellers and some types of investments (construction, building materials production, machinery and equipment, stock market, etc.).
3. Non-specialised assets of business groups, sales of which we can expect to maintain the liquidity of the core business.
4. Privatisation objects, such as utilities and power generating companies, Odessa Port Plant and Ukrtelecom, etc. However the profits from privatisation are expected to be low in current market conditions and the lack of consistent consolidated privatisation and investment policies at the state level are the limiting factors in the decision-making process of major international investors.



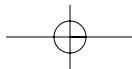
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## M&A legislation

Ukrainian M&A legislation has lots of internal conflicts. The economic crisis made the government improve legislation despite of all the political conflicts. In terms of international integration a new Law on joint-stock companies was adopted. It had been debated for a long period and finally was passed. It contains many provisions that meet international and European standards: joint-stock companies can be both private or public, and shares must be nominal and non-documentary, beneficial or ordinary. The main advantage of the law is that it defends the rights of minority shareholders. According to the law, shareholders have the privileged right to buy shares. The statute has to contain provisions about the terms of privileged rights, otherwise all shareholders must refuse to buy the shares, only after that shares can be offered for sale to the third parties. In case of violation of a shareholder's privileged right, it can be defended in the court. Also the share price must be fixed according to the market. One more provision provides the term for appeal on the regulations adopted by General Meeting and voting on all questions must be conducted with a voting paper. All these provisions protect private companies from illegal takeover. As far as stock redemption is concerned, before buying a company, a party has to inform the shareholders. There is also one more new element in the enterprises merger procedure: after a treaty on a company's merger has been devised, it must be accepted by the shareholders. All the existing joint-stock companies have to bring their statutes and other documents in compliance with this act by 2010.

## Summary

For the remainder of 2009, the M&A market will be the 'buyer's market'. Everyday there are more and more assets open to acquisition by potential buyers. Supply has now definitely exceeded demand and the cost of Ukrainian assets has already reached the level of that in 2004. However, owners that have the potential to maintain functional businesses in the market are waiting. The M&A market clearly demonstrates this trend: more than 50 transactions were concluded in the first quarter of 2009, but the amount of foreign direct investment is estimated at only US\$1.2bn. It has been forecast that as soon as the first signs of economic stabilisation appear, assets will be sold vigorously. As a result of M&A market activism, a new generation of owners will come, who will provide more effective administration and favourable conditions for business. Therefore, it can be the driver for the economy to overcome the crisis. Foreign investment is the main source of capital in the country, but the share of companies who raised it suffers from a lack of skills. Because it requires the knowledge of both the peculiarities of operating in the local market and international standards of conducting deals, the role of professional transaction support advisers in such an environment is increasing and becoming more essential.

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