

ALRUD

Russia & CIS
M&A

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Foreword

The M&A market in Russia and the CIS is at a crossroads. While transaction activity stabilised in 2021 following the COVID-19 disruption, dealmaking in the region has not raced ahead in the same way as in many other markets. However, that could change in 2022.

Our survey reveals that dealmakers in the region believe the pace of M&A is going to accelerate – 85% predict an increase in activity over the course of 2022, with consolidation and digitalisation driving the market. Russia's comparatively stable political climate, and the prospect of positive economic growth, add to the country's attractions.

Nevertheless, there may be bumps in the road. The pandemic still has potential to cause uncertainty and volatility – particularly with the Omicron outbreak. Cross-border activity may be held back by foreign investors' concerns about the sanctions. And some dealmakers have anxieties about the regulatory landscape.

Against this backdrop, this report charts the opportunities and challenges that now lie ahead in the M&A markets of Russia and the CIS. We consider how dealmakers plan to overcome key obstacles in order to exploit the undoubted potential of businesses in the region.



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Methodology

In the third quarter of 2021, Mergermarket surveyed 100 senior executives to gain insights on their M&A predictions in Russia and Kazakhstan*. The respondents comprised 43 corporates, 27 investment banks, 18 M&A law advisers and 12 private equity firms. All responses are anonymous, and results are presented in aggregate.

**The survey was conducted in November 2021 and, therefore at the time did not account for the political situation in Kazakhstan and the renewed tensions between Russia and the US/Europe over Ukraine and NATO expansion. However, the report has taken into account the current political situation (see page 6 for example).*

A clearer path: M&A in Russia and the CIS

Despite the rigours of the pandemic, dealmakers are optimistic about the year ahead as M&A rises up the corporate agenda

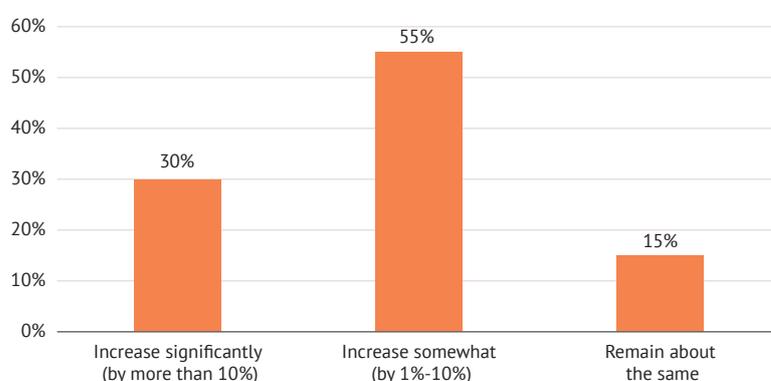
M&A activity across Russia and the CIS proved robust during 2021. According to figures from Mergermarket, by mid-November, Russia had recorded 111 transactions worth US\$18.0bn, closing in on 2020's final tally of 134 deals valued at US\$20.6bn. Across the rest of the CIS, there were 19 deals worth US\$925m over the same period, compared with 35 deals worth US\$812m during the whole of 2020, with Kazakhstan and Ukraine accounting for the lion's share of that activity.

Compared with other regions of the world, which saw a boom in M&A activity during 2021, the Russian and CIS market has been more muted. But that may be about to change. We found that 85% of the dealmakers we surveyed anticipate an increase in the pace of M&A activity during 2022; that includes 30% who expect deal volumes to increase by more than 10%.

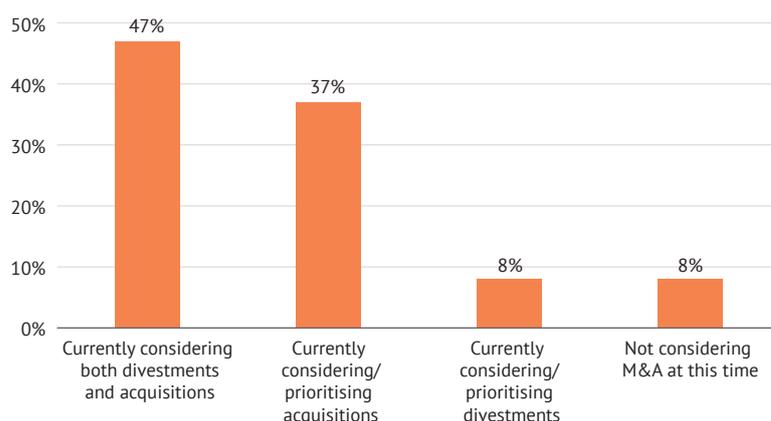
Many respondents suggest companies in the region are now focusing on recovery and growth, as the global economy bounces back from the impact of the pandemic. Indeed, the International Monetary Fund predicts GDP growth of 4.7% and 2.9% for Russia in 2021 and 2022 respectively.

"All market activity will increase because companies want the recovery phase to be accelerated," says a partner in a Russian law

What do you think will happen to the number of M&A deals in Russia & CIS in 2022 compared to 2021? (Select one)



Where does M&A currently fit into your corporate strategy? (Select one)



firm. The head of M&A at a Russian corporate adds: “Overall, market activity will increase as new efforts and strategies are discussed by most organisations – they have to improve the bottom line by raising capital and funding acquisitions.”

State of play

This is not to say every part of the market will benefit equally. Alexander Zharskiy, head of ALRUD’s corporate and M&A practice, divides the marketplace into two categories: businesses that are state-controlled or linked to the state through some sort of funding, and private sector firms. “I see significant appetite and motivation to get deals done among those state-linked companies,” he says. “But the private deals will be harder, given the way Russian inflation is rising and the impact that will have on consumer spending.”

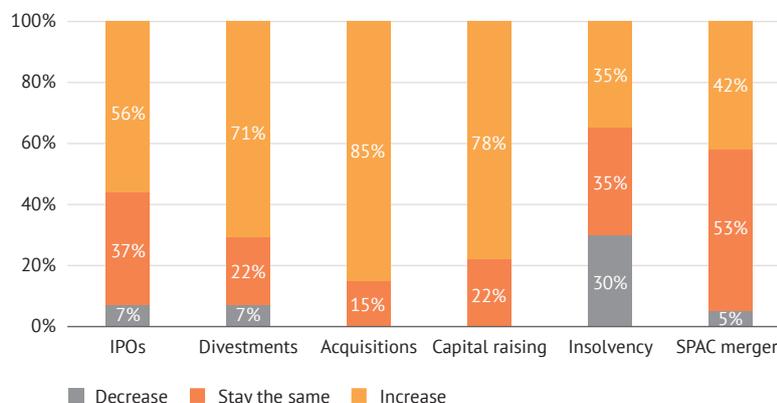
Nevertheless, many businesses in the region are now rethinking their strategy in the wake of the pandemic. Almost half of respondents in this research (47%) say they are considering both acquisitions and divestments. The managing director of a Russian investment bank agrees: “Acquisitions and capital raising will be important in getting over the economic slowdown – by pursuing new opportunities.”

Technology renewal and digitalisation is likely to be an important part of that story, says ALRUD partner Anton Dzhuplin. “The M&A market will continue to grow,” he predicts. “A large number of big corporations are building up their IT infrastructure and ecosystems.”

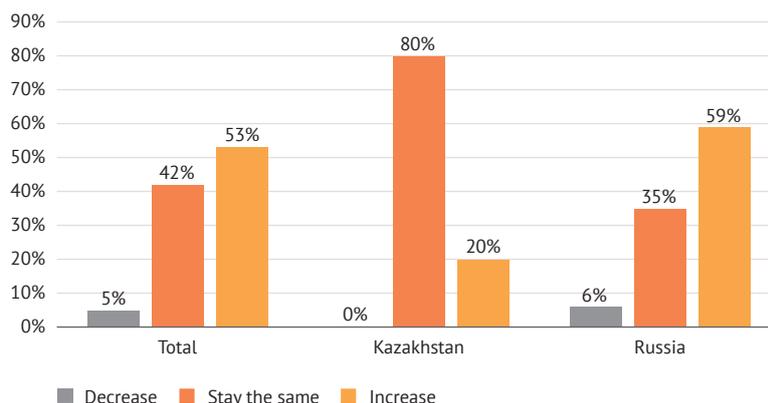
Buy, sell or bust

Against that backdrop, every type of transaction is likely to become more common over the next 12 months. While 85% of dealmakers anticipate an increase in acquisition numbers, 71% believe divestments are also set to grow. With 78% tipping an

What do you think will happen to the following types of market activity in Russia & CIS over the next 12 months? (Select one response for each type of market activity)



What do you think will happen to SPAC merger activity in Russia & CIS over the next 12 months?



increase in the number of capital-raising exercises, and 56% pointing to more IPOs, the market looks set to be busy next year.

Inevitably, however, the impacts of the COVID-19 downturn will continue to be felt, with more than a third of dealmakers (35%) predicting an upturn in the number of insolvencies during 2022. “Insolvencies are bound to increase: there are many companies in leisure, real estate and transportation that have not come close to their profitability targets,” warns the CFO of a Russian corporate.

Another section of the market that made headlines this year is the special purpose acquisition companies (SPACs). Globally, the SPACs phenomenon has smashed records in 2021 with 616 deals worth US\$158bn – up 140% (volume) and 88% (value) on the previous year, according to Dealogic figures.

While Europe including Russia has lagged behind the US, nine in 10 respondents expect deal rates to stay at current levels or accelerate over the next year.

The drive for deals

With so much diverse activity expected, dealmakers envisage a range of drivers for transactions during 2022. Consolidation is going to be an important theme, with 44% citing this as one of three most important M&A drivers in 2022 – including 23% who pick it as the top driver. As the fall-out from the volatility of the past two years continues across a broad range of industries, it is likely that more businesses will come together, seeking efficiencies of scale or making opportunistic acquisitions.

Digitalisation will also be a key factor in M&A activity, with 18% citing this as likely to be the leading driver of activity. “The technology sector spans companies ranging from start-ups to international players,” says ALRUD’s Anton Dzhuplin. “The market is not affected by political sanctions and there are so many companies looking to transform.”

Another potential driver of deal activity is the appetite of PE firms to pursue buyout opportunities. Figures from S&P Global show that PE firms globally are sitting on record dry powder of US\$2.3tn and almost every market is seeing heightened interest from these investors. In Russia and the CIS, 15% of dealmakers think this will be the most important driver of M&A during 2022. Although levels of PE investment are low compared with other European markets, Russia has seen year-on-year increases in PE buyout since 2016 culminating in US\$840m-worth of activity this year, according to Mergermarket figures.

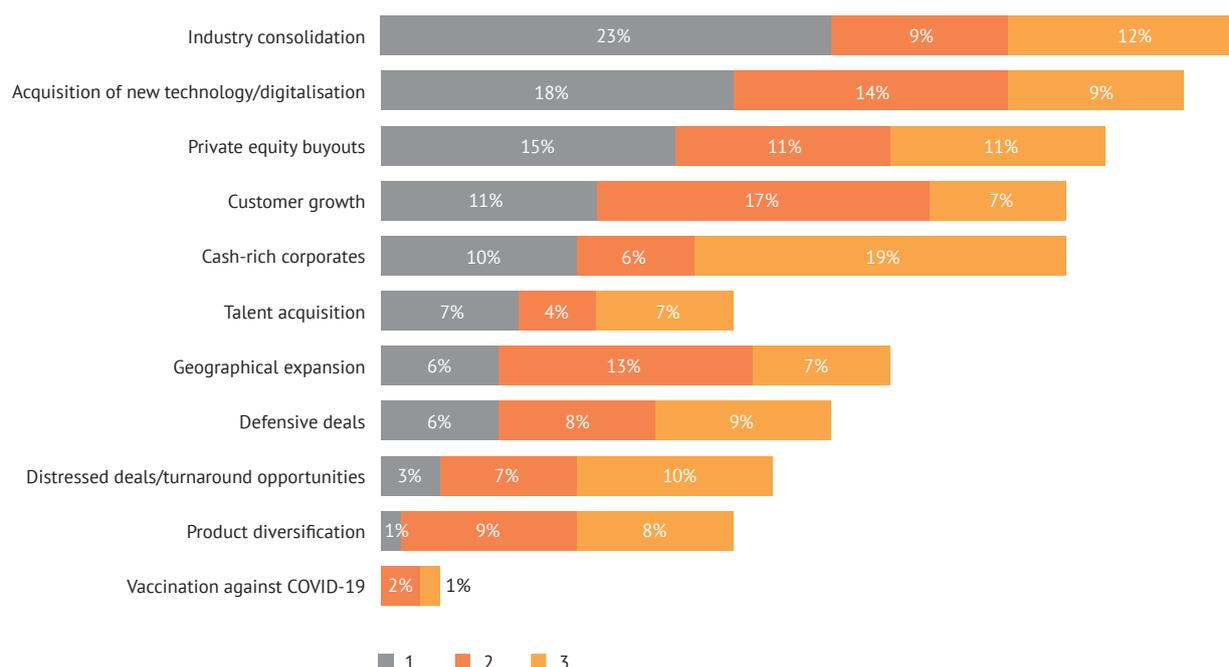
Hurdles to jump

However, these driving forces do not mean that dealmaking will be plain-sailing. More than a fifth of respondents (21%) point to the international sanctions currently in force against Russia as the most serious challenge to completing a transaction in the region. Clearly, with governments from the US, the

Consolidation is going to be an important theme, with 44% citing this as one of three most important M&A drivers in 2022.

EU and the UK effectively banning businesses from dealing with Russian companies in certain sectors or with links to certain individuals, there will be limited international participation in M&A in certain areas of the market. In addition, new tensions among Russia and the US/Europe over Ukraine and NATO expansion are only likely to exacerbate an already complex situation and could lead to greater disruption to M&A activity in Russia.

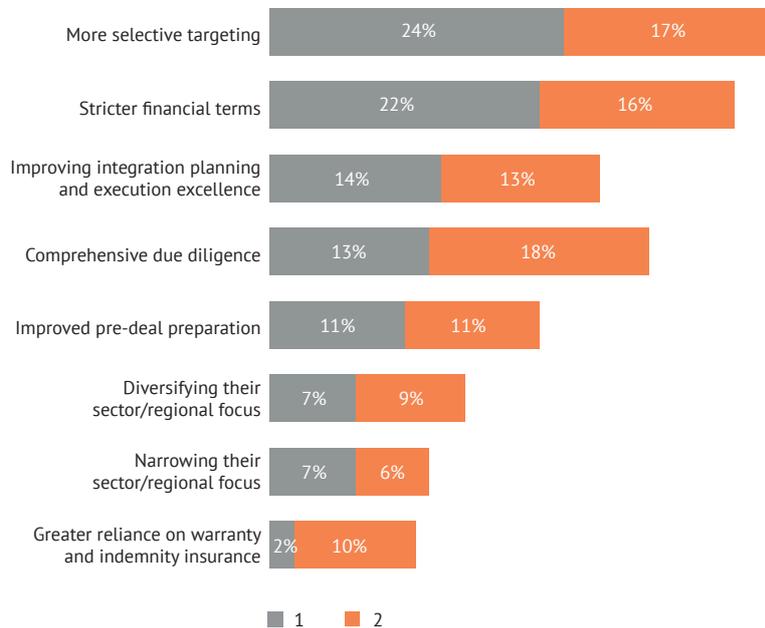
Which of the following will be the main drivers for M&A in Russia & CIS over the next 12 months? (Select top three and rank 1-2-3)



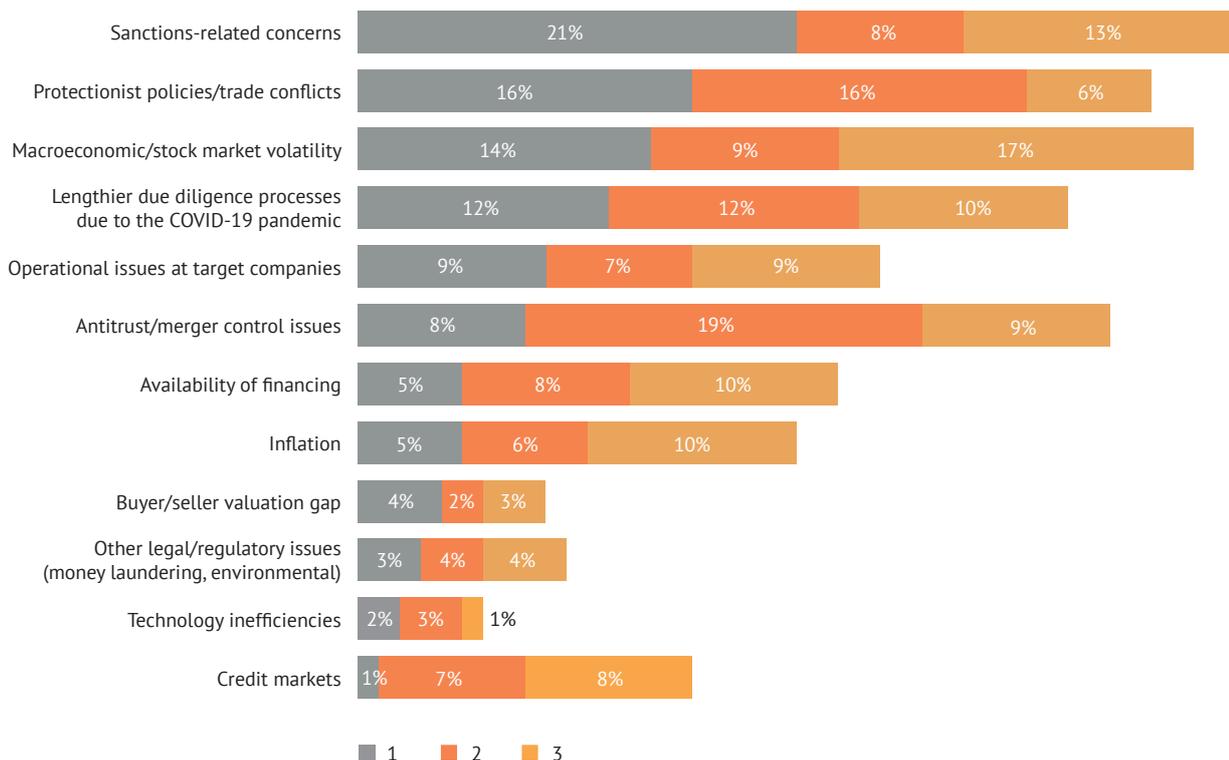
Protectionism is another commonly cited issue, with 16% of dealmakers pointing to this as the most difficult challenge they face right now. In common with many governments around the world, according to ALRUD's Alexander Zharskiy, Russia is reinterpreting its legislation on foreign investment in strategic companies to catch more deals than in the past – with more scrutiny on control and ownership as well as a broader definition of what counts as strategic. “This is a point of concern for foreign investors and it is becoming more important,” he warns.

Other challenges that concern dealmakers are more macro in nature. For example, 14% point to anxiety about economic or stock market volatility as the biggest challenge facing the M&A market. And 12% worry about the difficulty of doing due diligence given the ongoing complexities of the pandemic, with restrictions on travel and face-to-face meetings.

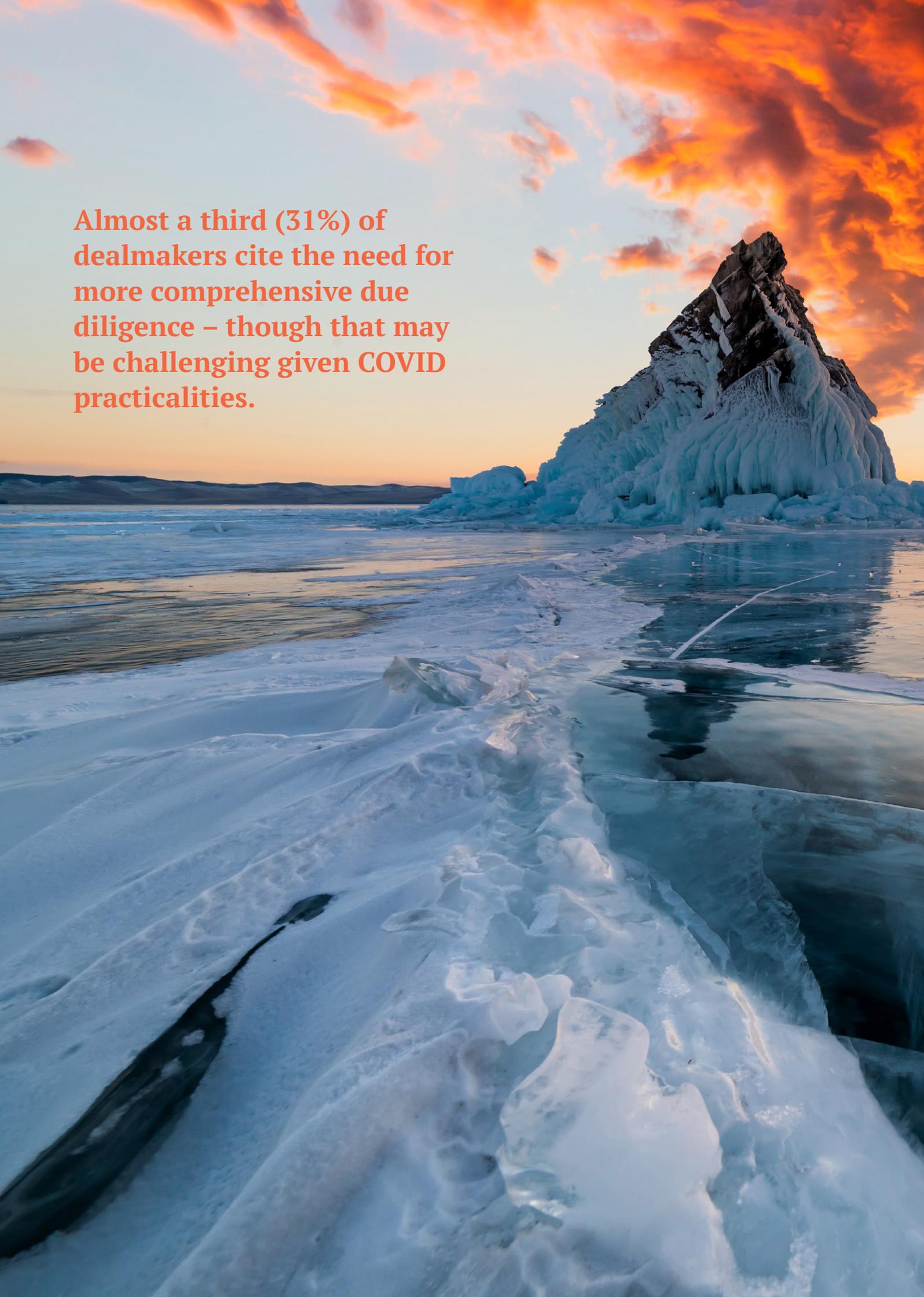
How can dealmakers in Russia & CIS best mitigate M&A risk over the next 12 months? (Select top two and rank 1-2)



What will be the biggest challenges to completing an M&A deal in Russia & CIS over the next 12 months? (Select top three and rank 1-2-3)



Almost a third (31%) of dealmakers cite the need for more comprehensive due diligence – though that may be challenging given COVID practicalities.



Dealmakers are exploring ways to deal with these issues. For example, 41% point to the need for more selective targeting of M&A strategies, while 38% expect to be stricter on the financial terms of the deals they pursue.

There is also a clear intention to focus on process and planning. Almost a third (31%) of dealmakers cite the need for more comprehensive due diligence – though that may be challenging given COVID practicalities – while 27% are intent on improving integration planning and execution ability.

In other words, dealmakers will seek to price deals more robustly – and then to move forward on deal execution with greater discipline. While it may be difficult to plan for continued uncertainties, there are steps dealmakers can take to squeeze out risk as they manage deal processes.

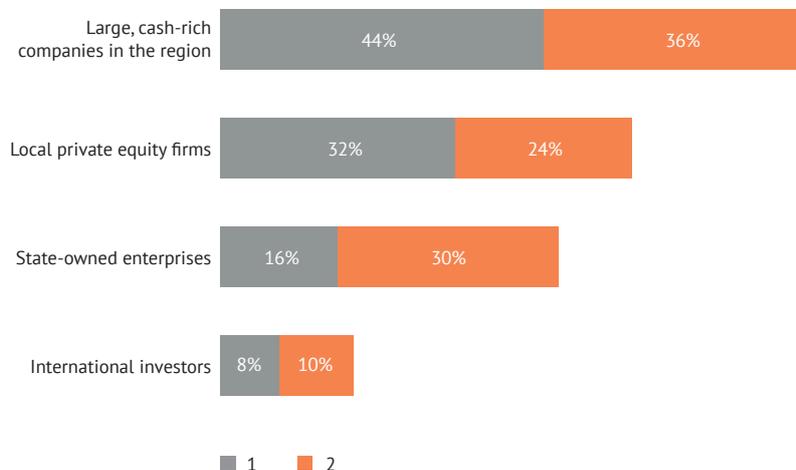
Taking the lead

Against this backdrop, the largest players in the M&A market may be the best equipped to cope with uncertainty and volatility. Certainly, 80% of dealmakers in this research believe that the region's large cash-rich companies will lead the way over the next 12 months.

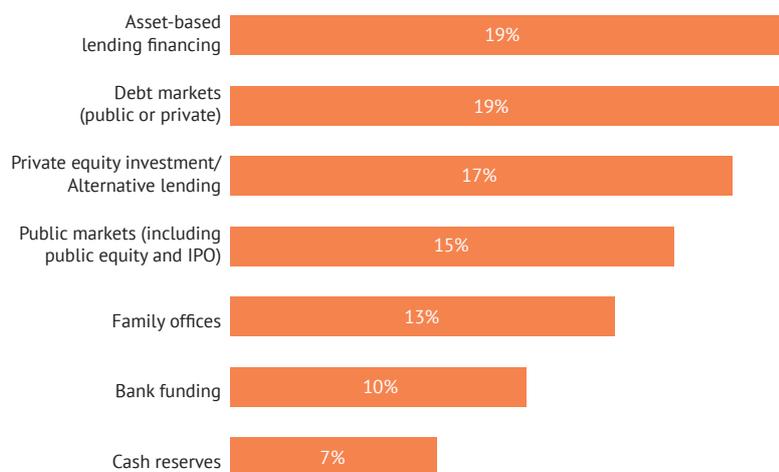
“Higher commodity and energy prices in 2021 mean corporates in oil, gas, mining and metals have significantly more liquidity,” says ALRUD partner Andrey Zharskiy. “That is likely to feed through the system next year as the largest businesses seek to deploy that capital.”

Clearly, given the amount of capital at their disposal, PE firms have potential to drive dealmaking, but respondents also point to the ongoing influence of state-owned or backed businesses. “There is the potential for these entities to invest in local markets across Russia and the CIS,” says the managing partner

Who will be the most important/influential M&A players in Russia & CIS over the next 12 months? (Select top two and rank 1-2)



How are you planning to finance your next acquisition in Russia & CIS? (Select one)



in a Russian PE firm. “They have the financing potential, which is a crucial point that differentiates them from other organisations.”

Funding findings

When it comes to financing M&A, dealmakers are exploring a very broad range of funding options as they contemplate future acquisitions, with no single source standing out. Lending will be an important part of the picture – with 19% planning to

use both asset-based finance and the debt markets, but others are looking to equity – both private equity (17%) and the public markets (15%).

It may be wise for dealmakers to keep their options open. “Lenders are being quite conservative following the COVID-19 crisis,” warns the partner of a Russian PE firm. “Even if the financial situation of an acquirer is stable, the financing approvals are not being expedited.”

Sector watch: The COVID effect

In terms of M&A volume in 2021, technology, media and telecoms (TMT) has been the highest-performing industry in Russia, with 32 deals pulling in US\$2.8bn. It is, therefore, unsurprising that 53% of dealmakers pick out the sector as the one that will see most activity in the post-COVID period.

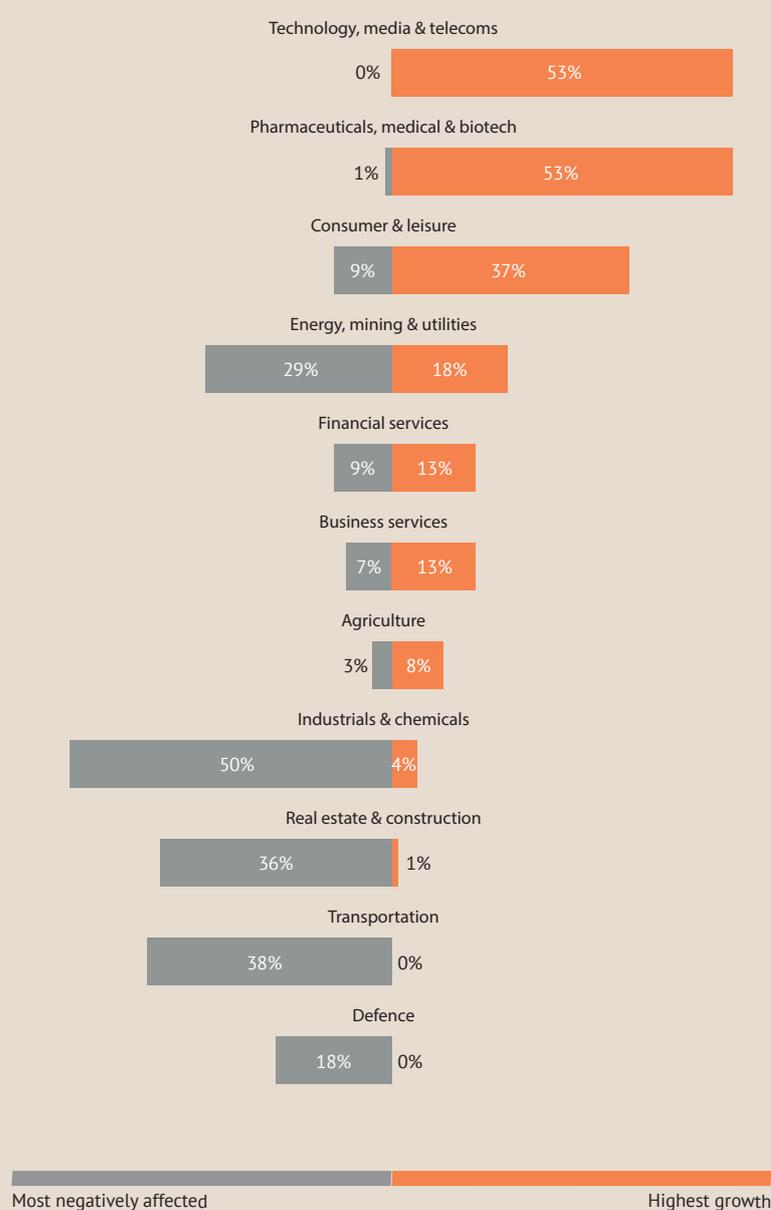
However, seen from the perspective of pure M&A figures, it is somewhat surprising that pharmaceuticals, medical and biotech (PMB) is viewed as being equally strong. In the last five years, PMB has been at the lower end of the top 10 sectors, both in terms of volume and value.

The pandemic is likely to change that. As the CFO of a Russian corporate says: "Amid the health threats, the services of this sector were crucial and the chase for a vaccine has also created additional demand." Russia's success in developing its own vaccine – its Sputnik V has been used in more than 70 countries worldwide – has highlighted the abilities of the country's biotechnologists and scientists.

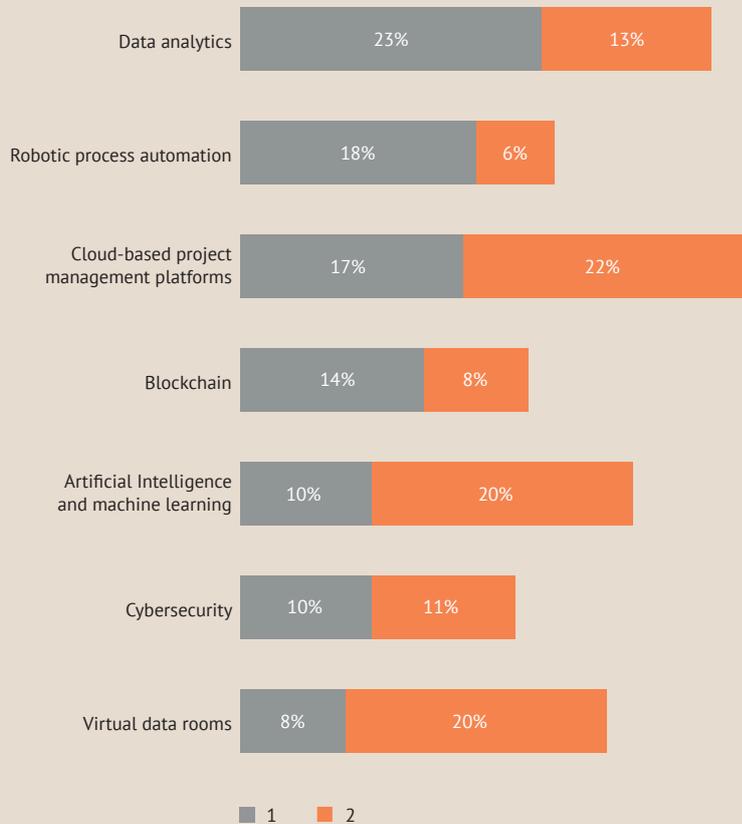
Leading the pack

TMT businesses, meanwhile, are attracting attention in the context of the digital transformation challenge facing so many industries. These businesses are in demand, given the returns they can generate as they sell digital tools and services, but they are also being targeted by strategic buyers anxious to secure their intellectual property. "The high level of technology integration in most sectors is driving positive changes," says the managing director of an investment bank in Kazakhstan.

Which sectors will see highest growth coming out of the COVID-19 crisis, and which will be the most negatively affected by the COVID-19 crisis in Russia & CIS over the next 12 months? (Select two sectors for 'highest growth' and select two sectors for 'most negatively affected')



What technology trends/improvements will most affect M&A processes in Russia & CIS over the next 12 months? (Select top two and rank 1-2)



As for other sectors, consumer and leisure is the only industry where more than a third of dealmakers expect higher levels of growth. And at the other end of the scale, 50% pick industrials and chemicals out as unlikely to see growth. “These companies cannot initiate faster development,” warns the head of strategy at a Russian corporate. “They require huge capital investment for development, and they are not ready for this.”

Notably, 29% of dealmakers pick out energy, mining and utilities as a likely negative area of the market. But ALRUD’s Andrey Zharskiy argues that it would be a mistake to write

this sector off; it may not generate larger volumes of deals, he suggests, but deal values are still likely to be significant. “Given higher energy and commodity prices, it will still be a dominant sector,” he says.

The rise of the TMT sector is also having a direct impact on the M&A process, with dealmakers pointing to a range of areas where advances and emerging technologies now provide significant potential for improvement. Data analytics tops the list, but robotic process automation, artificial intelligence, cloud computing and the blockchain are also key technologies.



M&A tactics: Home and away

As interest in M&A opportunities in Russia and the CIS grows, we investigate the support that cross-border acquirers need and the issues they may face

The pandemic not only affected rates but also the process itself. This is in addition to complexities that were already inherent in the system, such as protectionism and distinct IP legislation. For policymakers keen to support foreign investment in local markets, dealmakers see a number of potential measures that might ease the way.

In Russia, in particular, respondents are keen on measures that would ensure the parties to any deal have a contractual right to take into account new sanctions; 35% support this idea, which would reduce the risk of

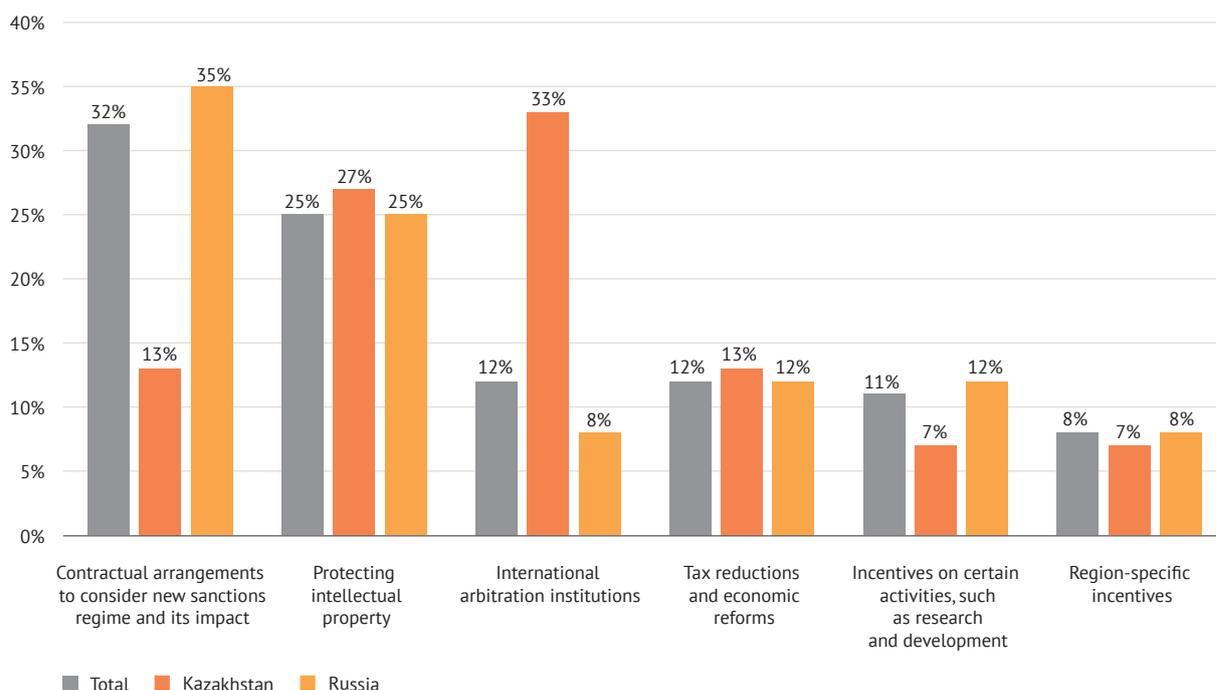
an overseas acquirer investing in a Russian business and subsequently being caught out by a change in policy in the West.

ALRUD's Andrey Zharskiy thinks that 'sanction clauses' will continue to attract attention in the months to come. "There is a risk of further political tension on some of the key issues between Russia and Western countries," he warns, pointing to flashpoints such as Ukraine and Belarus. "That does bring the risk of further sanctions to be addressed in documentation."

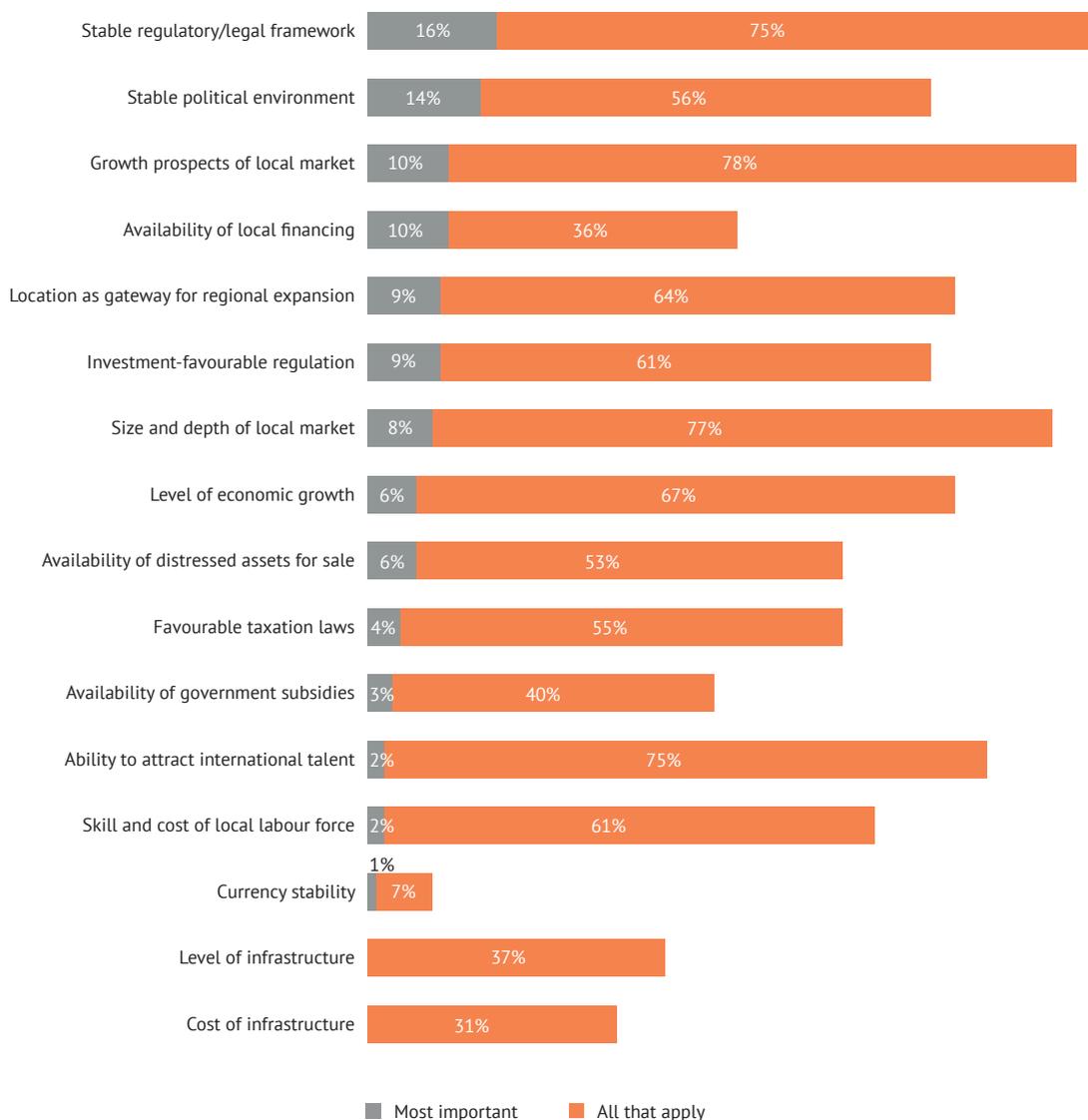
In Kazakhstan, meanwhile, the stand-out area of interest is in a move to work more closely with international arbitration institutions, cited by 33%. "We know that contractual disputes will be discussed in a non-biased way [by such institutions]," says a partner in a Kazakh law firm. "These institutions will have a very specific set of guidelines and rulings, which both sides can depend on."

There is also broad interest in enshrining greater protection for IP, cited as potentially valuable by 27% of dealmakers. "Without certainty about protecting intellectual

What policy changes or additions would be most helpful in facilitating an increase in the number of cross-border investments in Russia & CIS? (Select one)



What are the key factors that will most impact your investment choices outside your home country?



property, cross-border deals will be limited,” warns a Kazakh lawyer. “Foreign companies do not want to risk investing in companies if there is a chance their IP documents are not authentic.”

Keep calm and carry on

Dealmakers crave certainty when they contemplate cross-border transactions. Three-quarters of respondents (75%) say a stable

regulatory and legal framework is a key factor in the investment choices they make in other markets, with 16% picking this out as the most crucial factor. More than half (56%) point to the need for a stable political environment, with 14% ranking this as their most important requirement.

In this context, “Russia provides an example of a very stable political and legal regime,” says ALRUD’s Alexander

Zharskiy. And while a presidential election scheduled for 2024 might be seen as creating uncertainty, “there are no major risks associated with 2024,” he believes. Indeed, says Zharskiy, misconceptions in some quarters have actually created an opportunity. “Russian companies are trading at significantly lower multiples than similar businesses in Europe, so Russia does provide a lot of potential for foreign investors.”

COVID concerns

Some risks and challenges are more controllable than others, of course. Almost a quarter of dealmakers (23%) warn that COVID-19-related challenges represent the biggest risk when making investments in the country of their choice – and this is at least a concern for 70%.

Certainly, Russia in particular has had real difficulties coping with several spikes in infections over the course of 2021, with the country facing some of the worst rates in the world at times during the autumn. It also has disappointing vaccination rates, with only 39% of the population fully vaccinated by the end of November. Vaccination rates have also been disappointing in Belarus, Ukraine, Tajikistan and Georgia, where around 25% are fully vaccinated – though Kazakhstan, at 43% at the end of November, has done better.

Moreover, while Russia's political stability is not in doubt, there are worries about other areas of the region, with 85% of dealmakers in this research citing anxieties of this kind; 70% are concerned about an uncertain regulatory environment.

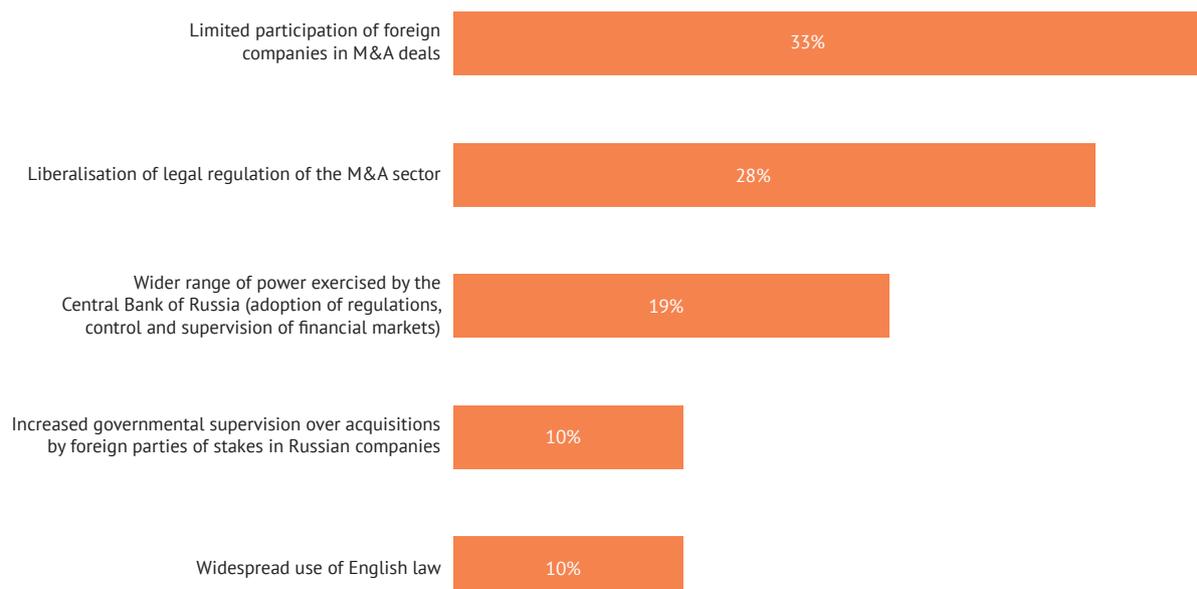
A failure to deal with these risks – at least those that can be addressed – is likely to act as a brake on the M&A market. However, it is not all bad news: 28% of dealmakers suggest liberalisation of legal regulation could have a significant impact on the landscape during 2022. “New liberalisation efforts have started in many countries,” says the CFO of a Russian corporate. “Officials are implementing more liberal rules for domestic and cross-border activity, so that companies can rebuild their operations successfully.”

More worryingly, however, 19% point to the wider range of powers

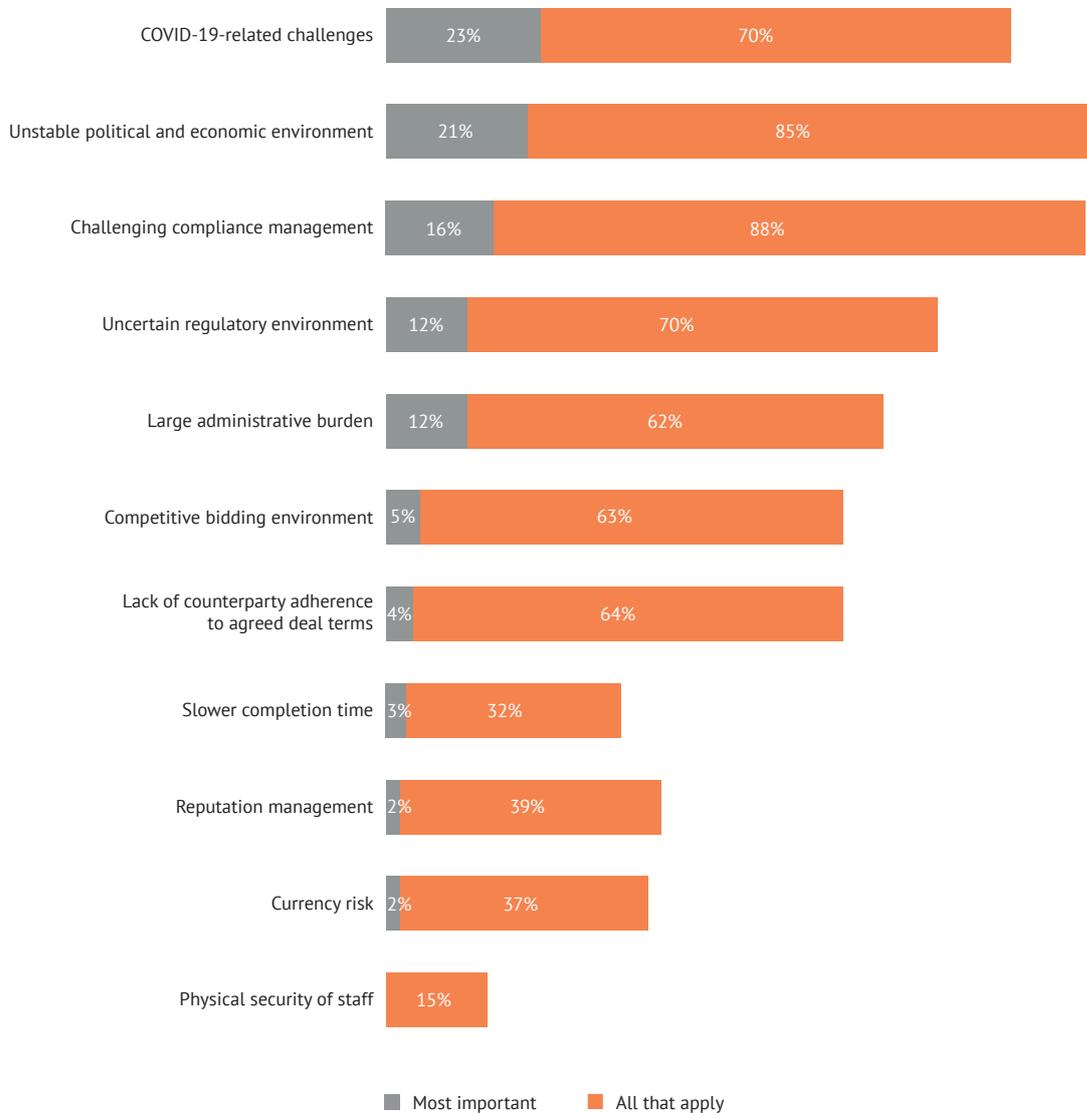
that the Central Bank of Russia is now exercising, and 10% point to increased government scrutiny of foreign investments in Russian companies. A partner in a Russian PE firm says: “When the regulatory framework is strict, investors are very cautious about letting management invest in these regions – they are wary of the long-term repercussions.”

Moreover, there is a danger of a ‘chicken and egg’ situation here. A third of respondents (33%) warn the limited participation of foreign companies in M&A in the region will have the most impact on its legal and regulatory landscape; without overseas acquirers and investors showing an interest in Russia and the CIS, there may be less scope for positive change.

Which of the following factors will have the most impact on the legal and regulatory landscape for M&A in Russia & CIS over the next 12 months? (Select one)



What do you think will be the biggest risks to investing in your country of choice?



Almost a quarter of dealmakers (23%) warn that COVID-19-related challenges represent the biggest risk when making investments in the country of their choice.

The legal labyrinth: A way through

A quarter of dealmakers in this report (25%) rate antitrust compliance as the most burdensome regulation they face when executing deals in Russia and the CIS. That comes as something of a surprise to ALRUD's Anton Dzhuplin. "The majority of deals filed to Russian antitrust authorities are cleared," he says. Clearly, there is some concern among investors about reviews of strategic investments – as we have seen, scrutiny is increasing – but here, too, Dzhuplin argues that most transactions do go through. The key in both regards, he suggests, is for "parties to do their homework and prepare good applications".

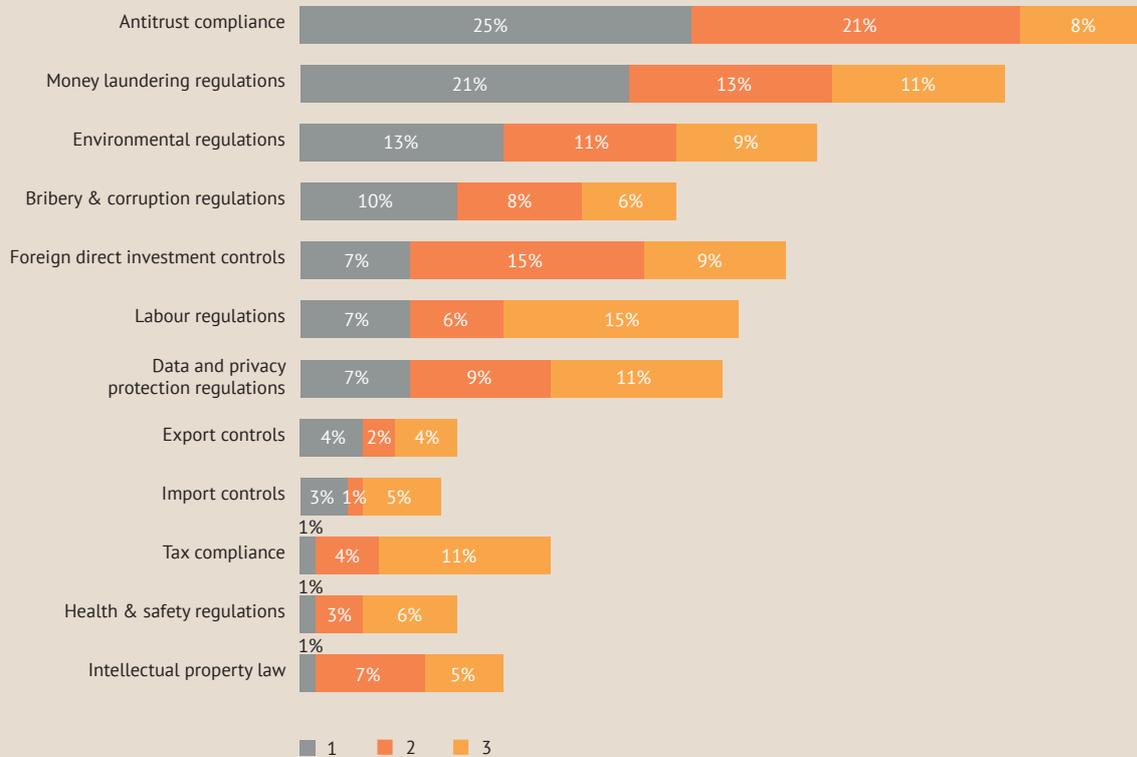
Elsewhere, other prominent issues include the need to deal with money laundering regulation – as authorities in jurisdictions around the world focus on financial crime – as well as environmental regulation. The latter may become even more important in the years ahead, as companies across the region come under pressure to reduce carbon emissions and contribute to climate change mitigation. Already, there have been a number of cases where acquired businesses have faced claims for damages relating to environmental problems from the past.

In the face of these regulatory issues – and broader M&A challenges – 46% of dealmakers in this report say they are likely to make more use of external legal advisers over the next 12 months. In Kazakhstan, that figure rises to 87%.

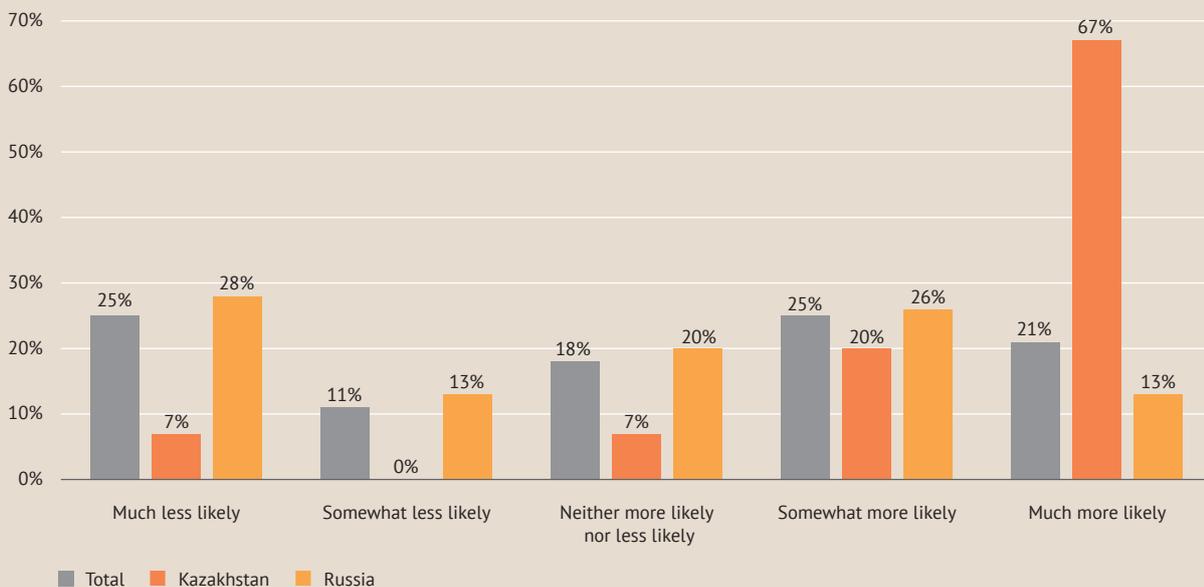
By contrast, some dealmakers do believe they have sufficient in-house legal experience and expertise to manage M&A without recourse to external advice: a third (36%) of respondents envisage reducing their use of external advisers.



What will be the most burdensome forms of regulation that dealmakers must contend with when executing deals in Russia & CIS over the next 12 months? (Select top three and rank 1-2-3)



How much more likely are you now to make use of external legal advisers compared to 12 months ago? (Select one)



The way ahead

While dealmakers remain upbeat over the prospects for M&A in Russia, we reveal five key factors that could expedite deals

The evidence of this report is that the outlook for M&A in Russia and the CIS is positive, with more dealmakers considering transactions and appetite increasing for activity in a range of sectors. This is not to predict a surge in deal volumes and values in 2022; challenges persist, from factors applying to markets worldwide, such as the possibility of further COVID-19 disruption, to local issues such as the difficulty for foreign investors in dealing with sanctions.

Nevertheless, after a relatively flat year for M&A activity in Russia and the CIS during 2021, the economic backdrop, the need for strategic consolidation and investment in technology, and the weight of PE capital all have the potential to drive the marketplace over the year ahead. Reasonable valuations add to the attractions of the region. To exploit the opportunity, however, dealmakers will need to:

- **Adjust expectations and assumptions to account for COVID-19.** Building contingency into deal structures and negotiations will be important. “Margins and profitability have decreased for some businesses,” says ALRUD’s Alexander Zharskiy. In such an environment, recent performance figures may be misleading – and visibility of future earnings will be more difficult.
- **Resolve the practical difficulties of due diligence.** While COVID issues have made due diligence

more difficult, limiting the ability to travel and meet face-to-face, innovation has a role to play. For example, 28% of dealmakers see virtual data rooms as supporting deal processes. If anything, due diligence now needs to be more thorough, says ALRUD’s Anton Dzhuplin. “With this shift to technology-related deals, the process of due diligence – specifically of intellectual property – has become more sophisticated and complicated.”

- **Be prepared for greater regulatory scrutiny.** More than a third of dealmakers (36%) cite antitrust regulation as a deal challenge, and advisers warn that Russian authorities are now more likely to scrutinise foreign investors’ bids for strategic assets. But with preparation, these obstacles should not be deal killers, says ALRUD’s Alexander Zharskiy. “The time it takes to obtain antitrust clearance in Russia is actually significantly shorter than in some other emerging markets,” he says. “And the trend towards strategic investment laws is a global trend.”
- **Explore a wide range of funding options.** With just 7% of dealmakers expecting to finance acquisitions from cash reserves, securing the right kind of funding for transactions is crucial. “State-owned and state-linked banks have capital to deploy as revenues from last

year’s higher energy prices flow through the system,” suggests ALRUD’s Andrey Zharskiy.

- **Get ready to move quickly.** Amid increasing competition for the best assets in the region – 63% of dealmakers point to the competitive environment as an investment risk – transactions are being completed more quickly. “Negotiation processes are typically taking two to four months, compared with four to six months a couple of years ago,” says ALRUD’s Anton Dzhuplin. Bidders not able to move quickly risk missing out to more fleet-footed rivals.

About ALRUD

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We provide full scope of legal services to local and international clients in the areas of corporate/ M&A, competition/antitrust, banking & finance, intellectual property, commercial law, data protection/cybersecurity, dispute resolution, white collar crime, compliance and investigation, inward investment, employment, restructuring/insolvency, real estate and tax.

Our clients include blue-chip multinationals, privately owned companies and Russian State-owned enterprises.

Outside of our domestic market, our clients are spread across Europe, Asia, North and South America.

ALRUD serves clients across a range of industries including energy and natural resources, mining, banking and finance, consumer goods and retail, investment management, government and public services, healthcare, life sciences and chemicals, industrials, technology, media and telecoms, transport and logistics.



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