

Russian M&As: Successful Deals on the Growing Mid Market

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Growing mid market

Despite the global credit crunch and high volatility in capital markets, in the first half of 2008 the volume of deals on the mid-market M&A sector of Russia increased as compared to the same period of 2007. The mid-market M&A deals are defined as deals of a size between USD 50 and 250 million in enterprise value. Companies on this market look attractive to domestic and foreign investors as they offer access to the growing markets in Russia and do not require as much financial resources as larger companies. Moreover, larger Russian companies and financial investors see these deals as an opportunity for consolidation. Therefore, despite generally unfavourable financial environment we expect the mid-market M&As to remain stable or even to increase over the medium term.

In the first half of 2008 the number of mid-market deals increased by 30% as compared to the first half of 2007, and amounted to about 60 deals. The size of deals also increased by about 40% and averaged at USD 120 million. Moreover, the share of the deals executed in the mid-market in 2008 reached 65% with the most active sectors being the consumer goods manufacturing, industrials and TMT (telecoms, media and technology) sectors.

There are several factors that facilitate the development of the mid-market M&A sector. Firstly, the quality of companies operating in the mid-market is increasing. Corporate governance practices are increasingly adhered to, ways of conducting business become more transparent and the quality of financial reporting improves. International investors, in turn, become more familiar with the Russian market. At the same time, many companies enjoy strong growth prospects, which result in high valuations.

Successful deals

A successful deal in the mid market requires a lot of effort, both from the seller and the buyer, and from the advisors. However, only professionally executed deals bring benefits to both owners and buyers/investors.

To benefit from the M&A deal on the mid market, companies' owners should prepare and execute the sale professionally. The sale process can be divided into 4 major stages – preparation, marketing, due diligence, and negotiations, signing and closing. On average, the whole process from start to finish takes about one year in Russia.

There are several issues crucial to the successful execution of such deals. First, it is the ability of the company and the advisors to prepare the business for sale. The owners of the business together with their advisors should prepare management accounts which correctly reflect the state of the business and are understandable to international investors, work out the structure of transactions that will minimise the risks for investors and increase the proceeds for the seller, and secure a basis for further development of the business on the “clean” platform.

It is also crucial to identify the list of investors that are likely become interested in acquiring the business. In general, investors can be broadly categorised as financial and strategic investors. Financial investors will stay with the business for several years, after which they will seek to realise their profit by exiting the business via a Trade sale or an IPO. Strategic investors will generally stay with the business for a longer term. It is generally observed that prices offered by strategic investors are higher than prices offered by financial investors. However, financial investors are more comfortable with minority stakes, while strategic investors prefer to acquire a majority stake.

Finally, it is important to properly prepare for negotiations. The sellers should understand the specifics of legal documentation that accompanies to the deal, and carefully determine their position in negotiations. For deals involving a foreign party, the deal documentation is usually prepared in accordance with the English law, which allows protecting both the buyers' and the sellers' interests. In addition to the price negotiations, the most important issues to agree at are issues of control over the future company, and warranties related to the company's past operations.

Overall, we believe that the potential for mid market M&A in Russia is high, but it will take an effort by all of the market participants to make the Russian market as efficient as some of the M&A mid-markets in the West.