

# M&A activity in the Baltic Regions

Estonia, Latvia and Lithuania make up the Baltic States situated in the North East of Europe adjacent to Finland, Russia, Poland and Belarus.

**The area has a chequered history with the three countries gaining independence in the aftermath of the First World War, but coming under Nazi, and subsequently, Soviet occupation until regaining their independence in 1991 with the collapse of the USSR. All three countries are member of the European Union and their economies have developed rapidly since independence in the early 1990s.**

Industries such as communications, retail, manufacturing and healthcare have all expanded significantly in the Baltic States and consolidation has begun in earnest with bigger domestic companies and multinationals acquiring smaller rivals to expand their presence in the Baltic region.

## Private equity and venture capital

Much of the deal activity to date has been through trade purchases or bank debt funded buyouts. Private equity and venture capital money has not played a big role in the Baltic corporate finance scene.

Figures from the European Private Equity and Venture Capital Association (EVCA) show that private equity fundraising is on the up in the Baltics, but is still at relatively low levels compared to other European regions.

Figures from 2007 show that Latvia and Lithuania received private equity and venture capital investment of around €159 million each (0.79% and 0.57% of GDP respectively), with Estonia receiving €52 million (0.332% of GDP).

Peeter Saks is the managing partner of private equity firm Baltcap, one of the few private equity players based in the Baltic region. The firm was established in 1995 and has made 38 investments worth €130 million in that time, with 23 fully exited.

The most recent investment was a 75% stake in Quattromed HTI Laborid OU, the largest private medical diagnostics company in Estonia.

Mr Saks says the private equity investment figures are influenced by one or two large deals and, in reality, the deal activity is quite uniform across all three countries.

He said: "These figures most likely include one buyout of a GSM operator in Lithuania by MidEuropa and a triple play telco in Estonia by Bancroft. In Latvia, the figures could include the proposed privatisation of Lattelekom by Blackstone. As all Baltic country markets are still small, the split can be affected by some large transactions year by year."

The EVCA figures also show that early stage and seed funding is underdeveloped in the region. Around €238 million of investment money was used as buyout capital in 2007, with €120 million used as replacement capital and just €10 million used for start-up or expansion capital.

Mr Saks said: "Early stage has been an orphan indeed and has mostly been financed by friends and family or business angels. I am confident, though, that there is much more finance than €10 million available. In the range from €1-3 million, there is a huge pipeline of deals to be done, but almost nobody is targeting that segment for investment right now."

Venture capital and start-up funding has been largely absent from the Baltics because of the availability of cheap debt, however, in the current economic climate, this is changing quickly.

Mr Saks added: "Bank funding used to be cheap and easily available, so it was the natural choice for entrepreneurs. This has changed dramatically since late 2007 and today venture capital is very much sought after, with entrepreneurs becoming more and more aware of what VC/PE is and what it brings."

## The M&A Environment – Multinational v Domestic Trade Buyers

The deal environment in the Baltics is very difficult at present with many companies chasing the small amounts of money available.

Bank funding has dried up and, as a result, most deals are being completed by multinational or large domestic trade buyers

less in need of significant debt or equity funding.

Raymond Slaidins, head of the Corporate and M&A practice group at Klavins & Slaidins LAWIN, in Riga, said: "The story right now is that strategic investors are coming in and picking up Latvian companies at a lower price than they have before. Typically these companies have their own money so don't have to finance the transaction. Multinational trade buyers have been our typical clients and the typical industry transaction in The Baltics."

He added: "The bulk of M&A activity has come from industry players. Most European players are from Scandinavia, firms from the Scandinavian region inject more than 60% of the Baltic region's FDI; the same is true of M&A activity. There is not as much influence from Russian investors as you might expect, they tend to focus on the big natural resources, utility investments or strategic infrastructure that can be controversial."

Peeter Kutman, partner and head of the Transactions team at Luiga Mody Hääl Borenius in Tallinn, supports the view that much of the deal activity is driven by Scandinavian businesses strengthening their position in the Baltic region. Despite this, he says there are still a significant number of domestic trade deals taking place.

He said: "During recent years the transaction flow has been high and the transactions vary from large international companies purchasing local companies, to domestic mergers. Our track list covers assignments from very different fields, such as the sale of the Estonian card payment processing company by Swedbank, SEB and Sampo bank (our clients) to leading Scandinavian operator Northern European Transaction Services (NETS) through auction."

He added: "We also advised on the purchase of "Delfi" Portal, the largest online media company in the Baltics, by Ekspress Grupp, the Tallinn Stock Exchange listed company."

Ieva Azanda is a senior associate and member of the Transactions practice at Liepa, Skopina / BORENIUS in Riga. She says that she has worked with a number of foreign investors recently, providing legal advice on the acquisition of telecommunications company BITE by Mid Europa Partners. Last year her firm advised on the acquisition of electronic communications firm Izzi by Contaq and the acquisition of gambling firm Admiralulub by Austrian Gaming Industries.

The Lithuanian market for M&A activity is very similar to the other Baltic states with companies from abroad and some local large companies and VC and PE firms active in the market.

Eugenijus Filonovas is a senior associate in the Transactions, Banking and Finance Group at Foigt & Partners / Regija Borenius in Vilnius.

He said: "The major deal in 2007 was the acquisition of UAB Bit Lietuva, a mobile telecommunications operator in Lithuania, and its subsidiary in Latvia, by leading central and eastern European private equity group Mid Europa Partners. We also advised one of the major international banks involved in the deal."

He added: "There was the acquisition of UAB Palink,

one of the leading operators of supermarkets chain IKI, by the Coopernic Group. Enterprise Investors also bought UAB Novaturas, the largest tour operator in the Baltic States. Private equity investor BaltCap purchased the Interinfo group companies in Lithuania, Latvia and Estonia, which is a leading operator of 'yellow pages' and electronic directories in the Baltics."

## Legal Frameworks in the Baltic Region

The legal systems in the three Baltic countries do differ, but none appear to present any significant hurdles to deal making.

Mr Slaidins believes the framework is similar across the entire region.

He said: "There are some specific situations regarding each country, but the framework for a typical M&A transaction wouldn't include anything that a savvy investor wouldn't expect; some local legal issues but nothing serious. We can usually use most of the provisions of international agreements and tool them for use in the Latvian legislative environment."

He added: "Most problems occur when implementing operations after a deal has been completed, rather than with the deal itself. The three countries are different enough so that you need slightly different operations in each country, for example employment law."

Mr Kutman said: "Estonia does not have specific set of regulative acts for private equity investments but we believe the general legal framework to be sufficient to support the deals. Estonian legislation regulates the rights and prohibitions of an investor quite well and gives enough protection to mitigate the risks."

Despite this he does have some criticism for the law in its ability to protect small shareholders.

He added: "The rights of a small shareholder are not well protected neither in practice nor theory. Therefore it is essential in the case of purchasing a minority shareholding to conclude a shareholders' agreement in which the management of the business is regulated, also responsibility, information exchange and prohibited/allowed transactions."

Ms Azanda said: "The Latvian legal framework is flexible enough to allow the structuring of VC and PE deals without any specific regulatory provisions governing the industry. The same refers to the overall M&A framework. Although, in the general M&A market, foreign law is often used, leaving Latvian law to be applied only in cases where it cannot be contracted out."

## Predictions for 2009

A continuing shortage of bank finance and a differential between seller and buyer expectations is likely to make 2009 a quiet year for deal making.

Mr Slaidins believes that a rapidly rising inflation rate has been replaced by the economic

downturn as the major economic issue in Latvia.

He said: "Inflation was up at around 15%, but has now fallen to 11% as the economy cools. Multinationals will continue to buy smaller firms in the Baltic countries as they try to create a presence in areas they weren't in before."

Ms Azanda, from Liepa, Skopina / BORENIUS is not optimistic about the chances of the deal market improving in 2009.

She said: "2009 is likely to see more mergers between local companies struggling to reorganize, survive and in some cases also increase their market shares. Also, instead of financial investors, the overall prognosis could be that strategic investors are more likely to invest in the region. Overall, the M&A market currently experiences a standstill period, so it is hard to predict that substantial increases in the activity will take place in the near future. To a large extent that is due to the very limited availability of financing."

Mr Saks, from Baltcap, sees 2009 as a good opportunity for brave investors.

He said: "For now the markets remain turbulent. A lot of companies are for sale or need extra capital, but there are very few investors around who have money to invest. Also the pricing remains an issue, as it is quite hard to match the expectations of sellers and buyers in this volatile environment. That said, 2009 will still probably be one of the best years to invest provided one selects investments carefully."

Mr Kutman, from Luiga Mody Hääl Borenius, believes private equity should become more prominent in the Baltic regions during 2009, because of the lack of bank finance.

He said: "The beginning of 2009 is probably still very quiet – sellers' expectations have not yet 'come down' and buyers are waiting for the prices to come down."

Due to the overall financial situation in the region, the trend for 2009 seems to be that there shall be more transactions from the strategic investors, also mergers between the competitors. However, as bank financing is very limited, this will give a chance for private equity companies to be more competitive."

Mr Filonovas, from Foigt & Partners / Regija Borenius, also believes a price expectation differential will make it hard to get deals done in 2009.

He said: "There are a lot of companies which need additional capital or are for sale. Local and Scandinavian VC and PE firms declare that they have money and are looking for possible targets for the investments, therefore VC and PE firms will be the main players in the Baltics M&A market during the year 2009."

He added: "Price is still the major issue, the owners of the companies, which are attractive for the VC and PE firms, still expect to receive the high price, while VC and PE firms look realistically."

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