PRUDENTIA M&A FOLIO

BALTIC M&A OVERVIEW

May – Aug 2015

Deal Overview

M&A activity in period from May to August, 2015 has risen significantly if we compare with first four months of the year. Such trend has been present for couple of years already. Number of deals in May-Aug period is 60, which is 40% increase from 43 deals in the beginning of the year. Last year the increase in respective periods was 24% (from 50 to 62 M&A deals). Despite the so called “vacation season”, June and July were the most active months this year (17 and 19 deals respectively).

Comparing the year-to-date M&A activity to the same period last year, we can observe a decrease. Current geopolitical crisis still has an impact on interest from foreign investors. Many companies’ exports decreased due to sanction and embargo from Russia. On one hand, this directly replicates on the M&A activity. On the other hand, such downturn can give opportunity for many investors to buy cheap if more distressed assets occur.

Another thing influencing the current M&A activity is the effect of the decrease in oil prices. Companies that use oil as their raw material or consume fuel in large quantities will benefit from current fall. This effect has two outcomes - it makes these companies to look more attractive and it frees resources for the companies to look for new acquisitions.

Largest Deal by Value in May – August 2015

Largest Baltic M&A Transactions in Period May – August of 2015*

Target Company (Country)	Acquirer (Country)	Deal Value (M EUR)
Latgran (LAT)	Graanul Invest (EST)	104
Real Estate object (LIT)	Promola (LIT)	40
Vorguteenus Valdus (EST)	Elering (EST)	19.9
Eco Baltia (LAT)	The European Bank for Resconstruction and Developemnt (UK)	10
Finasta (LIT)	Siauliu Bankas (LIT)	6.4

**NB: Table included only deals with publicly available transaction value.*

Latgran is Latvian based producer of wood pellets. In May 2015 Latgran announced that BillerudKorsnas AB and Baltic Resources AB have signed an agreement to sell the company to AS Graanul Invest for 104 M EUR. According to public sources on the July 2nd owners of Latgran have changed and the deal is closed.

Graanul Invest is the largest wood pellet producer in the Baltics, with 4 production factories in Estonia and one in Lithuania. This industry is very developed in the Baltics and this merger made Graanul Invest the largest European wood pellet company and one of the leading global players.

Siauliu Bankas engaged in several M&A activities in May 2015. First of all, they signed an agreement with Promola UAB to sell few real estate objects in Vilnius for more than 40 M EUR. Later, they announced that they also have signed an agreement to acquire 100% of AB Bankas Finasta and financial brokerage firm AB FMI Finasta for 6.4 M EUR. After the announcement the deal received the necessary approvals from Competition Council and from Bank of Lithuania.

The European Bank for Reconstruction and Development (EBRD) acquired a minority stake in Eco Baltia, a leading provider of waste treatment in Latvia for 10 M EUR. Money will be used to finance construction of a mechanical biological treatment plant for household waste.

Geographic Location

According to breakdown of the deal count between the Baltic countries, Estonia took the lead with 26 deals, followed by Lithuania with 24 deals. Latvia was involved in 16 transactions during the period from May to August 2015.

Lithuania still is more popular among non-Baltic investors, however, by very small margin. Foreigners invested in 6 Lithuanian companies, in 5 Estonian and 4 Latvian companies from May till August of 2015.

Only one Lithuanian company acquired company outside Baltics. NDX Group - a part of a group which has divisions and operations across 15 European countries, including Maxima, acquired Lantmännen Doggy - cat and dog food producer in Sweden. Transaction value is undisclosed, but sales of the company were approximately 60 M EUR and number of employees is around 170.

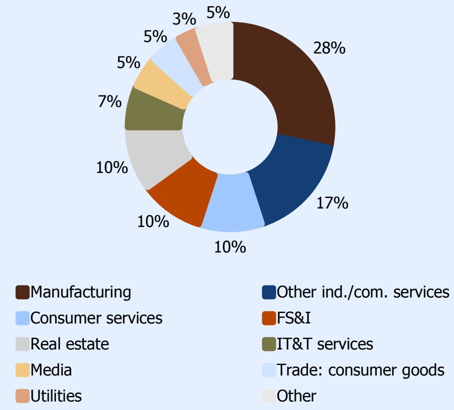
Industries and Deal Types

Manufacturing sector was the most prolific for the number of deals in period from May to August in 2015 (with a 28% pan-Baltic share). Almost half of the deals in this sector involved companies from Latvia (8 out of 17 deals). 4 manufacturing companies were acquired from Lithuania, 4 from Estonia, and 1 deal involves the above described Swedish manufacturer. This sector has already before been the most attractive for the investors in this region, and can be explained by lower production costs and lower share of other industries that are among the most active in M&A deals globally, like IT&T companies.

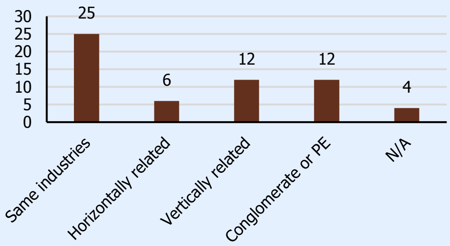
As usually most of the investors are corporate strategic investors accounting for roughly 70% of the total deal count. And most of the deals were observed in the sub-segment where an acquirer and a target operated in the same industry.

According to publicly available information, all announced M&A, PE, selected VC and selected real estate deals in Baltics in the corresponding time period are reviewed in this report.

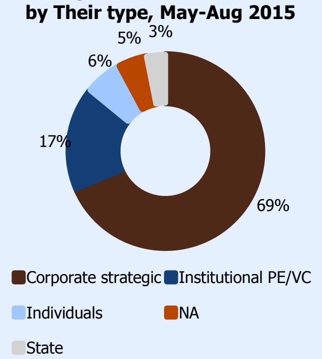
Percentage Breakdown of Deal Count by Industry, May-Aug 2015



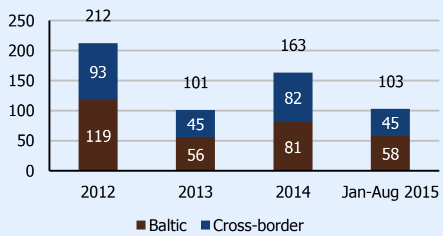
Breakdown of Deal Count by Relatedness of Acquirere and Target, May-Aug 2015



Percentage Breakdown of Investors by Their type, May-Aug 2015



Breakdown of Deal Count by Geographic Parameters



Sources: S&P Capital IQ database, Advisors' homepages, NASDAQ OMX Baltic, Bank of Latvia, Bank of Lithuania, Bank of Estonia

Slump in Energy Prices

One of the biggest global surprises in 2014-2015 was significant drop in oil price. Even though after the slump many people come up with the claim that they had predicted it, generally people were not ready for such shift.

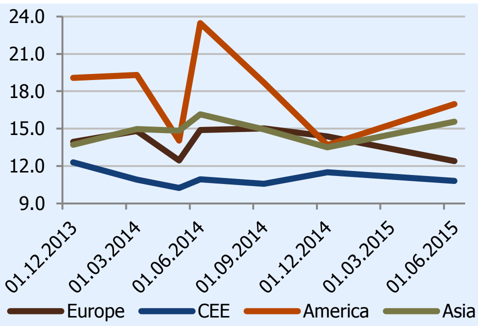
The importance of oil price is hard to overestimate. Contrary to ordinary shares, oil prices does not influence only wealth of one company's shareholder. Oil influences performance of many industries, budgets of many countries. Therefore it is very important to know future price for planning. However, forecasts for next year vary from 20 to 100 USD for barrel. Definitely, someone will be right.

Currently we won't try to predict what will happen to the oil, what interests us is what is happening right now with companies operating in the energy sector and companies consuming it.

Energy Price Effect on Capital Markets

A useful measure to look at, when analyzing the investor's expectations in context of the companies' financial performance, is price-to-earnings (P/E) ratios. P/E is more than a measure of a company's past performance. It also takes into account market expectations for a company's growth, since stock prices does not indicate company's value in vacuum, but it also includes investors' expectations.

In the table below we can observe how P/E has changed over last 3 years for companies operating in energy sector.



Source: Capital IQ Database

As you can see P/E ratios were steady/slowly growing and in second half of 2014 P/E ratios significantly dropped for American (from 23.5 to 13.7) and Asian (from 16.1 to 13.5) companies, European companies multiple fall as well, but to much less extent. This period corresponds to the fall in oil price (oil crossed 100 USD benchmark in late July (WTI) and in early August (Brent).

American, especially USA, companies were hit much stronger by oil price volatility. USA companies heavily invested in shale oil extraction, average breakeven price for which is 58 USD per barrel. For some projects breakeven price reaches 80 USD per barrel. So with current oil price it is not difficult to understand why markets are so skeptical.

Political issues only add complexities for energy companies. For example, Exxon Mobil terminated 9 out of 10 oil projects in Russia due to imposed sanctions and uncertainty in the market.

In addition to the reaction of oil price reduction on energy companies, other industries are also influenced by the low oil price. Below are some of the examples:

P/E by industries	31.12.2013	30.06.2014	31.12.2014	30.06.2015
Construction Machinery	15.3	17.5	15.8	15.0
Industrial Machinery	19.8	20.5	18.7	19.2
Steel	17.3	18.4	16.4	13.8
Airline	15.3	14.6	20.4	12.6
Marine transportation	14.3	14.2	12.9	12.0
Road and Rail transportation	19.2	21.0	20.8	17.7

It might seem that production companies (like construction and industrial machinery producers) should benefit from lower energy prices, however many of the industry players are producing for oil industry. With such oil price energy companies are much less likely to invest in new facilities, which influence other levels of supply chain.

Transportation industry was affected differently, even though fuel costs comprise significant part of the costs in all sectors of transportation industry. Airline industry was affected the most positively – P/E increased rapidly and together with oil prices they stabilized in first half of 2015. Outlook on marine transportation was even negative, which might be due to significant share of oil transportation in this sector. Share of fuel expenses in Road transportation is similar to Airline, however Rail transportation is also dependent on electricity (which only partially is influenced by oil price due to electricity generation methods). This in part explains the unaffected P/E ratio of Rail and Road industry.

M&A Activity in Energy Sector

Comparing to financial markets, strategic decisions are not so volatile, since involved more long term planning. In 2008 oil price surprised everyone with similar fall, however prices rebounded in few months (not to the same level, but much closer to 100 USD level than nowadays). At that time it almost did not influence M&A market at all. However, what we see now is completely different picture. Oil price fell and is at this level already for a year. Such long-term price shift leaves an impact on long-term valuations, which consequently affects M&A market, however with a lag. Therefore it is expected that we will be able to observe increased M&A activity, which will be initiated by this change in valuations.

M&A market in 2015 has already shown some increased activity. The largest deal was takeover of BG Group Plc by Royal Dutch Shell Plc. This 70-billion USD deal was announced in April and was subject to regulatory approval in U.S., China, the European Union, Australia and Brazil.

Complexity to this deal adds the fact that regulators have to be sure that Shell does not gain market power on several markets, namely Oil and gas exploration, liquefaction of gas, wholesale supply of liquefied natural gas.

So far the deal has been approved by the U.S. and EU competition authorities.

This deal made ground for rumors for even larger deal. Oil company BP (previously British Petroleum) was considered to be a perfect match for Shell, however after acquisition it is not in position to make such big investments. So the next candidate for this merger is Exxon Mobil, which is the largest oil company in the USA, the largest listed oil company in the world, and 4th largest oil company in the world by revenue. BP is 6th largest in the world. Merger would make Exxon Mobil the largest oil company with huge margin. However, size ambition is not the only reason for this deal, but also the possibility to gain from BP's weak financial situation making its valuation more attractive.

Moreover, Exxon Mobil has triple A rating from S&P and Moody's credit agencies. It provides opportunity for the company to obtain cheap financing for the deal.

Baltics

Effect of fall in energy prices is in fact estimated to be positive in the Baltics, because none of the companies operating in the energy sector have large oil refinery projects. This is because we are oil importers, not exporters, meaning that the economy will overall gain from the reduced energy prices. The drop in oil price in the Baltics have the largest impact on the end users of the energy. The financial performance of the energy supply companies, like Latvijas Gāze will be barely influenced since the gas prices to end users are directly tied to the oil price (maybe only due to a change in demand, which is however not expected to be significant).

As for the electricity price, in summer of 2015 in Latvia it fell by more than 20% to compare with the summer before. This has been influenced by the fact that during summer time the electricity needs to be generated by own production capacity of Latvenergo in CHPPs, which uses natural gas as the raw material (therefore influenced by the gas price). In a way Latvenergo became more competitive, which will have an effect on their performance. In addition, the electricity buyers that fixed the price last year mostly did not forecast this extreme price drop, therefore Latvenergo will have positive effect on their financial performance also through this aspect.

Overall, the gas and electricity end users (especially such heavy users as manufacturing, transportation and other companies) will gain from the global drop in oil price, through reduced expenses for gas and electricity. This positive effect is expected to reflect in increased transaction activity through development of these companies.

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