

Financial Services in the CEE region

A mergermarket study on Financial Services activity in Central & Eastern Europe



In association with





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Foreword

CMS and mergermarket have published the following report in order to shed some light on current Financial Services (FS) activity in Central and Eastern Europe (CEE). It provides an in-depth analysis of 2008 activity and takes a look forward at this year's deal prospects. It also uncovers market sentiment through a survey of leading FS executives and contains features looking at the impact of the credit crisis and M&A regulation in the region.

2008 was a year of change for deal makers, and the air of uncertainty looks set to continue. However, those involved in deals have become more savvy and aware of the current environment and are thus better equipped to cope with the year ahead.

The volume of deals in the FS sector in CEE has undoubtedly dropped; in Q4 2007 31 deals were completed whilst in Q4 2008 there were just under half of that with 15 deals completed.

Evidently CEE is not immune to the wider global economic problems and this is no surprise given that many of the large companies, which have been at the root of the crisis, have subsidiaries scattered across the region. Even so, many deals may not be aborted, but merely postponed until a more agreeable time. Of the respondents surveyed over half believe that the level of private equity buyouts in the CEE FS sector will increase in 2009 and 47% judge that low valuations will be the primary reason to conduct acquisitions.

It is clear that in the difficult economic environment of the coming year, seeking the right advice is essential. CMS has an active and efficient team working in the FS sector and has a first class reputation in CEE. We provide strategic advice to many international players on domestic and cross border deals.

If after reading this report you would like to discuss any aspects of the Financial Services sector in CEE and the CIS region we would love to hear from you.

Helen Rodwell

Head of Corporate, CEE
CMS Cameron McKenna



Historical data and analysis

Leading CIS/CEE Financial Services transactions 2008

Interros Company's €4.64bn purchase of a 50% equity stake in fellow Russian investment fund KM Invest from Onexim was by some way the largest financial services deal transaction in the CIS/CEE market during 2008. However, the deal between private investors was somewhat exceptional, standing well above the year's other deals and bucking prevailing market trends in what proved to be a slower year for transactions in the region.

Leading the market, defying trends

During 2008, 78 transactions were completed within the CIS/CEE region, a significant decline from the 115 recorded in 2007. Yet, in contrast, total deal value for 2008 stood at €17.5bn, a marginal decrease on the €18.4bn invested in the previous year.

In May 2008, Russian billionaire Vladimir Potanin's investment fund vehicle, Interros Company, acquired a 50% stake in KM Invest ZAO from Onexim Group, owned by Potanin's former business partner Mikhail Prokhov. KM Invest manages the assets of Potanin and Prokhov. The deal brought to an end the wrangling between both men over the division of their assets. Under the terms of the agreement, Onexim will buy from KM Invest a 27.5% stake in Open Investments, a real estate investment company, and 91% of shares in insurance company Soglasie.

As mentioned, at €4.64bn, the value of Interros's transaction by far eclipsed that of all other acquisitions within the CIS/CEE's Financial Services sector during 2008 with all the other top deals in the region totalling €700m and less. All in all, this anomalous deal should be somewhat discounted from many of the trends that have otherwise characterised the Financial Services sector this year. There is marked disparity between the volume and value measures of deals, their sector and geographic spread.

Deal flow by subsector

The difference between volume and value of M&A within the Financial Services sector spread also betrays the impact of the Interros deal. Banking and insurance related services accounted for 46% and 20% respectively of the number of deals, with fund management standing at just 8%. However, thanks to Interros, fund management deals represented 27% of the value of all transactions, compared to 47% for banking and 11% for insurance.

The geographic breakdown of the figures reveals that while M&A in Russia accounted for 43% of the volume of all transactions made within the CIS/CEE region, it also accounted for 71% of total deal values. Meanwhile, Poland made up 13% of total CEE deal volumes yet just 8% of overall valuations while the Ukraine and Slovakia, which accounted for 7% and 5% in volume terms respectively, represented a combined 9% of the total deal values. The bottom five performers – Macedonia, Azerbaijan, Belarus, Latvia and Lithuania – together accounted for 16% of the total number of deals, and yet just 1% of total value.

Perhaps of most significance has been the disparity between the volume and value of intra-regional and inbound investments made within the region. There was a near 50/50 split in terms of deal volume between intra and inbound investors, with each notching up 29 and 31 deals respectively. Meanwhile, intra-region investment for the period totalled €5.7bn, compared to an inbound cross-border investment total of €4.6bn.

As well as accounting for the highest volume of deals, inbound investment also accounted for 14 of the 20 most valuable deals during 2008. Indeed, after Interros and NPF Gazfond's purchase of a 4.5% stake in Gazprombank, eight out of the top 10 deals featured Western European buyers. The buyers and target companies of the next three largest acquisitions made after Interros provide a clearer illustration of the dominant trends during 2008 within CIS/CEE's Financial Services M&A activity:

Historical data and analysis

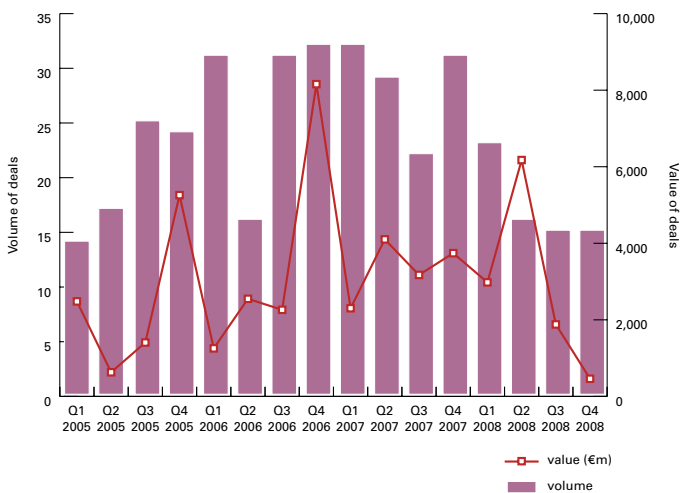
Leading transactions

One of the largest investments made last year was French firm Groupama's purchase in February of OTP Garancia Insurance for €612m from Hungary's OTP Bank. Groupama, a financial services company, bought the insurance company as part of Groupama and OTP Bank's joint commitment to form a CEE regional partnership. Under the terms of the agreement, Groupama also acquired OTP Garancia's wholly owned subsidiaries in Bulgaria, Romania and Slovakia. Additionally, Groupama acquired 8% of OTP Bank as part of the deal.

The fourth largest transaction saw Italian banking group Intesa Sanpaolo announce its purchase of Ukraine's Pravex-Bank Joint Stock Commercial Bank for a consideration of €516m in June. The deal was in line with Intesa's strategy of expanding its operations in CEE.

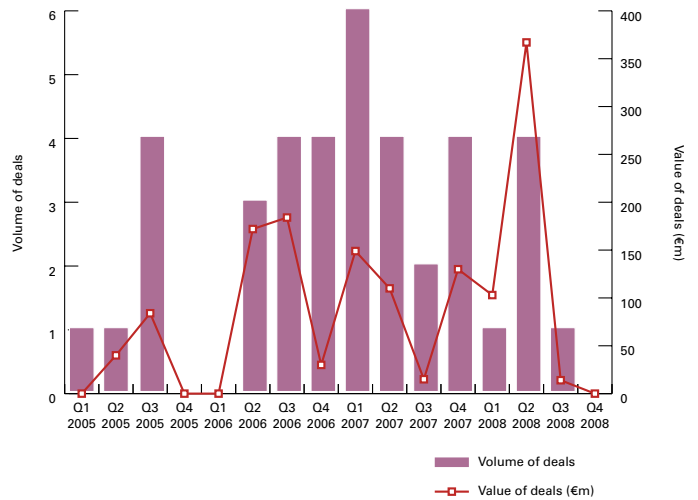
Britain's Barclays also helped to exert a decidedly Western European grip on the CIS/CEE this year, following its €487m acquisition of Russia's Expobank Commercial Bank from holdings company Petropavlovsk-Finance. Expobank has a presence in Moscow and St Petersburg, but is primarily focused on corporate and wholesale clients in western Russia. The deal reflects Barclays strategy of increasing its exposure to emerging markets, with Expobank becoming assimilated within the Barclays GRCB Emerging Markets business.

CEE Financial Services M&A Trends: volume and value of deals



- Interros's acquisition of a 50% stake of KM Invest in Q2 2008 caused the highest quarterly peak in deal value, in spite of an overall downturn in deal volume.

Private equity activity in CEE financial services



- While private equity activity showed a decline in volume, two major deals pushed the period's overall deal value to a three-year high.

Private equity: lower volume, higher value

Private equity interest in financial services in the region remains a minor plot. 2008 saw only six buyouts announced – a dip from the 16 announced in the same period in 2007. Two high value deals have, however, pumped the total value of this year's five transactions to €484m, an increase of €80m on 2007 figures.

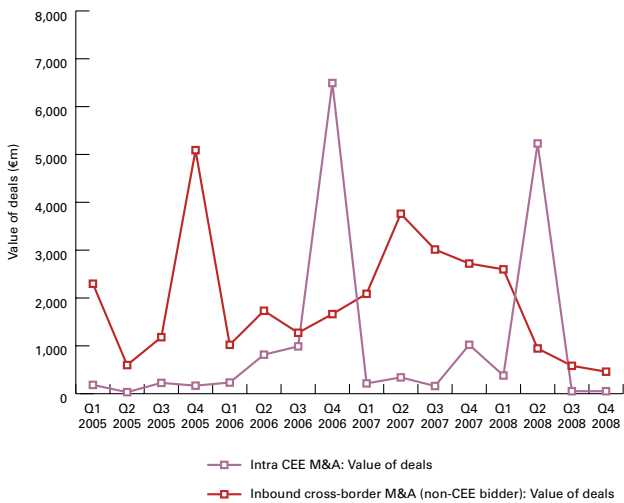
In June, Russia's Icon Private Equity bought a minority 49% equity stake in Ukraine's Delta Bank Russian investor Nikolai Lagun for €225m. Delta Bank is Ukraine's top consumer bank with a 25% share of the country's consumer lending market. Icon targeted the bank because of its potential for growth. The investment will initiate joint investments by the co-owners to boost Delta Bank's business in Ukraine and the surrounding region.

The second largest private equity transaction of the year to date saw Star Russia Investments III BV, a subsidiary of US-based insurance company Star International, and JCF FPK Sarl, the Russian private equity fund of J.C. Flowers, a US private equity company, together acquire a 40% stake in Russia's AKB Investorgbank for €136m. Under the terms of the agreement, reached in June, both will take a 19.9% stake in the target.

Historical data and analysis

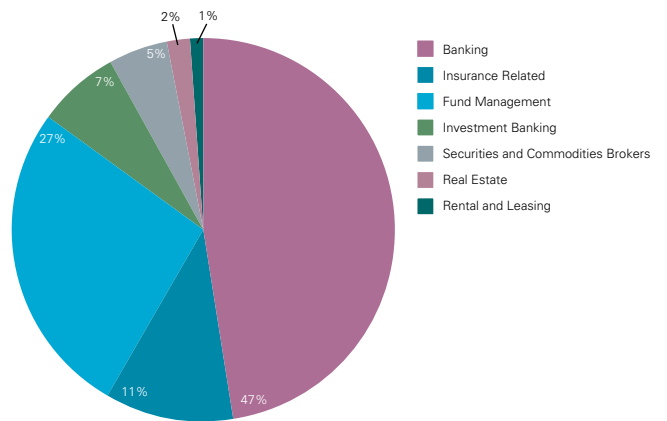
M&A activity in the CEE Financial Services sector

Buyer split of CEE Financial Services M&A: volume and value

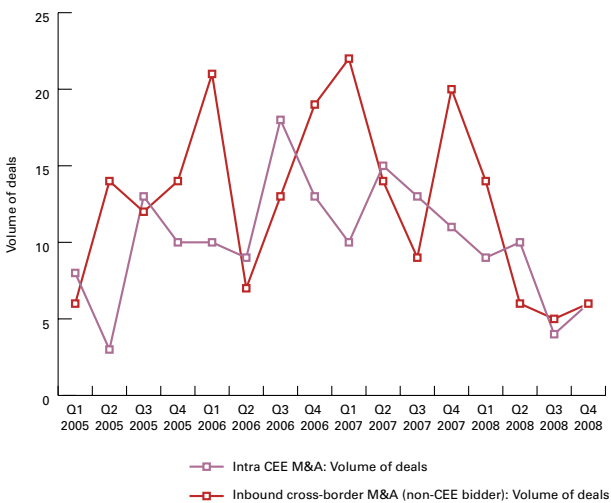


- Inbound investment value has continued to drop every quarter since Q2 2007, with intra-regional investment value remaining reasonably flat overall, aside from the Interros transaction-led peak in Q2 2008.

Sub-sector split of CEE Financial Services M&A: value

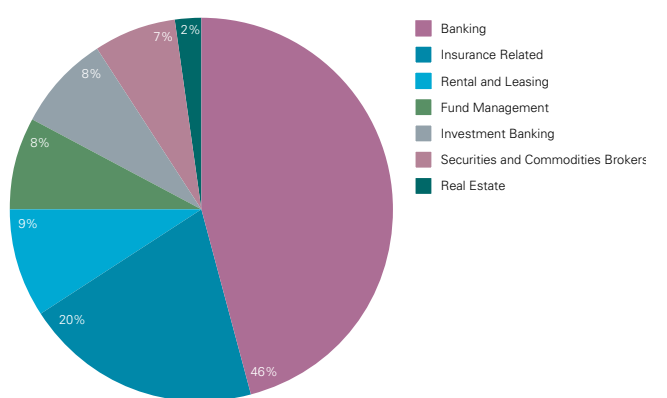


- While banking, insurance related and rental & leasing services together accounted for 75% of deal volume, they accounted for a little over 59% of deal value.



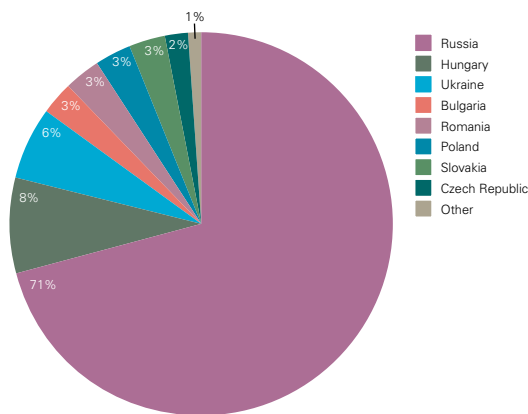
- A decline in the volume of intra and inbound investments has been pronounced during 2008, with intra and inbound investment activity at its lowest since 2005.

Sub-sector split of CEE Financial Services M&A: volume

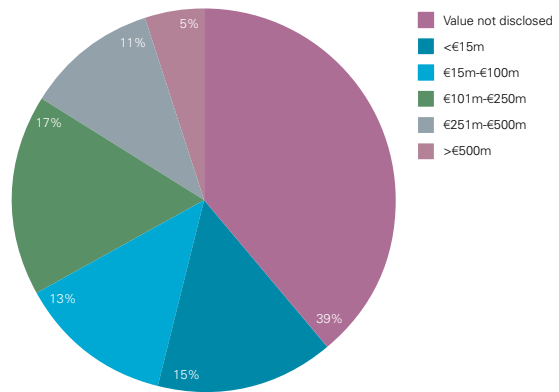


M&A activity in the CEE Financial Services sector

Geographic split of CEE Financial Services M&A: value

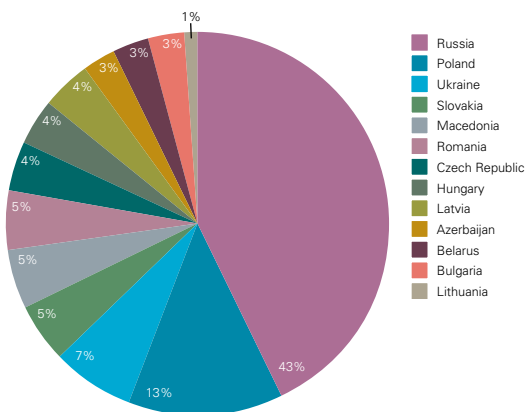


Deal size split of CEE Financial Services



- Russia's pre-eminent economy within CIS/CEE continued to dominate, providing the backdrop for 43% of all purchases within the region, which were worth 71% of the total value of deals.
- At the bottom end, Macedonia, Azerbaijan, Belarus, Latvia and Lithuania could only claim a 1% share of total deals value, in spite of hosting 16% of all deals.
- 17% of deals were in the €101m - €250m deal size range.

Geographic split of CEE Financial Services M&A: volume



Deal prospects

Looking forward into 2009, the global financial crisis could fuel M&A activity in the CIS/CEE Financial Services sector as troubled assets drop in price, setting them up as attractive targets for investors with cash to spend.

Deals such as Zurich Financial Services Group's €163m acquisition of the remaining 34% stake it does not already own in Zurich Retail Insurance Company, highlights the fact that despite the credit crisis, financial institutions are continuing to purchase undervalued assets or, in the case of Zurich, consolidating existing stake buys.

Elsewhere in the Russian banking sector, Anton Abugov, first VP of AFK Sistema, has indicated that consumer banks are in the sights of the Russian listed conglomerate. AKF are particularly interested in purchasing a controlling stake in the private Russian bank Severnaya Kazna, although they could face competition for the asset, namely from local compatriot Alfa Bank. The Russian media recently reported that the bank has acquired controlling stake in Severnaya Kazna.

Financial Services activity in Poland is also set to remain resilient in 2009, driven largely by the state-owned insurance group PZU. According to market reports citing PZU's President, the group is purportedly interested in acquiring a large Polish bank, and has around €3-3.65bn to spend. However, Polish banks PKO BP and Pekao are out of the question as they are valued outside of PZU's target range. Nonetheless, smaller Polish banks, such as BRE, BZ WBK, Bank Handlowy, or ING are all valued around the €1.5bn mark, and while none have explicitly stated that they are looking for a buyer, market commentators suggest that one of them may be put up for sale soon.

Meanwhile, PZU's pension fund (PZU Zlota Jesian), is mulling the option of acquiring a pension fund according to local media. It is claimed that Zlota is in talks with Polish pension funds Bankowy and Warta, and are reportedly 'determined' to acquire the Polish pension business of the US financial group AIG. The fund reportedly holds a €2.91bn acquisitions war chest.

Moving south, CIB Leasing, the leasing arm of Hungary's CIB Bank, is eyeing potential buys in the leasing segment of the market, but will only consider large leasing M&A transactions. CIB Leasing is scouring the region for stressed financial institutions looking to raise cash through the sale of their leasing arms. However, it was hard to tell which companies would be for sale in the coming months in Hungary and neighbouring countries. Recently, Bank, the Slovakian arm of Italy's ISP Group, bought Slovakia's last sizeable private leasing company in 2007. In addition, it is understood that banks might be reluctant to sell their leasing subsidiaries because their books often show higher profitability than the bank's books. Nevertheless, some banks might be forced to sell their leasing businesses at lower-than-expected valuations due to the credit crisis.

Looking at foreign interest into the region, Garanti Bankasi, the Turkish bank, is reportedly focusing in on acquisition opportunities in Romania and Ukraine. According to the bank, the two markets are a primary focus in the bank's expansion plans and the current economic climate presents good opportunities for the cash-rich bank to buy. Garanti may proceed with more than one acquisition by the end of 2009, and will consider both small and large targets. The bank had previously tried to acquire Partner Bank, a private Ukrainian bank, but the target had found Garanti's offer of €35m too low. The bank is rumoured to now be aiming at targets larger than Partner Bank, since the price they would now ask would not be prohibitive in the present climate. It is believed Garanti could spend €400m or more for two acquisitions during 2009. However, a profit decline of 14% in Q4 2008 will presumably dampen the appetite for such transactions.

At the same time, it has been reported that Cassa di Risparmio di Ferrara (Carife), the Italian savings bank, is looking to make buys in Romania. Carife recently launched a €70m rights issue to help fund the buys, as well as acquisitions in the Italian regions of Lombardy, Romagna, Veneto and Marche.

Meanwhile, on the sell-side, Russia's Investbank is allegedly considering strategic options, including a controlling stake sale to a strategic investor, a member of the supervisory board said. However, while the privately-held bank is holding talks with potential investors, it is in no rush to sell because current market prices do not reflect its real value. An initial public offering is also being considered for Investbank in the long term but not before 2010. In the short term, a minority stake sale to a private equity fund has been considered.

At the same time however, Investbank is not averse to conducting M&A if the price is right. While the bank's strategy does not call for any further acquisitions in the Russian market, asset prices in the financial sector are attractive and the bank is monitoring the markets where it would like to establish its presence for attractive opportunities. These markets include the city of Krasnodar and possibly the city of Khabarovsk, which the bank may enter in 2010.

Another Russian Bank, in this case, Agrokhimbank, the private bank, is also seeking an investor. The chairman of the bank's board of directors has said that the bank is in talks with a number of banks and considers Russia's Deposit Insurance Agency (ASV) as one of the possible investors.

Ever since the Royal Bank of Scotland (RBS) spent €71bn taking over ABN Amro in late 2007, the UK-based Financial Services conglomerate has been looking to divest assets which are now considered non-core. As a result, RBS is looking to sell its Polish arm, ABN Amro Polska in an asset sale estimated to be worth a total of €115bn. An announcement of any proposed sale is expected in early 2009.



Questions on the credit crisis: Financial Services sector of Central & Eastern Europe



Alex Doughty, Partner, Banking and Finance, and Todd Robinson, Corporate Partner and Managing Partner for the firm's Bucharest office, discuss the implications of the credit crisis on Financial Services M&A activity in the CEE region.

What is your outlook for CEE Financial Services M&A activity in the sector over the next 12 months?

Given recent developments across the sector generally, this is very difficult, if not impossible, to predict at the moment. Whilst a number of signed deals have progressed and been wrapped up, others appear to be moving much more slowly. In terms of new Financial Services M&A deal flow in the region, we envision that in Q1 '09 (definitely) and in Q2 '09 (most likely), there will be relatively little if any activity. This is primarily due to the fact that M&A players will be unable to value target businesses effectively and debt funding is in short supply. In addition, our sense is that the players anticipate valuations in this sector are likely to fall further, perhaps by another 20% or so, before bottoming out.

Nonetheless, while overall CEE Financial Services M&A flows are expected to trend downward in the first half of 2009, certain markets are expected to outperform. International multi-lateral financial institutions (IFIs), such as the European Bank of Reconstruction and Development (EBRD), are increasingly moving to undertake M&A deals in the region. A good example of how IFIs drive transactions in the sector was the EBRD's recent sale of a 37% stake in RESO-Garantia, the Russian insurance company to AXA, the French insurance group, for €810m late last year. Their presence within the CEE Financial Services M&A space is expected to increase as commercial banks increasingly avoid financing M&A deals.

In summary, we are pleasantly surprised by the number of Financial Services transactions that continue to make headway, even if at a slow pace, in what is admittedly a very difficult deal-making climate. Economic growth across the CEE region has been forecast to be between 3-4% next year and as a result, M&A practitioners are seeing a trend towards putting deals on hold – not abandoning them.

What is also clear is that, as governments continue to inject huge amounts of new capital and provide soft-loans/insurance to their respective domestic players, along with that funding will come an insistence on a return-to-basics and a focus on the relevant domestic market. As a result, banks will be put under pressure to rationalise their group structure and sell off subsidiaries - and with that level of direct or implicit political pressure will come greater realism in relation to valuations. So over the full 12 months, we see real opportunities.

How do you envision that Financial Services deals will be financed in 2009?

Financing these kinds of transactions is undoubtedly getting more difficult as we continue to crunch through the credit crisis. However, as deal valuations become clearer and more transparent, we anticipate that IFIs may well lead in terms of financing transactions, ultimately leading to commercial banks returning to the fray. At the same time, we are also bullish on funding from Private Equity funds in the second half of 2009. Private equity firms raised record-breaking funds last year and are currently waiting for valuations to bottom out before snapping up assets at fire-sale prices.

Up until this point, what impact do you think the credit crisis has had on CEE Financial Services M&A deal flow?

In our experience, typically CEE banks and financial institutions did not trade the complex and exotic financial instruments which were the initial cause of the crisis - so on the face of it, they were not as severely impacted as others, such as Bear Stearns, who were at the centre of things. However, the sudden and unprecedented reduction in global liquidity has had a direct adverse impact on the liquidity of bank groups with CEE business and even on governmental liquidity. The high growth rates that had been so characteristic of many CEE jurisdictions are now being scaled back and in many such countries, valuations were primarily focused on GDP growth rates as much as anything else.

Questions on the credit crisis: Financial Services sector of Central & Eastern Europe

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There is also a perception that, although the credit crunch caught most governments generally by surprise, even once the seriousness of the crisis became more widespread, a number of CEE governments continued to be in denial and for a while, were perhaps not working as hard as they could and should have been on contingency and crisis planning. Such a move created an undue amount of public anxiety and no doubt, exacerbated the effects of the credit crisis in the region.

Overall however, the impact, whilst definitely felt, has been subdued in comparison to Western European and US markets. Investors remain fairly bullish (albeit cautious) on Financial Services M&A prospects. The fundamentals of the underlying bank business remain strong and while certain sectors, such as Real Estate investments, have seen systematic declines, the appetite for doing deals in other areas remains robust and volumes are anticipated to pick up as soon as liquidity returns.

Some M&A commentators suggest that the credit crisis could prove to be a blessing in disguise for solid cash-rich corporates looking to acquire distressed competitors. Is this likely to occur within the Financial Services sector in the CEE region and why?

Consolidation will most likely be the dominant theme of the next 12-18 months. As well as the potential ‘political drivers’ for consolidation from any holding company’s jurisdiction, the reality is that in many CEE countries, the market is saturated

at the moment – for example Ukraine has more than 100 registered banks – and local regulators across the region are attempting to stamp out a blueprint for consolidation across the sector in order to create a viable and sustainable banking system once the credit crisis is over.

Whilst there are some corporates sitting on large cash-piles, the reality is that few banks and financial institutions have such resources at their disposal. Of course there are a number of Sovereign Wealth Funds and the like which have accumulated cash-piles. However, in the current market they are perhaps more likely to be looking at opportunities in the main financial centres, where there are banks trading at less than 10% of their share price a year ago.

At the same time, sellers’ valuations in CEE are, despite the credit crisis, still too high for even cash-rich corporates to contemplate acquisitions. On the other hand, Private Equity firms, with their \$1bn+ committed-funding war-chests are now increasingly interested in anticipation of the fact that valuations will continue to fall. So, overall, consolidation will occur, but driven primarily by political pressure, tighter regulation as well as cash-rich Private Equity buyers.

Although notoriously difficult to structure and to close asset-swap deals, for some of the existing Western and CEE bank and financial institution groups, asset swaps provide a relatively low risk approach to achieving business and operational synergies. With additional input at a political and at a regulatory level, we may well see some asset-swap deals as the market cruises down the consolidation highway.

Do you think that mid-market Financial Services companies in the region will increasingly face financial hardships as the crisis continues? If so, do you envision that consolidation within the mid-market will occur?

In the CEE region, the mid-market is generally classified as deal flow in the \$20-100m range – an area in which we remain fairly bullish. Once valuations become clearer, the mid-market will see an increased amount of activity, most likely due to Private Equity plays. This particular space is an ideal one for financial investors to invest in – it’s a niche area and one that is incredibly lucrative – a classic market for the two asset classes to exploit.

Questions on the credit crisis: Financial Services sector of Central & Eastern Europe

In fact, Private Equity firms which are dedicated to the region are set to enjoy something of a renaissance over the coming years as more generalist financial houses close down their regional operations due to the worsening economic climate. This has meant that smaller Private Equity houses can now breathe a sigh of relief – not only is competition for deal flow reduced, but staffing concerns are alleviated. One specialist Private Equity firm lost a large proportion of its team to a multinational competitor that recently moved into the region, only to see the firm depart the region just months later.

What particular sub-sectors within the CEE Financial Services space do you think will be most affected by the credit crisis?

A number of Financial Services sub-sectors have been affected by the credit crisis. M&A activity in the Banking and Investment Banking spaces have both been badly affected by the collapse of Lehman Brothers in September, while Insurance-related transactions could be boosted by the upcoming spin-offs of numerous AIG subsidiaries within the region.

Furthermore, we expect to see the Rental and Leasing market experience an upturn. However, the Real Estate sector is not forecast to bottom out any time soon, along with securities and commodity brokerage activity. In fact, the only area in which we remain relatively confident is M&A flows from the Private Equity and Sovereign Wealth Fund sectors. Both types of players are well capitalised and could enjoy some very cheap purchases from the end of Q1/Q2 '09 onwards.

Two sub-sectors that look to remain relatively robust over the next five years are Infrastructure Funds and PPP financings. State investments in the Infrastructure sector are likely to rise over the next half-decade given that CEE economies will look to stimulate lagging economic growth by utilising EU development funds. This rings especially true for those countries that have recently acceded to the EU, such as Bulgaria and Romania, with the latter reputedly having access to some €40bn of funds to modernise its infrastructure.

At the same time, CEE is increasingly finding itself at the forefront of the battle on the supply (and security of supply) of oil & gas to Western Europe. Anxious to avoid a repetition of the various previous disputes on gas supply, which adversely impacted the transit of gas to much of Western Europe, investors are seeking to fund alternative pipelines across the region – all of which stand to benefit CEE countries.

What advice do you have for a) bidders looking to acquire, and b) distressed sellers looking to exit, in the CEE Financial Services sector?

In terms of advice to buyers, we would say it's a good time! Just bear the following points in mind when seeking out a target:

- Conduct proper due diligence on your target.
- Employ the best advisers you can afford.
- In distressed situations, timing is very important. As we have seen, events in the financial markets can quickly overtake an M&A transaction, so aim to complete any deal as quickly as possible.
- Don't be put off by the reported dearth of financing options available to you in the current climate. Creativity will ultimately be rewarded and alternative transactions, such as non-cash deals, are rising in popularity.
- At the same time, be aware of the fact that conducting M&A in the CEE Financial Services sector is now very much a buyers' market. Use the fact that financing is difficult to obtain to your advantage.

A piece of advice for a distressed seller looking to exit from a business is, be realistic on your pricing (however much it hurts - and if it doesn't 'hurt', then your price is still too high) and build some leeway into your initial valuations. Set a strict timeline and don't cut corners... doing so will only come back to bite you.

“Once valuations become clearer, the mid-market will see an increased amount of activity, most likely due to Private Equity plays.”

M&A regulation in Central & Eastern Europe

Iain Batty, Head of the Commercial practice in CEE, and Malgorzata Surdek, Head of the firm's Commercial practice in Warsaw, talk about the region's regulatory systems, as well as the impact of the credit crisis on the region's Financial Services overseers.

Perhaps in response to the current economy, Financial Services regulators in the CEE region have begun attempting to limit the possibility for banks in the region to use 'exotic' financial instruments. Various banks have been asked to amend their articles of association in order to ensure that the range of financial instruments, in which they intend to invest, are clearly stated in the articles and approved by the regulators. Furthermore, regulators have also started to increase their risk analysis procedures on such financial instruments.

While both Partners acknowledge that financial Institutions based in the CEE tend to have limited exposure to the complex financial instruments that were the initial cause behind the credit crisis, they also note that many of the institutions now present in the CEE are actually subsidiaries of international banking groups such as Unicredit and Raiffeisen. As a result, Iain Batty notes that "in the early days of the crisis, many believed that the region would not be too badly affected by the credit crunch. However, this perception has changed now."

The fact that the region has proved to be much less isolated from the global financial shockwaves than originally presumed has proved to be a headache for local regulatory authorities. For example, in recent years, CEE countries, particularly Hungary and Poland, have seen very large proportions of domestic mortgages being denominated in foreign currencies, most notably Swiss Francs, Euros and Japanese Yen. Relatively low interest rates meant that these countries proved attractive havens for borrowers. However, such currencies have also appreciated against local CEE currencies, making debt servicing more expensive and resulting in a rising number of mortgage defaults. In response to this a number of regulatory authorities in the region are taking steps to push banks towards making mortgages denominated in foreign currencies available only to the most affluent customers.

As a result of this susceptibility to external shocks, Financial Services regulation within the CEE region is becoming progressively stricter. However, in the words of Mr. Batty, "the regulators in CEE often place an emphasis on form over substance." A focus on regulation, whether necessary or not, is the name of the game, and this looks to continue in the future as deal churn slows down and regulatory agencies have fewer deals to examine – a situation exacerbated by the credit crisis.

For those Financial Services M&A deals that are going ahead, Malgorzata Surdek believes that regulatory proceedings are becoming evermore complex and are now taking longer to complete. She also noted that regulators are now showing an interest in how a potential tie-up could be affected by macro-economic conditions – a matter that was simply not addressed pre-credit crisis. At the same time, Mr. Batty states that regulatory agencies are becoming increasingly concerned about the financial standing of multinational parent institutions conducting M&A in the region through their subsidiaries – presumably because they want to ensure the robustness of any potential transaction given the current market's volatility.

The two Partners also believe that the introduction of the EU's MiFID directive in late 2007 has proven to be more difficult for regional regulators to implement. And while CEE regulators enthusiastically accepted the new directive, it will no doubt prove to be the most difficult piece of financial regulation many of those agencies will have come across. Ms. Surdek went on to state that there exists a large gulf between merely translating the MiFID directive into local languages and promulgating it, and actually implementing it properly into the local legal framework.

Regulatory issues are rarely seen as deal-breakers when conducting an M&A transaction, however both Partners recommend that prospective buyers heed the following advice when looking to make an acquisition in the CEE Financial Services sector:

- Be as open and transparent as possible with the regulator. Building rapport could also help expedite any proposed transactions.
- Maintain constant communication with regulatory agencies. CEE regulators dislike hearing about a proposed bid or M&A development from the press. Therefore, ensure they are fully up-to-date on any M&A situation before talking to the media.
- Don't assume that CEE regulators won't benefit from a steer and guidance on financial regulation within their jurisdiction. Employ professionals to advise on regulation and, if necessary, to help liaise with the regulators.

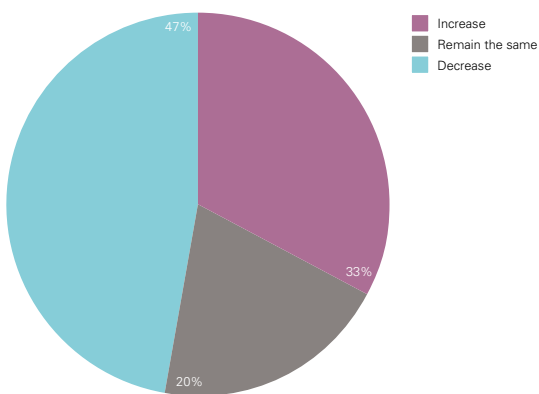
“In the early days of the crisis, many believed that the region would not be too badly affected by the credit crunch. However, this perception has changed now.”



Survey

The majority of respondents believe Financial Services M&A activity in the CEE region will at least remain the same in 2009

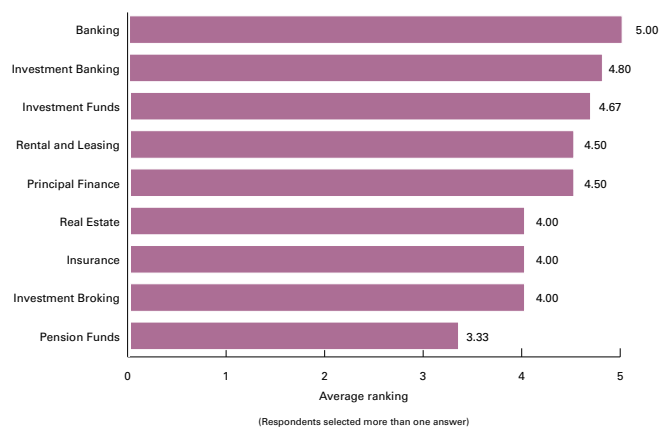
What do you expect will happen to Financial Services M&A activity in the CEE region during the calendar year 2009?



- A combined majority (53%) of respondents believe that over the course of the year, Financial Services M&A activity in the CEE region would either increase (33%) or remain the same (20%). However, a sizeable 47% consider that acquisitions in the Financial Services space will decrease in 2009.
- A number of respondents highlighted the fact that it is very difficult to predict what will happen over the course of the year, yet remained positive on the second half of 2009, saying, "perhaps we might see a re-vitalization in the second half of 2009 due to undervalued assets coming to market."

Banking and Investment sectors are likely to see the bulk of deal flow, while Pension funds are set to witness the least amount of M&A activity in 2009

Which sub-sector do you believe will witness the majority of Financial Services deals during 2009? (1=the least amount of activity & 5=the most amount of activity)

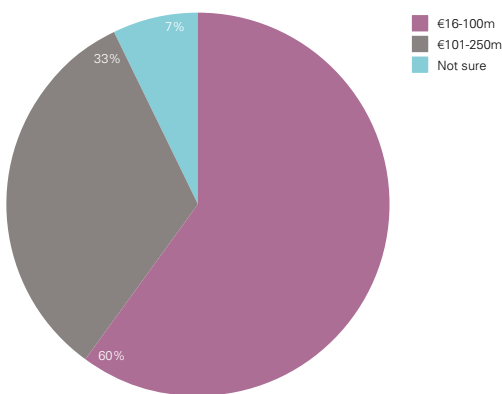


- Every respondent interviewed for the survey thinks that Banking M&A transactions will lead the sector, while corresponding average rankings for Investment banking and Investment fund M&A activity is 4.8 and 4.67 respectively. On the other hand, M&A deal flow in the Pension funds market garners an average ranking of just 3.33.
- One respondent writes that, "Deal flow very much depends on market structure. For instance, in Croatia, there will be some M&A in the Investment broking sub-sector as there has been a new law adopted for the capital markets which will take effect in January 2009."

Survey

2009 CEE Financial Services deal flow will occur in the €16-250m range say 93% of respondents

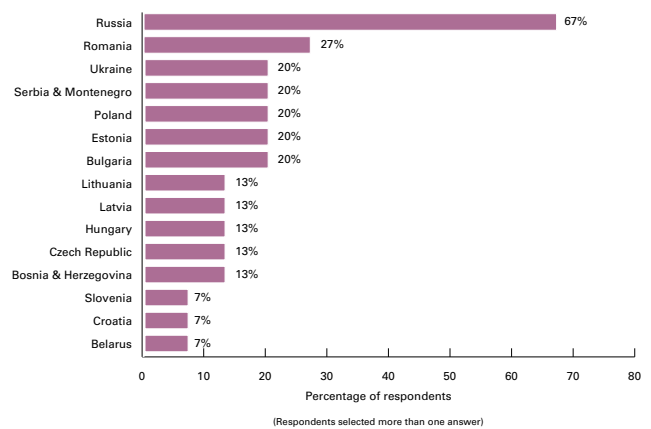
In which deal size range do you expect the bulk of CEE Financial Services activity to take place during 2009?



- 93% of respondents believe that the bulk of CEE Financial Services deal flow this year will be valued at under €250m. Of this proportion, 60% believe that the majority of transactions will be worth between €16-100m while a further 33% consider that valuations will fall in the €101-250m range. 7% were not sure.

Russia is expected to witness the bulk of CEE Financial Services M&A activity in 2009

Which countries do you expect will witness the majority of CEE Financial Services M&A activity over the next year?

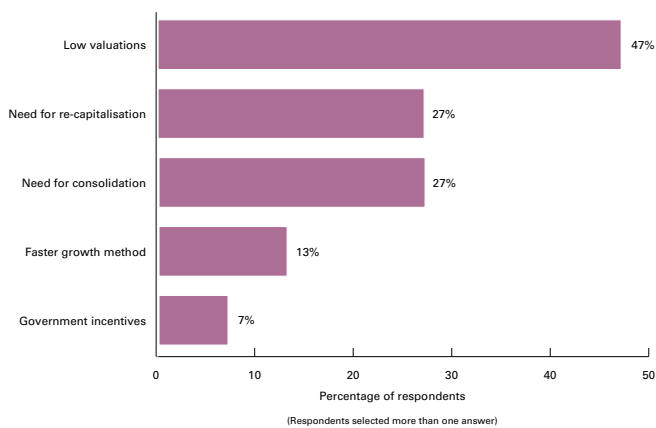


- 67% of respondents believe that Russian Financial Services M&A flows will lead regional Financial Services M&A activity in 2009. Interestingly, a further 27% of respondents consider that Romanian deal flows will lead regional M&A activity in the sector, while other regional economic heavyweights such as Ukraine, Poland and, to a lesser extent, Bulgaria, garner just 20% of respondents' views. At the other end of the scale, just 7% of respondents apiece believe that Slovenia, Croatia and Belarus will lead CEE Financial Services M&A flows in 2009.
- One respondent writes that: "In countries such as Poland and the Czech Republic, which are financially stable and where M&A activity is not forced, there should be some good deal flow. On the other hand, there might be forced and compulsory M&A activity in the Baltic States (Estonia, Latvia and Lithuania) - they have been greatly hit by the crisis."

Survey

Close to half of respondents believe that acquisitions will be driven by low valuations in the CEE region

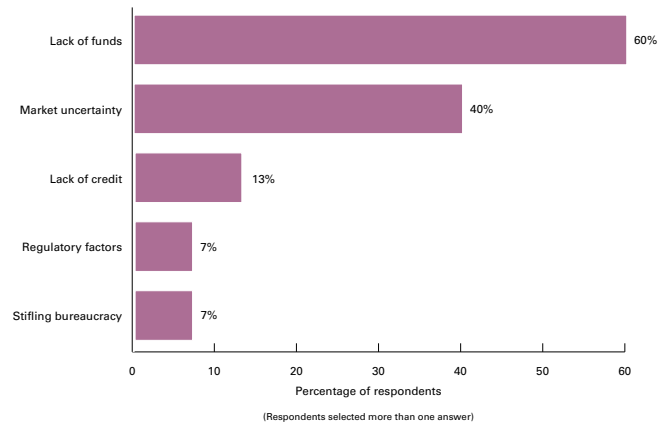
What will be the primary drivers to conducting Financial Services acquisitions in the CEE in 2009?



- 47% of respondents judge that the primary reason to conduct CEE Financial Services acquisitions in 2009 will be to take advantage of low valuations. 27% apiece also think that M&A will be undertaken in order to provide capital to re-capitalise depleted balance sheets, as well as to consolidate the industry.
- “The financial crisis has caused a decline in prices and as a result, there are many acquisition opportunities at lowered prices,” one respondent writes, while another says that: “There are plentiful opportunities now as companies need the operating capital.”

Lack of funds is the most likely obstacle to CEE Financial Services M&A activity in 2009

What will be the primary obstacles to conducting Financial Services acquisitions in the CEE in 2009?

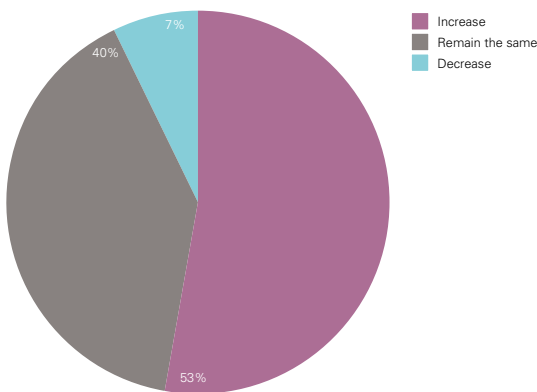


- The primary hindrance to 2009 Financial Services transactions in the CEE region will be lack of funds, say 60% of respondents, while a further 40% believe that market uncertainty will hamper deal flow over the year. On the other hand, regulatory factors as well as stifling bureaucracies account for just 7% of respondents’ opinions apiece.
- “There will be difficulty in obtaining funding. Some companies have already invested their cash into acquisitions,” one respondent says while another notes that: “It is really hard to say and also to see what will happen in the next three to four months.”

Survey

Over half of respondents believe that private equity buyouts in the CEE Financial Services sector will increase in 2009

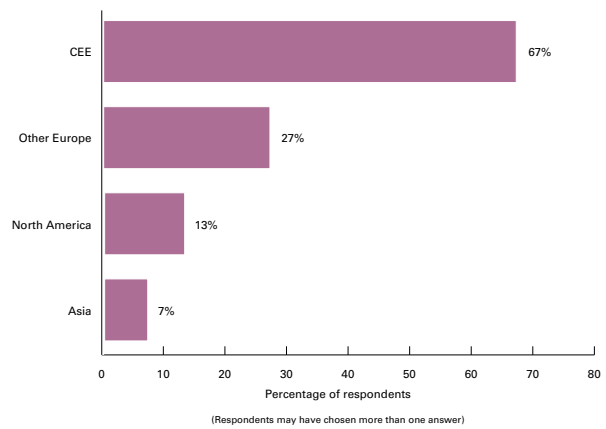
What do you expect to happen to the level of private equity buyouts in the CEE Financial Services sector during 2009?



- Intriguingly, more than half (53%) of respondents believe that the level of private equity buyouts in the CEE Financial Services sector will increase in 2009, while a further 40% consider that buyout levels will remain the same. Only 7% judge that private equity activity in the sector will fall this year.
- “There are a lot of cheap assets out there right now, and we’ve had foreign investors investigating the markets in Russia asking us for our analysis. They are looking at the analysis, the values, and are considering investing now,” one respondent states, while another, less optimistic, respondents says that: “I don’t think that the absolute level of private equity buyouts will see an increase but compared to other, healthier, times, the percentage share of private equity buyouts will remain the same.”

Private equity buyouts in 2009 within the sector are most likely to originate locally, say 67% of respondents

From where do you expect the bulk of private equity acquisitions in the CEE Financial Services sector to originate over the next year?



- 67% of respondents judge that the bulk of private equity buyouts in the Financial Services sector in 2009 will originate locally, while over one-quarter (27%) think that such buyouts will originate from European private equity firms.

Respondents believe the majority of outbound Financial Services will come from within the CEE region

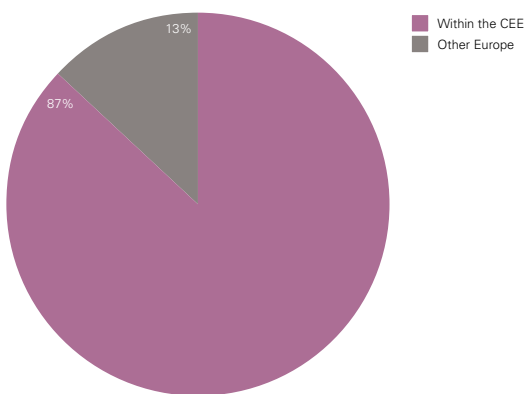
Which region do you expect the majority of outbound Financial Services transactions from the CEE to target?

- When asked which region they expect the majority of outbound CEE Financial Services transactions to target in 2009, 100% of respondents said that they expected the bulk of outbound deal flow to remain within the region. Investors will most likely “focus on domestic markets right now,” one respondent writes, while another notes that, “there may also be political reasons which restrict outbound investments. For example, Russia might be interested in investing in Western European financial institutions, but due to political reasons this may not be possible.”

Survey

Respondents believe inbound M&A transactions in 2009 will originate exclusively from within Europe and the CEE region

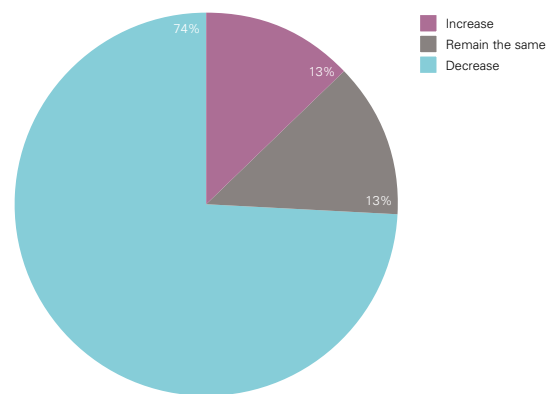
Where do you expect the bulk of inbound Financial Services transactions into the CEE to originate from?



- 100% of respondents consider that inbound Financial Services transactions will originate from either within the CEE or from Europe, with the majority (87%) believing that inbound transactions will originate from within the region.
- “Deal flow will not be from Asia or the Middle East except possibly India. There are big cultural differences at play here, which is a crucial point. Furthermore, I don’t think there will be a large amount of interest from Europe or North America. They will most likely want to wait and see what happens in the markets before investing in the region,” one respondent notes, while another writes that: “I expect to see predominantly domestic deals. It is risky for other countries to invest into the CEE!”

Respondents remain bearish on cross-border CEE Financial Services deal flow in 2009

What do you expect to happen to CEE cross-border Financial Services deal flow during the calendar year 2009?

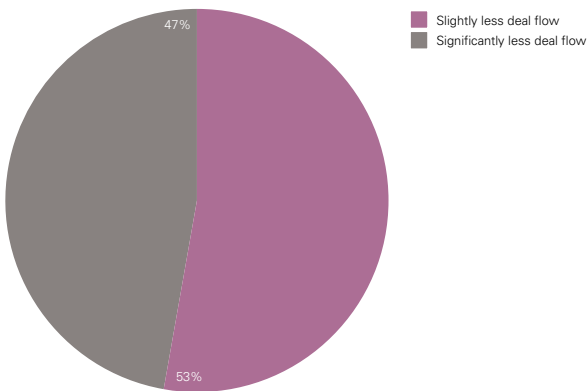


- Respondents remain relatively bearish on cross-border M&A prospects, with 74% suggesting that international deal flows will decrease over the course of the year. Of the remainder, 13% apiece believe that cross-border activity will either increase or remain the same.
- A number of respondents believe that “there shouldn’t be much activity from investors trying to find completely new investment opportunities” in the current financial climate, and that investors will most likely look for targets in their home market.

Survey

Respondents agree that the credit crisis will adversely affect M&A activity, yet they were divided over the level of severity

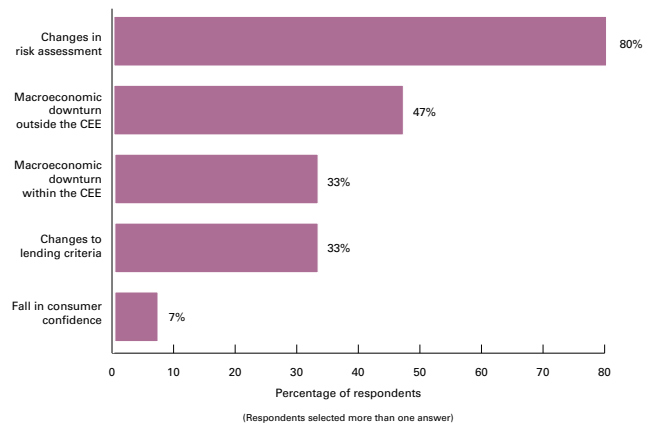
To what extent do you believe M&A deals in the Financial Services sector will be affected by the credit crisis during 2009?



- While all respondents agree that the credit crisis will result in a fall in CEE Financial Services M&A activity in 2009, they were split as to its gravity. A small majority (53%) believe that the crisis will lead to a slight reduction in M&A activity while the remainder judge that it will have a significant negative impact on M&A volumes.

CEE Financial Services deal flow is to fall in 2009 due to shift in risk assessments, say 80% of respondents

If you think that deal flow has been affected, what do you attribute this change to?

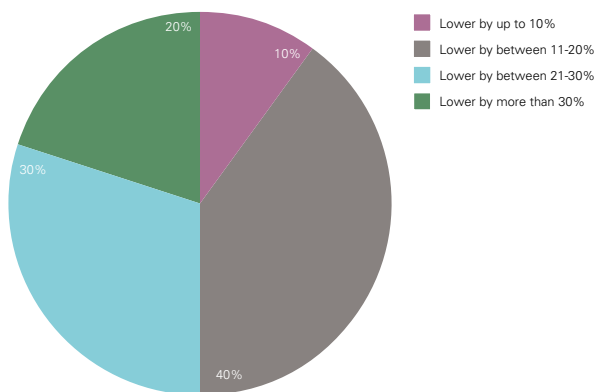


- Fully 80% of respondents believe that the reason the credit crisis has depressed CEE Financial Services M&A activity is because it has led to a change in risk assessments. Close to half (47%) also consider that the macroeconomic downturn outside the region has adversely impacted on M&A volumes, while – on the other hand – just 7% suggest that a fall in consumer confidence is to blame.

Survey

Of those respondents who believe that the operating profits of CEE financial institutions will be lower, half believe it will be by more than 20%

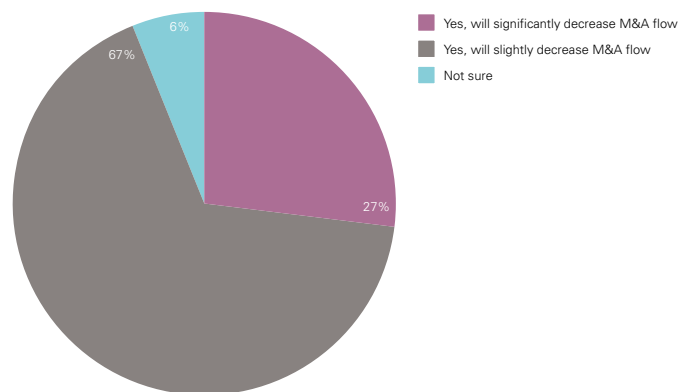
What percentage do you expect financial institutions' 2009 operating profits to be below 2008 figures?



- The vast majority of respondents – some 93% – believe that CEE financial institutions' operating profits in 2009 will fall compared to last year's, with respondents citing an average percentage drop of 23%.
- One respondent who demurred from answering said that: "The situation will become clearer after Q1 or H1 2009 when banks' financial results are released. Results will be very dependent on how companies in the real economy perform - based on their equity values and how money is placed to companies."

94% of respondents make a clear correlation between falling operating profits and decreased M&A levels in 2009

If you expect operating profits to fall, do you think the decline in forecasted revenue growth for 2009 will adversely affect levels of M&A flow in the industry?

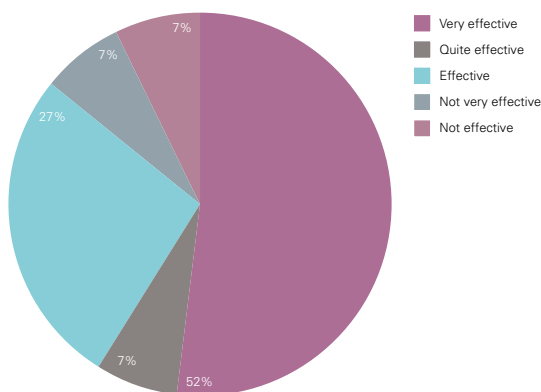


- A combined 94% of respondents believe that an expected fall in CEE banks' operating profits will result in a decrease in M&A flows in 2009, with 27% judging that a decline in profits will significantly decrease deal volumes and 67% considering that it will lead to a slight decrease. 6% were not sure about the link.

Survey

The bulk of respondents rate their respective regulatory agencies as 'effective' at monitoring M&A transactions

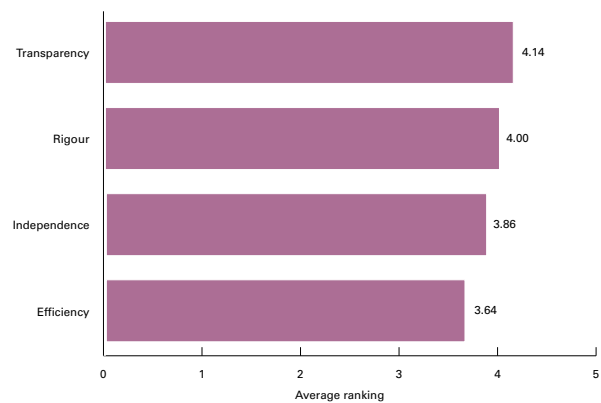
Do you believe the regulatory agencies in your country are effective at monitoring M&A transactions?



- 86% of respondents believe that their respective regulatory agencies are at least effective at monitoring M&A transactions, with over half (52%) judging that their regulators are very effective.
- One respondent who fell into this category notes that: "The regulatory agencies monitor deals very closely and there are no cases yet where an M&A transaction has been rejected by them. Also, in these times of crisis, banks for example, might need all the help they can get so the agencies will most likely be more flexible." However, another, who fell into the 14% who do not consider their local regulator as effective, writes that: "They only monitor deals regarding public companies. There is thus not enough competition protection for private companies in the M&A sphere."

CEE regulators excel in terms of transparency, however, efficiency leaves a lot to be desired

Please rate these regulatory agencies on the following, on a scale of 1 to 5 (where 5 = excellent and 1 = very poor)



- On average, respondents ranked CEE regulators at 4.14 in terms of their transparency (on a scale of one to five, where five is excellent and one is very poor), 4 for rigour, 3.86 for independence and just 3.64 for efficiency.
- One respondent ranked his local regulator highly on rigour, declaring that "they stick to their decision – a rejection is a rejection!" Another marked his local regulator down in terms of efficiency because "they are not as sensitive to macroeconomic changes as other countries."

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