

**ASSOCIATION OF EUROPEAN BUSINESSES
IN THE RUSSIAN FEDERATION**

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AEB M&A WORKING GROUP NEWSLETTER

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INTRODUCTION FROM THE CHAIRMAN

Dear M&A professionals

Welcome to the Q3 2011 issue of the AEB working group newsletter.

The global economic outlook remains unstable, with downgrading of the credit rating for the US by Stand & Poors, and the European countries continuing active discussions aimed at solving the looming debt crisis at some of the member states. This continues to exert a depressing influence on the overall Russian deal landscape, which remains relatively unstable with ups and downs rather than a definitive uptrend. At the same time, many deals continue to be happening and there are no apparent signs of slow-down in the Russian M&A activity.

This quarter's newsletter continues the trend of providing some useful and detailed insights into the recent performance of the Russian M&A market and contains some useful statistics. In this newsletter you will also find some useful tips from the practicing professionals into some of the recent trends on structuring Russian M&A transactions.

One of the recent trends that we are seeing more and more in Russian transactions is foreign investors having Russian partners, rather than buying our the Russian business. In our last group meeting we agreed to organise an open event aimed at sharing the experiences and discussing the typical issues that European investors face when entering into joint venture arrangements with their Russian partners. The event is tentatively scheduled for mid-February 2012.

With best regards

ANDREY SHPAK

PART I. TOP DEALS

Announcement Date	Target Company	Target Dominant Sector	Bidder Company	Seller Company	Deal Description	Deal Value (US\$m)	Deal Value (€m)
30-Sep-11	Polymetal OAO (82.85% Stake)	Energy, Mining & Utilities	Polymetal International PLC		<p>DAO Polymetal has agreed to be acquired by Polymetal International PLC.</p> <p>DAO Polymetal, the Russia based company headquartered in Saint Petersburg, is a precious metals mining company. Polymetal International, the Channel Islands based company, is an acquisition vehicle of Mr. Alexander Nesis, the Russian private investor and a founder of DAO Polymetal.</p>	5,940	4,436
3-Aug-11	Rushydro OAO (23.56% Stake)	Energy, Mining & Utilities	Government of Russian Federation; and INTER RAO UES OJSC		<p>DAO Inter RAO UES and the government of the Russian Federation have agreed to acquire a 23.56% stake in DAO Rushydro.</p> <p>Rushydro, the listed Russia based company headquartered in Moscow, is a power generation company. Inter RAO, the listed Russia based company headquartered in Moscow, is an electric power company.</p>	5,317	3,712
9-Aug-11	OOO Lenta (43.2% Stake)	Consumer	The European Bank for Reconstruction and Development; and Luna Inc	Mr. August Meyer (Private Investor)	<p>Luna Inc, the Cayman Islands based investment vehicle formed by TPG Capital, L.P., the US based private equity firm and VTB Capital ZAO, the Russia based investment banking business of VTB Bank, the listed Russia based provider of financial services, along with The European Bank for Reconstruction and Development (EBRD), the UK based international financial institution providing project financing for banks, industries and businesses, both new ventures and investments in existing companies, has agreed to acquire 43.1% stake in OOO Lenta, the Russia based retail hypermarket and cash and carry store chains, from August Meyer, the US based private investor, for a consideration of USD 1.1bn.</p> <p>The transaction valued Lenta at USD 2.6bn. TPG Capital and VTB Capital through Luna will acquire 34.2% stake and The European Bank for Reconstruction and Development will acquire 9% stake in Lenta from August Meyer who is selling 41% while the rest 2.5% stake will be acquired from other three minority shareholders. Post acquisition, Luna will increase its ownership from 30.8% to 65% in Lenta, while EBRD's stake will be increased from 11% to 20%.</p>	1,200	835
1-Aug-11	OJSC Power Machines (25% Stake)	Industrials & Chemicals	Highstat Ltd	Siemens AG	<p>Highstat Ltd has signed a definitive agreement to acquire 25% stake in OJSC Power Machines from Siemens AG.</p> <p>OJSC Power Machines, the listed Russia based company headquartered in Moscow, is a manufacturer of equipment for hydro, steam, gas and nuclear power plants, and equipment for transmission and distribution of electric power, transport and railway.</p> <p>Highstat Ltd, a Cyprus based company, is a holding company controlled by Mr. Alexei Mordashov, a Russian private investor. Siemens AG, the listed Germany based company headquartered in Munich, Bavaria, is a diversified electronics and electrical engineering company operating in the industrial, energy and healthcare sectors.</p>	617	433
19-Jul-11	En+ Group Ltd (4.35% Stake)	Financial Services	VTB Capital ZAO	Basic Element	<p>VTB Capital ZAO, the Russia based investment banking business of VTB Bank, the listed Russia based provider of financial services, has acquired a 4.35% stake in En+ Group, the Russia based company investing in mining, metals and energy projects, from Basic Element, the Russia based private equity firm, for a total consideration of USD 500m.</p> <p>The acquisition is in line with the strategy of VTB Capital to enhance its growth opportunity. Basic Element used a 25% stake in En+ as a collateral on a USD 1bn loan from VTB Capital.</p>	500	353
6-Jul-11	OOO Kolmar (51% Stake)	Energy, Mining & Utilities	Lonestate Assets Ltd	MMC InterGeo; and Amira Trading OOO	<p>Lonestate Assets Ltd, the Russia based investment holding company having interest in coal mining company and a subsidiary of Anatoly Mitroshin, the Russia based private investor, has acquired 51% stake in OOO Kolmar, the Russia based coal mining company, from MMC InterGeo, the Russia based company engaged in mining and exploration of diversified metal ores and Amira Trading OOO, the Russia based company having interest in mining sector, for an approximate consideration of USD 400m.</p> <p>The transaction was funded by Montlink Ltd through convertible loan. The acquisition will further boost the development of Komar into a high class and efficient operation. Prior to the transaction, remaining 49% stake in Kolmar was held by Anatoly Mitroshin through Bixcut Holdings Ltd. In April 2010.</p>	400	279
25-Jul-11	Sibur-Russian Tyres JSC (Certain assets)	Industrials & Chemicals	Pirelli & C SpA; and Russian Technologies State Corporation	Sibur-Russian Tyres JSC	<p>Pirelli & C. S.p.A., the listed Italy based holding company operating in fiber optics, tires, electric cables and real estate sectors, together with Russian Technologies State Corporation, the Russia based company engaged in providing support services to organizations, developers and manufacturers of high technology industrial products in their development, production and exports in the Russian Federation, have agreed to acquire certain assets of Sibur-Russian Tyres JSC, the Russia based producer of petrochemical products, for a consideration of EUR 222m.</p> <p>Under the terms of the agreements, they assets will be transferred to a 50-50 joint-venture being formed by Pirelli and Russian Technologies. EUR 55m of the consideration will be paid in 2011 while the remaining EUR 167m will be paid in 2012, which will be divided on a pro-quota basis between the joint venture partners.</p>	319	222
22-Jul-11	News Outdoor Company of Russia (79% Stake); and News Outdoor Romania (79% Stake)	TMT	VTB Capital ZAO; NOOH Investments Cooperatief UA; and Marathon Outdoor Cooperatief UA	News Corporation	<p>Marathon Outdoor Cooperatief U.A., the Netherlands based investment vehicle formed by Alfa Capital Partners, the Russia based private equity firm, NOOH Investments Cooperatief U.A., the Netherlands based investment vehicle formed by Peter Gerwe, the Russia and US based private investor and founder of CTC Media, Inc., the listed Russia based media holding company, and ZAO VTB Capital, the Russia based investment bank and a subsidiary of VTB Bank, the listed Russia based provider of financial services, have agreed to acquire a 79% stake in News Outdoor Russia, the Russia based out-of-home advertising company, and News Outdoor Romania, the Romania based out-of-home advertising company, from the News Corporation, the listed US based media company, for an undisclosed consideration estimated to be around USD 270m.</p> <p>The management of both target companies will hold the remaining 21% stake. Yevgeny Senderov of VTB Capital has been appointed the President of News Outdoor Russia.</p>	270	188
5-Sep-11	Energy Retail Company of Bashkortostan OOO	Energy, Mining & Utilities	Rushydro OAO	Bashkirenergo OAO	<p>DAO Rushydro, the listed Russia based energy company, has agreed to acquire OOO Energy Retail Company of Bashkortostan, the Russia based company engaged in the distribution of electricity, from OAO Bashkirenergo, the listed Russia based electricity generation company, for a consideration of RUB 5.77bn (USD 197.254m).</p>	197	138
15-Aug-11	Stavropolskiy Broiler CJSC	Agriculture	Resurs Group	Interros Company	<p>Resurs Group, the Russia based poultry producer, has agreed to acquire Stavropolskiy Broiler, the Russia based poultry producer, from Interros Company, the Russia based holding company engaged in mining, finance, media and real estate, for a consideration of approximately USD 160m. Stavropolskiy Broiler reported revenue of RUB 3.32bn (USD 109.38m) and a RUB 39.52m (USD 1.3m) net profit in the year 2010.</p>	160	111

Notes:

Based on announced deals, including lapsed and withdrawn bids
 Based on the dominant geography of the target company being Russia
 Based on deals announced from 01 July 2011 to 30 September 2011
 Data correct as of 24-Oct-2011

Activities excluded from table include property transactions and restructurings where the ultimate shareholders' interests are not changed

Source: mergermarket

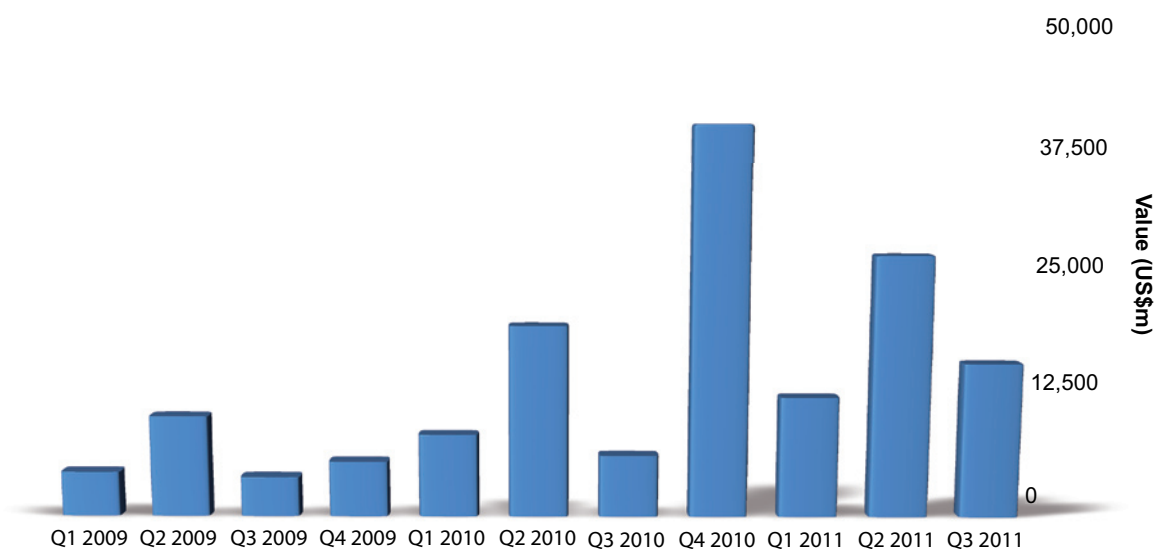
The third quarter of 2011 has seen quite a few notable deals in Russia. The deal landscape remains diverse with transactions happening in different sectors and with different rationales, from consolidation of electricity assets by Inter RAO UES, to eventual resolution of long-standing shareholder conflict at Lenta, and creation of a breakthrough joint venture between Pirelli and Russian Technologies with Sibur as the base company.

Foreign acquisition or exit vehicles continue to be used extensively even in transactions with eventual Russian beneficial owners (eg Highstat controlled by Alexei Mordashov acquiring a stake in Power Machines, Lonestate Assets acquiring stake in Kolmar etc). This reinforces the continued dominance of foreign law in Russia-related transactions.

Another interesting observation is that companies with significant Russian Government stake make a big contribution to the deal activity, with 5 out of 10 top deals having such companies with the government influence among the bidders.

The European debt crisis and the mounting concerns about the future of the US economy do not appear to have had any meaningful impact on the Russian deal activity in 2011. It remains to be seen whether this will continue to be the case going forward.

OVERALL DEAL TREND



COMMENTARY:

The Russian M&A market in the third quarter of 2011 saw the announcement of USD 15.7bn worth of deals, the highest third quarter total on mergermarket record since Q3 2007 (USD 22.9bn).

The most notable deals took place in Energy, Mining and Utilities sector.

The largest deal was the acquisition of OAO Polymetal, the Russia-based precious metals mining company by Polymetal International Plc, the Channel Islands-based acquisition vehicle of Mr. Alexander Nesis, the Russian private investor and a founder of OAO Polymetal.

The USD 5.94bn deal is in line with OAO Polymetal's strategy of getting incorporated abroad and list on the London Stock Exchange with a view to pay off some of its debt and obtain access to a wider investor base.

The second biggest deal worth more than USD 5.3bn was the acquisition of a 23.56% stake in OAO RusHydro by OAO Inter RAO UES and the government of the Russian Federation which will allow RusHydro to strengthen its position in the energy sector and expand its operations in Siberia and the Far East region of Russia. The share placement is being conducted under the auspices of the Russian government, whose goal is to restructure and reorganize its electrical power sector.

Other significant deals in 3Q 2011 took place in Consumer, Industrial and Chemicals and Financial Services sectors.

In the month to come Energy, Mining and Utilities sector will continue to drive the M&A deal activity in Russia closely followed by Transportation and Consumer sectors, according to mergermarket's intelligence.

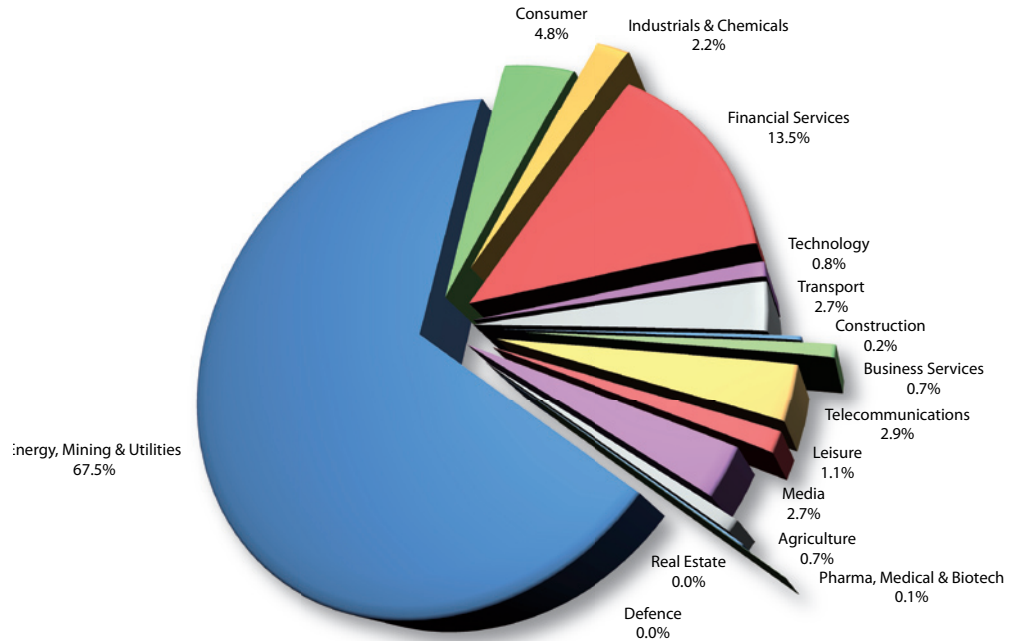
In the Energy, Mining and Utilities space, there are at least two factors that have the potential to spur M&A activity in the upcoming months.

Firstly, under a proposal by the Russian Federal Anti-Monopoly Service, international investors would be allowed to acquire up to a 25% stake (compared to 10% currently) in oil, gas and metals manufacturing companies that hold their own major deposits, without the necessity to obtain permission from the Russian government.

Secondly, the Russian government has put forward plans for privatisation of a large number of state owned enterprises including major energy and financial players such as Transneft, Rosneft, the Federal Grid Company of Unified Energy System and Sberbank.

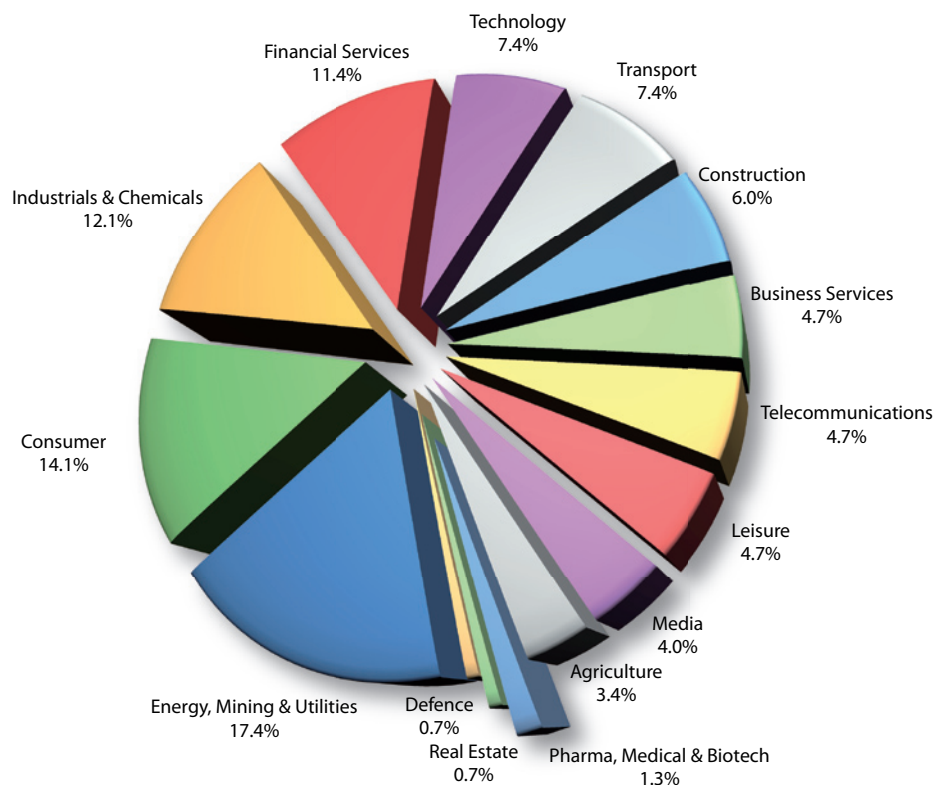
Other sectors that could see increased M&A activity in the near future include Financial Services, TMT and Consumer partly due to upcoming privatisations and the need for further modernisation.

Mix of Announced Russian Deals by Industry Sector Jan 11 to Sep 11 - Value



Source: mergermarket
Announced, excluding lapsed and withdrawn deals

Mix of Announced Russian Deals by Industry Sector Jan 11 to Sep 11 - Volume



Source: mergermarket
Announced, excluding lapsed and withdrawn deals

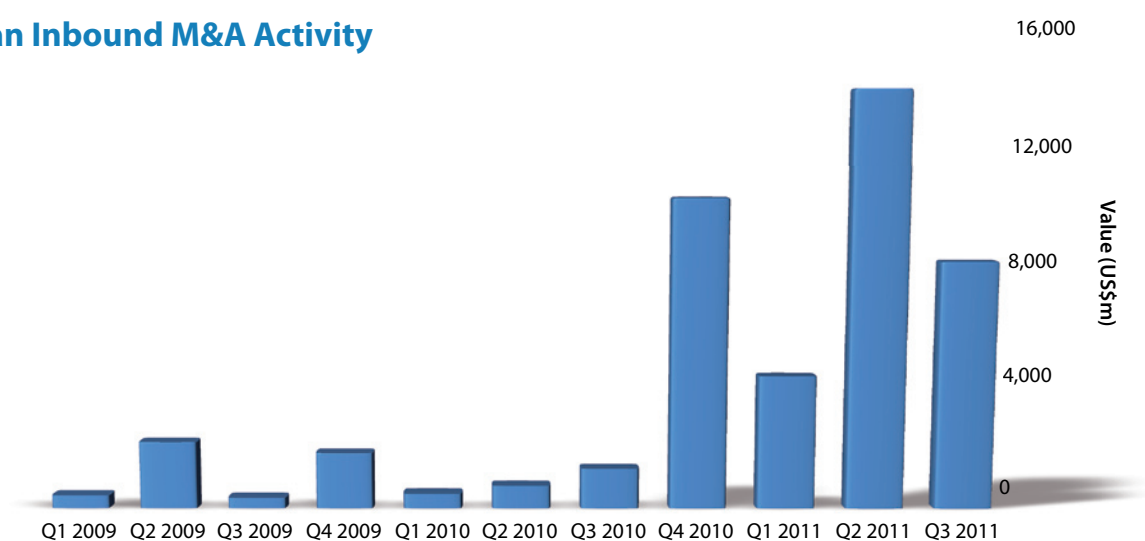
PART II: CHART OF THE MONTH - INBOUND VS OUTBOUND ACTIVITY

COMMENTARY:

2011 has seen a marked increase into the inbound transactions activity with average volume of inbound transactions of over US\$ 9 bln per quarter in the last 4 quarters versus average US\$ 1 bln in the preceding 4 quarters. The number of deals also increased significantly, with corresponding increase from 13 to 18 deals per quarter.

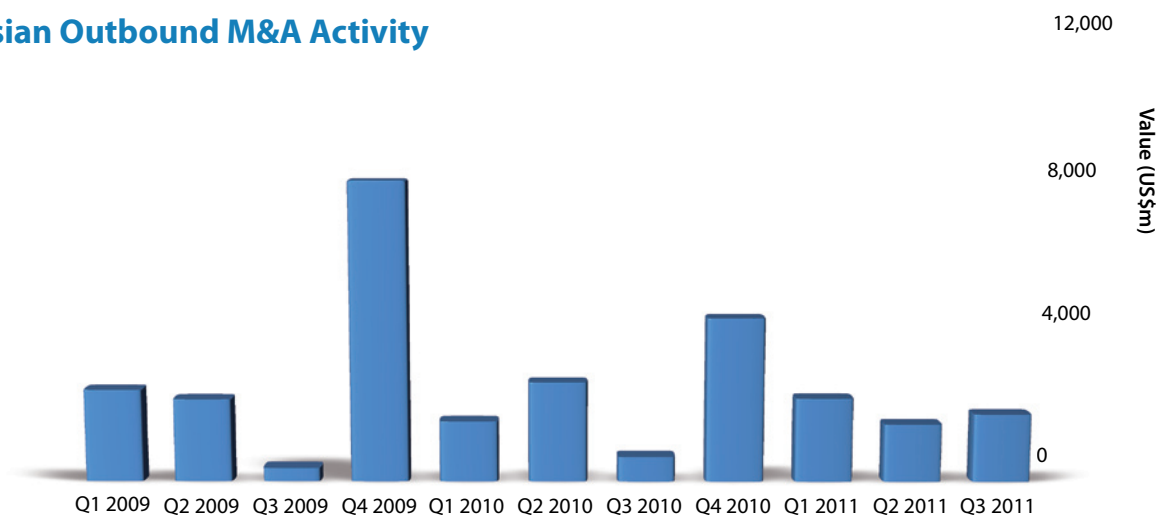
Russian outbound investment activity remains strong, although remains relatively stable with average volume of US\$ 2.5 bln to \$3.5 bln per quarter.

Russian Inbound M&A Activity



Source: mergermarket
Announced, excluding lapsed and withdrawn deals

Russian Outbound M&A Activity



Source: mergermarket
Announced, excluding lapsed and withdrawn deals

PART III. TIPS FROM THE PROFESSIONALS



THE “STAK”: A USEFUL INSTRUMENT IN M&A TRANSACTIONS

By **Jacob Hoogenboom**, *Managing Director at Intertrust Russia*

Introduction

A prerequisite for any smooth M&A transaction is the existence of sufficient trust between the parties. It is therefore fortunate that the modern lawyer's toolbox contains a number of instrument by which trust can be built up and fostered. One of these instruments is the so-called “STAK”, which is widely used in cross-border transactions and becoming increasingly popular in Russia as well.

What is it?

“STAK” is the acronym for “Stichting Administratiekantoor”, which means “administrative foundation” in Dutch. A foundation is a legal entity found mostly in civil law jurisdictions such as the Netherlands, whose key feature is that the entity is self-controlling and does not have any shareholders. Unlike trusts, foundations are legal entities in their own right, duly incorporated and registered with the chamber of commerce. They have their own directors, hold full legal title to their own assets and are – in most countries - able to conduct business as a regular company would.

The administrative foundation is a variant on the standard foundation. Unlike a regular foundation, which typically holds both the legal title and economic rights to its assets, a STAK primarily holds the legal title to its assets and has attached some or all of the economic rights to the assets to so-called “certificates”. The holders of these certificates benefit from the returns on the assets held by the STAK, be it dividends, capital gains or others, but do not hold any of the control (voting) rights on these assets. These control rights fully remain with the directors of STAK who are bound by Dutch law and the Articles of Association of STAK, but do not answer to any potential wishes or instructions given by any of the certificate holders.

Fiscally, the Netherlands has set up a very favorable framework for STAKs. If properly structured, these entities are seen as tax transparent for corporate income tax purposes. Similarly, distributions made by a properly structured STAK are not subject to any withholding taxes, regardless of the jurisdiction in which the receiver is based. STAKs can be combined with regular Dutch

holding companies to benefit from the network of double tax treaties the Netherlands has concluded with other countries.

How is it used in M&A transactions?

Many M&A transactions are achieved in stages or are governed by conditions by which there is a prolonged period of time during which both the buyer and the seller hold an interest in the assets / company being sold. During this period, there is a clear control risk. Both buyer and seller are tempted to use the control / voting rights that they hold at any point in time to optimize their personal outcomes. Think about siphoning of key-assets or key-staff from the company, engaging in transactions that are not in the best interest of the company as a whole, failure to pro-actively manage the company, etc.

By placing the assets / company being sold in a STAK during the entire period of the transaction, the buyer and seller effectively surrender their control / voting rights during this period and thereby mitigate the control risk. The assets are managed independently by the directors of STAK who are bound by a strict framework stipulated in the articles of association. Once the transaction has been fully completed and the buyer has acquired all the certificates in STAK, he can proceed to remove the entity from the structure and take direct control over the assets he acquired.

Conclusion

In this article, we have only touched upon the most basic application of a STAK in an M&A transaction. This versatile and wonderful structure does, however, have a large number of other applications possibilities. Think about employee participation programs, structures in which certain investors should not have access to regular shareholder information like annual accounts, confidentiality considerations, etc. Our recommendation is therefore to further explore the STAK and the benefits it can bring in the context of an M&A transaction.



CHOICE OF LAW FOR PLEDGE OF SHARES IN RUSSIAN JOINT-STOCK COMPANIES

By **Alyona Kucher**, Partner, and **Alexey Yadykin**, Senior associate, at *Debevoise & Plimpton LLP*

Many Russian transactions involve share pledge as one of the elements ensuring proper fulfillment of obligations by the parties. The proper choice law in this regard, as we discuss below, may be an important element in ensuring that your pledge is effective and can be enforced by Russian courts.

The choice of Russian law: key issues to consider

The traditional and most common choice of governing law for share pledge agreements in respect of the shares of Russian joint stock companies is Russian law. There exist good practical reasons making such choice advisable: such choice is more straightforward, it makes enforcement of the pledge through Russian courts simpler and recognition of priority in the course of Russian insolvency proceedings more likely.

However, the choice of Russian law has its drawbacks, too. Not only does it reduce the parties' flexibility, but there may be instances where choosing Russian law to govern the pledge agreement may cause serious legal problems, such as the need to satisfy the rigid requirements for defining the "essential (mandatory) terms" of a pledge agreement.

Pursuant to Art. 432(1) of the Russian Civil Code ("CC"), a contract is deemed concluded (entered into) if the parties have reached an agreement on all of the so-called "essential terms" (*sushestvennie uslovia*).

Among the statutory "essential terms" of a pledge agreement are the nature, amount, and time period for performance of the principal obligation secured by the pledge (Art. 339(1) of the CC). Russian courts have traditionally adopted a very rigorous approach towards defining them. In the event the court establishes that any of the "essential terms" are not sufficiently defined, the pledge agreement may be considered not concluded, i.e., ineffective from the outset.

A recent example of such approach is the Unicredit case (see Resolution of the 9th Arbitrazh Appeals Court dated August 16, 2011, Case No. A40-62359/10-38-239Б), in which the court considered a Russian law pledge agreement not concluded because the agreement defined the time of performance of the principal financial obligation by reference to an anniversary of an

unspecified loan drawdown date, rather than a specified calendar date or a time period running from it.

The Unicredit case exemplifies the high enforcement risks of entering into a Russian law governed share pledge agreement in instances where the nature, value and timing of the principal (secured) obligation are defined in a manner that is not straightforward and fully consistent with the Russian law approach and legal concepts. Such issues may arise, for instance, with complicated English law based corporate and financial transactions that need to be secured by pledge of shares in Russian companies. In such situation it may be worth considering foreign law to govern the pledge agreement.

The choice of foreign law: key issues to consider

Assuming there exists a "foreign element" in the relationship, e.g., one of the parties is a foreign company, Russian law allows the parties to choose foreign governing law for their agreement, including in respect of share pledge agreements. Russian law also does not prevent the technical perfection (establishment) of the pledge as an encumbrance of the shares based on a foreign law governed pledge agreement.

One should bear in mind, though, that a foreign law governed pledge agreement must not be fundamentally incompatible with Russian law.

First, under Art. 1206(1) of the CC, the origination (accrual) of the rights in rem (rights in things) is determined under the law of the country where the thing or asset is situated, e.g., under Russian law as regards shares in Russian companies. Arguably, the pledge holder's rights or at least elements thereof qualify as rights in rem, which means that it is ultimately Russian law that determines if the encumbrance of shares validly arises pursuant to the pledge agreement. Accordingly, a pledge agreement that is incompatible with Russian law, e.g., seeks to establish a form of lien that is unknown to Russian law, may be unenforceable in Russia.

Second, the pledge may have to be enforced through Russian courts, which will apply the relevant Russian procedural laws. There is certain ambiguity as to the consequences of any possible conflict between such procedural rules and the foreign law applicable to the pledge agreement. However, it is clear that should a pledge agreement provide for an enforcement procedure fundamentally incompatible with that envisaged under Russian law, there is a risk that such procedure may be unenforceable.

Based on these and other considerations, even if foreign law is chosen to govern the pledge, it is advisable to make the share pledge perfection and enforcement procedures consistent with Russian law.



RUSSIAN SUPREME COURT RULING ALLOWS RECOVERY OF TAX INDEMNITY FROM THE FORMER OWNER OF A RUSSIAN BUSINESS

By **Anton Sitnikov**, Partner, Head of Corporate Practice/ Mergers & Acquisitions, Goltsblat BLP

Many Russian transactions include provision of tax indemnities by former owners to the buyer of the business if performed under foreign (typically, English) law. Traditionally, questions were raised to which extent tax indemnities granted by Russian individuals under foreign law could really be enforced in Russian courts.

Recently, The Russian Supreme Court of the Russian Federation in its Ruling No 41-B11-4 dated 19 July 2011 confirmed the possibility of recovering damages from the seller and (or) guarantors under a share (ownership interest) sale and purchase agreement where the seller and (or) its guarantors undertook to indemnify the buyer for all losses in connection with operations of the company. In particular, the losses included those resulting from the seller's breach of any warranty or representation, arising before the end of the tax period in which the transaction is closed.

In the case concerned, the buyer filed a lawsuit to collect from the company the tax arrears for periods prior to the transaction date. The seller's obligation to indemnify the losses was guaranteed by two individuals (previous owners of the business). All elements of the transaction were governed by English law.

Since the seller failed to indemnify the buyer for the tax claims, the latter demanded indemnification from the guarantors. The guarantors objected to the claims relying on a number of procedural grounds (the general jurisdiction court being incompetent to hear the dispute, expiry of the guarantee term, etc) and the liquidation of the debtor that constitutes unconditional grounds for terminating a guarantee under the Russian Civil Code.

Notably, by satisfying the buyer's claims for damages in the form of additional tax assessed to the company whose shares were acquired by the buyer, the court not only entirely confirmed the reasonableness of the buyer's claims, but also provided a detailed interpretation of the contractual provisions between the parties on the basis of the legislation of England and Wales and dismissed the guarantors' arguments relying on the Russian civil law provisions.

This Supreme Court Ruling is a consequential precedent confirming the possibility of recovering damages from Russian entities with regard to the contractual purchase of Russian assets even if the recovery mechanism is not stipulated by Russian legislation but the Russian court applies the foreign (English) law.

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