Investment hot spot

We should explore Romania's emerging M&A markets to get a sense of the growth, say Miruna Suciu and Iuliana Craiciu of Musat & Asociatii

Recent market surveys and opinion polls show that despite the international crisis, Romania remains one of the most targeted countries for Mergers and Acquisitions (M&A) and that this trend should not change over the next two years. According to analysts, Romania retains its appeal for foreign investors, having been largely unharmed by the credit crunch. Some sectors have even experienced an increase of M&A deals.

While the international M&A pace has fallen one third on a year-to-year basis in the first semester of 2008, the M&A volume in Romania approximated €3.3 billion ($5.2 billion), a 150% increase on 2007. In this period, around 55% of all transactions that targeted Romanian companies were initiated by foreign investors. It should be no surprise then that the weight of foreign capital injected into Romania in the first semester of 2008 is substantial (estimated at €2.98 billion).

In 2008, local M&A market growth is coming consistently from medium-sized transactions (€20 – €40 million), while very large transactions seem to have, in contrast with the last two years' trend, a slower pace. However, the most consolidated and highly performing industries, such as banking and pharma, are likely to register bigger deals because of the rarity of available targets.

This slower pace of very large M&A transactions is partly due to the 2008 local and general elections: these inevitably affect continuing privatisation and energy projects. These processes are expected to resume their normal speed in 2009, when the newly-elected governmental structures will be in place and ready to continue the development of privatisation-driven projects.

In 2008 Romanian M&A seems to be influenced more by the political factor than the international crisis, which in the short-term we do not expect to significantly affect investors' interest.

In the longer term, a more cautious approach could arise because of the credit crunch, with investment funds and other potential buyers beginning to more carefully assess the dynamics of the increase in the price of all corporate assets (championed by the boom in real estate values) with the decrease in investment yields. As such, for a successful exit strategy, investment funds will need to target companies with increased growth potential that is either organic or supported by further acquisitions.

At the moment, although capital is more expensive, thus diminishing the rate of return on investment, Romania still has a great potential for development, with many sectors far from achieving an acceptable degree of consolidation.

Emerging markets

Real estate

Real estate continues to be the most dynamic sector, as the M&A volumes grew by 30% in the first semester of 2008 compared with the same period of 2007, after a slight reticence at the beginning of the year.

As numerous real estate projects have been announced during 2007, the market is flooded, in some cases over-crowding urban areas hardly able to support the expected level of development. Therefore, analysts say that there are relatively few transactions and low values compared with industry potential because there are few easy to sell projects on the market. Moreover, some developers are struggling to secure the financing required for their projects from local banks, international banks having become less flexible because the credit crunch.

Investment funds active on western markets are striving to compensate their real estate portfolios through new acquisitions in emerging markets such as Romania. While the investors' appetite has not diminished, developers are beginning to focus on undertaking projects of higher quality which could secure steady incomes. With the growing maturity of the market, more complex deals should follow in the near future.

> "Romania remains one of the most targeted countries for M&A. This trend shouldn't change over the next two years"

Energy

The Energy sector dominates M&A worldwide, with over two thirds of the transactions located in Russia. In Romania, as in all emerging markets, M&A is largely a privatisation-driven sector. Power, oil and gas seem to have been the basic pillars of the M&A market in Romania in recent years. In May 2008, the Italian utilities company Enel closed the acquisition of Electrica Muntenia Sud, one of the most important electricity distribution companies in Romania, in the largest privatisation deal to date. A stake of 67.5% of the company's share capital has been acquired for €820 million. This fresh acquisition follows an earlier deal whereby Enel acquired 51% of Electrica Banat and Electrica Dobrogea for €112 million. Further transactions in this field are those concluded by CEZ and E.ON, following which the majority stocks in the electricity distributors Electrica Oltenia and Electrica Moldova have been purchased for $326 million. This success story started four years ago in the gas industry, with the takeover of Distrigaz Nord and Distrigaz Sud by E.ON Gas and Gas de France, as well as OMV's acquisition of Petrom.

Apart from energy privatisation projects, a spectacular transaction was recorded in 2007 with the Romanian oil company Rompetrol putting 75% of its stock at stake for no less than $2.7 billion, paid by the Kazakh oil company KazMunaiGaz. It was the second largest takeover of a Romanian company after Erste Bank bought the Romanian Commercial Bank for €3.75 billion in 2005.

In 2008, continuing high-profile privatisation projects include the development of units three and four of the Cernavoda nuclear power plant initiated by the Romanian Government (a project estimated at more than €4 billion), as well as brownfield projects involving electricity and thermal power stations on the existing platforms at Braila, Doicesti, Borzesti and Galati initiated by Termoelectrica, the largest electricity producer in Romania. Hidroelectrica (the owner of hydroplants) is also expected to take around €160 million from the sale of its last micro-hydro stations. Last but not least, renewable energy, in gaining momentum, with an increasing number of projects undergoing development, typically through a joint venture of foreign and local investors. The focus on renewable energy is being driven by the need for green energy under the European directive regarding renewable energy production quotas.

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Financial services

Financial services come third in the ranking of hot M&A activities. For example, the insurance market has been reshaped by recently closed transactions. The high number of bidders is an indication of the interest in this industry. Further to the acquisition of 100% of shares in BT Asigurari from Banca Transilvania for €100 million in December 2007, Groupama strengthened its position by acquiring Asiban for €350 million, a record figure for the industry. Uniqua Group Austria recently announced its takeover of Unita for €250 million from Vienna Insurance Group (VIG), while BCR Asigurari and BCR Asigurari de Viata switched sides following the European-level disposal of insurance companies formerly part of Erste Bank Group to VIG.

Banking

In the banking industry, large banks are expected to continue to strengthen their presence over the coming years amid fierce competition, rising costs and declining profitability. An unparalleled expansion of banking networks took place in 2007, resulting in more than 1,000 new branches (most of them in urban areas) opened in one year. However, the lack of specialists has caused a general increase in labour costs, contributing to a trend of decreased profitability.

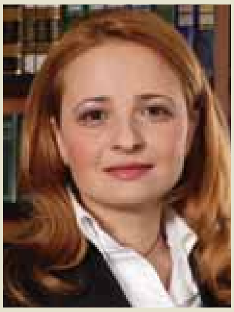
With competition for clients swelling, large banks have consolidated their dominant position within the banking system, accounting for up to 63.2% of all banking assets. Smaller banks lost ground and saw their market share shrink by over 7%. Although lending is the most competitive activity at the moment, there is considerable potential for growth: bank

Author biographies

Miruna Suciu
Partner, Musat & Asociatii

Miruna Suciu has developed a broad expertise covering complex transactions involving energy regulations, M&A and privatisation, as well as competition and antitrust matters. Ms Suciu's other main specialisation is banking and finance, where she has gained unparalleled experience by advising on a broad spectrum of financial products and services including syndicated lending and leveraged and acquisition finance, asset finance, derivative products, project finance, financial regulation, insolvency and restructuring and structured finance. Ms Suciu has gained considerable experience in and understanding of energy-related projects, energy sector financing and restructuring. She has also advised major companies in the utilities industry in complex transactions and issues brought about by continued market liberalisation, including legal and functional unbundling.

Ms Suciu has assisted clients in meeting the increasingly complex demands of regulatory frameworks in areas such as emissions and energy trading, power generation, distribution, transmission and supply licensing. She has been consistently engaged in a variety of high profile deals over the years, advising on matters relating to structuring and negotiation projects, as well as overseeing regulatory compliance and its successful implementation. She is a frequent lecturer on banking, project finance and energy matters. Ms Suciu is a member of the Bucharest Bar Association and the National Insolvency Practitioners Association. She is fluent in Romanian, English and French.



Iuliana Craiciu
Partner, Musat & Asociatii

Iuliana Craiciu has built an impressive expertise in banking, finance and capital markets matters, where she has advised large international companies on a wide range of projects, from acquisitions schemes structuring and negotiation, secured and unsecured loans, project and asset financing, to greenfield and consumer finance projects.

Ms Craiciu's expertise in capital markets and securities covers cross-border securities transactions, regulatory compliance and corporate governance issues including international securities offerings, leveraged and structured buy-outs and derivative products. Her other areas of expertise include M&A with a focus on projects in the banking, capital markets, insurance and energy industries, where she has advised blue-chip corporations on numerous occasions.

Being at the forefront of developing innovative and practical solutions to difficult issues arising in complex transactions, Ms Craiciu has also achieved considerable skill in domestic and cross-border taxation matters, including direct or indirect taxation and transaction structuring with a view to achieving maximum tax benefits.

She has advised large international companies in a wide range of insurance-related projects including, among others, regulatory compliance to bancassurance and life insurance.

Ms Craiciu is a member of the Bucharest Bar Association and the National Insolvency Practitioners Association. She is fluent in Romanian, English and French.

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loans account for less than 10% of financing sources.

As the banking sector is dominated by subsidiaries of major foreign banks, M&A deals between them are highly unlikely at the moment. Companies interested in entering the market could either become involved in a greenfield project or target one of the remaining three local banks on the market: CEC Bank (undergoing extensive restructuring at the moment), Banca Carpatica and Banca Transilvania.

Pharmaceuticals

Large investors like GlaxoSmithKline and Zentiva dominate the Romanian pharmaceuticals industry, together with local companies. The pharmaceutical industry is among the most attractive for strategic and financial investors, as evidenced by the record 53 letters of interest received by the Romanian State for the privatisation of Antibiotice SA. At the moment, investors eagerly expect the Antibiotice privatisation to be resumed (it was suspended in March 2008) by a government decision. The acquisition of Labormed by the US investment fund Advent International was recently announced. It marks Advent's comeback in the pharmaceutical industry, which it exited two years ago by disposing of Terapia Cluj to Ranbaxy. Acquired in 2003 for €39.8 million, Terapia was sold for €277 million three years later. Such an impressive move makes everyone wonder what strategy Advent has in store for Labormed.

Automotive

In the automotive sector, Ford's recent entry on the market triggered an increase in greenfield projects initiated by car components manufacturers who have extended their Romanian operations in an attempt to cut costs. They are expected to enter the consolidation stage in the near future.

Telecoms and internet

The telecoms industry is riding a wave of consolidation as the largest mobile operators have indicated their interest in acquiring local distributors (for instance, the acquisitions of Proton Tehnologies and Vegastel by Vodafone Romania). The market awaits Zapp's comeback, which could occur quite soon as the mobile operator has just received a facility from the China Development Bank, with €220 million to be invested in extending the operator's 3G network in Romania.

The online industry has recently come into the spotlight with local entrepreneurs selling their online businesses, for surprising sums, to private equity funds. The sale of eJobs and Neogen were the first transactions that set a price for locally-developed online businesses and raised standards for the industry. Valued at more than 30 times Ebitda, they signaled an over-excitement in investors and an over-valuation creating high expectations in the market. More internet entrepreneurs are expected to cash in on the success of their businesses.

Expected trends

Despite the lack of very large transactions in 2008, the M&A market in Romania has the capability to improve itself in the coming years. While legislation could become more stable, predictable and friendly towards foreign investors, the country's potential and resources can hardly be overlooked by those intending to expand their business in the region. Having a stock market (the Bucharest Stock Exchange) that suddenly became a target for similar institutions overseas and opening its borders in line with the principle of the free movement of capital, goods and services, Romania expects more economic growth and business expansion.

Fortunately, at this time the leading Romanian law firms are at the peak of their expertise and growth, after more than ten years of handling both private and public transactions. The ever-expanding legal knowledge, the ability to override risks and the refinement of tailored solutions and options for investors are traits that saw lawyers gain respect and influence from a select group of international corporations.

Since the pace of M&A deals closely influence and fuel the development of adjacent markets (legal services, management consultancies, financial advisories), the consultancy market is expected to reach €400 million in 2008, of which €150-€200 million accounts for the legal services market. The gap between the top three law firms and the rest of the market is expected to grow in 2008, while the international law firms who recently entered Romania still have to prove their stand against the dominant local firms.