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M&A boom in the CEE: how firms are harnessing the trend

By **Dearbail Jordan** 30 January 2017 00:00

The M&A market in Central and Eastern Europe (CEE) ended 2016 with a bang. While the volume of transactions fell to 5,079, according to data from Thomson Reuters, the total value doubled, to $250bn (£250bn).
A recent deal by Japanese brewer Asahi to buy SABMiller's CEE assets from new owner AB Inbev for €7.3bn (£6.3bn) is hopefully an auspicious sign for M&A activity in the region. This major deal is set to close in 2017.
However, with Europe facing significant political headwinds including elections and a new US administration, will buyers and sellers become risk-averse? And why have international law firms dominated M&A tables for so long? *The Lawyer*'s CEE experts discuss.

On the panel

bpv Jadi Nemeth managing partner Andrea Jádi Németh, and partner Péter Garancsi
Kocian Solc Balastik managing partner Dagmar Dubecka
Lakatos Köves and Partners managing partner Péter Lakatos
Maravela joint managing partner Alina Popescu
Nagy és Trócsányi Ügyvédi Iroda partner Péter Berethalmi
PRK Partners managing partner Martin Kriz
Ţuca Zbârcea & Asociaţii deputy managing partner Ştefan Damian

Did the M&A market grow in your country in 2016? If so, what helped activity – and if not, what hurt growth?

Dagmar Dubecka, managing partner, Kocian Solc Balastik: In contrast to the West European market the CEE M&A market appears to have grown somewhat in 2016.

In the Czech Republic this probably comes down to a combination of strong domestic performance and the relatively weak CZK against the euro. There are attractive businesses to buy, with a foreign exchange discount. Outward investment remains strong, particularly further east into Central Asia, Asia and the BRIC countries. This has brought firms like ours interesting opportunities in those regions.

As elsewhere, there is evidence the CEE remains a sellers' market, with more auctions, more competitive auction conditions (including more bidders getting into – and the requirement for lending commitments in – round two) and sellers accepting less conditionality. Alternative lending is on the increase.

Péter Garancsi, partner, bpv Jadi Nemeth: The regional M&A market has seen a slowdown overall compared with 2015, but transaction activity seemed to be picking up by the year-end.

Nevertheless, industries performed differently in 2016; for example, the real estate market continued to buoyantly grow both in terms of volume and value throughout the region, particularly in Hungary and the Czech Republic, whereas Poland remained a stronghold for the IT sector. Both private equity and strategic buyers are active in the markets, with a strong US presence having the benefit of the robust dollar against the euro and local currencies.

Financial services is yet to fully recover from a period of consolidation, with declining profits and regional players leading the acquisitions. Disappearing Russian investments are being offset by growing interest from Chinese equity.

The region continues to be fragmented, with certain countries perceived as riskier due to their domestic political agendas, notably Poland and, perhaps to a decreasing extent, Hungary. The latter is also peculiar due to the fact that the state is a strong participant in the transaction market, keeping local and international advisers occupied.

Overall, prospects for 2017 are positive in the CEE and we expect an intense year of M&A work.

"Investors no longer consider CEE a coherent investment area, as countries present differing risk and market circumstances"
Péter Berethalmi

Péter Berethalmi, partner, Nagy és Trócsányi Ügyvédi Iroda: The M&A market in the CEE was relatively stable in terms of the announced deals, but declined somewhat in terms of value.

In general, investors no longer consider CEE a coherent investment area, as countries present differing risks and market circumstances.

In Hungary the market got back to the pre-crisis level, but in 2016 number of disclosed deals decreased by 9 per cent.

Domestic transactions, where both the seller and the buyer were Hungarian entities, continue to dominate. In the CEE, and in Hungary in particular, the manufacturing sector was the most active.

Alina Popescu, joint managing partner, Maravela: Although 2015 was an excellent year for the M&A market (worldwide, including the CEE region), 2016 saw a slight decrease in volume and value.

Investors' appetite has diminished due to increased risk in transactions as a consequence of unstable economic and geopolitical factors including the US election, Brexit and a slower Chinese economy.

Have you made any changes to your firm to accommodate changes in M&A? For example, have you recruited sector specialists or expanded? Have you built your public and/or private M&A teams and/or acquisition finance teams?

Péter Lakatos managing partner, Lakatos, Köves and Partners: We've made a number of significant hires in the past year. At partner level we have been joined by Ádám Máttyus and Eszter Ritter, two partners from regional firm Kinstellar, who joined our corporate M&A team. Our offering in relation to competition law, in the FMCG sector and for German clients has been significantly enhanced by these arrivals.

In addition, senior M&A and competition associate Iván Sólyom has been promoted to partner. The partnership has also been joined by English finance lawyer John Fenemore, from Clifford Chance in London, who enhanced our finance – and, in particular, acquisition finance – capability.

Martin Kriz, managing partner, PRK Partners: We've kept growing steadily over the past few years. Our M&A teams are certainly more broadly based in terms of specialisation than they used to be and we recruit specialists if we feel our home-grown practice is not strong enough.

This is most definitely not the case in [acquisition] finance, which has always been our flagship practice. Public M&A has never been a particularly high proportion of legal work as we are countries of non-listed subsidiaries. If or when this changes we should be rather well-positioned to seize the opportunity, given the strength of our capital markets practice.

Ștefan Damian, deputy managing partner, Țuca Zbârcea & Asociații: As a full-service firm there was no real need to build new departments from scratch as M&A changed, and the surge in transactional work I mentioned earlier happened in areas we already covered pretty well.

Instead, we have strengthened departments to cover the need for specific types of M&A, such as retail, banking, pharma and medical services; and food and agriculture. We did this mainly by way of internal promotions and relocations and, to a lesser extent, by lateral hiring.

British, American or German law firms have dominated the M&A league tables in CEE for the past five years – is this a concern? How do you compete, and how can your firm differentiate itself from overseas competitors?

Lakatos: We see the international network firms across the table from us on most of our large transactions because our client base is as international as the Budapest offices of many of those international firms, because we have more foreign qualified lawyers in our team.

We differentiate ourselves as being one of the only firms to be locally focused but with an international outlook and client base. Much of our work comes from leading international law firms who do not have an office in Budapest.

To the extent that we need to assist our clients and those firms elsewhere in the region we have a good relationship with the leading firms (our peers) in the countries of Central and South Eastern Europe. We consider our firm to be committed locally and not burdened with an international network.

"The Hungarian state showed an increased interest in strategic businesses"
Andrea Jádi Németh

Andrea Jádi Németh, managing partner, bpv Jadi Nemeth: The past five years have seen a rather mixed M&A landscape in the CEE region.

Naturally, corporate combinations between and among large multinationals required derivative and ancillary M&A counselling, this work frequently being carried out by the Hungarian affiliates of large Anglo-Saxon law firms.

The Hungarian state also showed an increased interest in strategic businesses and acquired privately owned companies in diverse sectors. And the state sought the transactional advice of the large international law firms' Budapest offices.

Nonetheless, global political instability and risks of regional economies compel investors large and small to apply conservative and cautious budget-planning concerning transactional costs.

We have found that this trend has benefited the more 'individualised' specialised law firms with subtle local market knowledge, who are able to perform top-quality work with flexibility and speed. We take pride in having been involved in some of the largest and most intricate corporate transactions of recent years and look to the future with optimism.

Also, besides relying on our regional alliance, bpv LEGAL, we've been strengthening our ties with the UK- and US-based law firms not disposing of formally affiliated Hungarian offices.

We see the combination of all the above factors as drivers for our increasing M&A portfolio in deal value and deal volume.

As far as German investors are concerned, two years ago we opened a German desk headed by native German attorneys. We are hoping that our culturally responsive business-oriented approach finds favour with our German-speaking clientele.

Berethalmi: In the CEE, Hungary is slightly different as domestic transactions continued to dominate so I'm not sure the British or American firms had an advantage. We differentiate our firm from the overseas firms in Hungary by having relatively large teams of experienced lawyers on the ground with proven records across most sectors.

Often in these transactions it's quality local advice that clients need, not least because of the Hungarian language and legal system. They can't always get this from UK, US or German firms.

League tables are all very well but they only show the headline figures of firms choosing to submit, not the complex legal advice we can offer.

Also, we have strong ties with British and American independent law firms and with our Lex Mundi fellow firms around the globe.

"The transatlantic elite prefer to team up with top domestic practices to do the deals you see reported in league tables"
Martin Kriz

Kriz: The league tables don't convey the full picture. When overseas firms arrived here in the 1990s on the wave of foreign direct investment, local competition was non-existent: practically all the top-ranked practices were international brands. Since then, many overseas firms have either left or downsized substantially. In the meantime, domestic firms have outgrown the local practices of international firms and now represent a good half of top-ranked firms.

Is it really domestic firms who should be concerned? Another important factor to consider is that these days the transatlantic legal elite mostly do not have offices in our jurisdictions, preferring instead to team up with top domestic practices like ours to do the deals you then see reported in league tables.

We consider those elite firms as our strongest allies and personal friends, and our co-operation is a significant source of high-profile work rather than a concern or a threat.

Popescu: It is normal for M&A deals touching on several jurisdictions to be entrusted to global law firms that have a presence and a reputation for acting internationally.

However, in Romania there are relatively few foreign law firms and some have even stepped down, such as Garrigues, Gide Loyrette Nouel, Linklaters and White & Case. The market is dominated by local players and internationals normally partner with locals when a deal has a Romanian dimension. As such, there's not much of a concern from our perspective.

Nonetheless, if Romania keeps its present growth and development rate we can envisage the opening of new international offices in a few years' time. There is also information about international firms scrutinising the market.

In any case, what stands out for us is solid local knowledge coupled with expertise at the highest international standards.

Add on our membership of IBLC [international business law firm network ranked by Chambers] and a good network of contacts internationally and I'd say we're well-prepared to compete at an international scale.

Last but not least, due to our size we can afford to take a friendlier, personal and tailor-made approach that is appealing to clients, this being one of the advantages of a smaller law firm.

Damian: It depends on the type of investor and type of deal. For example, investment funds seem to have the upper hand over domestic firms as they prefer to hire international firms, this being the case especially with funds that are fairly new to the market.

International firms are still preferred in international and regional deals involving Romania, too. However, when we talk about strategic investors things change quite a bit as such investors prefer to deal with large domestic firms, mainly because these firms are full-service, covering all areas of practice, whereas internationals tend to focus on a couple of lucrative areas.

The same goes for certain investment funds that are accustomed to Romania. I'd say being a full-service firm is a big differentiating factor.

We basically provide the same services as international law firms which, in Romania, have difficulty in delivering all the services we do at the same level of quality and manpower. Another important differentiator is market knowledge, in which I would say, we excel.

Market knowledge is a must for any domestic firm and not that important for an international one; it can make the difference between sealing a deal, or doing so in time, and failing to do so.

What are the biggest barriers to M&A growth your country faces in 2017? The changing political landscape? Brexit?

Kriz: We're bullish and tend to see opportunities rather than barriers.
My perception is that central banks keep printing money and investors are keen to spend. Politics won't derail these activities that easily.

Naturally, no-one is able to rule out the chance that the dynamics of the business cycle will change in 2017 and hit conventional M&A activity. But even if that happened I'd see it as an opportunity for doing distressed M&A and restructurings rather than a calamity.

Popescu: Barriers in 2017 may include reluctance due to changes in the political landscape. An unstable international climate remains the biggest barrier in terms of investors willing to develop new perspectives and not just consolidate the existing business. Then you have to factor in things such as: underdevelopment of the Romanian capital market as M&A activity is mostly private equity; difficulty in accessing local financing; underdeveloped infrastructure; low purchasing power of the population; and overall underdevelopment of the economy, which translates into a lack of appealing targets.

Damian: Like it or not, politics influences the economy, in particular the economy in CEE.

I'm not only referring to Brexit but also to the political events that will come along in 2017 – elections in the EU (Germany, Italy and France, the last two having strong parties with anti-EU platforms) that could make countries focus more on their internal markets while companies from these countries will probably wait for the results of the elections before making any substantial expansions plans.

The US will also be, at least for Romania, an important element; I mean, the Trump administration's policies in relation to this region. The situation in Ukraine should be a cause for concern for the region, too.

In addition, economically, prospects are quite dull – EU GDP growth is close to zero, Greece has never-ending financial problems and there are problems with the entire banking sector in Italy.

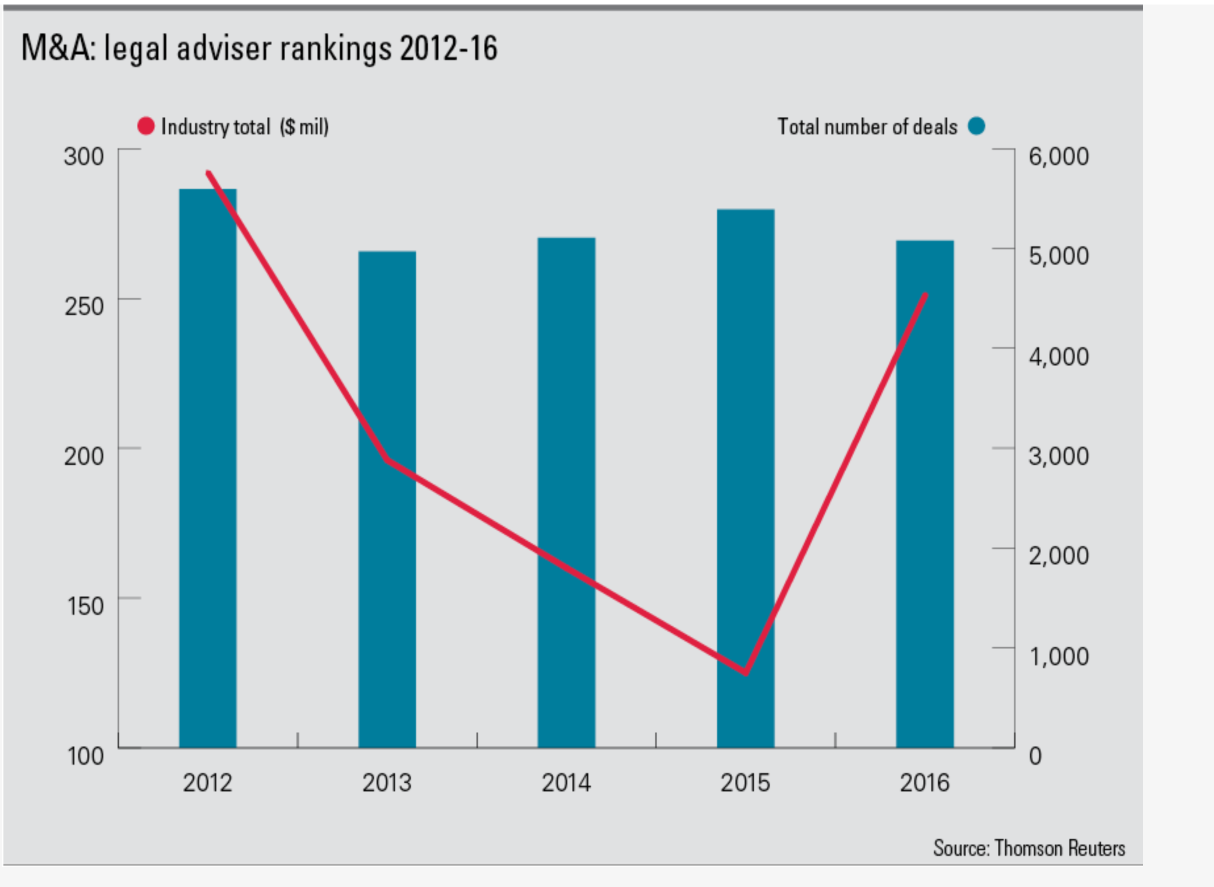
Ironically, notwithstanding all the above, Romania looks politically and economically pretty good and stable: economic growth seems to be continuing at a high rate; we have just completed Parliamentary elections; and the winning coalition and new government seem to be strong and stable with a focus on economic development. However, we don't have a buffer against the rest of the world unfortunately, and if the world – and especially the EU – suffers, we will suffer.

All in all I'm moderately optimistic about 2017. We'll probably see an increase in M&A activity compared with 2016, but it will definitely not be a boom.

Dubecka: Although political risk is increasing generally on the international stage, the CEE region is not directly affected by Brexit or anxieties about the direction of the US post-election.

Political risk, as well as slow domestic growth in eurozone markets, is likely to have only an indirect effect on the Czech Republic in the sense that investors from affected countries may be more cautious about making investments here.

Indeed, the Czech legal market generally has arguably been one of the most buoyant in the CEE region in recent years due to relatively liberal regulation and the attractiveness of Prague as a hub for CEE business.



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