PRUDENTIA M&A FOLIO

BALTIC M&A OVERVIEW

Jan – Apr 2015

Deal Overview

In the first 4 months of 2015, M&A activity in the Baltic states had decreased in comparison to the same period in 2014. During this time period 43 deals were announced, which is by 14% less than in January to April 2014. Interestingly, the M&A activity in the Baltics was considerably calmer in the first 3 months of 2015 - in comparison to the same period of 2014, there was a 25% drop in count of announced transactions, while in April the number of deals started to pick up again.

By the end of 2014, it was projected that the global M&A activity will continue its growth further in 2015, however, it was also noted to keep our expectations more moderate regarding the Baltic states. Dilatory effect of deteriorated geopolitical climate can be perceived as one of the reasons for reduction of the Baltic M&A activity.

The proportion of M&A deals that took place between two Baltic companies compared to deals, where at least one party is from outside the Baltics, continues to withhold so far observed trend - relative convergence to 50/50 percent level. In the first 4 months of 2015, 18 out of 43 deals involved at least one party that did not represent one of the Baltic states.

Largest Baltic M&A Deals in the First Quarter of Year 2015

Target Company (Country)	Acquirer (Company)	Deal Value (M EUR)
BPT Optima Baltics and Poland Real Estate Portfolio (Lithuania)	Partners Group Holding (Switzerland); Baltic Property Trust Asset Management (Denmark)	163
PZU Lietuva (Lithuania)	Gjensidige Forsikring (Norway)	54
Astlanda Hotell and 3 thousand m^2 office (Estonia)	Eften Capital (Estonia)	46
Nt Valdos (41.73%) (Lithuania)	Lietuvos energija (Lithuania)	29.99
Baltnetos komunikacijos (Lithuania)	Atea (Norway)	10.4

NB: Table includes only deals with publicly available transaction value.

A new investment vehicle established by *Partners Group* and *Baltic Property Trust Asset Management* bought portfolio comprising the majority of the assets of *BPT Optima*. The acquired portfolio includes seven well-known office and retail properties in Tallinn, Riga, Vilnius, Kaunas and Klaipeda. The transaction marks the largest real estate investment into the Baltics in the post-crisis period.

The largest Baltic M&A deal of 2014 was performed by a Polish insurance major *Powszechny Zaklad Ubezpieczen* (*PZU*) with acquisition of insurance operators in all three Baltic states from a trade seller *RSA*. However, in order to make this deal happen, *PZU* had to divest its non-life insurance business in Lithuania - *PZU Lietuva.* This was a condition set by *Competition Council of the Republic of Lithuania. PZU Lietuva* was bought by *Gjensidige Forsikring* - the leading Nordic insurance agency with operations carried out also in the Baltic states. The acquisition is in line with *Gjensidige's* strategy to grow in the Baltic region. The Group's market share in the Baltics will increase from approximately 7% to 13%, while in Lithuania the market share will increase to approximately 21%.

Geographic Location

According to breakdown of deal count between the Baltic countries in the first 4 months of 2015, Lithuania ranks first with 20 transactions, followed by Estonia with 17 transactions and Latvia with 12 (it has to be noted that 6 of the announced transactions in the Baltic states were between two Baltic countries). When looking at non-Baltic investment inflows, Lithuania again takes the lead with 8 such transactions, followed by Latvia and Estonia with 5 M&A deals each.

In the first 4 months of 2015, the most active investors investing in the Baltic states were from Sweden and Norway. Only in 3 of all transactions during this time period Baltic funds have gone outside the Baltic countries, to Austria, Sweden and USA, pointing to Baltic investors' passivity to make direct investments in further regions.

Industries and Deal Types

In the first 4 months of 2015, operations with real estate was the most prolific industry regarding the number of deals having 23% share of all Baltic M&A deals in this time period.

According to breakdown of deal count by country in real estate industry, Estonia and Lithuania takes the first place with 4 such transactions, while Latvia had only 2. Also in 2014, leader positions in this sector were held by Lithuania and Estonia, with 11 and 8 deals respectively.

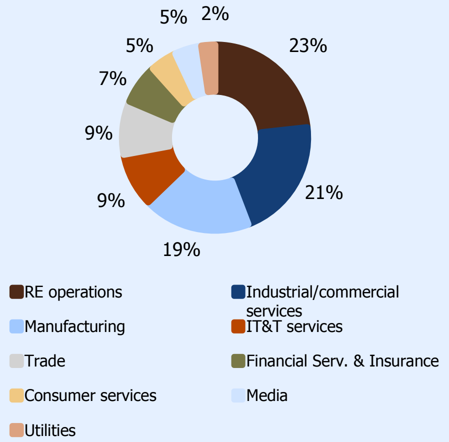
Previously observed trend of high consolidation in the market is also observed during the first 4 months of 2015 - the largest transaction activity is observed in the segment where both the acquirer and the target operates in the same or horizontally related industry. These transactions form 49% share of the total deal count. This trend is justified by greater added value that is created for the businesses through expansion or market position strengthening.

Consistently with the investor and target relatedness, the most frequent investors in the Baltic M&A transactions during the described period were strategic investors accounting for about 72% of the total number of transactions. Institutional investors[1] with a 23% share comprise the second largest group of investors.

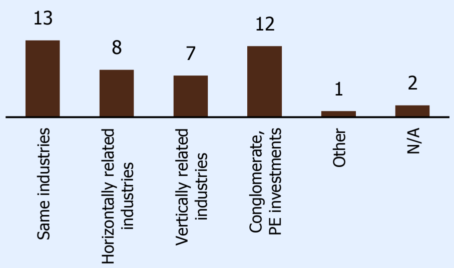
According to publicly available information, all announced M&A, PE, selected VC and selected real estate deals in Baltics in the corresponding time period are reviewed in this report.

[1] Including selected VC-financed deals.

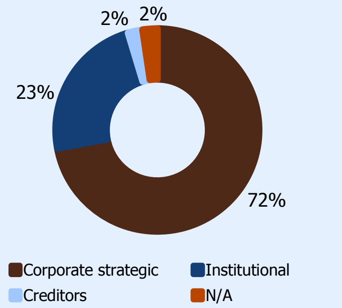
Percentage Breakdown of Deal Count by Industry, Jan-Apr 2015



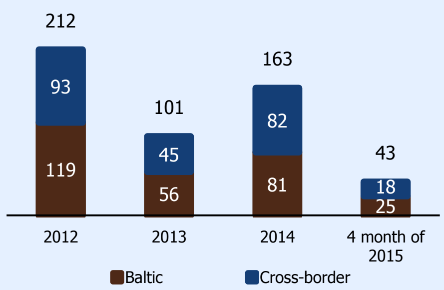
Breakdown of Deal Count by Relatedness of Acquirer and Target, Jan-Apr 2015



Percentage Breakdown of Investors by Their Type, Jan-Apr 2015



Breakdown of Deal Count by Geographic Parameters, Jan-Apr 2015

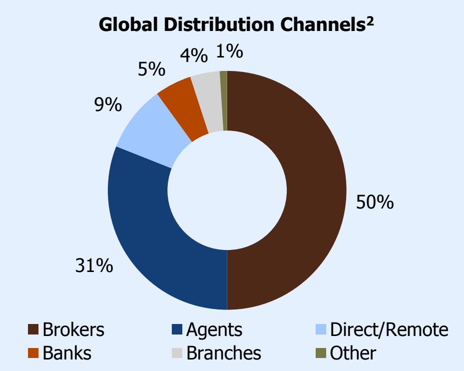


Sources: S&P Capital IQ database, Advisors' and Enterprises' homepages, NASDAQ OMX Baltic, Media

Insurance Industry Distribution Channel Types

There is a wide range of ways of selling the insurance product to the end customer, and it depends on several factors, such as the product itself, the local specifics and national legislation, customer preferences, technological development and many other.

The main source of insurance distribution globally are still the intermediaries, such as brokers with around half of premiums written through this channel and agents with a share of around one third. Other distribution channels are direct writing, bancassurance (insurer uses the bank sales channels in order to sell their products) and other.[2]



The choice of distribution channel by the end customers is highly dependent on the insurance product bought and its complexity. For example, such products as motor third party liability compulsory insurance (MTPL) and travel insurance are becoming more like a commodity product. The choice of insurance company and distribution channel is highly driven by price, so increased sales volume and cost reduction are crucial for insurance companies to stay competitive in these segments. This leads to innovation and automation of processes. Brokers and direct online sales are important sales channels in these segments.

On the other hand, in more tailor made product categories such as life and property insurance, the agent, broker and direct sales channels remain among the most popular ones.

Innovation in Insurance Industry

The intensifying competition in the insurance industry has led the insurers to think of cost reduction, like lower-cost distribution channels. Technological development and search for innovation within the industry is one of the main sources of growth, as well as trigger for increasing the M&A activity.

For example, the leading French insurer *AXA*, in search for new and more innovative distribution channels acquired *BRE insurance* - subsidiary of the 4th largest retail bank in Poland – *mBank*, which is unquestionable leader in digital innovation segment. *mBank* after 14 month of implementing their new internet bank platform gained 6 global awards for innovation.

In 2014, *AXA* announced that they reinforce their presence in Poland through exclusive 10-year bancassurance agreement with *mBank* and 100% acquisition of *mBank's* Property & Casualty subsidiary in Poland, *BRE Insurance*. Partnership implies 10-year exclusive distribution agreement for Property & Casualty and Life Protection insurance.

AXA's motivation is quite straightforward – they plan to access Polish market through *mBank's* innovative and fast-growing multi-channel distribution model, while shifting its business mix towards more Property & Casualty and Life Protection products, which is in line with *AXA's* strategy.

Results of this merger/bancassurance was highly evaluated by experts. In March 2015 *mBank* won another innovation award, but this time *Celent Research* appreciated their insurance sales model. *mBank* provides more than 30 complete insurance products from distance, via modern processes and through all the available channels (internet, mobile, video-calls and outlets).

One of the award criteria was effectiveness of the project, hence this can serve as a clear indicator that digital channels do work.

Increasing Importance of Insurance Brokers

At the same time, the leading distribution channel – brokers – do not stay still on this digitalization and innovation boom. The brokers become more integrated and automated, for instance, by directly linking the search mechanisms to other databases (like centralized car registration and insurance companies' claim history databases) for sale of MTPL and CASCO insurance products thus reducing time required for purchase of the insurance product, as well as reducing administration costs.

The insurance brokers are nowadays gaining a role as fully integrated sales channel. This means that the brokers take on more and more distribution functions from the insurance companies. It is beneficial for both the insurance companies and the end customers. The insurance companies can focus more on their core business by effectively outsourcing the distribution function, and the end customers, at the same time, can have one place where to compare prices, products and after all, get the best deal.

Since brokers start to take their own important role in the overall insurance industry supply chain, it will be a significant M&A activity driver also in this segment.

For instance, in April 2015 one of the largest insurance brokers in the world *Willis Group* announced an offer to acquire French insurance broker *Gras Savoye* to expand its operations in France, Eastern Europe and the Middle East and to add customers seeking coverage for specialized risks.

The transaction is expected to close by the end of 2015 and is subject to customary regulatory consents and approvals, and acceptance of the firm offer by *Gras Savoye's* shareholders.

This was not the only transaction recently that allowed Willis Group to extend its geographical coverage. In January 2015, *Willis Group* acquired *Miller* to expand in London and prior that, last year the *Group* also acquired *Max Matthiessen* to increase its presence in Sweden and Nordic region.

Overall, this draws a trend of market consolidation and moving closer to long-term global brokerage leaders.

What can Latvians expect?

In current market environment it is hard to predict further digital development in Latvian insurance industry. Low interest rates and regulations put negative pressure on companies' budgets. However, most of the insurers in Latvia are subsidiaries of international companies with substantial budgets. So it is more likely that innovation will come from them, due to available resources for the constant innovation race.

Also it is expected that outsourcing of insurance services to intermediaries (brokers) will become more popular with a goal to reduce insurance companies' costs and adopting the Western European operational model, where many insurance companies in specific countries are operating only as risk underwriters. Outsourcing possibilities of insurance services could also lead to a situation when a global MTPL or CASCO insurance company is represented in Latvia without having a need to open a local office (a marine and aviation insurance currently being as a successful example of such model).

Nevertheless, the penetration rate for use of online distribution channels and other innovative digitalized products is higher in Latvia and other Central and Eastern European countries than in so-called "Old" Europe. In addition, the innovation and automation of brokers' work has been in recent years more advanced in this region than in the Western part of the continent. One of the reasons of this trend might be significantly lower development costs. Since development of any platform should be cheaper for small country, due to smaller requirements for server and smaller wages for developers. Also, companies themselves are smaller, meaning that there is a lower internal bureaucratic system for trying new products and ways of distribution.

An example of "distribution" driven deal is the recent *PZU* deal, which was partly driven by relatively high direct sales and cozy distributional channels. Such public recognition can be result of friendly support and simple claim fill on the internet.

Level of innovation in this region is high so we think that targets in insurance industry from CEE will continue to be popular and their innovation will serve as a major M&A deal driver.

[2]*Source: McKinsey Global Insurance Industry Insights*

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