

## Merger, takeover type

### Metinvest and the Smart Group united to forge a monopoly on the iron ore market

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At the end of September the company System Capital Management (SCM) owned by Rinat Akhmetov and the Smart Group controlled by Vadim Novinskiy officially announced the merger of their assets in the mining industry. Talks about the possibility of such an alliance began back in the middle of the summer. The announcement of the joint modernization of Makiyivka Steelworks (Makiyivka in Ukrainian) was the first sign of cooperation between SCM and the Smart Group.

Initially, US \$3 bn in investments figured into the picture. Later, this figure was upped to US \$5 bn. Metinvest, which is the holding company that manages SCM assets in the mining and smelting industry, received the right to sell metal products produced in Makiyivka.

Insiders of the companies involved in the deal claim it to be a merger, while outsiders are more inclined to label it an acquisition of Metinvest by the Smart Group.

The three enterprises controlled by Novinskiy – Makiyivka Steelworks, Inhuletskiy Ore Enrichment Plant and the Promet Steel Mill (Bulgaria) – will become part of a new company that will keep the name Metinvest. Around 80% of the shares of Metinvest belong to SCM, while the remaining 20% belong to the Dutch company Metinvest B.V., which is also controlled by Akhmetov. SCM representatives say that the merger will be completed by the end of this year.

As a result of the merger, Smart-Holding, which manages the assets of the Smart Group, will become the second owner of Metinvest. Here it is quite typical that Novinskiy's shares in the Pivdenniy Ore Enrichment Plant, the Balaklava Mining Group, Moldova Steelworks and the Kryviy Rih Ore Enrichment Plant (in the event it is formed), which is a joint venture between the State Property Fund of Ukraine and Russia's Metalloinvest to complete its construction, do not figure into the deal.

Igor Syroi, General Director of Metinvest, says that this deal will not be made through a money transaction. Instead, the Smart Group will transfer all its shares in three enterprises to Metinvest and in exchange will receive a share package in Metinvest's authorized capital. Novinskiy's share in the future company is not being disclosed as the talks continue.

According to assessments made by Yevhen Chervyachenko, an analyst at the Concorde Capital investment company, the owner of the Smart Group will receive a share of around 25% in the joint venture.

Oleksandr Makarov, an analyst for Keramet Invest, agrees with this assessment: "We expect concessions of 20-25% in the share of Metinvest (the majority belongs to Metinvest B.V.) in favor of the non-resident companies controlled by Novinskiy. In exchange we will witness the sale of the share packages in the companies controlled by Novinskiy to Cypriot companies, which belong to the very same Dutch company Metinvest B.V."

Appraising the value of the merged structure will not be an easy task. Makarov explains, "Because Metinvest is not a publicly owned company, it is impossible to talk about capitalization. If its shares were to be circulated on the stock market, the capitalization of the new company in the current market climate would be estimated at US \$25 bn."

Andriy Bolshakov, Director of Strategy and Investments for Metinvest, gave a similar figure in his appraisal of the value of the new amalgamation. He said that capitalization of Metinvest prior to the merger was approximately US \$18 bn, where the value of the two holding companies appraised separately is lower than the value of the merged structure. At the same time, Chervyachenko is more reserved in his assessment saying that capitalization of the new structure will be slightly more than US \$16 bn.

Industry experts say that after the merger of Metinvest and the Smart Group, the Ukrainian market of iron and ore raw materials will become more consolidated. Chervyachenko estimates that the share of Metinvest in the market will amount to 70%. In Makarov's opinion, the total production of concentrate by the joint venture will exceed 55 % of Ukrainian concentrate. The expert at Keramet Invest offered his assessment: "The company is basically monopolizing the Ukrainian concentrate sales market and will occupy approximately 75% of it."

This poses a potential threat to the main clients of the Inhuletskiy Ore Enrichment Plant – namely, Mariupol Illyich Steelworks, Zaporizhstal and Alchevsk Steelworks.

At the same time, the Anti-monopoly Committee of Ukraine (AMC) obligated the Inhuletskiy OEP (i.e. it gave the Metinvest B.V. Private Limited Company the green light to purchase more than 50 % of the shares in the steelworks) to sell its products at equal prices to all its consumers. Makarov offered his supposition: "We believe that there will be no diversification of prices for different consumers. Moreover, there is no reason to expect an increase in the final price of iron and ore raw materials sold to steel mills following market trends, rather due to the merger of these ore enrichment plants. The more likely scenario is the introduction of more transparent schemes of price-setting and the sale of products of the Inhuletskiy OEP."

Be that as it may, Oleksander Pilipenko, Vice President of the Industrial Group, which manages the assets of the Donbas Industrial Union, sees no danger in the merging of assets of these holding companies, though this should be performed on certain conditions: "If the state is responsible to recognize the joint holding company as a monopolist and then later regulates prices, this not pose a threat to metallurgical companies and there will be nothing wrong with such a form of monopolism. There are many monopolies operating around the world, but their activity is regulated. If the holding company takes advantage of its monopolistic position and operates in non-market conditions, then we will have to seek a solution to this problem."

Not waiting for the AMC to make its move, Ukraine's metallurgy companies began seeking alternative ways to guarantee them a supply of raw iron ore. As an example, the yet to be registered joint venture to finish construction at the Kryviy Rih Ore Enrichment Plant gave Arcelor Mittal Kryviy Rih to attract such allies as the Mariupol Illyich Steelworks and the DIU to complete the mill's construction.