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Analyst's Notebook

Ukraine / Metallurgy
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****Editor's Note:** In order to keep our coverage of the Ukrainian market as up to date as possible Concorde Capital is launching a new product – Analyst's Notebook. Unlike our more in-depth desk notes and reports, Analyst's Notebook provides rapid feedback on breaking news in the Ukrainian market. Analyst's Notebook gives you our analysts' first impressions of a situation and may set the table for further investigation. Our analysts will use their experience in their sectors to take a look at the situation and provide insight or speculate on possible scenarios. We want to emphasize however, this product consists mostly of the analyst's intuition and may require further analysis.

Zaporizhstal's Ownership Restructuring

Buzz In The Media

Rumors that one of Zaporizhstal's key shareholders is about to forgo its stake in the company have been drawing a lot of headlines.

Presently, there are three major shareholder groups which own approximately equal stakes and participate in the management of the company's operations. These are: Kyiv Investment Group (~30% stake), Midland Resources (~29% stake) and Zakhid-Reserve (28.5% stake). The Kyiv Investment Group allegedly associated with Vasyl Khmelnytsky (interests in Kyivenergo, Kyiv Bread, real estate and retail chains in Kyiv) is rumored to be exiting the business.

The Facts

We have received several indirect confirmations that suggest that one of the shareholders may sell or has already sold its stake in Zaporizhstal. Specifically, in December 2005 the Head of the Anti-Monopoly Committee (AMC) Oleksiy Kostusev hinted that there was a bid for the purchase of a 29% stake in the company. At the same time, the AMC issued permits to UK-registered companies Mawerton Ltd (apparently related to Kyiv Investment Group) and Global Steel Investments Ltd (believed to be linked to Midland Resources) to consolidate a controlling stake in Zaporizhstal by contributing their stakes to a new company, Steel Group Ltd (Cyprus).

What's Really Going On?

The question is, what is behind all of this shareholder reshuffling. In our view, the new entity, Steel Group Ltd, will now own ~59% of Zaporizhstal, and be controlled solely by Midland Resources, cutting out Kyiv Investment Group. There is a good economic reason behind this move, Midland Resources controls 60-70% of Zaporizhstal's exports, and Zakhid-Reserve controls the remaining 30% through its respective trading arms. By fully controlling the company's exports, these two shareholder groups have the most say in managing its overall operations and do not need a third wheel, Kyiv Investment Group.

Thus Midland buying out Kyiv Investment Group's stake looks probable. Therefore, we believe that only two shareholder groups will now exercise operating control over Zaporizhstal: Midland Resources with an enhanced stake of 59% and Zakhid-Reserve with a stake of 28.5%. In the future Midland will likely incorporate the stake of Zakhid-Reserve through its subsidiary Steel Group Ltd.

A Spring-Board For Going Public?

By consolidating control, Midland can make Zaporizhstal's development strategy more consistent. In particular, there will no longer be any need to align the interests of different shareholder groups with blocking stakes in regard to sources of the company's external financing. We think that transferring control of the company over to one particular shareholder group may facilitate any of the following: an IPO, the issuance of Eurobonds or a take over.

All in all, we view the share consolidation process in this case as inherently positive both from the standpoint of operating efficiency and as means for making raising capital easier.

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