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Analyst's Notebook

Ukraine / Metals
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Recommendation: **Suspended**

Another Dilutive Bomb: ZaporizhCoke

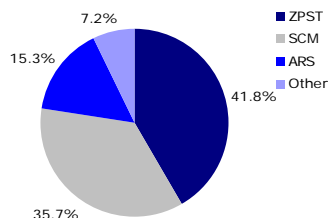
Company Signals Dilution Threat in Obscure Local Paper

Today ZaporizhCoke (ZACO) published a notice in an obscure local newspaper in Zaporizhyya of its plan to hold an EGM in mid-October. According to the agenda outlined in the notice, ZACO plans to increase its charter fund ~11 times, by nearly USD 2.2 mln to USD 2.4 mln, in order to finance the acquisition of a certain TOV Zarf, a legal entity of which we failed to find any trace in any available data bases. The shares of the additional emission will be exchanged for a 100% stake in Zarf. Minority shareholders will not be allowed to subscribe. The owners of Zarf are not known.

Who Stands Behind the Emission?

Currently three shareholder groups, Zaporizhstal (**ZPST: Susp**), System Capital Management and ARS have the largest stakes in ZACO. None of them have full control over the company's operations (see the chart below).

ZACO's Current Shareholder Structure



One hypothesis on the market is that the issue is a scheme to arrange payment for acquisition of ZACO, either by SCM, Zaporizhstal or a third party. Since 75% of shares are required to approve a capital increase, the only possible pair of parties able to do so are Zaporizhstal and SCM. According to this hypothesis, Zarf is an SPV recently created and controlled by whoever is buying control of ZACO. That would allow the payment for the stake in ZACO to be made offshore, and thus no tax obligations would arise in such a transaction, unlike in a direct sale. Below we outline three possible scenarios based on who owns Zarf:

Case 1: SCM Owns Zarf

SCM has plenty of reasons to be considering increasing its stake in ZACO. First, after such an acquisition, SCM together with Privat would control the domestic coke market and increase their export potential. SCM is already by far Ukraine's largest coke producer. Second, SCM is currently busy restructuring its diverse holdings into separate metal, energy and telecom businesses, with separate IPOs planned in about two years. SCM could be interested in building up its coke segment in Metinvest, the managing company for SCM's metal-related assets.

New Shareholder Structure. Case1. SCM:

SCM	93.7%
ZPST	4.1%
ARS	1.5%
Other	0.7%

Case 2: ZPST Owns ZARF

We do not exclude that Zaporizhstal's owners could be targeting ZACO. They have long been rumoured to be seeking to sell out of Zaporizhstal, and they could significantly boost the price if ZACO were included in the package. The recent scandalous dilutive share issue at Zaporizhstal (please see our ANB of April 20) could be a sign that the owners are preparing to sell the company. ZPST is a large domestic stand-alone steel mill. Getting full control of ZACO would make ZPST self-sufficient in coke, making it significantly more attractive to a potential strategic investor.

New Shareholder Structure. Case2. ZPST:

ZPST	94.3%
SCM	3.5%
ARS	1.5%
Other	0.7%

Case 3: A Third Player Owns ZARF:

It is possible that ZPST's owners might have already agreed on a sale of ZPST and ZACO to a third party. In this case the acquisition of ZACO could be the first stage of the deal. This third party would have to have agreed on the price with ZACO's major shareholders, and Zaporizhstal's sale would follow.

New Shareholder Structure. Case3. Third Party:

Third Player	90.2%
ZPST	4.1%
SCM	3.5%
ARS	1.5%
Other	0.7%

We Suspend Our Recommendation

Whatever the scenario, should the share issue materialize as planned, minority shareholders would be diluted 11 times. Unfortunately, only a week after upgrading our target price, we now have to suspend our recommendation on ZACO. We contacted Metinvest and were told unofficially that any buy-out offer to minorities would be somewhere between the par value of ZACO's shares (USD 0.002) and the market price (which yesterday was USD 1.25 and today fell to around USD 0.80). We will keep you informed promptly of any further developments.

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