Friends reunited?

Russia has six steelmaking groups and three are long on raw materials. But those that are short may have a chance to solve their deficits by crossing the border into Ukraine. Metalloinvest, Mechel and EvrazHolding all started out with coal or iron ore assets and then set about scooping up the small and medium-sized mills that remained outside the three biggest groups – Magnitogorsk, Severstal and Novolipetsk.

Faced with "difficult Russian conditions", steelmakers are obsessed with owning raw material resources. Although they have never abandoned the vertically integrated model, control over the supply chain is more fragmented than in Soviet times and the big three, while having some equity in mines, have raw material deficits, or have none at all. Worst off is Magnitogorsk which can supply only 5-10% of its iron ore needs.

The diversified groups are comfortable in their own supplies and with some left over to take to market, they are enjoying the raw materials boom. Metalloinvest has no coal, but since January it has had control of a massive 40% of Russian iron ore production, with its steel operations that need to consume only a quarter of it (*see page 24*). The Mechel group is in a similar position – it is short of iron ore, but has a large surplus of coking coal (*see page 20*). EvrazHolding is in a good position, being 95% self-sufficient in iron ore and the biggest player in coke.

Hot metal at Mechel, and plenty of coke to spare. The mining and steelmaking group is interested in Ukrainian assets, "once the dust settles"

The difference in the Russian markets for iron ore and coke, according to Alexander Ignatov, head of a Moscow industry intelligence agency, is that there is enough independent coke production to plug the gaps in the market, but no independent supply of iron ore. Only the 5.3m tpy Kovdorsky iron ore mine is outside a steel company, but it is owned by the powerful financial group MDM and not vulnerable to a takeover.

Russia and Ukraine are theoretically self-sufficient in iron ore, but with an average iron content of 36%, enrichment is vital. "Lebedinsky [belonging to Metalloinvest] is the most modern – it has an HBI plant and this is a way to solve the quality problem. It's economic to install HBI at Lebedinsky and Mikhailovsky, but more difficult for Evraz – they have 15 mines and they're scattered," Ignatov says.

No wonder then, that all eyes are on Ukraine as the privatisation programme unravels. But president Yushchenko has been slow to produce the promised list of privatisation deals, implemented during the discredited regime of Leonid Kuchma, that he said his government would challenge. The plan is not to renationalise, but to hold new auctions at which the present owners would be invited to match the highest bid. However, it appears that more than one list has been compiled and reaching agreement is delaying the review.

Ignatov thinks that the Ukrainian tycoons are unlikely to fall in with the auction plan. Based on media reports and private discussions with officials and Russian steel companies, he concludes that the new owners cannot win at auction – they simply do not have enough money. On the other hand, Russian steelmakers have been making large profits. "They [the Ukrainians] would make more by selling directly, and the Russians would also prefer not to go to auction. However, they [the Ukrainians] could remain as junior partners. The Russians are interested in having partners who know the country," he says.

Possibly encouraged by their political leaders who are still pushing for a "common economic space", Russian steelmakers are not shy in expressing their interest. Magnitogorsk is first off the block. Although the mill is having supply troubles this year and its main ore supplier, Sokolovsko-Sarbaisky in Kazakhstan is about to merge with Metalloinvest, it may yet make a perfect landing. Last month Magnitogorsk struck an agreement with the owners of Ukraine's Poltavsky pellet plant for monthly deliveries. The 7.5m tpy pellet producer is not part of the state-run mining conglomerate Ukrrudprom and, unlike Ukraine's other major mines, is not facing re-privatisation. Speculation about buying a stake in the enterprise is not far behind.

Raw material assets are one target, but so is steel, including the mills bought by Ukrainian entrepreneur Rinat Akhmetov. Krivorozhstal has occupied the headlines, but according to Ignatov, Azovstal (*see page 28*) also appears on all the lists. But because the privatisation took place some years ago, and serious investment is going into the mill, it may well be saved from the review.

If the Ukrainian government has bowed to the idea of Russian investors, there is still resistance in some quarters. Volodymyr Pikovskyy, deputy director of the government's information and analytical body Derzhzovnishinform, and head of the metallurgical division, has said that his department would much prefer western investors. He is probably not the only one worrying that Russian steelmakers will regard Ukraine as an annexe to their own steel industry. ■