Domination by the largest

With privatisation all but complete in the Ukrainian steel sector, three major combines have emerged controlling assets from mining to distribution, and leaving little to enable the few remaining independent mills to compete.

BY G VALENTIN & C COURONNE*

Consolidation has been the name of the game in the international steel industry for the past 15 years. Europe and the US have witnessed mega-mergers, concentration of resources and streamlining of operations between steel mills, raw material suppliers, iron and steel makers, equipment manufacturers, traders, etc… Ukraine had to go through the same process, but did it while managing its post communist transition and trying to find the right formula to ensure the survival of the largest and most crucial sector of its economy. Today, the sector is showing a radically different face than 15 years ago, when most of the industry was in the hands of the Ukrainian state. As of today, the privatisation process is largely complete with the last major mill sold being Kryvorizhstal, the country's largest. Only a few, ill placed companies are still listed by the state as waiting for a private owner to revive their destinies.

Ten years ago there were 32 iron and steel works in the country, including integrated works. A decade on, a number of them have shut down or almost totally phased out steel production, leaving room for the fittest to survive and become the much sought-after assets in a movement of consolidation that has now been almost completely achieved. Today, the sector gathers 365 enterprises, including 14 metallurgical factories and plants, 7 pipe production plants, 10 plants of hardware production, 16 coke chemical plants, 17 plants producing refractory products, 26 ore mining enterprises, 3 iron alloy plants, 26 plants for non-ferrous products and 35 enterprises producing blackplate and coated items. The figures highlight a wide distribution of production for iron and steel, while almost all of the output of crude steel and pig iron is actually produced by 11 steel mills making over a million tonnes a year. Five main steel works are generating two third of the sector's revenue, with the balance spread between at least 15 plants. This also suggests a rather atomised sector, from upstream down, while the level of concentration is actually very high and is the result of intense activity in the political, financial and industrial fields.

RESTRUCTURING STEEL

The concentration and restructuring movement in the Ukrainian steel industry was a period coinciding with great instability in the country and a climate of violence that could have discouraged many willing to invest in the sector. Rival clans, commanding competing industrial assets from the two major bases of steel production in the country; Donetsk – capital city of the Donbass region and Dnepropetrovsk – the main city of the Dniepr Basin, were jockeying for ownerships and political influence. President Kuchma, himself a former metal works manager from Dnepropetrovsk, had to rein in the warring factions to keep order in the industry and the country's loose democratic principles. For a long period of time, hazy dealings, fragmented ownership and difficult court cases complicated the work of the industry to a huge degree, to the extent that some companies had trouble knowing who really owned them at any given time. The intense concentration observed today derives from this period of instability and dubious dealings and nevertheless managed to turn the Ukrainian iron and steel industry into a global business, despite major shortcomings notably due to the technological backwardness of parts of the sector. Today, with sky-high steel, iron ore and coke prices, the sector is in the best of positions to successfully manage its transition one step further.

INTERPIPE

During this decade of consolidation, groups comprising financial institutions and industrial assets have emerged, soon to become the dominant forces in the economic life of the country. Three major Industrial-Financial entities have surfaced from Ukraine's transition to assume control of the largest works and raw material suppliers and turn the industry around. From the shadows of the early years, Dnepropetrovsk and Kiev-based Interpipe, owned by Victor Pinchuk, President's Kuchma son in law became a key contender in the steel pipe business worldwide. Turning over $900M and exporting to 70 countries, the organisation is involved in seamless and welded pipe making, manufacturing of railway wheels (10% of the world's market share) and production of manganese ferro-alloys including ore extraction (11.4% of the global markets). The building of what is now the fourth largest pipe-making conglomerate in the world and the largest in Ukraine took over a decade and put Interpipe into a very strong position of power within the industry.

Today, the group controls the largest pipe

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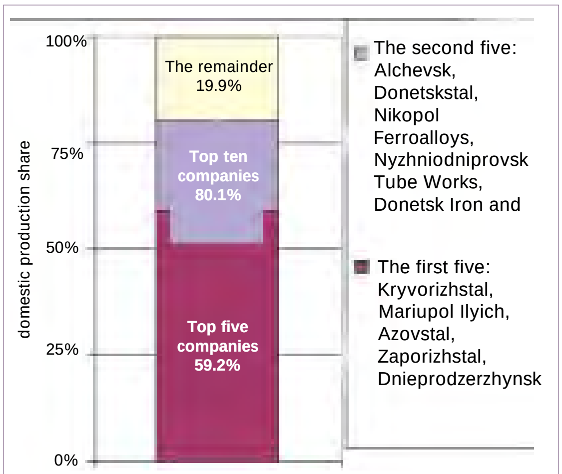
making factories in the country: Nizhnedneprovsk tube rolling plant produces over 800kt/y of hot deformed pipe and is leading the pipe industry in Ukraine in terms of volumes produced. Novomoskovsk Tube Mill has the largest production capacity, at 1.3Mt/y of welded pipes, and the factory is not producing at full capacity. Following the Russian inspired slump in the market in 1998, most of the sector suffered steep reductions in purchased volumes and it took some time to readjust production to reduced demand. Yet today orders are up again; on the back of sustained high oil prices, the oil industry is buoyant and infrastructure work is on the rise, fuelling a strong demand for pipes worldwide. Novomokovsk Tube Mill, for instance, saw its production levels shoot up 33% year on year in 2003.

Besides these two major mills, Interpipe also controls smaller operation such as the Nikopol Seamless Tube Plant Niko producing just less than 300kt/y of products, as well as a handful of smaller works and mills. The Interpipe Corporation also controls ferroalloy production through the Nikopol Ferroalloy Plant, Europe's largest producer of ferroalloys (annual capacity 1.2Mt), specialising in the production of silicomanganese and ferromanganese. The main advantage of the plant is its local source of raw materials, which allows the company an unrivalled domination in the CIS ferroalloy market. Over 70% of output is exported throughout the world. It holds approximately 57% of the CIS market, 48% in Eastern Europe, 39% in the Middle East, and 15% of European Union's markets. With the latest massive upsurge in prices of ferroalloys, fuelled by sustained Chinese demand, the Nikopol Ferroalloy Plant is a prime asset for Interpipe in the overall metallurgical picture. And it is a disputed one: Interpipe and Igor Kolomoisky's Privatbank fought hard to obtain a controlling stake in the ferroalloy plant, originally put for sale at $10M the stake was eventually sold after a very acrimonious battle and went to Interpipe for $77M, more in line with the company's international value.



The industrial concentration of the Ukraine ferrous metals production, by total sales revenue, 2002

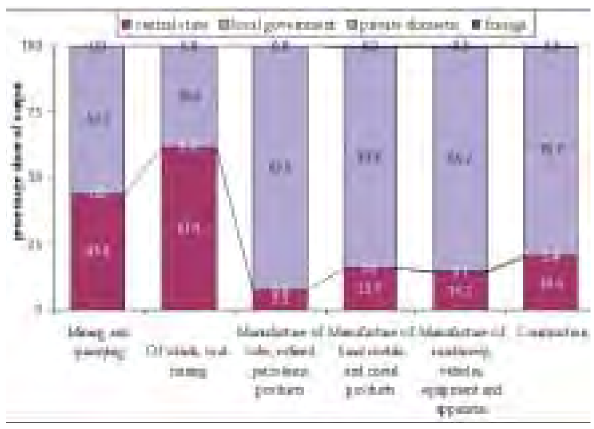
Source: Vlad Mykhnenko, Rusting Away? The Ukrainian Iron and Steel Industry in Transition

INDUSTRIAL UNION DONBASS

The second large industrial-financial group that built a position as an iron and steel conglomerate is the Industrial Union of Donbass (IUD) or ISDJ. The company is vertically integrated and gathers under its control some of the country's largest mills. It has also built a strategic alliance with Swiss based trader and steel plant owner, Duferco, and hence gained market access in one of the greatest steel marketing platforms of the world. As far as productive assets, IUD is a key contender in Ukraine: Alchevsk Iron and Steel Combine has a capacity of 3.3Mt/y and is currently undergoing an upgrade of its plant that should help boost its profitability and sustain competitiveness. In September 2003, IUD and Duferco signed a contract with Voest-Alpine Industrieanlagenbau (Austria) for the supply of two continuous casters and two ladle furnaces for Alchevsk. The cost of the modernisation project amounted to €140M, and has the objective of boosting output and quality at the Alchevsk plant to 5Mt/y.

Another member of the IUD group of companies, until June of this year, the Dniepropetrovsk Petrovsky Steelworks, is one of the oldest works in Ukraine and is showing signs of its age. Today work is underway to renovate one of its blast furnaces although IUD has sold its 42% stake to Pryvat Bank, who was already holding a stake in the company, alongside strong participations in other ferroalloy concerns (Zaporizhia Ferroalloys, Stakhanov Ferroalloys, Nikopol Ferroalloys) as well as in coke plants. In the case of Petrovsky, it seems that the two stakeholders could not agree on a common concept for the future of the works and IUD decided to call it quits, hardly a year after taking the controlling stake.

This year IUD was also on the acquisition trail with its purchase of the Dnieprodzerzhynsky Iron and Steel Combine confirmed this year for a price of $133M and the commitment to invest another $180M in plant upgrades by 2008.



Ownership structure of Ukraine's metals sector and its major domestic customers, as of 31st December 2002

Source: Vlad Mykhnenko, Rusting Away? The Ukrainian Iron and Steel Industry in Transition

The corporation also used to control the Azovstal mill, the country's second largest, as well as the Khartsyzsk tube works, also one of the country's best, but lost them to another heavyweight metallurgical corporation of Donetsk, Donbass: System Capital Management (SCM). Today, besides its remaining major steel mills at Alchevsk and Dnieprodzerzhynsky, the strength of IUD lies in its vertical integration in coal, coking coal and in its diverse downstream activities in pipe making, construction engineering, machine building and mechanical engineering. In the area of mining, the very strategic concentration of IUD allowed it to produce and deliver more than 5.5Mt of coal concentrates to coke and chemical plants and more than 4.2Mt of coke to iron & steelworks in 2002.

Its partnership with Swiss-based steel trader Duferco gives IUD a much broader market penetration potential to the products of its mills, pipe works, mines and heavy manufacturing companies. Interestingly enough, the company has also been very active abroad, successfully bidding for the Dunaffrer works in Hungary, the largest steel mill in the country, although it did hit harder times with Huta Czestochowa in Poland where IUD was initially declared the winner of the bid, but was shunned by the former government who then declared multinational giant LNM, already owner of Huty Stali (PHS), Poland's largest mill, winner of the privatisation bid. Since then, the process has run into further trouble with the victory of LNM contested in the courts and the new Polish government displaying a will to revert to the original decision. The European Commission also refused the contents of Poland's restructuring programme for the mill and is about to launch an inquiry concerning illegal state support. During the process, smear campaigns against IUD, highlighting the shadowy origin of its funds and the lack of transparency of its structure, were conducted and the corporation had a hard time clearing its name and fighting for its reputation. Today, it is engaged in a battle of proceedings to have its victory in the bid for Huta Czestochowa recognised. Why so much effort to pursue this purchase? One of the reasons for the latest and vigorous foray can be found into the increasingly competitive market conditions in it home markets.

SYSTEM CAPITAL MANAGEMENT

The expansion of Donetsk-based System Capital Management (SCM) might appear as irresistible to anyone observing the Ukrainian iron and steel sector of the last decade. Reputed to being controlled by Ukraine's richest man, Rinat Akhmetov, the group has pursued an aggressive policy of vertical and horizontal integration that leaves today's SCM with pretty much most of the prime assets of the industry. Alongside its associates, Danko and ARS, SCM controls the largest iron ore mine, a number of major dressing and concentration plants, coal mines and coking plants, as well as the largest steel and metals

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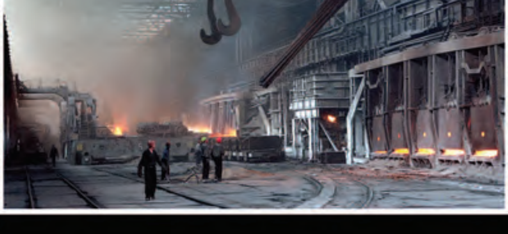
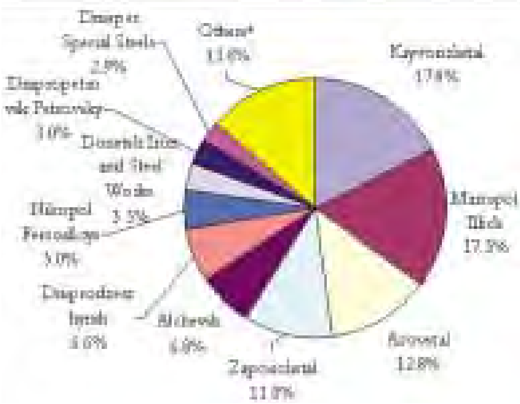


trading organisation of Ukraine, Switzerland-based Leman Commodities. SCM affiliate ARS is said to control about 90% of Ukraine's coking coal mining and coke producing companies, giving it considerable leeway in the domestic sector, and to put it bluntly, massive control. Further downstream, the list of assets is impressive: The Azovstal Iron and Steel Combine (output 2003, 5.34Mt) the Yenakievo Iron and Steel Works (capacity 3Mt) and the Khartsyzsk Tube Works were the jewels in the crown until being eclipsed by SCM' share in the recent privatisation of Ukraine's largest iron and steel concern, Kryvorizstal.

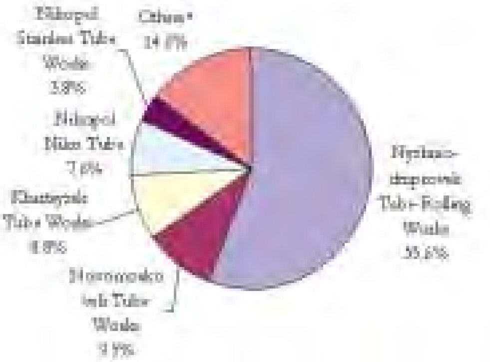
Teaming up with the Interpipe Corporation to form the Investment Metallurgical Alliance, SCM and its new associate took control of the plant and its iron ore base for $800M, keeping at bay some of the world's best known iron and steel players all jockeying for control of this much coveted asset, the largest and most profitable combine of Ukraine.

The positioning of SCM as the definitive leader of the industry also marks the end of the major consolidation within the local industry. A few worthwhile assets remain on the privatisation list, notably the Makiivka plant in the Dnepropetrovsk region and a number of coalmines still under government control. But, in general, the sector is consolidated and in the hands of what seems like aggressive, yet focused organisations that have showed their intentions of investing in the development of the industry and the sustainability and expansion of its economic value. The concentration also highlights the rise and today's predominance of the Donbass region and its regional capital Donetsk over Dnepropetrovsk.



Ukraine's steel companies by annual sales share, 1999-2002 average

Source: Vlad Mykhnenko, Rusting Away? The Ukrainian Iron and Steel Industry in Transition



Ukraine's tube mills by annual sales share, 1999-2002 average

Source: Vlad Mykhnenko, Rusting Away? The Ukrainian Iron and Steel Industry in Transition

The consortium established between Interpipe and SCM to win the bid for Kryvorizstal is in itself a clear indication that things have changed, and the industry has matured to one that can now take on the world. Today, problems arise for those left aside in the movement, and hang on to the illusion of independence. With the most intense concentration arising upstream, in raw material supplies, and further downstream in the control of the most powerful marketing channels, little is left to those who are alone. Mills that have decided to opt for a stand-alone policy will be pushed out of the Ukrainian metallurgical sector by lack of access to the key resources, ores, energy and capital. For example, the Mariupol Ilyich works is calling upon political assistance to help it survive, but Ukrainian politics, already placed under the influence of the metallurgical sector, has already taken into account the sweeping changes and is supportive of its corporations and the oligarchs that have emerged.

The fiscal advantages offered to the metallurgical sector in the Donetsk region and its tailor-made investment regime are a further testimony of that recognition, and of the fact that the political and industrial balances of powers have shifted east, much closer to the Russian border than before. And Ukraine's new attitude towards EU and NATO memberships, no longer priority items on the national agenda, are also a recognition of these facts: Russia is Ukraine's natural trading partner, supplying much needed energy to Ukraine's metallurgical sector, and buying a large part of its production. But also both countries compete and partner on the world iron and steel markets. A strong source of influence in Ukraine, Russia is now paying close attention to the rebirth of Ukraine's heavy industry. STI

OLD AND NEW WAYS

The Ukrainian industry, mainly concentrated in the southeastern regions, revolves around three major poles: Upstream, iron ore is extracted from a variety of deposits, located along the lower Dnieper river region. Similarly, coal is extracted from the Donbass basin. Downstream, two major centres struggle for both industrial predominance and political influence in Kiev and the national institutions. The Donbass region, with Donetsk as its capital is host to thirteen iron and steel works and thirteen coal-coking plants. On the city's doorstep is the coastal town of Mariupol on the Sea of Azov, concentrating the second and third largest combines of Ukraine: Azovstal integrated steel mill (8.3Mt/y capacity) and Ilyich (7.2Mt/y capacity) and employing 23000 people. Further downstream, machine making is thriving in Mariupol, with machine builder Azovmash leading the national pack. Tube and pipe makers are active both in the Dnepropetrovsk and Donetsk regions. More capacity can be found in Lugansk, in the most eastern part of the country and at Alchevsk.

The whole industry suffered heavily from the collapse of the Soviet Union in 1991, already having to face steep reductions in consumption in the late 1980s, it found itself deprived of market prospects, short of cash, sometimes without energy to run the plants and operated by managements that had limited international experience and exposure to the world market's harsh realities. A period of barter deals, featuring steel for energy trades emerged, where the reputation of the industry was affected and production levels plummeted.

For a decade, the Ukrainian iron and steel industry was shadowy, ripe with scandals and not in the best of shape. Ten years on, the picture is radically different: Ukraine is back in focus as the seventh largest producer of steel worldwide, and one of the three largest exporters of steel. The sector has almost completed its ownership restructuring, its consolidation from raw material extraction through to steel products is solid and the Ukrainian iron and steel industry is now looking at strengthening the next phase of its evolution: its anchorage in the world market and the competitiveness of its industrial tool.

Recently, the privatisation of the country's largest integrated iron ore and steel plant, Kryvorizhstal, attracted an impressive short list of local and international contenders and expectations were to see the plant go for at least $1.5bn.

Yet, hopes were short lived as Kryvorizhstal was snapped up by local contenders, at a discount and after international bidders were mariginalised in a dubious fashion. Following this episode, most questioned the country's willingness to open up and signal its attachment to market values as well as best business practices.

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TÜV CERT

Difficulties in moving forward for the Ukrainian steel industry

Out of date plant and the concentration of the ownership of most raw materials in the hands of a few major steel groups is challenging the survival of the second tier steelmakers in the Ukraine.

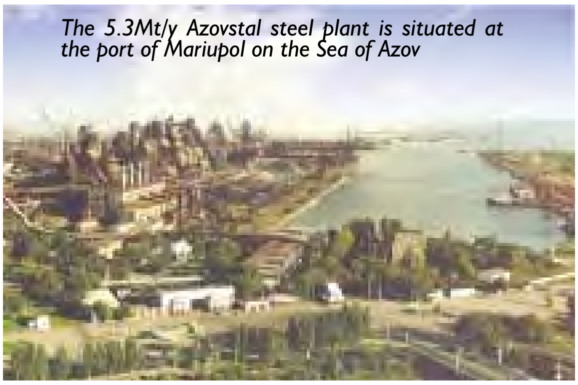
BY G VALENTIN & C COURONNE*

In the 1870s Ukraine was a land of opportunity and transformation: the discovery of iron ore deposits in many parts of south eastern Ukraine, along with coking coal and anthracite deposits found in abundance in the Donbass region led to an influx of entrepreneurs, some of them foreigners, willing to tap into this subterranean wealth and turn mineral reserves into iron and steel. For instance, a Welshman, John Hughes from Merthyr Tydfil, established the first large iron and steel plant at Hughesovka (now Ukrainian Donetsk) in 1869. Today, the country's iron and steel industry is mainly a direct descendant of those early days though shaped by later developments. Further plants were built in the 1930s, when Ukraine had both the misfortune of suffering from Stalin's implacable repression of peasants yet also had the chance of participating in the edification of an iron and steel powerhouse designed to fuel the Soviet Union's industrial development.

Inherited from this double-edged historical development, the regional concentration of the industry is striking and allowed many synergetic developments along ore reserves, power resources provided by the Dnieper river's hydroelectric infrastructure and transportation potential thanks to navigable rivers, Ukraine's coastline on the Azov and Black sea and the extensive railway systems developed under Stalin's rule.

Today, after going through the radical overhaul of its fundamental role, ownership structure and raison d'etre, the industry is emerging from over a decade of confusion and protracted struggles as an almost fully integrated iron and steel cluster, featuring the complete production cycle of iron and steel, from raw material extraction through to semi-finished and finished metal products. Possessing iron ore, including high concentration ores, manganese, as well as metallurgical limestone, kaolin, dolomite, coking coal in the Donbass region, anthracite and a range of other mining products, Ukraine was clearly destined to be a metallurgical hub. Twenty years ago, the country was one of the world's top four producers of pig iron and crude steel, churning out up to 57Mt of crude steel before plummeting while the country was coming to terms with its post-communism transition.

The significance of steel production in the country's economy is immense and Ukraine cannot be economically viable for long without a strong steel sector. Despite the steep decline in production volumes from the mid-1980s onwards, the industry started showing some signs of recovery in the mid-90s. From just below 57Mt of crude steel produced in 1986, output declined to under 25Mt in 1995, representing almost a 60% loss of output, before rebounding to over 35Mt in the past two years (2003: 36.9Mt). Export volumes picked up with ferrous metals accounting for up to 30% of the country's overall foreign sales and 80% of the domestic iron and steel production total sales. Reorganising the industry was painstakingly difficult, protracted and a somewhat gloomy business and the shadows from this period are still very present in many Ukrainian memories. Finally, the harder times are now behind, at least as far as setting up a coherent sector organisation. But beyond knowing formally the names and address of who owns what, lies another critical issue for the Ukrainian iron and steel sector: the shape of that which is owned.


The 5.3Mt/y Azovstal steel plant is situated at the port of Mariupol on the Sea of Azov


Azovstal plans to increase output from the present 5.3Mt/y to 7.5Mt in 2006

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AGEING TOOLS

The industry is clearly showing its age regarding the production processes employed in the country. In 2003, 45.9% of steel was produced from open-hearth furnaces, placing Ukraine in the number two position of open-hearth produced steel in the world. Oxygen steelmaking (BOS) accounted for 48.6% or the overall production (17.9Mt) and only 5.4% was produced from electric arc furnaces (2Mt). With 16.9Mt of open-hearth output, Ukraine has the undesirable title of being second only to China for this most antiquated production method, and Chinese steelmakers appear to be phasing out open-hearth furnaces much quicker than Ukrainians. This highlights one of the major issues at stake in the industry: the unfitness of most of its production tool and its severe lack of modern, profitable and efficient, steelmaking facilities. Yet, the leaders of the sector are displaying a tendency to tackle the issue with a mix of bullishness, vision and for some, resignation.

KRYVORIZHSTAL NEWLY PRIVATISED

The largest organisations are spread across the southeastern region. Some players are benefiting from real 'house-hold recognition' on international markets, for good reasons, like being recognised as part of the first league of global exporters, or for bad, like being at the centre of sometimes unjustified controversies. By revenue, profits and production volumes, the company that stands out from the pack is the recently privatised Kryvorizhstal (See Privatisation in Ukraine: – *Could they have done better?* in this issue). The world's 26th largest steel company by output and fully vertically integrated, the giant is reaping the benefits of a continuous supply of iron ore from Ukraine's largest mine and is also the steel mill with the largest turnover in the country, with over a billion dollars in sales and strong profitability levels. It is squarely placed at the centre of an industrial hub comprising one of the largest iron and manganese ore deposits, open cast mines, ore processing and agglomeration plants, and the steel work's is Ukraine's largest producer, with an output of 6.9Mt of crude steel in 2003, and employing 52 000 workers. An investment plan was a condition of a successful privatisation offer. It is hoped that the new owners, a mighty alliance of Donetsk-based System Capital Management (SMK), the biggest powerhouse in Ukraine and Dnepropetrovsk and Kiev-based Interpipe (controlled by President Kuchma's son-in-law), will combine their efforts in developing further the giant into an even larger player in the years ahead. This will come to pass provided its new owners implement the right mix of large-scale investment and sound marketing policy. But before looking to these future hopes, the investment simply required to maintain such iron and steel works and to push them into the next stage of development is anticipated to be huge and must be made. And with such a large-scale workforce, productivity cannot be expected to be high. Despite the stated commitment of the new owners to invest in the works and preserve employment, some fear that it may not be enough. Yet, the keen interest displayed by the big names of the

Ilyich employs 60 000 workers in Mariupol and produced 6.5Mt in 2003 but mostly by open hearth furnaces

world's iron and steel industry during the privatisation process are a further testimony that the Ukrainian steel works conveyed a lot of appeal, despite the associated upgrading works.

AZOVSTAL INVESTS

The dilemma of refashioning and shaping old production workshops into efficient steel making facilities is faced by all the sector's leaders: Azovstal, formerly the country's largest steel producer, is following in Krivoyrizhstal's footsteps, producing 5.340Mt of steel in 2003 (3.8Mt is BOS steel and the rest is open-hearth). The company plans for 2004 and beyond involve ratcheting up output from 5.9Mt (4.4Mt by BOS) this year to 6.5Mt in 2005 and 7.3-7.5Mt by 2006, including around 6Mt of BOS steel. For this, Azovstal, one of the two giant mills of the seaport Mariupol, has embarked on a vast modernisation programme to keep up with acceptable levels of competitiveness and outputs. Mr Velyi, Azovstal General Director gave a few highlights on the major restructuring undertaken by the company: "At the moment we have five working blast-furnaces, and we are currently rebuilding furnace number 2, which has been stopped since 1998. The new furnace will be fired in June 2005. We have also undertaken some reconstruction in our BOS converter shop, connected with continuous slab casting, and we are building a caster. The reconstruction of two casters is being undertaken by Novokramatorsky Mashinostroitelny Zavod JS Co, a leader in production equipment for the steel industry, using technology from the Austrian based plant builder, VAI. Besides, we have bought a liquid oxygen plant from the French company Air Liquide. The total investment is approximately $320-350M. This year we will spend $208M and the rest next year."

The company is presently producing X80-X90 grades and will be able to produce X110 and X120 steels by the addition of a ladle furnace and a vacuum degasser.

The investment effort put together at Azovstal is a sign of confidence, as well as a mark of maturity.

Despite increasingly competitive offers from domestic technology suppliers, Ukrainian steelmakers are also turning to international service providers to upgrade their plants. For instance, Azovstal called upon the services of Germany's SMS Demag for mastering rapid cooling of thick rolled steel while keeping all the product's strength characteristics. New technology is going into all aspects of the company's activities, including management procedures, integrated IT systems and redeployment of sales and marketing efforts. "This effort is a revolution in many respects," affirms Mr Velyi.

ILYICH GLOOMY PROSPECTS

Other key players like Ilyich, the second giant works of Mariupol, are looking at maximising the use of their abundant workforce and versatile production, diversifying into ship building, agricultural land, manufacturing apparel and canned food production. The strategy of such diversification may bring straightforward profit. In its core business, the factory is a giant by all standards, employing a staggering 60 000 workers and producing 6.5Mt of steel in 2003, mostly using open-hearth technology. For more than 100 years OJSC Ilyich ISW has produced high-quality metal products: cold- and hot-rolled metal, galvanised sheets and coils, seamless oil tubes, longitudinally welded tubes, pressure vessels, and ferroalloys are amongst the product list and the works has received many certificates for shipbuilding steel of normal and high strength, boiler steel, strip, bridge steel, structural carbon and low-alloy steel, electro-welded tubes. But clearly today, challenges are piling up, as the company was left outside of the industry's concentration phase. Today, Ilyich's independence, guaranteed by its employee and management ownership, may become its curse, as access to raw material, in particular to Ukrainian iron ore and coke production is now fully controlled by the vertically integrated 'majors' that have emerged from the market's concentration. This is threatening the status of the works and could in the future precipitate the company's purchase, locally, or its economic collapse. In this case, Vladimir S Boyko, the company's Chairman of the Board is calling upon the state to help the company going through hard times: "We need strong action from the government to guarantee that companies like Ilyich have access to raw materials, under market conditions. Today, everyone thinks that the market is without rules and big groups are dictating their rules to us. This is how, despite working at high capacity, we still lose money."

Despite modernisation attempts of its industrial plant, the company remains one of the most archaic iron and steel manufacturer in the country and the cost of staying both alive and fit for the global markets is extremely high and is not expected to decrease. With the largest employment in the sector, the productivity levels per worker are lagging behind most international counterparts. Industry-wide, these levels are said to be very low, as suggested by some researches pointing out that an average Ukrainian steel worker produces only 76% of a Polish steel worker's output, 18% of a Brazilian's, 14% of an EU steel worker, 11% of a US colleague and 10% of the average South Korean's output. (Vlad Mykhnenko, *Rusting Away? The Ukrainian Iron & Steel Industry in Transition, 2004*) In this case, the clock is ticking for the very survival of works like Ilyich. In sum, the litany of woes and life threatening issues faced by the company means the future of one of the greatest iron and steel works appears increasingly gloomy.

Dnieprospetsstal located in Zaporozhye on the river Dnieper produces special steel grades

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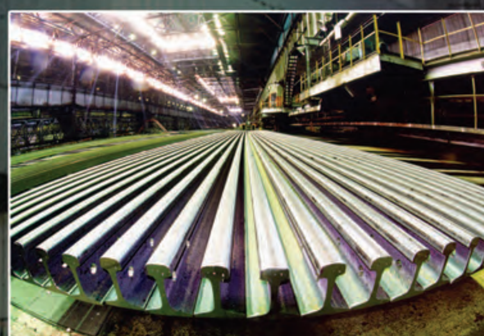
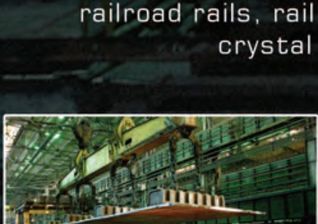
Solutions


The major products of the Works are certified by the leading international classification societies: Lloyds Register of Shipping, German Lloyd, Det Norske Veritas, American Bureau of Shipping, TUV Rheinland, American Petroleum Institute, Bureau Veritas (France), Maritime Register of Shipping (Russia), by whom 35 certificates have been issued to AZOVSTAL's steel products. ISO 9001 Quality management System has been implemented at the Works.

Azovstal Iron and Steel Works produces:
Cast iron and pig iron, slabs, squares, rolled sections, plates, railroad rails, rail chairs and fishplates, granulated BF slag, crystal glass, home and office furniture.



Public Joint Stock Company
AZOVSTAL - Iron and Steel Works
1, Leporsky str., 87500, Mariupol, Donetsk region, Ukraine
Telefax: +380(629)52-70-00 **E-mail:** oao@azovstal.com.ua
Web: www.azovstal.com.ua

Minimill Istil based in Donetsk has two international subsidiaries, one in UK and one in USA

ZAPORIZHSTAL SEEKS AUTO MARKET

The Zaporizhstal works, in Zaporizhia is another one of the country's top five mills, ranked as 55th steel producer in the world. Far from complacent, the company has here again engaged in a race against time to strengthen the efficiency of its production plant and brace itself for tougher days ahead, should steel prices follow a downward trend. Producer of carbon, low alloy, alloy and stainless hot rolled coil and cold rolled coils, the company comprises a sinter shop (six sinter machines), five blast furnaces, an open-hearth furnace shop with nine furnaces and a shop for preparation of ingot-mould trains. The company also has four rolling mills for hot and cold rolled flats, strip, tinplate and cold rolled formed sections. Total annual production of the Works is 3.5Mt of flats and 600kt of cold rolled formed sections.

Zaporizhstal is investing for increased performance: it is for instance completing a $66.5M investment to refurbish its blast furnace No 2 and improve the energy efficiency of the unit. It is also starting the installation of a 300kt/y capacity ladle furnace in the teeming bay of the open-hearth furnace shop for processing medium and high-carbon and low-alloy steels. The work is being undertaken by a variety of local suppliers, notably Novokramatorskiy Machine-Building Plant, Ukraine and international leaders such as Germany's SMS Demag, Austria's VAI; and Danieli from Italy. Zaporizhstal is also building a pickling unit, at a total cost of $40M over three years, started 2003. The company is also prompting a number of other prime investments, following indications that leading carmakers may increasingly choose Ukraine for sourcing high quality automobile sheet. The purchase and installation of a galvanising line and paint line at Zaporizhstal is, for instance, planned around 2007-2008, at a cost of $100M.

Such major capital expenses, alongside other planned investments, are a further testament that the sector is not standing still, and that despite the advanced age of most of the production plant, the industry is working hard to sustain competitiveness and quality and is fighting for keeping a leading position amongst top global suppliers.

DNIEPROSPETSSTAL

Dnieprospetsstal Special Steel Works is a very dynamic operator in the market also. Maker of special steels, (bearing steels, heat resistant, structural steel, high speed steel,…) it relies on a 5.8Mt capacity and is also investing heavily to expand, notably putting the final touches to a finishing shop. "We benefit from the edge of our products in the first place" explains Alexey Alekhin, Chairman of the Board. "But this cannot be the complacent approach to privilege. In today's market place, we have to strive for excellence and competitiveness and this is where we direct most of our efforts. We are permanently listening to market demands and are implementing an ambitious reform programme, both on the production side as well as in the management of this organisation. Our goal is to be recognised as one of the best suppliers of special steels in the world."

MINIMILLS

Investment programmes are trying to sustain the self-proclaimed bullishness and improve energy efficiency and flexibility to enable Ukraine to play its part in global markets. Oxygen converters and electric arc furnaces are being purchased and installed and the industry is working overtime to catch up with the world's standards of production. Here, the experience of smaller steel mills, such as the Istil minimill, in Donetsk, is of great value. The company is one of the rare foreign investments in the sector and therefore has been somewhat of a pioneer, as well as a rarity in Ukraine. Originally a UK and US company, Istil has its main manufacturing base in the Donbass heartland, following the acquisition of Donetsk Metal works in 1996. It also has two finishing mills outside Ukraine, one in the south of England – the former Queenborough Rolling Mill, and one in Milton, Pennsylvania, USA. In Ukraine, the company has been constantly upgrading its minimill, investing a total of $85M in an electric arc furnace, a vacuum degasser, continuous caster and upgrading some of the blooming mill equipment. The company is trying to adopt a strategy of differentiation, producing round billets from 80mm to 330mm diameter to respond to an increasing, yet exclusive, market demand in machine making and construction worldwide. "We want to improve the value added side of our products by increasing the size of our rounds but we are also planning to install a heat treatment unit in the near future. We have to be very proactive in keeping up with the best technology", explains Dr Farooq Siddiqi, Senior Vice President of Istil Ukraine. Extending his analysis to the other companies of the sector in Ukraine, he adds: "The companies that won't do it here won't be able to compete with lower costs producers. It is more than a conundrum, it is a life necessity for the industry".

MORE TO PRIVATISE

Makiivka metallurgical Combinat is on the privatisation list for this year but the company has had to go through a number of misfortunes that pushed it to the brink of bankruptcy. Unscrupulous 'investors' siphoned off some of the company's assets and left its 4.05Mt of capacity, scarcely used, and brand new production equipment half installed due to lack of resources. The company notoriously has a brand new 3500mm rolling mill still waiting for final installation and Valery Dudnik, its director is eager to underline the inner value of the industrial plant: "We want to be optimistic, as this works has been investing in the upgrading of its production capability, before being turned astray by some. Today, we want to put all our efforts into taking this company out of a difficult time and back to where it should be". This may be achieved thanks to the arrival in the company's shareholder structure of the Ukrainian State, through state company Naftohaz Ukrainy, the oil and gas state company. At stake, is the very survival of the Makiivka metallurgical combine. The state operator bailed it out taking on board the company's $31M debt, and committing itself to helping the company find new markets and secure its energy needs. Privatisation of the plant is expected to take place this year, and India's Tata Steel, at one stage interested in the privatisation of Kryvorizhstal, also mentioned Makiivka then as a potential target. Following the effective exclusion of foreign bidders during the privatisation of Kryvorizhstal, Makiivka may have to make do with a lower turnout of eager foreign investors but the industry is nevertheless attracting much overseas interest and Makkivka's senior management is hoping to benefit from this renewed interest to ensure the survival of one of the larger works in Ukraine.

Behind these individual stories, the dominant pattern emerging is one of combining crucial issues stemming from the companies ownership structure and owners' will. Following the intense concentration period of the last decade, new steel moguls have arrived and are yet to show their full intentions with regards to the industry's future. Resource allocation, concentration of raw material supplies under a few players and the cost of major restructuring will undoubtedly prove to be fatal to the survival of some companies. The companies that are currently under-utilised, too costly to upgrade and offer a limited product mix lacking real long term commercial value will feel the pain. And this is a real challenge that the industry will have to face: moving from the current ensuring survival – largely helped by a cyclical upsurge in global steel prices – into the next stage of creating a sustainable future. To prove its worthiness and ensure its long-term success whilst also limiting the socio-economic costs of a second wave of 'readjustments' and to take the whole of Ukraine into the next stage of its economic revival , the iron and steel industry is now facing a monumental task. Some have started tackling the challenges and are busy working to perpetuate the economic importance of the industry in Ukraine. Others may have to face extinction and shall come to illustrate the excruciating difficulties of a complete transition movement, from one economic and political system to another radically different one. STI

Ukrainian steel: – vulnerable overseas, weak at home

Ukraine's remarkable recovery in steel output since the collapse of 1991 is heavily export dependent with 70% of output exported. The domestic market has not kept pace with the recovery of the steel industry making steel vulnerable to world markets, often hostile to the Ukraine.

BY VLAD MYKHNENKO*

Before the end of the Cold War and the collapse of the Soviet Union in 1991, Ukraine had been the world's fourth largest steel-producing country after Russia, Japan, and the United States. The Ukrainian steel industry entered the period of the post-communist transformation as a fully-grown and densely located manufacturing sector. Yet, as the result of exogenous trade shocks caused by the collapse of the internal Soviet steel market in the early 1990s, and due to the overall disorganisation of production, management and commerce, the main outcome of the Ukrainian steel industry's transition to the market was a massive, sharp, deep, and long decline in the ferrous metals output. In the first half of the 1990s, Ukraine's crude steel output declined by 58%, from 52.6Mt in 1990 to just 22.3Mt in 1995.

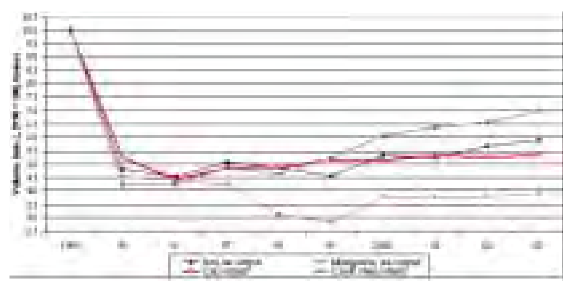
Radical market and structural reforms initiated at the end of 1994 by the Ukrainian government, fast large-scale privatisation, and the reported improvement of the business climate in the country, have returned the steel industry back on the growth path. Already in 1996, the Ukrainian steel industry recorded a 12% annual sales increase; and 8% growth followed in 1997. In absolute volume terms, Ukraine's crude steel output increased to 25.6Mt in 1997 – for the first time in the country's independent history. In 2003, the Ukrainian steel enterprises produced 36.8Mt or 70% of the 1990 output level. On the international scale, the turn of the Ukrainian iron and steel industry towards recovery and growth has put the country back into the league of the largest steel producing countries. Currently, Ukraine occupies seventh position in the world steel ranking, behind Germany, South Korea, Russia, and the world's top three steel-producing giants – China, the United States and Japan.

VULNERABLE OVERSEAS

The apparent recovery of Ukraine's ferrous metals sector has been propelled by a remarkable export expansion. Between 1990 and 2002, the country's share in the world steel output halved to 4%. Nevertheless, by the late 1990s, Ukraine became one of the world's top three major steel-exporting countries. In 2002, Ukrainian steel companies exported 25.9Mt of steel, slightly behind Russia's 27.7Mt and Japan's 35.2Mt. Considering net export figures, Ukraine, on a par with Russia, is currently the world's second largest steel exporter. The Ukrainian steel companies sell annually abroad around US$6-7 billion worth of crude steel, while ferrous metals account in general for about 40% of the country's total exports.

EXPORT RESTRICTIONS

The overseas steel market expansion notwithstanding, since gaining independence in 1991, Ukraine has been faced with what a recent International Monetary Fund report describes as 'a plethora' of unwarranted anti-dumping investigations and external market restrictions. Export opportunities for the Ukrainian iron and steel producers have been badly damaged by a wave of anti-dumping sanctions, import tariffs, quantitative restrictions, and other protectionist measures imposed by the European Union, the United States, and a number of other steel-producing countries.



Ukraine's ferrous metals sector: raw materials and crude steel production, 1990-2003 (volume index, 1990=100)

Source: Vlad Mykhnenko

Currently, 69 restrictive measures imposed between 1999 and 2002 against Ukrainian steel exports are in place. According to the World Trade Organisation and IMF data, Ukraine has been ten times more likely to have anti-dumping measures imposed against it as the country's share in the international trade could suggest. For instance, over the January 1995 – June 2002 period, out of a total 1161 anti-dumping measures, WTO member countries imposed 37 measures on Ukraine. The 3% share of measures imposed on Ukraine is disproportionate to the 0.3% Ukrainian share of world exports, but it is partly explained by WTO members' propensity to impose measures on metal trade (one-third of all measures) and the dominating role of metal products in Ukraine's total exports. WTO trading partners that have imposed anti-dumping measures against Ukrainian exports include Canada (3 measures), Chile (2), Colombia (2), EU (8), India (4), Mexico (4), Turkey (2), US (5), and Venezuela (2). Apart from the imposition of antidumping duties, Ukrainian exports are also subject to quotas and licensing based on intergovernmental agreements. Agreements currently in place govern exports of various metal products to the EU, the US, Indonesia, and Russia.

The European Union and the Unites States have both designated Russia and Kazakhstan as market economies, but, for specific political reasons, Ukrainian efforts at receiving a similar designation has not met with success. Furthermore, the Ukrainian steel companies are at a competitive disadvantage vis-à-vis the new EU member-states from Central Europe. After the EU enlargement in May 2004, the competitive disadvantage of the Ukrainian steel industry in comparison with the new EU members of the single market have increased; at the same time, exports to Central Europe have been negatively affected, as these countries adopted steel-common EU tariff and other protection policies. As the great bulk of the Ukrainian steel export has been barred from the US and EU markets, the primary target for the Ukrainian steel exports are China, South-East Asia, and Russia. The rest of the world appears to be of secondary importance.

As long as China and the countries of South-East Asia generate strong economic growth, the Ukrainian steel industry should have enough space for output growth and market expansion overseas. At least, this view seems to be widely shared by Ukraine's top steel managers. Yet, China, Japan, South Korea, and Taiwan – the largest economies of South-East Asia – are also amongst the world's twelve largest steel-producing as well as steel-exporting nations. The Southeast Asian steel companies are in strong competition with their Ukrainian counterparts both domestically and overseas. Moreover, with the most recent efforts by Beijing to stabilise the country's overheated economy, China's 'steel hunger' could well be alleviated. Where could the Ukrainian steel industry turn in that case?

WEAK AT HOME

A potential disruption of the steel expansion overseas would be the greatest trouble the Ukrainian steel industry has been faced with since the collapse of the Soviet Union. On the whole, the Ukrainian steel producers export between 75 and 85% of domestically produced steel. While in the late 1980s the Ukrainian domestic market for steel was as large (on a per capita basis) as that of any industrially advanced economy of the West, by 2002 it contracted by 80%. The current level of Ukraine's per capita crude steel consumption (84kg) is half that of the world's average (162kg) and far below the level of such steel producing giants as Japan (571kg) or the US (406kg). To date, Ukraine's heavy engineering and construction industries – the two major ▶00

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Khartsyzsk Tube Works

Masters of Tube Works

The Public Joint Stock Company "Khartsyzsk Tube Works" is the biggest producer of longitudinal large (20" – 56") diameter pipes for oil and gas pipelines in Europe. The production capacity of the Works is 1,600,000 tons per year. Century-old experience of production together with modern technologies ensure high quality and reliability of bare pipes and pipes with external and internal anticorrosion coating.

The System of Quality Management of Public Joint Stock Company "Khartsyzsk Tube Works" is certified according to ISO 9001:2000, ISO 14001 and OHSAS 18001 international standard requirements. The enterprise has been certified into American Petroleum Institute as producer of pipes according to API Spec 5L standard for PSL1 and PSL2 levels of requirements and in system of UkrSEPRO (Ukraine).

Khartsyzsk Tube Works
9, Paton Street, Khartsyzsk, 86703 Ukraine **Tel/Fax:** +380 6257 45695 / 44443 / 46401
Website: www.khtw.net **E-mail:** marketing@khtw.net

Ukrainian steel fostering a domestic market

Domestic demand for steel is being grown by major steel combines investing in downstream heavy engineering activities, sometimes with international partners, to ensure a market for their steel output.

BY G VALENTIN & C COURONNE*

The 1990s witnessed the collapse in domestic demand in Ukraine and other CIS countries due to the rapid decrease in military orders from the Ukrainian State and its Russian neighbour and the slump in heavy machinery sales, both at home and abroad. The financial difficulties faced by the iron and steel sector and the Russian financial collapse of 1998 did the rest to send production spiralling downwards. Russian orders plummeted and the industry found itself in deep trouble. Meanwhile, the tube and pipe makers were also feeling the blow and suffered a complete collapse in orders, which accelerated the restructuring and concentration of this sub-sector of the steel industry.

Consider these facts the revival is all the more impressive. The companies behind these achievements have also gained their status in the first league of world producing and exporting steel mills, and the finished products manufacturers have had a staggering revival, proving the resilience of an industry that many were forecasting to disappear when their export markets collapsed. The pipe industry has accelerated a restructuring process that made it one of the world's largest export producers and the major industrial and financial conglomerates of the country have been prompt in asserting control over a branch of the industry that, at times of high oil prices, is benefiting from infrastructure investments and from the renewed optimism in oil and gas producing countries. The chief export market for local pipe makers is obviously Russia, and despite the occasional Russian attempts to curb market access, the mood is set on optimism. Pipe makers had to readjust their market strategy swiftly as, aside from Russia's erratic purchases, Europe, another obvious and traditional market, was striking the pipe sector with trade barriers.

Illya Shapiro, General Director of Dnepropetrovsk Tune Works, a medium size mill belonging to System Capital Management, when asked about where the major market challenge occurred for his company, replies: "The European market. It's very serious and important. The enterprise used to have its market before the new policy of transitional quotas and duties. People used to know what to produce and how to produce for this market, and there was appropriate control, as we knew the particularities of each country and the exact type of product they needed. Tubes for Portugal or Sweden are completely different, and if you look at the range of products we produce, you'll see a great variety. As the production gets accustomed to a particular market, when you lose this market, you have very little time to get re-oriented". Industrial consolidation that created giants like Interpipe, controlling two of the largest pipe plants in Ukraine, alongside a handful of smaller mills, or like System Capital Management, owner of the Khartsyzsk Tube Works, one of the most profitable pipe making operations in the country, has created a vacuum. It is only those with strong marketing ability to reach and redevelop their sales and redeploy their strategy fast enough to ensure the viability of their works.

Khartsyzsk tube works owned by System Capital Management is highly profitable

Smaller players have had to struggle twice as much to gain their position in the limelight. The company UVIS, manufacturer of corrosion resistant pipes and running the Nikopol Stainless Tube mill, is one of them. Yuriy Atanasov, Commercial Director, explains that to successfully manage the market challenges of the year ahead, innovation is required. The company may, for instance, be considering producing its own stainless steel. "Plans are very active, and we need a lot for active development. And we need it not in 10 years, but now. Approximately two years ago, when we first approached international markets, we understood that we needed our own steel production. Not only from the point of view of optimising costs and controlling the process, but to guarantee the quality of our products; we need stable quality at every stage. The second point is that by having our own steel production, we can work on the development of new products. And when we address our customers, we can bring in a very long chain of innovations. We do not have to explain to the customers our commercial interest in the development of a new product. We have to do it. We have to take these risks. Without this we will lose our market tomorrow."

The machinery building sector in Ukraine is a growing market for domestic steel

HOME MARKETS

Other areas where Ukraine has pressed ahead with expansion are mechanical engineering, machine building and heavy manufacturing. After a dramatic slump in orders in the early 1990s, the machinery sector of Ukraine seems to be bouncing back, albeit not at the levels experienced when Soviet Union orders were abundant. Major machine and production equipment makers like Novomokovsk Machine-building plant (NKMZ) and Azovmash, in Mariupol, are pushing the domestic consumption of iron and steel up, helping compensate for the difficulties encountered by iron and steel exporters faced with trade sanctions, quota restrictions, anti-dumping actions and other protectionist measures. Steel makers in Ukraine are increasingly turning to the domestic market, hoping to find secure exits for their products. It is then only logical that finished products manufacturers have also become part of the consolidation movement and are being absorbed by the newly emerged conglomerates. The Industrial Union of Donbass (IUD), for instance, controls a number of mechanical engineering enterprises (Slavtyazhmash, Starokramatorsky Engineering Plant, Druzhkovka Engineering Plant, Donetskgormash) that have become prime users of steel rolled in the IUD mills.

MACHINE BUILDERS

The System Capital Management group controls Azovmash, in Mariupol, one of the country's two largest mechanical engineering firms, jockeying for title of leader with NKMZ. The factory's number one output and a global sales success that has sustained the company's results is ▶00

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Nikopol Stainless Tube Mill

Nikopol Stainless Tube Mill (NSTM) made its first delivery to Western Europe four years ago and has successfully become a recognised supplier of seamless stainless pipes. A $20M investment in reequipping production facilities is currently underway.

Yuriy Atanasov, Director for Economic & Commercial activity UVIS Ltd

In an interview with *Steel Times International*, Yuriy Atanasov, Director for economic and commercial activity of parent company UVIS Ltd and member of the Interpipe Group, tells about the sales strategy and production plans of the Nikopol Stainless Tube Mill.

STI – Mister Atanasov, how after four years has the Nikopol Stainless Tube Mill positioned itself in the world market and what are the basic priorities in relations with western customers?

I believe we are not beginners in the world market already. We are known both in Europe and in America. Although our present output is not as large as such giants as Sandvik and Tubacex, we are among the world's five largest manufacturers of stainless tube. We position ourselves as one of the largest specialised enterprises in Europe that manufacture seamless stainless tube. Today we produce the range of pipes that is most popular and is in greatest demand by European consumers. We produce austenitic steels, ferritic steels (410, 405, & 417), and are entering into duplex steels, which are not offered by all manufacturers of stainless pipes.

In our business, quality is and will be the priority. It is the only thing that allows you to win and maintain the interest of the established buyer.

STI – NSTM was established on the production shops of the former Nikopol Juzhnotrubny Plant, and you have inherited, we should say, not the most up-to-date equipment. What have you done about updating the production facilities?

We have repaired and essentially modernised various equipment. Speaking about the concept of technical development of production lines as a whole we are relying on the recommendations and conclusions of domestic and western advisers and have made a decision to focus on outstripping scientific and technical development instead of simply catching up with modernisation. That is, our position is not just local improvement of out-of-date equipment, but the systematic purchase of new modern machines and technological lines.

Today, the plant is engaged in setting up the product flow in the pipe-drawing shop for production of high-quality 24-meter long pipes. A Mahler bright-annealing furnace is already operating. Within the next two years we plan to buy all the equipment for this line including a cold-rolling mill, a unit for high-quality cleaning of pipes, straightening and grinding mills and non-destructive testing facilities. We have started work on the production line for finish processing of pipes that will be used by the nuclear industry: the pipe straightening mill from Bronx (UK) has already started operating and our near plans are to acquire Loeser grinding machines from Germany.

In 2004-2007, we are planning to replace six old cold-rolling mills by modern close-type units and to update the rolling mills and the draw benches. We are also considering the possibility of purchasing pipe-bending and heat-treatment equipment for the manufacture of U-bent pipes. The estimated cost of the technical development project for NSTM in 2004-2008 exceeds $20M.

STI – What foreign standards do you use today in your business?

Everything depends on the requirements of our customers. We master the standards that are most demanded in the market. At the same time, we are trying to expand specialisation to the maximum. Today we deliver pipes produced according to such foreign standards as ASTM and UNI 6904, as well as the domestic GOST standards.

STI – Concerning steel grades, what strategy are you adhering to? Today, 70-80% of world steel manufacturers are producing the standard 304L and 316L steel grades, and only a few producers are making other less common composition steels. How could you comment on this situation?

We have no problems rolling standard steel grades. I agree that the market for alloys is a very expensive and a specific one. Sometimes, certain steel grades are the prerogative of only one manufacturer. But nothing is impossible for us in respect to alloys: requirements for chemical composition in our GOST Standards differ little from the equivalent Western standards. Basically, we have already mastered the main foreign alloys and today we are going to include them into our specialisation.

Speaking about the CIS market, here our position is strong in nickel-base alloys. In the days of the Soviet Union, they were part of the specialisation of our Hot-Extrusion shop. However, taking into account the present situation with the high price of nickel, today our experts are engaged in developing new pipe materials made from more economic alloys and nickel-free steels.

At present, we are mastering the duplex steel grades, which are in extraordinary demand in Europe. And of course, for western customers, we are seriously projecting manufacture of pipes made of high-nickel and carbamide grades of steel.

STI – What serious industrial problems are you still facing?

As before, we are still facing the problem of manufacturing those sizes, which were not previously produced by NSTM. We manufacture tubes from 4mm minimum diameter to 168mm maximum diameter. Today, we have the desire to expand the assortment of hot-rolled commodity pipes to meet the requirements of the western

NIKOPOL STAINLESS TUBE MILL

Nikopol Stainless Tube Mill (NSTM) is one of seven pipe producing enterprises which were established from the largest former USSR stainless producer, Nikopol Juzhnotrubny Plant when it was re-structured by the Government. In 2000, the Dnepropetrovsk metal company UVIS suggested privatisation of the stainless pipes facility. The project was recognised as the best solution, and the same year UVIS became the main shareholder of the Closed Joint-Stock Company Nikopol Stainless Tube Mill. This new enterprise comprises the Hot-extrusion Shop No4 and Cold-drawing Shop No2 of the former Nikopol Juzhnotrubny Plant.

Today, the plant manufactures about 1000 standard sizes of pipes of more than 60 domestic and foreign grades of steel. Products are manufactured to meet ASTM, DIN, NF, UNI, GOST and TU standards.

The quality control system of NSTM has been certificated by the German Certification Centre TUV Nord and meets the international standard ISO 9001-2000. The plant has international certificates for products in compliance with the Pressure Equipment Directive PED 97/23 EN for high-pressure boilers and the European Regulations AD.2000-WO. Today, work on the mill's system for environmental safety to meet the requirements of the ISO 14000 standard is in its final stage.

Seamless tube ready for dispatch

market. Alas, for the time being we are unable to start production of long hot-finished pipes, which are in great demand. To solve this problem we are planning to install an extrusion press of 2000t force capacity in the Hot-Extrusion Shop in the near future to manufacture H/F pipes ranging from 36 to 75mm outer diameter.

STI – Until recently, the Swiss company Sepco SA was your international distributor. This year, it seems that you have changed the distributor?

Not exactly. A group of Sepco SA's experts has set up a separate division – the company UAS (Ukrainian Allied Stainless), which, started operations on May 1 of this year. This is now our official international distributor. Unlike Sepco, UAS will focus its business exclusively on sales of stainless pipes manufactured by two Ukrainian enterprises – Nikopol Stainless Tube Mill and Nikopol Tube Company. The priority markets for UAS are Western Europe and North America. As for our company, we are also engaged in independent sales of pipes to the CIS countries where we have an extensive dealer network, as well as to Eastern Europe and other areas. This year we are planning to sell about 3kt of pipes through the UAS, and by 2008 to increase these sales to the Western market to 10kt per year. For today, these are only plans, but with the help of UAS we hope to strengthen our position in the market and to find new customers. STI

World markets for stainless tube in 2003 and share of NSTM supply (kt)

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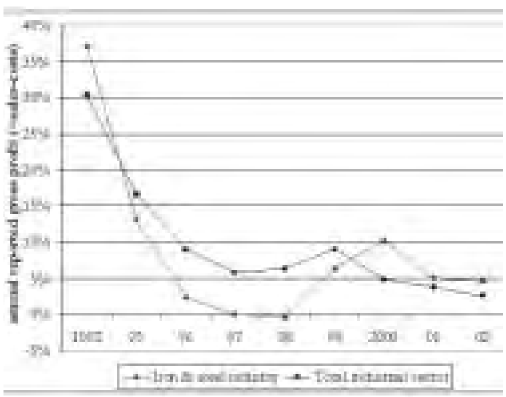
00 Ukrainian steel: – vulnerable overseas, weak at home...

domestic steel consumers) – are lagging far behind the steel industry in recovery. In 2002, market sales of the Ukrainian heavy engineering firms were only 46% of the 1990 level, whereas construction orders were down to 22%.

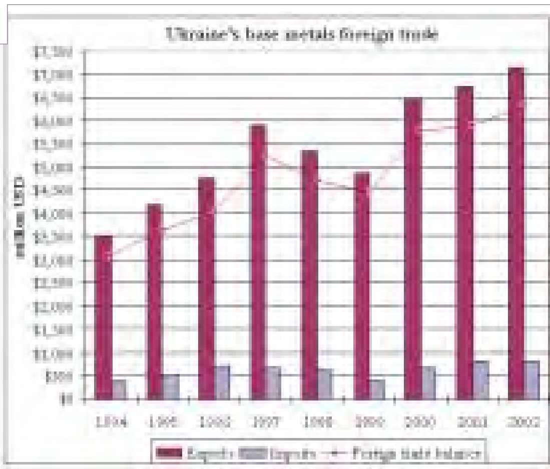
The post-communist story of the tube-rolling branch of Ukraine's ferrous metals sector indicates one potential grim scenario for the industry as a whole. After the collapse of the Soviet market, the output of steel pipes declined from 6.5Mt in 1990 to 1.2Mt in 1999, or by 82%. Given the absence of viable domestic consumers, by 2003, the Ukrainian tube-rolling mills managed to recover to the annual output level of 2.1Mt, or to just one-third of their production level a decade ago. Opportunities for any further market expansion of the Ukrainian tube-rolling branch are severely limited to the capricious behaviour of Russia's gas monopoly Gazprom, the major consumer of Ukraine's steel pipes abroad.

As the drastic collapse of the domestic market for the Ukrainian ferrous metals has not been reversed and given the highly volatile and, at times, politically-charged nature of the world steel market, the weak standing of the Ukraine steel industry at home will remain the industry's greatest challenges for years to come. STI



Ukraine: reported annual profit rates (sales-costs), steel industry and total industrial sector, 1992-2002

Source: Vlad Mykhnenko



Base metals in Ukraine's foreign trade, exports of ferrous and non-ferrous metals, 1994-2002, US$ milion

Source: Vlad Mykhnenko

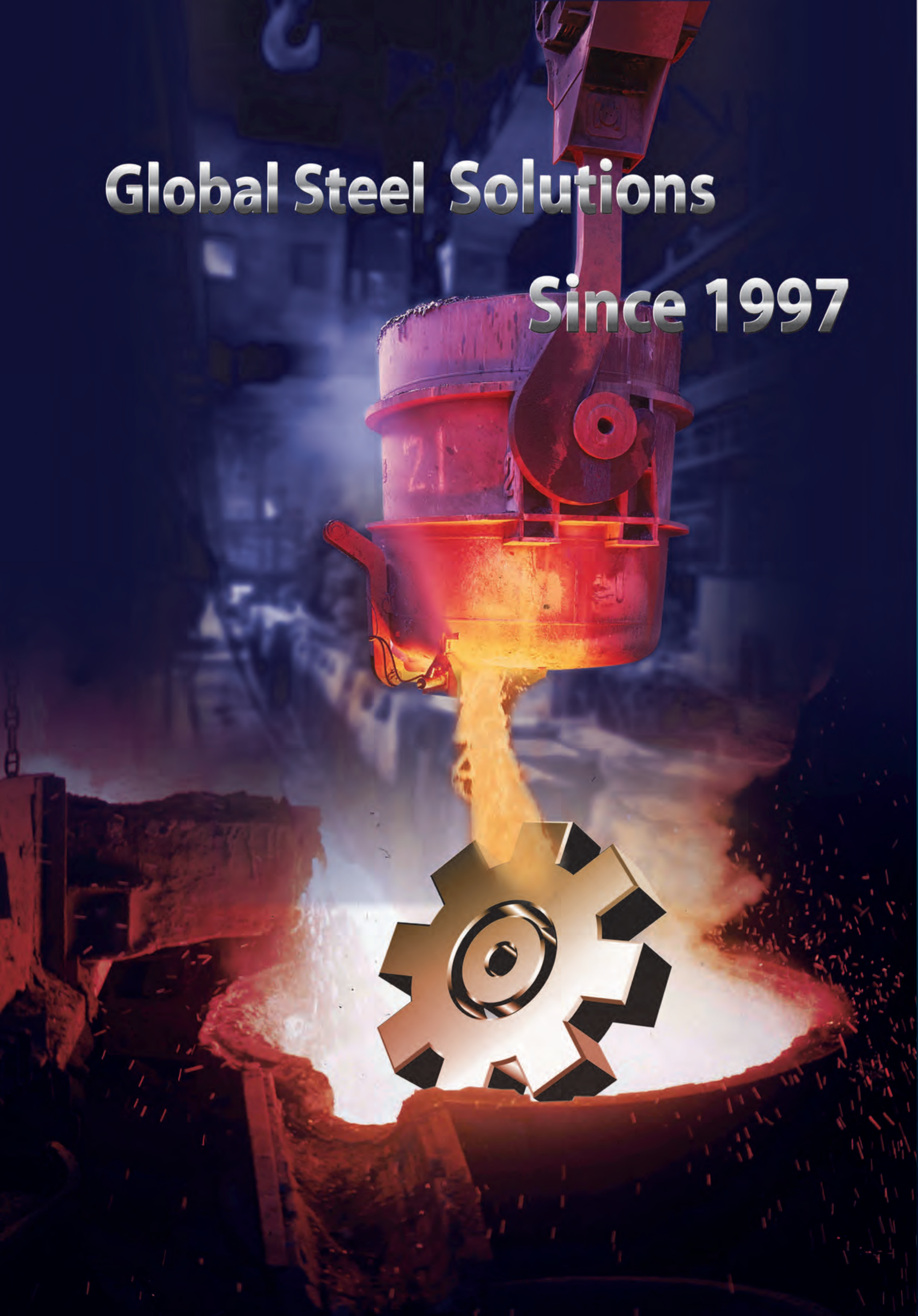
00 Ukrainian steel fostering a domestic market...

railway tank cars, but Azovmash is also engaged in the production of armoured vehicles, once the major product churned out of its assembly line. Today, this activity is markedly reduced but thanks to its in-house product development and innovative designs, the company has struck a few international deals that keep this activity alive.

Finally, and representing a growing third of its turnover, the company is producing steelmaking plant, notably in cooperation with engineering firm Danieli of Italy for the refurbishment of some of the Ukrainian iron and steel mills. Furnace rollers, continuous slab casters and other heavy steel making equipment can be manufactured by Azovmash, who sees a bright future in the type of cooperation it established with Danieli, Kunkel-Wagner and other world-class design and engineering companies: "We decided that the key strategy for our success would be to combine our efforts with such world-known companies. These companies give us the design project and we provide them with the finished products. If we propose a better design, they agree to work to our specification, if their design is preferred we do the manufacturing of the units. And the cost of manufacturing equipment in Ukraine is cheaper in comparison with most parts of the world. That's why our products have the highest technical standards and are cheaper: all this makes them competitive and we expect to see more cooperation of this nature in the years ahead" explains Anatoliy D. Chepurnoy, Azovmash Vice-President.

This example of cooperation is in itself bearing much optimism for local operators. NKMZ, the other giant heavy engineering company in the Ukraine producing a wide range of rolling mill machinery, reinvented itself. To ensure the sustainability and the success of its industrial base machinery, metallurgical, press and forging equipment, the company has also had a number of successful alliances with world-class metallurgical equipment makers. Despite the strong handicap of lack of financing capabilities, these organisations have a sound base of know how, inventive production abilities and are open for cooperation. This offers great opportunities for partnership and should provide some room for manoeuvre to the iron and steel industry.

From tube and pipe makers through to heavy engineering, the dedication, bullishness and will of Ukraine's domestic sector are striking. Despite production levels still lagging way behind the pre-transition ones, the industry has reacted with courage and should be reckoned with on the global stage. Here again challenges abound but Ukraine is a country that has faced many of them before. Today, the ones at hand seem addressable. STI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Privatisation in Ukraine: – Could they have done better?

Ukraine's largest steel plant, the 7Mt/y capacity Kryvorizhstal was privatised this June with ownership passing to a consortium of two major Ukrainian companies, Interpipe Group and System Capital Management, despite much higher offers from international bidders. Whether the price of this desire to keep Kryvorizhstal in national hands makes commercial sense remains to be proven.

BY G VALENTIN & C COURONNE*

Privatisation involves securing raw materials as well as steel plants

June 2004 might have been a turning point in Ukrainian history and in the economic development of the nation. For a transitional economy such as Ukraine, privatisation is not only a necessary step towards economic development, it is the only way to attract foreign investors.

In 2003, Ukraine received only US$6.7bn of foreign investment, that is less than 10% of the $68bn received by neighbouring country Poland over the same year. The highly lucrative privatisation process of the Kriyviy Rih Mining and Smelting Plant – better known as Kryvorizhstal – was one of the major steps of the Ukrainian Government's privatisation programme announced for 2004 and an opportunity to see the country's share of FDI increase. As stated by Mr. Anatoliy Kinakh, the then Prime Minister of Ukraine, "The Government of Ukraine considers privatisation as part and parcel of the establishment of a market-economy and as an integral component of the structural reforms of the national economy".

Kryvorizhstal is one of the world's largest steel plants, and produces nearly 7Mt of steel per year (2002 = 6.9Mt). Its privatisation thus promised to attract iron and steel giants from around the world, as well as local interests who had been jockeying for control of the works since the start of the privatisation process in the 1990s.

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Much to the annoyance of the participants from afar, it was the local bidders who won. A consortium of two Ukrainian national giants, the Interpipe Group and System Capital Management (SKM), called Investment Metallurgical Alliance won with a final price of $800M (4.26bn HRV) and were rewarded with a 93.02% stake in the steel works. The groups are controlled by Mr Rinat Akhmetov, the Ukraine's wealthiest man for System Capital Management, and by Mr Viktor Pinchuk, son-in-law of President Leonid Kuchma for Interpipe – clearly a powerful concoction. For Ukrainian patriots, the result can only be seen as a success; Ukrainian business remains Ukrainian. Unsurprisingly, the losers and the international press claimed that there had been foul play and the playing field not level (a caveat had been added that any bidder must have produced and sold at least one million tonnes of coke in the Ukraine in recent years). Even patriotic Ukrainians raised an eyebrow when they considered that the bid starting price was $1200M – 50% above the winning price; and that the steel giant LNM had offered a bid amounting to $2700M.

However, from the outset, it had always looked as though it was going to be very difficult for the foreign firms to compete. In a country whose industry is dependent on steel and one that contains some of the world's largest reserves of ore and coking coal, it is not easy to walk away with its largest and most strategic national steel works.

OBSCURE CONDITIONS

Some people describe the conditions stated in the tender as 'patriotic'. Others describe them as 'discriminatory'. Nevertheless, the tender attracted a great number of prospective buyers from overseas who should have noticed that one criterion of the bid was to produce a minimum of one million tonnes of coke in the Ukraine; almost a de facto ruling out of any foreign participation. Interpipe and System Capital Management however control considerable reserves of coke in the Donetsk region, ample to fulfil the tender's conditions. Any foreigners hoping to get a look in on the deal might have been wiser to team up with a Ukrainian partner is the way same way that Mr Akhmetov and Mr Pinchuk did when forming their Investment Metallurgical Alliance, specially designed for the tender.

Despite this and similar clauses promising an uncertain bidding process, world giants still dispatched their best teams to the Krivoy Rog region, in an attempt to win the coveted production plant. The Indian company Tata Steel, the Russian company Severstal, the world's biggest metallurgical concern Arcelor, as well as the LNM Group and US Steel consortium offered some of the most impressive efforts to win this bid. Joining forces, LNM with US Steel submitted the strongest bid comprising $1.501bn for the 93% equity plus an additional $1.2bn for the implementation of a capital expenditure programme. The consortium also made a point of complying with international environment rules as well as to the national requirements for the development of the plant. The LNM-US Steel Consortium declared "its commitment to maintaining and improving social harmony at the plant" and proposed a development plan to reach a steel production superior to 11Mt, to provide access to global markets as well as increasing supplies to the domestic market, to "ensure EU compliance on environmental issues", and finally to commit to purchasing Ukrainian raw materials including iron ore and coke.

Yet on June 14, Mikhail Chechetov, Chairman of the State Property Fund, announced that the Ukrainian bid had been successful.

Scandalous as it may seem, national interests will always trump international norms of fairness and, with stiff competition for resources access in the capacity constrained steel industry world wide, there is extra incentive to maintain the asset in national hands.

Kryvorizhstal will now belong to the consortium of Kiev-based Interpipe Group and Donetsk-based System Capital Management. Interpipe is already the major share holder in the pipe business, including companies Nizhnedneprovsk Tube-Rolling Plant; Novomoskovsk Pipe Producing Plant and Nikopol Seamless Pipes Works Niko Tube making Interpipe the fourth largest pipe producer in the world, and the second largest supplier of manganese ferroalloys.

For its part, System Capital Management ▶00

STABILITY & LONGEVITY

Enakievo Iron and Steel Works is one of the first joint-stock enterprises in Ukraine. Looking ahead with confidence, the company implemented the reconstruction of a ladle furnace, fired in September 2002, and a continuous billet casting line increasing the overall output of billets up to one million tons per year.

Today, the installation of the second ladle furnace, of a second continuous billet caster, of a new oxygen block (scheduled start-up May 2005) and the forthcoming construction of blast-furnace number 5 will take us one step ahead.

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JSC "EMZ"
9, Metallurgov Av., Enakievo, 86400, Donetsk Region, Ukraine
Telegraph: ENAKIEVO "RUBIN" **Teletype:** 330733, 330743 **Fax:** (+ 38 06252) 5-01-01
Telex: 115738 "SHLAK" **E-mail:** oves@emz.en.dn.ua ; marketing@emz.en.dn.ua

An interview with Sergey A Taruta, Chairman of the Board of the Industrial Union of Donbass

The Industrial Union of Donbass (ISD) is one of three major groups that have emerged within Ukraine's steel industry. As well as acquiring two integrated plants on their privatisation, Alchevsk and Dnieprodzerzhynsky, it also owns down-stream operations in Ukraine including engineering plants. It is vertically integrated assuring raw materials supply by ownership of coal and ore mines. It has an international outlook, having a partnership agreement with Swiss-based international trader, Duferco and is in the process of buying Hungary's largest steelworks, Dunaferr (which now includes DAM). It also unsuccessfully bid for Poland's largest steel group, PHS and later its attempt to buy Huta Czestochowa was thwarted by a decision of the Polish government, which is presently being challenged in the Courts. Here, Global Business reports speak with Mr Taruta.

Q: A lot has happened to the Ukrainian iron and steel industry in the last few years and a lot has happened to the Industrial Union of Donbass and to its name for good and maybe some bad reasons. Could you tell us what has happened to this organization in the last couple of years?

Sergey A Taruta: A lot of changes have occurred in the last few years. First of all the recognition of Ukraine as a real player in the world market of metal. Coming back to Soviet Union times the USSR wasn't a substantial player on the foreign market, but nowadays, both Ukraine and Russia, along with Brazil, China and Australia, present the main resources for raw materials and semi-finished products. And the recent privatisation of Kryvorizhstal clearly shows that the privatisation activity of enterprises of the metallurgical complex is increasing, and is attracting the attention of foreign partners.

Q: But for the privatisation of Kryvorizhstal there was greater interest than ever, featuring the biggest names of the industry, from LNM through to Arcelor, US Steel and Severstal.

SA Taruta: Well, you know, if somebody had suggested $200M for Kryvorizhstal three years ago, he would have been given a medal for courage. Not many believed in the effective work of Ukrainian enterprises or maybe there were some other restrictive factors, such as the political factor. The situation nowadays has changed completely. We are becoming members of the world market. And the world market has changed its attitude towards us, and towards the steel industry in particular. If we talk about the Industrial Union of Donbass, we have completed many planned tasks in the past two years. We have chosen the path of a public company. We are integrating ourselves with European partners. We participate in the privatisation of European enterprises. And this direction given to our activity gives us particular results, where we have the possibility to invest in the development of our enterprises. We are actively working with the company Duferco which is enlarging its trade net. We have a positive experience from cooperation with VoestAlpine Industrieanlagenbau, (VAI) who is helping us reconstruct our enterprises. We recognize that there are big Ukrainian mechanic engineering enterprises, such as NKMZ and AzovMash, but unfortunately they have no possibility of meeting the long-term investment programmes we need at this stage.

Q: Your group is active across a wide range of activities, from energy and gas, through to mining and the metallurgical sector, but also in the agro food business. What is the relative share of metallurgy in the overall picture?

SA Taruta: I'd like to put it in other words. The share of metallurgical and support industries in our turnover is 83-85%. Including the machine building industry and coal mining – everything that is needed for metallurgy. Our company has several directions, and we are reinvesting the income from these into our development, but the metallurgical drive is the main one. Currently, there is a restructuring programme in the Alchevsk Iron and Steel Works, and there's going to be the same programme at the Dnieprodzerzhynsky Iron and Steel Combine.

A joint group from VAI and our specialists has already started the development of the preparatory programme depicting the strategy and stages. And this year we have already started several projects.

Q What is the investment envelop for this year?

SA Taruta: It's a rather big sum of money. But I wouldn't like to announce the exact figures, taking into account that we work in an aggressive environment. This money will go into upgrading existing equipment and the introduction of new capacity in blast furnaces and steel-melting equipment. We have a government obligation to invest in our activities following the privatisation process: The investment required is in the range of $350-400M. And we are implementing the investment programme faster than originally planned.

Q: Another big story for the Iron and Steel community is the Dunaferr operation in Hungary. What sort of plans do you have for this plant? How do you plan to build synergies between your Hungarian operations and your Ukrainian assets?

SA Taruta: Now we are at the final stage of privatisation (of Dunaferr). All the questions are settled; technical and financial ones. We have a detailed business plan. It appeared to be better than those of our competitors. Investment, social and ecological programmes are depicted there. The amount of investment is about $300M. We foresee a great potential in this enterprise. First of all we will increase the output of steel within the limits of present capacity. This enterprise was interesting for us mainly due to its untapped potential and possibility to increase capacity by selectively investing. Besides we'll have surplus value on processing of our semi-finished products. We have a common border that

Investments will include improved environmental protection

allows us to supply energy resources, ie gas, electricity, coal and raw material. Besides we plan to export some finished products from Dunaferr to Ukraine. I mean products that are not produced here in the Ukraine. Alongside with this company, we have also bought service centers. They were of great interest to us as the creation of service centers in Ukraine and outside the country coincides with our conception of marketing.

Q: It's also a fantastic foot in the door to the European market.

SA Taruta: When we started the privatisation of this enterprise three years ago, we didn't expect that Europe would come so fast. This enterprise has immense possibilities and perspectives. It's the only significant metallurgical enterprise in Hungary and 60% of its output is destined for its domestic market – it's a very stable position. The remaining 40% is sold on foreign markets, to countries like Italy, Austria and Germany. We still have some problems but I'm sure we'll overcome them in a short time; and the plant will become profitable. In recent years, the Hungarian state had problems with the effectiveness of this enterprise. The programmes that are taking place now in Alchevsk (Ukraine) aim to produce products that will be delivered to Dunaferr as well. We have an obligation to maintain the number of people working at the plant and objectively they are more than we really need. That's why we can cope with this obligation only by increasing production capacity and decreasing costs. As for production of crude steel we evolve within limits, meaning that we can't increase production as it will involve a greater investment, notably concerning the ecological aspect. But as for rolled metal we can produce in addition to the present programme up to 800kt. And in this case the enterprise will be balanced. We hope to put out 2.3 – 2.4Mt/y of rolled metal (from Dunaferr).

Q: Another story that was in the headlines is about Huta Czestochowa of Poland which you attempted to acquire. It has been a very controversial operation, and in the bid, politics played a dominant factor. Could you tell us your views on what happened there?

SA Taruta: There has been so much information published in the last six months about the privatisation of this enterprise! Even when I called a vice-premier of Turkmenistan, and that country has little to do with metallurgy, he asked me what was going on with Huta Czestochowa… so, it was a really burning topic of the day. According to statistics, this question even took first place as the most frequent and argued topic in the mass media. Actually Poland has created this situation itself. First of all they had to decide whether they wanted to sell this enterprise or not. I had a feeling during all this process that they were trying to create a deadlock. They didn't want to sell it to anyone except LNM (who had already purchased the largest Polish steel group, PHS). And they didn't expect any other company to participate in the privatisation. This so-called tender took place at the same time as the Hungarian one. The Hungarian state used Price Water House Coopers who clearly formulated and defined all the terms of the tender. They typified all the propositions of all the partners. There were rules; and all the members of the Tender Committee proceeded using these rules, and they had a genuine view while fixing the points of contention. In contrast, in Poland the Polish government formulated the tender rules. The rules were constantly changing. That gave the ground to manipulate the results. There were a number of financial, economic, and technical propositions. But when they compared them it was clear, that our proposition was the best. Hence further changes were made (by the Polish government). All this was done with the sole purpose of giving LNM the works and there wasn't a need for a tender at all. When the Privatisation Committee first announced Donbass as the winner, the Polish government reversed the decision, which concerned not only Poland but Ukraine as well. During the 10 years of Ukrainian independence there had been special relations between the two countries. Poland played the role of an elder civilized brother, who told us how to live, where to get an education, whom to love, whom to be friends with. And when all this story happened everybody, even those ones who didn't really like IUD, took it as a personal offense. And there was a common negative attitude from the part of our President, government and public. And the demand to explain 'why?' was natural. All this was just a farce. The Polish arguement that they wanted to have only a producer of steel was contrary to the idea of running this tender. They also mentioned that they didn't plan to increase the output of steel, ie openly saying that this enterprise was sick and they preferred it to die. This enterprise is now broke: It's unprofitable because it doesn't work. And the government says that it is not going to increase output – they took the position to let the enterprise die. There were four official arguments. The first one is that they wanted to see the players from the 'First League'. And the last argument was that the origin of our capital was not clear to them. But they had eight months to clear up all the questions during this procedure. So, as you see, not a single argument was grounded and solid enough to justify their decision. Today we have won in the Court of Justice and we have blocked this process. And the new government understands that the Committee's revised conclusions were not right. I am sure that they will make the right choice. If they want this enterprise to work, then they should give us the possibility to privatise it. But if they don't want (success), then they should announce it openly.

Q: In the Central and Eastern European steel industry, there has been a lot of interest from key competitors, from LNM through to Corus and US Steel. Here in Ukraine we have seen Arcelor, Severstal and other major players lining up for Kryvorizhstal… don't you feel that you may be punching above your weight in your own backyard? Or is it on the contrary a sign that IUD is entering the First League of global steel groups?

SA Taruta: I have already mentioned that nowadays Ukraine is quite an active player. And the fact that we participate in the privatisation of assets outside Ukraine speaks for the fact that production volumes in Ukraine are insufficient. We look for energy, energy that will provide us stability in the future and will help us to compete with new players. And the main player now is China. A few years ago we were all looking at the US market, now we are very attentive to China. It's very difficult to survive on the metallurgical demand of Eastern Europe. Especially for those who are far from the ports because transport costs and raw material costs are determinant factors. The level of technology is no longer the deciding factor, as it used to be. Having high standards in the ecological sphere, having a high salary, plus expensive transport costs already make it critical for the enterprise's activity. If we take Arcelor, it produces more than 40Mt/y of steel, but its income is the same as that of KryvorizhStal. This shows that Ukrainian players have leading positions now. We have a favorable geographical position, a well-developed logistic net and natural resources. Those are our advantages. And I'm sure that step-by-step we'll reach the ecological level demanded and we'll secure better ways of living. This task demands more expense, and we'll talk about another index – a 'surplus value'. All our investment projects in Ukraine are aimed at decreasing costs, and improving quality. All our enterprises provide the possibility of creating a surplus in value. Nowadays we see the process of globalization and consolidation of the metallurgical business. We are not substantial players on this market yet. What we see now is a process of aggressive absorption by LNM of all the

The Alchevsk steel plant is to undergoing a Euro 140M investment which will eventually replace its six open-hearth furnaces

Eastern European steel producers.

Q: Coming back to the situation in Ukraine. As you said Ukraine is a key player – it is the 7th largest steel producer in the world. And there are such major power steel houses as SKM and obviously the IUD. Are there any prospects of concentration here and of witnessing the birth of one single major player? There has been a lot of concentration already, and a lot of transfer of working assets. The next stage could be a concentration between the actors of the concentration themselves…

SA Taruta: I'm not sure that it may happen. At least not in the near future. Each group is independent by itself. Each one is ambitious. The success of each company depends on the right choice of strategy. But let's wait and see what will happen in the future, maybe there'll be a fusion of companies, on equal terms, or even there may be absorption of the weaker company by the stronger. Anything may happen, but we are independent from each other at this stage. Besides we have partners in Europe, and we can't take decisions without discussing it with them. We don't plan to buy new enterprises in Ukraine; we plan to increase the output of the existing plants.

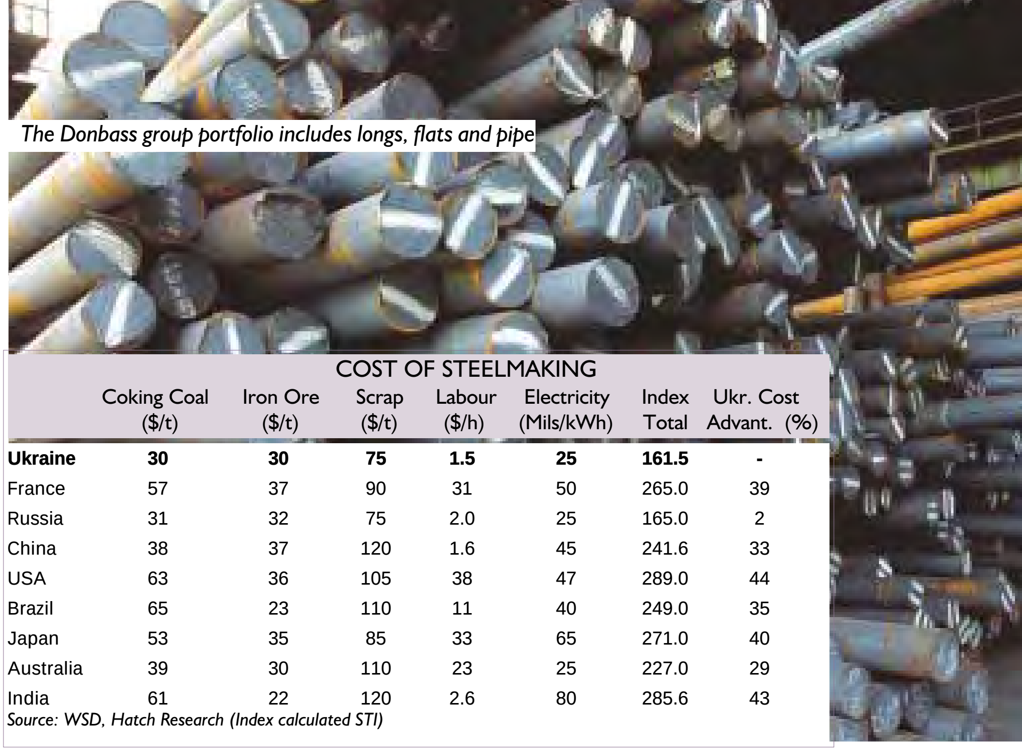
Q: What would be an ideal scenario for the steel industry here in Ukraine? Where do you expect to see this industry in the next 10 years?

SA Taruta: As I see it, there will be a further process of globalization, and small plants have no chance of survival, as there's a process of globalization not only in capacity but in raw materials as well. All the plants will pass a stage of technical reconstruction: that's of great importance now. Ukraine is going to integrate the world market. Production of steel will be competitive. The main competitors that we see now are Brazil and China. Russia is our competitor only on the Russian market. Then I can foresee pressure from the state. And here the situation will depend on events that will happen in our country. We don't have state enterprises anymore. And the government will make owners pay attention to the ecological factor and will make them raise salaries. Then there shouldn't be disproportion among the branches. The energy costs are going up too, but that's not going to be a crucial factor. We have reserves from implementing energy saving technologies. Ukrainian metallurgy will be profitable, and it will be problematic for our competitors, mainly for Western Europe and the USA, as our costs are lower. Any increase of output in Ukraine may lead to decrease of output in Europe.

Q: As the president of one of the organization that has taken the Ukrainian industry outside of Ukraine where do you see IUD within the same frame and where would you like to take it?

SA Taruta: I see a future expansion on the foreign market, both from the trade and production points of view. Unfortunately Ukraine doesn't consume as much as it's growing output. As far as we have a strategy of stepping up the output we'll have to work in foreign markets. As for China forecasts, they are not favourable for us. But if we look at all the forecasts, seminars and programmes of the last three years, they haven't come true. But the true fact is that the lower your costs the more chance you have to survive. And Ukraine is very competitive in this aspect. If we talk about IUD, we have increased slab output to 5.5Mt/y for the last three years. Some of the slab will be sold here (1.5Mt), and we will process the remaining 4Mt for export in order to guarantee stability. We have joint-venture projects in the USA of 1.2Mt capacity. Some steel would have gone to Huta Czestochowa in Poland. EU regulations put strict limits on the amount of public support a state can provide for its companies. and Huta Czestochowa was not included in the steel-sector restructuring agreement signed between Poland and the EU.

We still have some spare capacity, and now we are again thinking about what assets to acquire, where to process this surplus material. That's why further integration within the foreign market continues. STI



The Donbass group portfolio includes longs, flats and pipe

COST OF STEELMAKING

	Coking Coal ($/t)	Iron Ore ($/t)	Scrap ($/t)	Labour ($/h)	Electricity (Mils/kWh)	Index Total	Ukr. Cost Advant. (%)
Ukraine	**30**	**30**	**75**	**1.5**	**25**	**161.5**	**-**
France	57	37	90	31	50	265.0	39
Russia	31	32	75	2.0	25	165.0	2
China	38	37	120	1.6	45	241.6	33
USA	63	36	105	38	47	289.0	44
Brazil	65	23	110	11	40	249.0	35
Japan	53	35	85	33	65	271.0	40
Australia	39	30	110	23	25	227.0	29
India	61	22	120	2.6	80	285.6	43

Source: WSD, Hatch Research (Index calculated STI)

Table 1 Cost advantages of steel production in Ukraine

00 Privatisation in Ukraine – Could they have done better?...

controls companies such as the vast steel producer Azovstal, Leman Commodities, Yenakievsky, Silur, Azovmash and Khartzysk Tube Works. In a nutshell, the consortium controls the lion's share of the steel industry in Ukraine from iron and steel producing (Azovstal), machine and heavy equipment manufacturing (Azovmash), Tube and Pipes manufacturing (Interpipe Group and Khartzysk), ferroalloys production and steel trading via the Leman Commodities support. Both groups have demonstrated their skill in turning around huge but outdated assets that they have inherited from the cash strapped state and each has accumulated the vast amounts of capital that they needed to win the tender and that they will need to modernise their new plant. Furthermore, the groups have become something equivalent to national champions and represent the very rare example of Ukrainian companies with the strength to become international players. This latest addition to their empires will ensure that Ukraine will boast a world beating company in the country's single most strategic sector.

Investment Metallurgical Alliance's successful acquisition will ensure the two giants control most of the supply and production chain for steel and have a plentiful supply of raw materials, especially iron ore and coke. Iron ore and coke raw materials are currently at peak demand levels. With the ever-increasing demand from emerging China, companies and countries, which control these resources, are well placed to assure themselves strategic leading positions in the future.

The outcome should not come as a surprise given the history of Ukraine's privatisation process. The foreign investors kept at bay denounce the failure of the Ukrainian government to seize an opportunity to increase investment, technology and market access which will be greatly needed for the consortium now in control of one of the most integrated steel-production infrastructures in the world. Furthermore, a winner from abroad would have been perceived as an encouraging sign to other potential foreign investors eager to do business in Ukraine, who might now be put off. But now it is left to the new owners to prove what they can do with the plant and given the rapid rise of the two groups over the past decade, we should expect to be hearing a lot more about them in the future. STI

Silur, owned by System Capital Management, adds value by making finished product