

Enakievo ISW and Metalen: merger via dilution imminent. Stay informed

PFTS ENMZ, Bloomberg ENMZ UZ

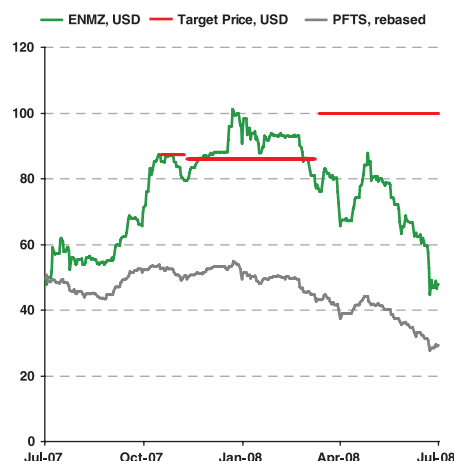
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Current rating

BUY

Target price, USD	100.0
Current price, USD	47.8
Upside	109%

Stock data



Shares outstanding*	16,264,134
Market cap., USD mln	777
EV, USD mln	615
BV, USD mln	521
Par value per share, UAH	15.25
ADR/GDR Ratio	n/a

*Including the likely issue of 5.7 mln of new shares

Shareholders structure

Metinvest/SCM	95%
Free float	5%
Free float, USD mln	39

It has just become clear that Enakievo ISW and Metalen LLC will indeed merge, and that this will happen soon. We take investors beyond overcoming these risks through the question of HOW the merger will happen. We emphasize that the minority shareholders of Enakievo ISW will be diluted 1.54 times in order to finance the acquisition of Metalen, according to the usual practice in Ukraine (Azovstal in 2006 is the most relevant example). The dilution is not a risk but a certainty, which has, for some time, been fully accounted for in our valuation of the company.

Executive summary

- Conjoined siblings.** OJSC Enakievo ISW formally smelts pig iron and rolls a relatively small amount of billets from steel that is smelted and cast by Metalen LLC. After the recent small share issue, OJSC Enakievo ISW formally has 10,550,688 shares outstanding.
- How to value the stock?** The market has long expected a merger that would create a normally operating, full-cycle steelmaker called the Enakievo ISW group. Management of the Metinvest Holding, the controlling owner, indicated on several occasions that this is the right way of looking at the situation, and insisted that the two companies will eventually merge. **Three things have been uncertain regarding the merger: Will it indeed happen? When? In which way? The first two issues seem to have just been resolved:** yes, soon the companies will merge.
- Recent rating upgrade.** On July 18, 2008, the Ukrainian rating agency Credit-Rating upgraded OJSC Enakievo ISW from uaBBB to uaA. From that upgrade we infer an important point: a merger of OJSC Enakievo ISW with Metalen LLC has become more certain and is likely imminent.
- The 2006 rating: separate entities.** On June 15, 2006 Credit-Rating assigned the uaBBB rating, citing as limiting factors: (a) the absence of a full operational cycle at OJSC Enakievo ISW due to Metalen LLC owning steel smelting and casting capacities; (b) risks due to possibility of redistributing cash flows and capacities within the Enakievo ISW group. **Conclusion: at that time, the two companies were viewed as separate entities by the rating agency.**
- The 2008 rating: merger imminent.** The July 18 rating upgrade announcement cited neither of the above limiting factors. **Instead, the absence of official consolidated financials was mentioned. Conclusion: the agency now views the Enakievo ISW group as a whole. Conclusion: a merger is much more certain and closer in time than previously.**
- How will the merger proceed?** Look at our December 02, 2007 report for details of our view. In short: (1) 9,074,421 shares will be issued, diluting minorities 1.86 times; (2) all shares will be exchanged at face value for member stakes in Metalen LLC, which will cease to exist; (3) OJSC Enakievo ISW will form a treasury stock of 3,360,975 shares, which it will likely cancel (**this is the main uncertainty now**), resulting in 16,264,134 shares outstanding for the Enakievo ISW group (a 1.54 dilution from present number of shares).
- Recommendation: stay calm, BUY. We stand by our last valuation of the company: USD 100 target price, implying an upside of 109%.** We emphasize that **we had incorporated the impending unavoidable dilution into that valuation.** The company is fundamentally strong: the negative increases in source material prices (iron ore, coke, scrap) should be more than offset by the **enormous positive increase of steel prices.** Even though the Enakievo ISW group had three disappointing quarters since 2Q07 (Figure 1), **the Metalen LLC 2Q08 results, revealed on July 23, are much better. We recommend BUYing,** especially if the market reacts nervously and negatively to the initial dilution.

Figure 1. Key indicators

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	2008F
OJSC Enakievo ISW											
Net Sales	150.1	154.1	175.6	222.0	209.0	251.0	247.4	307.6	377.9		
EBITDA	6.2	11.4	14.3	22.7	12.7	42.5	10.7	(6.9)	7.9		
Net Income	2.0	5.0	0.6	23.4	4.8	24.3	4.6	(3.7)	(1.0)		
Metalen LLC											
Net Sales	184.2	195.4	214.8	267.5	209.2	200.9	202.4	289.0	283.6	360.9	
EBITDA	12.3	25.7	19.3	9.2	8.5	13.6	12.1	(8.0)	13.2	39.3	
Net Income	6.3	17.5	10.2	3.1	3.7	8.3	1.9	(5.4)	5.3	30.4	
Enakievo ISW group											
Net Sales	198.2	215.2	235.5	283.2	257.2	300.8	294.2	356.6	441.9		2,631.0
EBITDA	18.4	37.1	33.5	18.0	21.1	56.0	22.8	(18.0)	20.7		312.0
Net Income	8.3	22.5	10.8	12.5	8.3	32.5	6.5	(12.2)	3.8		191.0

Source: Company data, Sokrat estimates

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