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MMK to Pay $583M For Australian Miner

By The Moscow Times

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Magnitogorsk Iron & Steel Works, or MMK, is to buy Australian group Flinders Mines for an agreed 554 million Australian dollars ($538 million) in a deal highlighting concerns over the Russian steelmaker's debt burden and prospects for its existing iron ore production.

Steelmakers have been buying upstream assets to lock in supply and keep costs down, allowing them to remain profitable during downturns. ArcelorMittal, the world's largest steelmaker, is also one of the top five producers of iron ore and coking coal.

MMK has been seeking to boost its mining operations and increase the proportion of iron ore demand it can supply itself. Currently, it is 30 percent self-sufficient in iron ore, according to analysts.

Its 30 cents per share cash offer was an 82 percent premium to Flinders' last traded price Tuesday, before MMK's interest was disclosed, and sent the Australian exploration company's stock galloping 70 percent to a record high of 0.29 Australian dollars on Friday.

Analysts, however, said the deal raised questions about the success of MMK's existing iron ore project, Prioskol.

The acquisition will probably not contribute to earnings until 2015 at the earliest, said Barry Ehrlich, a senior analyst at Alfa Bank in Moscow.

"From an [MMK] investor's point of view, this is a bad deal and the stock will most likely underperform over the next six months," he said.

Flinders is targeting production from its Pilbara iron ore project by 2015, it said.

Ehrlich said he would have preferred to see MMK develop its own Prioskol project in Russia, which would not have involved a major cash outflow, adding that the Flinders deal suggested Prioskol was not going forward.

Analysts also pointed to debt at MMK, which had long-term borrowings of $2.6 billion at the end of June and total non-current liabilities of $4.2 billion. MMK said earlier in the week in a statement expressing interest in Flinders that it could obtain a loan from Bank of Moscow for up to $100 million.

"The company is stretched on the balance sheet, it is overleveraged and the last three quarters have been weak," VTB Capital analyst Igor Lebedinets said.

MMK's deal came a day after Japanese group Mitsubishi offered to buy Murchison Metals' stakes in another iron ore project and infrastructure in Australia for $315 million.

Snapping up Flinders will, however, help cushion MMK against iron ore price rises.

"Ownership of an iron ore business in Australia represents a natural hedge against growing prices for iron ore, the main cost component for MMK," UniCredit analyst Marat Gabitov said in a research note, noting that there were no obvious synergies between the Pilbara iron ore project and MMK's main production site in Magnitogorsk, given the geographical remoteness.

Gabitov said the increase in the price of iron ore had halved MMK's EBITDA margin to 15.6 percent in the second quarter from 31.2 percent in 2006, while steel prices rose a third over the period.