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Analysis: Mechel Scrambles to Finance $9Bln Debt

By The Moscow Times

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Steel and coking coal producer Mechel may have to call in state support to finance its $9 billion debt pile in 2012 if it once again fails to pull off an initial public offering of its mining unit in New York or London.

The company, controlled by tycoon Igor Zyuzin, must repay or refinance more than $2.6 billion in loans in 2012, according to its own figures — just over a quarter of its total net debt of about $8.7 billion as of the end of September.

Several financial sources said Mechel had hoped to service the debt with $2 billion raised from a long-anticipated initial public offering of its flagship-mining unit.

But the plan was derailed last year after global equity markets slumped and Mechel's share price lost 70 percent as investors fretted over the firm's critical debt situation.

“Investors believe that the company is under a lot of pressure to make a decision: come to the market, sell assets, do something to reduce its debt burden,” said Chris Weafer, chief strategist at investment bank Troika Dialog.

Mechel says it does not see any problems paying its debt and referred to comments by senior vice president for finance Stanislav Ploshenko to analysts in December: “We don’t expect any problems or challenges in implementing this debt repayment program.”

A Mechel spokeswoman declined to comment on the possibility of an IPO.

Adding to the pressure on the company is a slump in coking coal prices — falling since China cut Australian imports in 2011 — which looks likely to hurt Mechel’s future earnings. An HSBC report in January forecast an average of $261 per ton this year, down from the $289 per ton average last year.

“If coking coal prices continue to decline, then Mechel’s EBITDA will fall as well. Therefore there is a real chance that the company will breach its covenants. If that happens it will have to refinance its debt,” Renaissance Capital metals and mining analyst Boris Krasnozhenov said.

Earnings before interest, taxation, depreciation and amortization, or EBITDA, are viewed as a proxy for the cash flows that a company can draw on to sustain its debt load.

Mechel’s debt-to-EBITDA ratio of 3.5 times means the U.S.-listed company is also close to breaching its debt covenants, making the company’s financial position all the more precarious, bankers and financial analysts say.

Sceptical Markets

Mechel’s big problem is that capital markets have been effectively closed since August, with the successful $250 million listing of oil and gas explorer Ruspetro earlier this month a rare success story.

It is seen as one of the companies most desperate to realize its IPO ambitions in 2012, but only if it can secure a valuation that would make a difference to its debt pile.

Mechel’s valuation, based on recent stock prices, is about $5.8 billion, roughly 61 percent below its end-2010 figure.

The mining unit represents about 70 percent of company assets, so a float of 20 percent of its equity would raise just $623 million at current prices — well below the reported goal of $2 billion.

“The IPO will be back on the table when Mechel returns to $18 a share,” said Alfa’s Barry Ehrlich, referring to a price last seen in early September.

An IPO in New York where Mechel itself is listed, rather than London, could also boost Mechel’s chances of success, said Iryna Trygub-Kainz, steel analyst at Raiffeisen Centrobank.

“The perception of Russia in New York is also better [than in London] — they see it not as a

European but more as a developing country," she added.

Foreign Banks

The most likely path to financial security looks to be a refinancing of its 2012 debt by Russian state lenders, which held 46 percent of Mechel's borrowings as of Dec. 1, followed by an IPO of the mining unit.

Foreign banks, which hold 33 percent of the debt, could also be persuaded to take part in the refinancing in order to gain a slice of the mandate, and fees, for any IPO, analysts say.

"I would not exclude the foreign banks taking part, although in pennies rather than dollars. They will be there to gain a place on the IPO," said Barry Ehrlich, a metals and mining analyst at Alfa Bank.

A state-backed loan followed by an IPO would mirror the route taken by Oleg Deripaska's aluminum giant RusAl, which refinanced a $4.5 billion loan in late 2009 before raising $2.5 billion in a Hong Kong and Paris IPO a few months later.

The RusAl IPO has been a disaster for investors, however, with the shares trading at little over half their listing price of 10.8 Hong Kong dollars.

Send In the Doctor

Mechel is thought to be able to count on the backing of Prime Minister Vladimir Putin for state financial support despite an incident in 2008, in which Putin launched a high-profile attack against its owner Zyuzin for pricing policies and alleged tax avoidance.

The incident, in which Putin promised to send the unwell Zyuzin "a doctor and a prosecutor," caused Mechel shares to crash 40 percent on fears the company could suffer a similar fate to oil major Yukos. Yukos was broken up and its oligarch owner Mikhail Khodorkovsky jailed after falling foul of Putin in 2003, a case critics say was politically motivated.

But two years later Putin said he regretted making comments that were so detrimental to Mechel's share price and thanked Zyuzin for "behaving correctly," a gesture taken by the market as a sign the tycoon was back in favor.

"Of course the company has strong state support — Prime Minister Vladimir Putin would instruct state lenders VTB and Sberbank to help the company," said Irina Trygub-Kainz at Raiffeisen.

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