Executive MBA
Mergers & Acquisitions

Efficient corporate governance and its impact on company value and performance - the case of ArcelorMittal Kryviy Rih (Kryvorizhstal)

A Master's Thesis submitted for the degree of
"Master of Business Administration"

supervised by

Univ.Prof. Dr. Klaus Gugler

Lesya Kovalenko

0605496

Vienna, 28. June 2010

Affidavit

I, **LESYA KOVALENKO**, hereby declare

1. that I am the sole author of the present Master's Thesis, "Efficient corporate governance and its impact on company value and performance - the case of ArcelorMittal Kryviy Rih (Kryvorizhstal)", 52 pages, bound, and that I have not used any source or tool other than those referenced or any other illicit aid or tool, and
2. that I have not prior to this date submitted this Master's Thesis as an examination paper in any form in Austria or abroad.

Vienna, 28.06.2010

Signature

Abstract

The research tries to find relationship between corporate governance and company performance and as a consequence of this company value on representative case of Ukrainian steel company ArcelorMittal Kryviy Rih.
It is found that there influence of corporate governance on firm`s performance and firm`s value. Using of three different analysis tools showed a positive relationship between ownership structure and company performance. The changes made by foreign investor towards improvement of corporate governance versus state ownership with very poor transparency and high interference from state rulers proves the influence of company corporate governance and owner's identity as independent value drivers for Ukrainian companies.

Chapter I

In this diploma thesis “Efficient corporate governance and its impact on company value and performance - the case of “ArcelorMittal Kryviy Rih” (Kryvorizhstal) “, I intend to analyze the case of the largest full-cycle metallurgical enterprise of the Mining and Metallurgical Complex of Ukraine - "ArcelorMittal Kryviy Rih" (formerly ‘Kryvorizhstal’).

Definition of corporate governance: “Essentially, corporate governance is about the distribution of decision and control rights; it is about governing and monitoring management, which typically has important residual decision rights; it is about influencing business policy; and it is about protecting stakes which are exposed to the risks arising from the incompleteness of contracts and markets and the asymmetric distribution of information and decision rights” (Schmidt 2003).

The subject of this diploma thesis is the issue of corporate governance, which emerged as one of the most important problems faced by firms as they were privatized or went into foreign partnership.

Since 2001, Corporate governance issues have raised public attention, especially after the downfall of many US companies (among them Enron and Worldcom).One consequence was that in 2002 the US Congress passed the Sarbanes Oxley Act in order to assure a high level of corporate governance in US enterprises and for major stock exchanges to strengthen requirements for listed companies. These actions made the corporate governance level almost identically high for US – based and US –listed companies (Bauer et al.2003).
In contrast to the developed countries, where the systems of corporate governance were built progressively, countries with transition economies faced problems developing a system of good corporate governance: vague and confusing relationships between the state and financial sectors, weak legal and judicial systems, absent or underdeveloped institutions and scarce human resource capabilities.

The question of the interdependence of corporate governance and company performance has been widely investigated, but still there is no scientific consensus to this question. There is evidence to support both characterizations of the relationship. Many authors e.g. Morck, Schleifer & Vishney (1988), McConnell & Servaes (1988), Core and Larcker (2002), and Gugler (2003) find that governance structure affects firm value. Demsetz and Lehn (1985) and Agrawal and Knoeber (1996), on the contrary argue that managers can select different governance structures and each of these structures may maximize the firm value, but none of these structures are related to corporate performance.
McKinsey's 'Global Investor Opinion Survey' (2000 (updated in 2002)) is the most widely quoted opinion-based research into the link between corporate governance and performance as measured by the valuation of the company. McKinsey surveyed over 200 institutional investors and found that 80% of the respondents would pay a premium for well-governed companies.

Furthermore, cross-country analysis made by La Porta et al. (2001) reveals that market valuation of similar companies is higher in the countries that apply higher overall corporate governance standards. While there are doubts whether cross-country analysis can be meaningful (Klapper, 2002), most research and surveys show that foreign investors tend to pay a premium for the equities which are better governed.

Relevance of Research: This topic is especially important for the Ukrainian economy, which has been hard hit by the global financial crisis since the end of 2008 (de-leveraging, the collapse of external demand, a drop of real GDP by around 20 % year-on-year, the collapse of steel output, as well as the contraction of the construction and retail sectors). Therefore, to overcome this challenging situation it is essential for companies to secure stable earnings and preserve their market share by increasing firms' competitiveness and attracting investors. In this case good corporate governance can bring significant competitive advantages for Ukrainian companies primarily in attracting foreign investment. Thus investigating the interdependence of the ownership structure and company value is an increasing number worthwhile since companies are considering the costs and benefits of applying high corporate governance standards and the accounting costs of good governance for a companies may be significant (some including remuneration of independent directors, creating and maintaining an investor relation department in the company, paying higher fees for internationally recognized audits, etc.).

Subject of analysis:

1. Corporate governance in Ukraine and its general effect on company value and performance
2. characteristic of different types of shareholders and their negative or positive effect for the company

on the basis of the ArcelorMittal Kryviy Rih case.

Twin agency problems, (i.e. poor corporate governance and high political risk), are a major reason why capital does not flow to transition countries (in these case, Ukraine) where the physical marginal product of capital is highest.[3] When the state works poorly, those who control the state pursue their objectives rather than enforcing property rights and facilitating contracts among private parties. They can either expropriate investors directly or impose additional costs on investors, but either way they reduce the payoff to investors from investment in the country. The case of ArcelorMittal Kryviy Rih is particularly interesting, because it covers both aspects of the twin agency problems. The company has significant political and economical importance and value for the Ukraine and therefore it was always seen as a choice morsel by state rulers as well as by private investors. Due to this fact and poor investor protection in the Ukraine, ArcelorMittal Kryviy Rih has been sold twice during the last 10 years. It has been owned by three different institutions: the Ukrainian state (until 1992 by the USSR, then the Republic of Ukraine), a domestic investor (financial industrial group), and finally a foreign private investor. Each of those changes impacted company procedures, governance, process and financial figures. With the example of this case I attempted to compare what type of owner is

[3] Stulz R.M. (2006) Financial Globalization, corporate Governance and Eastern Europe. In: Financial Development, Integration and Stability: Evidence from Central, Eastern and South-Eastern Europe, National Bureau of Economic Researchpp.pp.16 - 40

the most efficient in Ukraine, i.e. state, private foreign investment or Ukrainian financial-industrial groups and how this influences the company performance and company value?
This is also notable as it is the first time that a foreign company – ArcelorMittal (former Mittal Steel) has entered the Ukraine's domestic metallurgical market, which previously had been vigorously protected from outsiders.

On the basis of Kryvorizhstal case study
This study aims to answer following questions:

- the relationship between ownership structure, investor relation and firm performance (How do ownership structure and investor protection relate to firm performance and what explains this relation?);
- the changes in the productivity of the company and the efficiency of its management with the changes of ownership structure;
- the theory of Shleifer and Vishny's (1997) that ownership concentration is an efficient governance mechanism in countries where investor protection is weak, and that such concentration therefore leads to an improvement in firm performance;
- whether the ownership concentration is significant and positively related to post-privatization firm performance;

I intend to investigate the effects of different types of ownership on the performance of Ukrainian companies based on the **"**ArcelorMittal Kryviy Rih" (Kryvorizhstal) example**;** it addresses two important issues, namely distinguishing between different types of owners and reverse causality between ownership and performance. In the research I intend to study the three-dimensional effect of corporate governance in Ukraine. The question is whether good corporate governance practices influence (1) equity returns (2) a firm's performance and (3) value of companies in Ukraine.

For clearly represented research of the above mentioned topic the following diploma thesis has been structured in 5 chapters.

Chapters I and II explore the current legal and regulatory framework in the Ukraine, shareholder protection, problems in the legal environment for investors, and provide a short overview of the ownership types and legal entities in the country. The main problems that investors are facing are:

- weak regulatory and institutional infrastructure that makes corporate governance at the company level often the most important factor in establishing investors' confidence;
- lack of strong institutions to uphold the rule of law creates trouble for foreign and domestic investors with enforcing contracts, collecting debts, and resolving disputes.

Chapter III proceeds with the characteristics of corporate governance in the Ukraine, and gives a brief general assessment of corporate governance status separated by sector (steel, banking, real estate etc.). This will include general conspectus of

Ukrainian corporate development: the outcome of the entire privatization process from 1992 until now (3 main stages), its achievements and delays, the characteristics of the ownership structure of the economy that has been achieved through privatization and it will show the actual share and role of the remaining state sector. There is also a short discussion of the former state privatization programs and review the privatization prospects under the new political circumstances.
Chapter IV will go through the historical development and changes in the corporate governance of ArcelorMittal Kryviy Rih across the changes of the ownership. Present a broad overview of the transfer from state to private ownership structure (3 stages of privatization, statistics, particularities etc.) Provides a short overview of the reprivatization process in the Ukraine and its main highlights (1990 -2008), and the privatization of Kryvorizhstal in 2004 (the purchase of the company by a local investor). It will look at the main problems that appeared during the privatization – in the Ukraine more broadly, and particularly in the company.
It will provide a brief analysis of the three ownership periods of the company and the main highlights (stated-owned, "address privatization" by local investor, and repurchasing by a foreign investor). It will look at the pros and cons of every type of ownership for Kryvorizhstal, and related changes in the company's corporate governance structure with the new ownership.
Chapter VI will assess the company value and its interaction with efficient corporate governance – AM[4] Kryviy Rih over time using the DCF and peer comparison methods:
Efficiency depending on the form of ownership concentration, analysis of the company financial figures and performance over time (comparison of state and foreign investor ownership using the Discounted Cash Flow (hereafter DCF) analytical method to calculate the firm value.

Mittal Steel Kryviy Rih manufactures flat steel bars, reinforcing bars, wire rod, as well as processed iron ore concentrates, in Dnepropetrovsk in the South of Ukraine. . Formerly, Mittal Steel Kryviy Rih was known as Kryvorizhstal Kombinat (Kryvorizhstal Mining and Metallurgy Kombinat JSC**)**.
For the moment OJSC "ArcelorMittal Kryviy Rih" is the largest metallurgical enterprise in the Ukraine. Its market share on the domestic market is 77% for reinforcing steel bars and 61% for wire rods. Arcelor Mittal Steel Kryviy Rih has 50.000 employees, produces approximately 10 m tons of steel per year (Thyssen Krupp: 17.6 m tons) . This makes it the 30th biggest steel producer world-wide. Kryvorizhstal became internationally known when after more than 70 years of state ownership, the enterprise was purchased by the Ukrainian Investment Metallurgical Union[5] in 2004. After the Orange Revolution, when the Ukrainian state made an attempt to revise an entire wave of privatization, this transaction has been declared

[4] Hear and hereafter ArcelorMittal
[5] In 2004 one of the world's largest steel plants has been privatized to a consortium called "Investment Metallurgical Union" which has especially been created for the purchasing of Kryvorizhstal. The beneficiaries of this consortium were System Capital Management owned by Ukraine's wealthiest man Rinat Akhmetov, and Interpipe owned by businessman Viktor Pinchuk (former President Kuchma's son-in-law and Ukrainian media mogul). Other foreign and domestic investors bid in the tender, but they failed because of the discriminating additional conditions. E.g. a consortium of the international firms LNM and US Steel had offered $1.5bn for Kryvorizhstal, but the Akhmetov-Pinchuk partnership won despite bidding half as much. According to the additional conditions only a company that produced no less than 1 m coke in Ukraine during the last 3 years could purchase the company. That is why in the end phase only 2 companies could claim the purchasing - "Investment Metallurgical Union" and "Industrial group". Finally, "Investment Metallurgical Union" has acquired 93% of shares for $800. Mio

invalid by the supreme court of the Ukraine in 2005[6], and the company has been re-purchased by the Indian-owned Dutch company Mittal Steel (now Arcelor Mittal[7]) that also renamed the company ArcelorMittal Kryviy Rih.
This re-preprivatization has inevitably affected the remaining results of the privatization as such. It resulted in a massive weakening of property rights, which may be detrimental for the revival of privatization and for attracting new investors. Even giving up the idea to “revise privatization” did not allow the last three governments in power to resume the process.
I will describe the ownership structure that emerged from privatization and examine its development regarding the degree of the ownership concentration and the identity of owners.

Methodology of research:

A detailed investigation of the KSTL[8] has been undertaken by the author. The following items have been researched:
- Ownership structure;
- Financial statements’ elements (earnings, sales, volume of export of goods and services, operating expenses and structure of operating expenses, degree of depreciation of fixed assets, size of fixed assets).
- Current legal framework in Ukraine regarding corporate governance
- Historical figures of the KSTL

The period of investigation is from 1991 to 2008. The following data sources have been used to conduct this investigation:
- Annual reports of KSTL and ArcelorMittal(could only be found for the year of the ArcelorMittal company ownership)
- Annual reports of the State Securities and Exchanges Commission in Ukraine;
- Stock market reports, developed by famous Ukrainian investment companies.
- Researches on corporate governance issue made by an Ukrainian analyst
- BS of the KSTL
- Relevant legal acts and amendments

The procedure of research consists of the following stages.
The first stage is to determine the role of corporate governance for the Ukrainian economy as a whole, and on KSTL performance and company value in particular
The second stage is to review privatization processes in Ukraine and three ownership types for the company (KSTL), brief analyses of pros and contras of each period. How these ownership institutions affected the company development, management structure and behavior, image, productivity and efficiency of the company.

[6] During the Presidency of Viktor Yushenko the acquisition of Kryvorizhstal by Investment Metallurgical Union” has been nullified by the supreme court of Ukraine and the enterprise was restored to the state ownership.
[7] Arcelor Mittal is the largest producer of steel in Europe, North and South America, Africa, the second largest steel producer in the CIS region, and has a growing presence in Asia, particularly in China. ArcelorMittal has steel-making operations in 20 countries on four continents, including 66 integrated, mini-mill and integrated mini-mill steel-making facilities which provide a high degree of geographic diversification. Approximately 36% of its steel is produced in the Americas, approximately 49% is produced in Europe and approximately 15% is produced in other countries, such as Kazakhstan, South Africa and the Ukraine. (http://www.arcelormittal.com/rls/data/upl/638-7-0-ArcelorMittal_AnnualReport_2008.pdf)
[8] Arcelor Mittal Kryvyi Rih is listed on local stock exchanges - ticker KSTL

The third stage is to assess the efficiency depending on the form of ownership concentration, analysis of the company financial figures (profitability) and performance over time.
Finally, the fourth stage is to describe the correlation between ownership type of the companies and the company value, following. The core problem of corporate governance research in Ukraine – quality and reliability of firm level corporate governance data.
The data was collected from periodicals and specialized presses in Ukraine, the internet, educational manuals, consulting agencies, and private contacts.

It is also important to review the political factors that are an essential issue in Ukraine. Business is not separated from politics, when the state works poorly and the rule of law is weak. Those who control the state pursue their own objectives rather than enforcing property rights and facilitating contracts among private parties. They can either expropriate investors directly or impose additional costs on investors, but either way they reduce the payoff to investors from investing in the country.[9] (see chapter III).
According to Dyck and Zingales (2004), privatizations are more likely to occur through private sales, and ownership is more concentrated in countries in which private benefits of control are greater (i.e. countries with weak legal protection). This is true also for the Ukraine where during the early stages of state privatization (the years 1992-2003) the inconsistency in market price and purchase price was an important issue. The purchase price was substantially lower (as we will see on the Kryvorizhstal example sold by the state to an oligarchs' consortium in 2004) which created a strong private interest in lobbying the privatization (maintained personally by former President Kuchma). Such privatizations are called "address privatization" (when the owner, purchase conditions and price are agreed in advance, therefore a "public" privatization is conducted only as a formal procedure).
As a consequence of the weak legal system and strong interest in lobbying hostile takeovers are not rare cases in other post-USSR countries, and particularly in the Ukraine[10].

---

[9] Stulz R.M. (2006) Financial Globalization, corporate Governance and Eastern Europe. In: Financial Development, Integration and Stability: Evidence from Central, Eastern and South-Eastern Europe, National Bureau of Economic Research pp.16 - 40

[10] Samoylenko V. (2008): Hostile Takeover – Made in Ukraine www.eba.com.ua/files/Analytical_Reviews/Hostile_Takeover.pdf - accessed on 12.05.2010

Chapter II

The quality of legislation regulating the creation and activity of joint stock companies is one of the key factors affecting corporate governance practices in Ukraine. The Ukraine is still struggling to build a legal system that facilitates easy interaction with the international community. Many issues are not dealt with by a single law, so it may be necessary to piece several laws together to develop an understanding of an issue. The various laws may also be ambiguous or contradictory, which further complicates the issue. The majority of Acts that define basic principles of corporate law in Ukraine go back to 1991, when the Ukraine became an independent state. Application of these Acts over the years has shown numerous inadequacies and gaps.

Due to the mass privatization, large parts of the population have become shareholders (detailed information about privatization follows in the next chapter), but the unsatisfactory situation of corporate law has created a major potential for violation of minor shareholders rights. The majority shareholders can also be restricted in their performance by great dependency on other shareholders (e.g. breaking up of shareholder meetings, court bureaucracy etc.)

Of crucial importance is that the current legal system does not promote high corporate governance standards. Law provisions are formulated so loosely that publishing something like "Hey, last year was great" in a newspaper would likely meet all requirements. Timely and non-discriminatory dissemination of information is rare and the official publications where companies are required to publish their information are very primitive in quality.

The regulation of relations in the field of corporate governance was based on the following legislative acts:[11]

- The *Civil Code of* the Ukrainian SSR dated 18 July 1963 (repealed 1 January 2004); it regulated civil relationships, the establishment of legal entities and personal property rights.
- The *Commercial Code* dated 1 January 2004 was enacted on the same day as the Civil Code, and governs business relationships. The Commercial Code is intended to regulate issues that are not dealt with in the Civil Code, although, in practice, there is some overlap.
- The Law *"On Securities and Stock Market"* No. 1201-XII dated 18 June 1991, governing the public issuance and trading of securities.
- The Law *"On entrepreneurship"* No. 698-XII dated 7 February 1991 (repealed 1 January 2004), which defined an enterprise in Ukraine, its rights of a legal entity, and regulated permits and licensing provisions and restrictions.
- The *Law "On Protection of Economic Competition"* restricts business monopolies and aims to ensure an efficient operation of the Ukrainian economy through the development of competition. The majority of mergers

[11] On 1 January 2004, the following came into effect:
• Civil Code of Ukraine, No. 435-IV dated 16 January 2003;
• Commercial Code of Ukraine, No. 436-IV dated 16 January 2003.

and acquisitions in Ukraine are likely to require pre-approval from the Antimonopoly Commission.

- The *Law "On Protection from Unfair Competition"* aims to protect business entities and consumers against unfair competition.
- The *Law "On Environmental Protection"* establishes a framework for pollution charges to be imposed on any legal entity that discharges contaminants into the environment.
- Intellectual property rights are governed by various laws, including: *On Protection of Rights to Inventions and Useful Models*, *On Protection of Rights on Industrial Design*, *On Protection of Rights for Trademarks for Goods and Services*, and *On Copyright and Related Rights*.
- The *Law "On Procedure for Foreign Investments"* sets out in broad terms Ukraine's policy on inward investment and the rights and obligations of foreign investors.

The normative regulation of relations in the area of corporate governance in Ukrainian joint stock companies is also performed at the level of subordinate legislation. In particular, this system includes:

- The Law of Ukraine *"On the state regulation of the securities market in Ukraine"* dated 30 October 1996, carrying out government regulation of the Ukrainian securities market. The normative documents issued by the Securities and Stock Market State Commission (SSMSC) are based on this law.
- The Law of Ukraine "*On the National Depository System and particularities concerning the electronic circulation of securities in Ukraine*" No. 710/97-BP dated 10 December 1997.
- The Law of Ukraine "*On the State Privatization Program*" No. 1723-III dated 18 May 2000.
- Law of Ukraine "*On business associations*" No. 1576-XII dated 19 September 1991 defining the organizational form of legal entities (business associations) in the Ukraine, its structure, functioning and procedure as well as general rights and duties of its participants.
- Law of Ukraine No. 514-VI of September 17, 2008 "*On Joint Stock Companies*" amending and modifying the issues covered in business associations law, redefining the organizational type of main legal entities, higher protection of shareholder rights, etc.

The main objectives concerning the improvement of the legal framework for corporate governance in Ukrainian joint stock companies are set forth by Presidential Decree No. 280/2002 "On measures to improve corporate governance in joint stock companies" dated 21 March 2002, and by Cabinet of Ministers of Ukraine Directive No. 25-p "On the adoption of measures to implement priority development objectives for corporate governance at joint stock companies" dated 18 January 2003.

Despite the great number of the above mentioned normative documents, current legislation in the Ukraine does not comprehensively regulate all aspects of company activity, including corporate governance issues.

The acting[12] Law of Ukraine "On business associations" No. 1576-XII dated September 1991 did not regulate the majority of corporate governance issues, and did not guarantee the basic rights of majority as well as minority shareholders. This led to various corporate conflicts, negatively impacting financial and industrial figures of the affected companies.
As of 1 January 2004, two fundamental laws addressing corporate issues, the Civil Code and the Commercial Code, became effective. The Commercial Code governs business relationships, and was intended to regulate issues that are not dealt with in the Civil Code. In reality, parts of the two Codes overlap, including a number of provisions dealing with the establishment and operation of legal entities.
These Codes amended the norms that are regulating the functioning of business associations and referred to the separate law that will specify the standards in more detail. The Civil Code directly foresaw such separate laws that would regulate the joint stock companies or "business associations".
Therefore, at that stage, the following issues of high importance were not covered by the corporate law of the Ukraine:

- Distribution of dividends (the main problem was the undefined terms, standards, procedure of the distribution and sanctions in the case of nonpayment):
- Standards and procedures of the exercising of pre-emption rights in the case of capital increase;
- Exerting of the non-compliance right (steps and procedure)
- Authorities of the shareholder meeting (detailed definition of shareholder meeting authorities, e.g. extinguishment of shares, purchasing of other securities, adoption of market value of company assets, election of the financial auditor, etc.)
- Role of the supervisory board (detailed description of the board authority, procedure of SB member election

However slow, continuous government initiatives towards improvement of corporate governance fields have been made.

In 2003 the Securities and Stock Market State Commission adopted the principle of Corporate Governance. Because any implementation of stated Principles was neither required nor stimulated, few changes have occurred. On the contrary, the web site www.smida.gov.ua for online publishing of quarterly and annual reports created by the Securities and Stock Market State Commission became one of the main sources of information for investors. At the beginning the disclosure of the statement online was not required, but the further step from the State Property of Ukraine was an official request to publish company statements on the web page mentioned above.

In March 2007 the National Bank of Ukraine moved to bring local legislation in line with Basel II's Market Disclosure requirement standards with the adoption of the regulation "Methodological Recommendations for
Improving Corporate Governance in Ukrainian Banks"
Then, in the first quarter of 2007, more than 800 companies began publishing quarterly financial statements and information concerning corporate ownership,

[12] Was modified by Law of Ukraine " Law on Joint Stock Companies, which became effective in April 2009 and will fully replace the previous law in April 2011

management and market data online at www.stockmarket.gov.ua as part of a pilot project by the State Securities & Exchange Commission (SSEC).
Currently, companies with more than 25% state ownership and all public debt issuers are obliged to do so (the SSEC plans to extend this to more companies), though without an enforcement framework in place, reporting is far from universal (every fourth bond issuer does not report).

Another significant improvements regarding corporate governance are initiated in 2008 - with adoption of the new version of Law on Joint Stock Companies, which became effective in April 2009. The New Law introduced the following major novelties to the regulation of joint stock companies, as provided in the Civil Code of the Ukraine, the Commercial Code of Ukraine, and the Law of Ukraine on Business Associations (collectively, the "Current Law").

Charters and other internal regulations of joint stock companies that were founded before this new Law came into force, should have been brought into conformity with provisions of this Law not later than within two years from the date when the Law on Joint Stock Companies became effective (until April 28, 2011). Until this term, the activity of national joint stock companies will be regulated at the same time by the old law on business associations dated 19 September 1991, and by the new one for Joint Stock Companies, which will definitely cause some difficulties in the changeover phase.

E.g. in the event that after the new Law took effect (from April 29, 2009), the General Meeting of a JSC that had been founded before this Law became effective took a decision to change the amount of the company's charter capital, denomination of shares and issue of securities, this company should bring its activity into conformity with this Law and incorporate relevant amendments to its charter and other internal documents. Failure of a joint stock company to incorporate amendments to its charter and other internal documents forms a basis for refusal of state registration of securities issued by this company.

The Ukrainian law distinguishes two types of Joint Stock Companies**,** private and public joint-stock companies (previously, according to business association's law "closed" and "open" JSC).

1. A public joint stock company that may conduct public and private placement of shares and which is obliged to undergo a listing procedure with a stock register of at least one stock exchange.
2. A private joint stock company - that may conduct only private placement of shares. The number of shareholders in a private joint stock company may not exceed 100.

Founders of a joint stock company can be represented by one, two or more persons. Founders may conclude a founders' agreement in written form.

A JSC may place shares of two types – ordinary and preference shares. Ordinary shares of the JSC are not subject to conversion into preference shares or other securities of the joint stock company and a part of preference shares in the charter capital cannot exceed 25%**.**

The shareholder's pre-emptive right to subscribe for newly issued shares is preserved only for shareholders of a private joint stock company Shareholders of a private joint stock company do not have a pre-emptive right to buy shares transferred to an heir-at-law or a legal successor of a current shareholder.

If the net assets value becomes lower than the minimal amount of the share capital as established by this Law, a company should, within 10 months starting from a date when such inconsistence arises, remove such inconsistence or take a decision on liquidation.

A mandatory condition to increase the share capital of a joint stock company is its compliance after such increase with the minimal amount comprises 1250 minimal wages as of the date of registering amendments to the company's charter.

The joint stock company's reserve fund shall not be less than 15 percent of its capital fund.
The shares are issued only in non-documentary form (this provision will take effect upon expiration of a two-year period in April 2011).

The charter of a joint stock company may provide for creation of a special provision for paying dividends on preference shares. The State Committee for Securities and Stock Market (the SCSSM) establishes the procedure of formation and application of this reserve.

Corporate governance legal framework of Joint Stock Companies:

A JSC is obliged to call an annual General Meeting, which should be conducted not later than on April 30 of the year following the accountable year. The agenda of the annual General Meeting must include issues on: approval of the JSC's annual report; distribution of profit and loss of the company; making decisions based on the results of the report consideration by the Supervisory Board, report of the Executive Board, and report of the auditing commission. In addition, the General Meeting may take decisions on any issues of the JSC's activity**.**

Proposals of shareholders who own in total 5 or more percent of ordinary shares (changed from the earlier amount of more than 10%) should be included in the meeting agenda.

Shareholder(s) who, as of the date of making a list of shareholders entitled to take part in the JSC General Meeting, own in total 10 or more ordinary shares, and the SCSSM may appoint their proxies for supervision of procedures of shareholders' registration, conducting the General Meeting, voting and summarizing meeting outcomes.

The General Meeting of the JSC has a quorum on condition of registration of shareholders holding in total at least 60 percent of the voting shares.

Candidates who have collected the largest number of votes among those who collected more than 50 percent of votes are considered elected to the joint stock company's Executive Board.

It is also important to emphasize that Ukrainian law also stipulates a provision enabling a shareholder to appeal against the General Meeting's decision in court within three months after the decision.

The JSC Supervisory Board is a body protecting company shareholders rights and providing control and regulation over the Executive Board. A Supervisory Board must be formed whenever a JSC has 10 or more shareholders owning ordinary shares.

Members to the Supervisory Board of a public joint stock company may be elected exclusively by cumulative voting (multiplying the total number of shareholders' votes by a number of joint stock company Executive Board members being elected) and a shareholder may either support one candidate with all votes calculated in this way or distribute these votes among several candidates.

Supervisory Board members within a private joint stock company are elected according to the principle of proportionality of the shareholders' proxies in the Supervisory Board in relation to a number of voting shares held by shareholders or by means of cumulative voting.

The number of members in the Supervisory Board is established by the General Meeting. The Supervisory Board in companies with 100 – 1,000 shareholders owning ordinary shares should include at least five persons, those over 1,000, should include at least seven persons and with over 10,000 persons should include at least nine persons.

The other common form of company establishment is limited liability companies (LLC), which is more common for foreign investments that do not involve Ukrainian partners. It is easier and quicker to establish, has lower minimum capitalization requirements (approximately USD 9,000), and is less regulated. LLC also does not have shares in a traditional sense. Instead, participants in a LLC own a percentage in the company's capital, as specified in its Charter. One potential issue with a LLC is that members may withdraw their contributions at any time by giving three months notice. Establishment of an LLC is more timesaving as the registration of share issuance and corresponding procedures are not required. The member's liability in respect to the company's debts is also limited to the value of their individual contributions (so-called "portions").

Corporate governance legal framework of Limited Liabilities Company:

LLCs have two corporate bodies.

The Participants' Assembly consists of the participants of the LLC, each of whom has votes proportional to its interest in the company capital. The quorum for a participants' assembly requires the presence of participants holding at least 60% of the votes. Most resolutions are approved by a simple majority of the votes present at the Participants' Assembly, although resolutions amending the Charter and a limited number of other decisions must be approved by a majority of all participants' votes.

The Board of Directors is the executive body of a LLC, and is responsible for managing the day-to-day activities of the LLC and representing the LLC against third persons. There is no formal requirement to appoint a company president, corporate secretary or any other office holder. The structure of the Board, its authority, and its working procedures are specified in the Charter of the LLC.
There is no limitation on the percentage of ownership by a foreign investor in most types of Ukrainian companies. Some industries, including banks, insurance companies and financial institutions, are more heavily regulated, so these entities must be established in compliance with specific requirements.
When analyzing the quality of normative regulation in the Ukraine, it should also be taken into account that the legal status of many joint stock companies is additionally determined by banking, insurance, investment, and hard-currency legislation, as well as legislation that regulates professional activity in the securities market, etc.
As of August 2008, 32,000 joint stock companies have registered in the Ukraine. Among them 11,000 are opened (public) and more than 21,000 are closed (private). They produced close to 75% of the GDP of the Ukraine[13].

[13] Libanov M.(2008): Who and why need the new Law of Ukraine on on Joint Stock Companies, In: Zerkalo Nedeli (weekly newspaper), Kiev, pp.20

Chapter III

International standards of corporate governance appeared primarily as a result of heightened public interest in corporate governance generated by the globalization of financial markets and the liberalization of capital flows. “Corporate Governance Principles”, adopted by the Organization for Economic Cooperation and Development in 1999 can be considered as the most common general standards of the corporate governance. The main principle of those principles can be found in different corporate, national, and international documents and applies to five major areas: Shareholder rights, equal and fair treatment of shareholders, role of stakeholders, disclosure and transparency and board responsibility.

Over the past 10 years the issue of corporate governance has become the center of attention for many researches. For Shleifer and Vishny (1996, p.2) “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. In the case of state-owned companies the “bureaucrats controlling state firms have at best only an indirect concern about profits (because profits flow into the government budget), and have objectives that are very different from the social interest. State ownership is then an example of concentrated control with no cash flow rights and socially harmful objectives. Viewed from this perspective, the inefficiency of state firms is not at all surprising.[14]”

In the public sector, better corporate governance of state-owned firms would increase the efficiency and competitiveness of the state firms that remain in the public sector. In privatization, improved governance would result in increases in efficiency, transparency, and fairness in the privatization process. In the private sector, strengthened governance would allow the creation of a role model for the improvement of general corporate governance practices for the benefit of all corporations and their stakeholders. The business and investment climate would also benefit from the creation of a level playing field to increase the potential for domestic and foreign direct investment.

In this context, privatization has the potential to reduce the agency problem, one of the key distortions regarding corporate governance.

Faced with the need to press ahead with privatization and the restructuring of enterprises, corporate governance has become a topical issue in transition economies of the former Soviet Union. In the context of more integrated and globalised financial markets and economies Ukraine cannot remain on the sidelines of corporate governance development processes as well. Effective corporate governance serves both the efficient use of domestic financial resources and the attraction of foreign investment[15]. This is especially important for Ukraine and other Eurasian transition economies where domestic savings remain relatively limited. Still both domestic and foreign investors encounter difficulties at a practical level. These do not relate

[14]Ruud A. I. van Frederikslust; James S. Ang; P. S. Sudarsanam (2008): Corporate governance and corporate finance: a European perspective, Routledge, UK , pp. 70

[15] Total foreign direct investment at 1 January 2007 stood at around USD 23.2 billion, according to data from the State Statistics Committee. Foreign direct investment in 2006 totaled USD 6.3 billion.

specifically to the issue of foreign ownership or investment, but rather to administrative hurdles that are arbitrarily enforced or randomly delayed.

Since the 1990s, the world has experienced an unprecedented wave of privatization. This has been driven partly by the dismantling of communist economies and, additionally, by globalization and the spread of the capitalist model (causes that have been, in turn, driven by both politics and economics).
Privatization has involved substantial transfer of assets from the public to the private sector and has also been argued to have radically altered patterns of efficiency. The majority of analyses so far conducted regarding privatization in Ukraine and elsewhere have been characterized by a focus on two types of issues: the economic success of privatization in terms of its contribution to public finances and in relation to its impacts on productive efficiency, once private owners take the helm of companies. As Gray (1996, p.2) puts it, in the case of transition economies: "the primary goal behind privatization is to create true representatives for capital and thereby to change the fundamental objectives of enterprise owners towards greater efficiency".

The process of the property deprivation/transfer from the state ownership started in Ukraine already within the USSR period. A variety of methods, including voucher systems, direct foreign investment, public rotation, and outright theft have been used to transfer control from the state ownership to private hands. Privatized by private investors companies have seldom moved to an atomistic ownership structure, but have most often come under the control of their former managers or, not so common at the end of USSR era, foreign strategic investors.
The establishment of small enterprises and cooperatives began with the passing of the act/law regarding "individual employment" (1986) and law about "Business Associations in USSR'" (1988).
Often this cooperatives and enterprises were established in order to gain access to redemption of the state assets or their evaluation and further allocation. In 1998 the law "about state enterprises" came into force; this law allowed the employees to lease operating resources (production equipment). The directors of such enterprises represented, as usual, on the one hand the employees but at the same time they were also part of old nomenclature and, accordingly, the new business elite. Thus they had widespread opportunities to not only by conduct/manage the state property, but to gain their own benefits as well. The actual establishment of the private property occurred, however, in the context of privatization. The official privatization in Ukraine started in 1992 and can be divided into 3 stages.
The first was initiated in July 1993 with the privatization prearrangement (preparation) for the large business units (undertaking); the presidential order about "corporatization of the business units" came into force. This order determines the change of the corporate form of middle and large state enterprises and closed joint stock companies (more than 75% of the share capital in public property) into open joint stock companies. At this stage there were not yet developed conceptual approaches for defining limits and content of the state and communal sectors.

The state sector is mainly comprised of large enterprises. The average value of fixed assets per one entity in the state sector is UAH 8.3 million, communal - UAH 3.4 million, private and as little as UAH 0.57 million[16].

Since the privatization of enterprises of high national importance has been prohibited for a long period of time some economic sectors the state property dominates, such as:
• Military-industrial complex
• Fuels and energy complex
• Defense industry
• Objects of natural monopolies and adjacent markets
• Infrastructure industries
• Mills and cereal factories
In addition, from the very beginning the privatization of enterprises of the social sector (medicine, education, and culture) as well as objects of science has been prohibited.
As a result, the state sector still possesses huge assets and consists of strategic objects having strong influence on the country's economy as a whole. But further privatization of the public sector is one of the opportunities or important reserves for further economic growth which have not yet been utilized.

Between 1992 and 1995, 28,054[17] state enterprises have been privatized.
The second phase of the mass privatization started in 1995 with so-called privatization-property certificates that enabled the participation of individuals and legal persons, which did not participate in the privatization so far purchasing the shares of the privatized business units through the certificate auctions. From 1996 to 1998 in this way 33,266 state enterprises have been privatized[18].
This stage can be also characterized by the strengthening and consolidation of the most influential Ukrainian financial industrial groups (FIG).[19] Uncertain origin of their capital forced FIGs to run their business in an opaque manner. Public information about Ukrainian FIGs does not allow market participants to detect whether a certain market participant is FIG or not.

Oligarchs regulated the privatization process in a way which would meet their business interests. They bought whole Ukrainian companies at the lowest price[20] (A. Krakovsky, 2000). Krakovsky insisted that large shareholders do not follow the corporate governance best practices. They do not care about transparency and responsibility. Moreover, minority shareholders are helpless, because they are not protected by the legislation. They are not equipped with knowledge of corporate governance mechanisms and they are not used to consolidating their minority power to run companies in their interests.

---

[16] Data from Center for social and economic research, "Analytical report and recommendations for the state privatization program", Vladimir Dybrovskyi, Alexander Pashkhaver, Lidia Verkhovodova, Barabra Blaszczyk, Kyiv, Warsaw 2007
[17] Grundlagen der Corporate Governance in der Ukraine, in: A. Sell und A. Krylov (Hrsg.), Corporate Governance. Unternehmensverfassungen im Ost-West-Dialog, Peter Lang, Frankfurt a.M. u.a. 2006 (mit Alexander N. Krylov) S. 299-306
[18] State Statistic Committee of Ukraine, official web page - http://www.ukrstat.gov.ua/
[19] Detailed information about the characteristic and definition of FIGs is to find it chapter IV
[20] Krakovsky A. (2000): Corporate governance practice in economies in transition. In: Journal of problems of practice and theory of corporate governance pp. 24-35.

Within the third phase started in 1999 until 2006, the privatization of 46,315 state enterprises has been accomplished. The sole type for this privatization phase is an auction method. Most of the Ukrainian enterprises have been sold during this period of time, the majority of them in the heavy industry. This privatization process showed a positive effect on the Ukrainian economy: during this time the percentage of the Ukrainian GDP increased from 10 in 1992 to 40 in 1999 and to 65 in 2006. According to research conducted by A.Kostyuk[21] in 2005, during 1998-2001 corporate control over the companies under research moved from employees to Ukrainian financial-industrial groups and executives. Thus, at the beginning of 1998 only 11 companies were under the control of Ukrainian financial industrial groups and only two companies were controlled by executives. At the beginning of 2002, the number of companies, controlled by Ukrainian financial-industrial groups and executives had increased to 31 and 5 companies respectively. The number of companies controlled by employees decreased from 18 to 2 companies[22].

Because of the less developed state institutions' poor law regulation, Ukrainian enterprises were searching for methods to control management. The most popular method to control the manager became majority shareholding. In this way, many Ukrainian enterprises have chosen this major shareholder model. So we can assume that bad corporate governance caused the concentration of shares by one or few shareholders.

On the whole, Ukrainian companies are still far behind their Western peers in terms of corporate development. Most have never considered formulating a corporate strategy; the management feels uncomfortable facing simple questions from experienced shareholders. Ownership is generally highly concentrated, which does not facilitate the development of higher business standards. The supervisory boards of most companies are nothing more than rubber stamp committees for the benefit of the owner.

Market self-regulation works partially. Those companies that are planning or have already issued initial public offering (IPO) have increased their corporate governance standards. Most of the companies have no concern about having their shares listed and traded.

Ownership structure is only made public to a certain degree, (i.e. beneficial owners are generally cleverly hidden in order to protect their business from legal attacks from rivals), and make getting detailed information about ownership plans and motivation a chore. Legal requirements are patchy and most companies can stay within the parameters of the law and reveal very little.
The bulk of companies either have no websites or websites that contain little information of interest to shareholders and they are rarely updated.
A ray of light in this opaqueness is the memoranda at bond issuances, even their local placements. They contain plenty of valuable information thanks to the demanding nature of the regulations.

[21] Kostuyk A. (2005): Business innovations and structure of Corporate Governance in Ukraine. In: Corporate Governance: the journal of Business and Society, Vol. 5 Iss: 5, pp.19 - 29

[22] Forty one Ukrainian companies from the metallurgy and machine-building industries were investigated by A.Kostyuk in,researching period from 1998 to 2002, relevant diagram can be found in the append. 2

The plan of the new government (2005) to initiate another re- privatization campaign (the first step was done with KSTL) pushed the business community to improve their corporate governance in order to forge closer ties with western Corporate Governance. In February 2007 financial institutions thus protected themselves from possible hostile moves by the government. Despite this self will of the Tymoshenko government many of Ukrainian firms thereafter found attracting capital on western markets a much easier and cheaper alternative to more shady local forms of financing and continue to make strides towards the development of a corporate idea. Moreover, in 2006 a new law regulating the activities on capital markets brought Ukraine's legislation another step closer to contemporary standards.

Unlike Russia, analysis of corporate governance practices is scarce in Ukraine systematic especially from the point of view of a portfolio investor. Both Standard & Poor's (S&P) and the International Finance Cooperation conduct studies in this area, but their analysis is confined to the banking sector. Additionally, the scope of S&P's research is limited to transparency/disclosure only.
In fact, a recent study of corporate governance by Standard & Poor's for thirty Ukrainian banks is the only attempt made to tackle this issue.

The last data regarding the research into corporate governance in Ukraine have been derived in March 2009, by international Fitch Ratings agency in a published report "Corporate governance perspective for Ukraine, Russia and Kazakhstan. "[23]
According to the report, the current situation has exacerbated due to the economical crises that will examine the efficiency of the corporate governance in these countries and will impact their further development. This analysis showed that Russia has achieved the highest rate/level of corporate governance development among others transition countries. Kazakhstan follows Russia and the situation in Ukraine is at a very early development stage.
As usual, the estimation of the corporate governance in Ukraine is based on the rating method which has been separately developed by "Credit rating" and Concorde Capital. The participation in these rankings of the "Credit rating" is on volunteer basis and is often paid by the rated company.

The more or less comprehensive Corporate-Governance-Rating has been conducted by Concorde Capital (February 2007 and May 2008) in the following key areas:

(i) Reporting & disclosure - - willingness of the companies to disclose their financial data and ownership structure, availability of IFRS accounting, quality of UAS reporting, and disclosure of ownership;
(ii) Investor relations - management accessibility (e.g. willingness of executives to meet with and present the company to potential investors, arrange site visits, discuss company operations and share business information), public information about the enterprise (efforts to keep the public informed of its activities, updating information on company websites);

[23] The state agency of Ukraine for investment and innovations", report "Current situation regarding corporate governance in Ukraine in year 2009", http://www.in.gov.ua/

(iii) Minority concerns – paying interest to minority shareholders including: the risk of dilutive action, the existence of a depository receipts program (to show higher interest in attracting investors and equity financing) and IPO.
(iii) Strategic Risks - related to inefficient corporate governance practices that directly or indirectly impact negatively on the business of a company (abuse of control by majority shareholders involving related-party transactions, asset stripping or unjustifiable acquisitions).
They rated 118 companies, including some listed on foreign exchanges, in all sectors of the Ukrainian economy. This rating evaluates corporate governance of the company on the 0 to 11 scale, whereas the score 9-11 already aligns with a high corporate governance value according to international standards.
The result of this research showed that only 5% of ranked companies obtained the peak values. The average score of 1.9[24] clearly indicates that the corporate governance standards in Ukraine in a majority of the companies are at the very early development stage. However, this figure varies depending on the firm – e.g. the companies listed on Western exchanges were by far the leaders in maintaining high standards while those with little or no experience in attracting foreign capital in some cases had never even heard of Corporate Governance.
Concorde Capital evaluated companies in different areas: banking, real estate, consumer goods, steel industry, etc[25].
The score in the steel industry (Metals & Mining) was one of the lowest ones compared to the overall results of the ranking, but Nyzhnoydniprovsky Pipe and Mittal Steel Kryvy Rig still obtained the strong scores of 7.5 and 6.5 respectively.

All in all, this analysis showed a trend toward increasing the number of Ukrainian enterprises with better corporate governance. An important issue that impacts the establishment of good corporate governance in Ukraine and the development of the Ukrainian economy as a whole is the crucial need for attracting new investment. As economic growth of the previous years (before the global economical crises) was mostly provided by usage of old manufacturing capacities remaining from the Soviet heritage and the capacities of such usage are time limited, Ukrainian industry strongly requires the modernization of its capital stocks that on the other hand depends on the extension of external business financing. Also, the global economic crises affected the business landscape in Ukraine. According to the analysts' forecasts current crises will evoke a wave of mergers and takeovers, as a sole effective strategy for sustaining Ukrainian business, with the following main players[26]:

- The large Ukrainian enterprises (especially steel companies that have financial resources)

[24] The total scores possible in the rating ranges from -0.0 to 11.0. The classification of all companies is based on the following five categories:
11.0 – 9.0 Quality corporate governance standards (**Q**)
8.5 – 6.0 Above Average (**AA**)
5.5 – 3.0 Average (**A**)
2.5 – 0.0 Below Average (**BA**)
0.0 or less Poor (**P**)

[25] Detailed ranking made by the Concorde Capital can be found in append. 3

[26] Evgeny Frank, associate Professor of the Samara Technical University, international conference, "Corporate governance and sustainable growth: strategic decision and corporate efficiency", Moscow, October, 2006

- The Ukrainian State that would be interested to support some enterprises for the benefit of social stabilization (e.g. by buying back the shares of previously privatized companies)
- Russian enterprises (especially after the presidential election in 2010, large Russian companies tend to invest in the Ukrainian economy mainly in telecommunication, trade chains and machine building

Therefore, during the next year, a big change in the Ukrainian corporate structure is to be expected. For approximately 15 years the development of the enterprises moved from non- transparent ownership structure and major shareholder model toward the model of efficient owner. This development is still not completed and will to a large extend depend on the reaction of Ukrainian business and state to the foreseeable challenges.

Chapter IV

This chapter will briefly go through the brief history of the Kryvorizhtahl in three periods with 3 different owners: state, domestic investor (in our case financial - industrial group[27]) and foreign investor. By analyzing the pros and contras of every ownership period trying to identify the most efficient owner with respect to the company and society as a whole can be identifies and the influence on company performance can be determined.

According to study made by the World Bank in January 2009,[28] in most post-communist economies privatization to foreign owners results in a rapid improvement in performance of firms, while performance effects of privatization to domestic owners are less impressive and vary across regions, coinciding with differences in policies and institutional development.
The state ownership in post-socialist enterprises is still a common form of corporate governance and is often considered as less efficient compared to private owners. Even taking into consideration that state ownership is inherently political in the 90s absence of state ownership, large corporations might be impossible. This is especially true in Ukraine, where without strong shareholder protections, the state can be the only means of bringing large amounts of capital to bear.
The members of the board of directors are usually the representatives of the state, the ruling party, public corporate bodies or even the banks. Thus the boards of directors fail to exercise a true monitoring role. The absence of 'real owners' leads to neglect of the interests of capital itself and thus to degradation in the quality of the capital, damaging the long-term interests of the firm (Babic, 2001).

Does the Ukrainian state have the ability to efficiently implement its ownership policy – to admit, supervise and control the management of such a huge industrial enterprise like KSTL? Due to the lack of transparent ownership policy state bureaucrats and company executive have wide possibilities to violate their authorities in order to gain private sustainable benefits.

Another form of ownership relocation and concentration occurred in Ukraine during the privatization phase with the creation of large groups - so-called financial – industrial groups (FIGs). [29]
What are the risks, challenges and advantage for Ukrainian firms owned by domestic financial-industrial group?
The main business-driven motives for appearance of such new form of enterprises, which usually purchased large block of shares, were:

- Development and restructuring;
- Expectation of short term returns (obtaining cash dividends in the short term);
- Influence and power (as many Ukrainian financial-industrial groups are headed by famous men in power (politicians), thus purchasing of companies

[27] Definition from the working paper "Investment Financing in Russian Financial-Industrial Groups", by Enrico C.Perotti and Stanislav Gelfer

[28] Estrin S., Hanousek J., Kocenda E., Svejnar J. (2009): The World Bank Development Economics Department, world bank Policy Research Working Paper

[29] Malygina K. (2008): Geldblasen: Auswirkungen der weltweiten Finanzkrise auf die Ukraine. In: Ukraine-Analysen №46, pp. 2-3.

aimed ensuring of strong influence of economic and political situation in Ukraine;

The distinctive features of these financial – industrial groups are:

- Putting great value on the formal controlling process so as to avoid nepotism,
- Access to the own financial institutions. For independency reasons ,FIGs often hold own insurance companies or banks (for the special case of Krivorizhstal, both oligarchs owned specific financial structures before purchasing the company),
- For strategic reason FIGs prefer to keep their activity "in the shade" and therefore have less interest in improvement in efficiency of corporate monitoring.
- The concentration of the share capital. Of 18,000 active joint stock companies where regular shareholder meetings have been held, approx. 14, 000 are held by less than 100 owners.

Undoubtedly, one of the advantages of the transition process in Ukraine was the emergence of the possibility to attract foreign capital as far as domestic economy has become more open. Recent economic literature documents the benefits of direct foreign investment in terms bringing new technologies and managerial techniques, increase in productivity and competition in domestic industry (e.g. Javorcik 2004). As we may see in the example of KSTL, foreign institutional investors are much more active in financing the companies' activity with equity, which can be considered in Ukraine as financial innovation.
During 1998-2001, each company, under the control of institutional investors affected three issues of new equity. During the same period of time, each company controlled by Ukrainian
Financial-industrial groups and executives only issued new equity only 0.9 and 1.1 times respectively.[30]

1. State ownership period

As the largest manufacturer of both reinforcing bar and wire rod steel in the former Soviet Union, AM Kryvyi Rih has always been at the center of interest in different political and economic groups. But neither of group had enough influence to transform the company to private or even at leasehold property. Kryvorizhstal remained state owned until 2004.
At the beginning of the 1990s, the company faced serious economic difficulties due to a loss of market share, an industrial slow-down, the impact of the shadow economy, barter trade (typical for the transition period), and as a consequence of this lack of floating assets and accrued payroll, theft etc.
Against this background, it became clear that an efficient manager who would be able to act under the new context of the developing market economy (emergency market), who could establish a proper market strategy, and ensure the continued supply of resources was urgently needed to preserve the company from bankruptcy. In 1996, the Ukrainian ministry of trade and industry appointed a new director-general –Severenjuk (who had a background in industrial purchasing and supply, had

30 Data from “Business innovation and structure of corporate ownership in Ukraine”, Alexander Kostyuk, 2005

a track record for good negotiation and lobbying skills, and excellent contacts in the steel industry).
His first step in the position of director-general in 1996 - 1997 was to push for integrating (merging) its main suppliers – two ore and coke production factories (i.e. the Novokrivorozhsky GOK & Krivorozhsky Coking plants) into Kryvorizhstal. Due to this merger, Kryvorizhstal became the first vertically integrated steel company in Ukraine with a full metallurgical cycle. It achieved synergy effects such as reducing intermediate tax payments, and the availability of input resources at manufacturing price. As a result, the wholesale costs of the company were significantly reduced, and its resistance against further economic upheaval strengthened (e.g. a decline in world steel prices).
This downstream integration was not a very complicated operation, as the two concerned factories at that time did not have any other customers, and Mr. Severenjuk put them under strong pressure by not purchasing their products until they give their consent to the merger.
From the perspective of corporate governance it is important to understand that Director-General Severenjuk was known for his autocratic leadership style. Despite the fact that the decision of purchasing the two suppliers had not been approved by the management of Kravorizhstal (out of 30 members of the Executive Board only 1 member in the official procedure voted in favor of this deal), he overcame the official approval procedure and completed the merger. Because of weak public ownership policy (corporate law), scarce disclosure, weak control and reporting systems, the executive directors of Kryvorizhstal as long as they had good connections to the state level, enjoyed unrestricted freedom of decision-making not subject to stringent corporate governance.

By 1999, the distribution system of Kryvorizhstal had become the prerogative of local traders which usually had good private relationships to the management of the company. This significantly worsened the company's performance.

Standard procedure of such cooperation between intermediate firms and company management works as following - manager signs the contract with such firm in the name of the company and then benefits by receiving a "private discount" (kick back) as reward.

In 1999, the Ukrainian president appointed a new director-general – Oleh Dubina. Dubina had been recommended to the president by the president's son in law – Viktor Pinchuk, one of the Ukrainian's oligarchs, who had ambitions to own Kryvorizhstal in the future himself. The new director-general started with squeezing the local traders and other intermediate seller institutions and worked towards establishing a direct distribution system. To avoid discontent of the managers who were interested in keeping the trader's distribution system, he brought with him a new management team--mostly from Dzherzhinskyi Metallokombinat where he worked as general manager before. He fully empowered his new team and delegated key responsibilities to them, while he concentrated on managing the company's relationship with the government.

According to Kryvorizhstal own figures, the profitability [31] of Kryvorizhstal in 1999 reached 14.82%. In 2000, it reached 33.7%. In 2001 and 2002 profitability decreased to 17.3%, due to price increases in energy supply and resources in the following two years had not fallen lower than 30%.
Some analysts consider that the company owes its success also to its favorable position with president Kuchma, who presumably planned to own the company after termination of his presidency in 2004 jointly with the Ukrainian Oligarch Pinchuk. This may also explain the fact the former president at the time strongly insisted on keeping Kryvorizhstal in state ownership, even when the State Property Fund of Ukraine (SPFU) in 1999 put the company on the privatization list to make up for budget shortcomings, Kuchma personally crossed it off. The official explanation was that Kryvorizhstal was a profitable enterprise and that there is no need to sell it to private investors.
As a matter of fact, since 1999 the performance of Kryvorozhstal went up significantly and the company kept a sound leadership against its peers. Under the management of Mr. Dubina, the following improvements have been made[32]:

- Kryvorizhstahl became a testing ground for new industrial and management technologies - during this time, 5 patents for new technologies had been received;
- Expenditures technologies, reconstruction and modernization increased markedly;
- The production range and the sales market had been significantly widened (the latter from 33 countries in 1999 to 80 in 2002).

In 2003 Kryvorozhsal signed trader contracts for the distribution of Kryvorozhsal products with 2 new intermediate sellers[33]: Swiss Trader Steelex, acting in the interest of the presidents'son in law Viktor Pinchuk, the company "Interpipe" and also the Swiss company Leman Commodities S.A. (fully owned by another Ukrainian oligarch – Renat Akhmetov who also had ambition to purchase Kryvorizhstal, and the company „System Capital Managment") Both traders got a monopoly on the distribution of the products of the company.

Pros/cons experienced state ownership transiting countries:

- Due to the unpredictable, inefficient and unstable political and economic environment, none of the companies' executives had powerful enough incentives to establish long-term development plans for the company (as they did not know how long they would hold their positions), or to increase the transparency and controlling system of the company (also given that the systems in place at the time allowed them to gain sustantial private benefits).

[31] Data from the interregional center of business cooperation, research on the Kryvorizhsal conducted in 2004, http://www.mcds.ru
[32] Pankratov P. (2009): Gazovyi kancler v belyh noskah (biography of O.Dubina). In: Tema, http://www.tema.in.ua/article/4794.html - accessed on 3.04.2010
[33] Khoroshilov K. (2003): Leman Commodities cooperates with Kryvorozhstal. In: Delovaya stolitsa, Kyivpress, pp.12-13

- The company was able to enjoy the protectionism policy of the Ukrainian state, so that e.g. during the management /leadership of Mr. Dubina a substantial amount of company debt and charged fines could be written off.

- Under the auspices of politicians at the highest level, the company has not been prone to hostile takeovers, or other potential oligarchs' attacks.

- Due to the close relationship with the state the company enjoyed better access to restricted information and new technologies (which helped it to become a testing area for new technologies).

- Being in state ownership company has no explicit requirement for a certain payout of dividends and therefore more available costs for R&D expenditure.

- Typical problem that state owned companies are facing is that the bureaucrats main concern is to achieve their political objectives, which do not necessarily coincide with the profit maximization objective (Shleifer & Vishny, 1997) Almost always, the state will infuse the corporation with goals other than value maximization. It is especially likely that the state will sacrifice value to consolidate the political power of some ruling group or to further the social welfare of labor.
- Violation of minor shareholder interests. Because of the absence of such important components as value-maximization targets and the discipline that comes with a natural-person residual claimant and potential for outside shareholders to be expropriated using force of the state can became deadly for minority shareholder interests.

- Another risk for state owned companies is that the state tends to be a rather passive (Kostyuk 2006) shareholder and therefore is more rigid in applying corporate governance mechanisms. And as a consequence of this it became difficult to control management of companies and prevent managerial opportunism and agency conflicts development, which destroy shareholder wealth.

2. Institutional ownership/industrial group

Influential groups close to president Kuchma in 1996 initiated the privatisation of state-owned heavy industries with a view of ensuring that they would be purchased by specific persons. That is the reason why the sale of the most valuable industrial assets if the Ukraine, including Kryvorizhstal, started six months before the presidential elections. In order to prepare Kryvoristal for privatization, its ownership structure was transformed from its then status as unitary enterprise in state ownership[34] to a joint-stock company[35].

[34] A unitary enterprise is a form of a business in Russia and some other post-Soviet states. Unitary enterprises are business entities that have no ownership rights to the assets they use in their operations. This form is only possible for state and municipal enterprises, which operate state or municipal property, respectively. The owners of the property of a unitary enterprise have no responsibility for its operation and vice versa. (http://en.wikipedia.org/wiki/Unitary_enterprise)

[35] There are two types of joint stock companies: "open" joint stock company (OJSC) and "closed" joint stock company (CJSC). The minimum capital requirement for both JSC is the equivalent of 1,250 Ukrainian monthly minimum wages at the

In 2004, Kryvorizhstal had sales of USD 1,897 mio., EBITDA of USD 551 mio., EBIT of USD 505 mio. and net income of USD 478[36] mio. Realistic key data were only available from Kryvorizhstal political decision-makers and top management of the enterprise, due to 100% state ownership. Political and business risks in the Ukraine impact negatively on the value. Hence the State Property Fund estimated Kryvorizhstal at more than 3 bn UAH[37] (approx. 550 USD mio. in 2001, and then in 714 USD mio. in 2004).

Both oligarchs[38] Viktor Pinchuk and Renat Akhmetov were the most realistic candidates to purchase Krivorizstal before the presidential elections in 2004. The State property Fund already had an expertise in engineering such “public sales” in favor of predefined candidates (in Ukrainian this is called “address sale”). The only question was who from the oligarchs had enough political influence and free cash flow to afford this purchase. Due to the unclear situation regarding the candidacy for the next Ukrainian presidential elections, Pinchuk and Achmetov joined forces and formed a consortium, called Investment-Metallurgical Union, to carry through the Kryvorozhstal deal.

According to Mr. Vydrin, the Director of the European Institute Integration and Development in the Ukraine – “the Ukraine - is a country of corporate capitalism, where all important economic and political projects are done only in case of mutual or dominate cooperation.“

At the time an extensive development approach prevailed in Ukrainian business – i.e. to extend their influence (improve their business performance) by purchasing new companies.

In June 2004, a 93.02% stake of Kryvorizhstal was sold to the below mentioned consortium for a sum of USD 800 mio. Offers exceeding USD 1 bn. from foreign investors were rejected on technical grounds.

This deal has been widely criticized by the opposition and abroad as an example of corruption and state property mismanagement.

During 1999 -2008 majority of companies, especially in heavy industry were privatized (via the State Privatization Fund).
Due to privatization, the GDP growth rate in the Ukraine increased significantly from 10% in 1992, to 40% in 1994 and above 55% in 2004 (data from the ministry of economy of Ukraine).

---

time when the JSC is formed. Based on the 2007 Budget Law, the following minimum capital requirements apply for JSCs established in 2007. A CJSC is typically financed mostly by its founders. Shares in an OJSC may be offered to the general public and traded on a stock exchange, whereas ownership of shares in a CJSC is limited to the founders. OJSC is suitable when business intends to collect substantial capital by means of the issuance and sale of shares to the public. JSCs are required to submit quarterly and annual reports to the State Commission on Securities and Stock Market. These reports include the annual audited financial reports, quarterly financial reports, reports on securities circulation, and details of any shareholders owning more than 10% of the shares. JSCs should also publish their annual report in the official media not later than 30 April of the following year.

[36] Data from   http://steelguru.com/ (2005)

[37] State Property Fund of Ukraine, official web page http://www.spfu.gov.ua (data from 2001)

During this phase, because of the underdeveloped legal system, Ukrainian enterprises were looking for options to better control management.

For this special situation, the model of majority shareholdings offered best controlling features against managers' negligence and using private benefits. At this time, plenty of enterprises of such type were formed; as usual those were the financial – industrial groups (FIG). In a nutshell – bad corporate governance caused the concentration of shares among major shareholders.

This was also true for the Pinchuk –Achmetov consortium, but they also faced other difficulties, in particular the start of a predictable power struggle, which stemmed from having two owners who actually were economic competitors.

The new owners Kryvorizhstahl after the purchase showed great willingness to improve company performance and competiveness. The following changes were implemented during the year Kryvorizhstal was in the ownership of the Ukrainian consortium (with a budget of over 4 bn. UAH):

- A widening of the product range/assortment;
- An improvement of the product quality and lowering of the production costs;
- A measurement on improvement of energy saving and environmental technologies/modernization of energy saving technologies;
- An opening of new distribution markets;
- An improvement of working conditions for employees.
- Furthermore 6.8% of the company shares were offered to the employees at a discounted price.

However, the company's owners did not insist on changing key executives – the management team of former director–general – Anatoliy Sokurenko apparently satisfied the official owners and remained in place.

Officially, Kryvorizhstal was owned by the oligarchs' consortium less than one year. No notable changes in company corporate governance were made.

Pros/Cons of financial industrial group ownership (local investor):

- Due to the unpredictable economic situation, owners and executives often prefer an extensive approach of business development – i.e. enlarging their business by conducting hostile takeovers or purchasing new assets, rather than an intensive one – i.e. by increasing efficiency: modernization and new technology, improvement of management performance, corporate governance etc.

- Managers and owners often fear that transparent processes will make the company more vulnerable to competition (especially higher risk of hostile takeovers, corporate raid and industrial espionage due to weak legal protection etc.)

- Moreover, weak transparency of their companies can erode any success of these companies in the way of development of innovation. Such companies are not transparent to customers. Therefore, innovation, developed and applied by the companies, will not be detected and valued by the market.

- During the time of racket development of the Ukrainian economy, the lack of well qualified managers/experts caused high labor fluctuation, especially with regard to key positions. In such a situation, company owners prefer to keep important information closed and not to delegate decision-making.

- Considering the wish of Ukrainian financial-industrial groups to pay dividends it may be concluded that the companies under their control experience a very low level of reinvestment.

- This factor is a strong barrier on the way of development of innovation in the companies.

- Hardening of budgets constraints (i.e. curtailing firms' access to formal or informal state subsidies) was also found to have a positive effect on restructuring.

During the Presidency of Viktor Yushenko, this privatization deal was dismissed by the Supreme Court of the Ukraine in June 2005, in order to sell the company again in a fair auction. State ownership was restored.

The State Fund organized a shareholder meeting, but did not initiate essential changes in top management. The director-general Anatoliy Sokurenko, who held this position before the company was transferred to the oligarch consortium, remained in place again.

After restoring the state ownership of Kryvorizhstal, again a shareholder meeting was held in June 2005.
The meeting amended the profit distribution of the year 2004: 60% after tax earning to improve/complete company cash assets; 5% to a reserve fund; and 35% to dividend distribution.

3. Foreign private investor ownership

In October 2005, in a bidding process broadcast live on Ukrainian television, the stake was sold to a foreign investor. Mittal Steel acquired 93.02% of the shares of Kryvorizhstal. Under the terms of the share purchase agreement, 3,590,038,755 shares have been transferred to Mittal Steel for a total consideration of UAH 24.2 bn (USD 4.84 bn.). The transaction has been financed out of Mittal Steel's own cash resources and credit lines for USD 4.81 bn., well in excess of the USD 3 bn. predicted by analysts. The company was renamed to "Mittal Steel Kryvyi Rih", and then (after merger of Mittal Steel and Arcelor Mittal) to ArcelorMittal Kryvyi Rih. With this deal Mittal Steel has also taken some obligations concerning employee headcount, wages, environmental and social issue, except this 1 bn. USD has to be invested in the company modernization and reconstruction technologies.

After purchasing of Kryvorizhstal Chairman and CEO of Mittal Steel Company - LN Mittal informed the public, that it was a key, strategic acquisition that provides Mittal Steel with a large size, low-cost production platform in a core and fast growing market. The company had immediately started to work on the improvement of the competitive position of Kryvorizhstal.

A new shareholder meeting appointed a new CEO of the company – Narendu Choperi (previously CEO by Mittal Steel Galati – Romania and Mittal Steel Temirtau Kazachstan), who has spent its first year in control stomping out grey schemes with its traders and improving the plant's efficiency.

A supervisory board has also been elected, and reduced from 7 to 5 members. According to public information the Supervisory board gets no remuneration for its function.

Since purchasing ArcelorMittal continuously makes steps to integrate the company towards the world's best practice standards and improve competitiveness within the country's steel sector:

In the beginning of 2008 ArcelorMittal embarked on a management reshuffle at AM KR making a milestone in the company's development.

The company's January AGM appointed Jean Robert Jouet as CEO. Before coming to AM KR. Mr. Jouet was the Upstream and Site Manager at Arcelor Mittal Flat Carbon Western Europe in Dunkirk France. In June 2008 AM KR announced that Christophe Cornier joined the Company's Board of Directors. Mr. Cornier currently holds the position of technical director within Arcelor Mittal, primarily responsible for the execution of Greenfield steel projects.

The company management continuously makes steps towards the modernizations and implementation of international standards:

(i) In February 2008 "ArcelorMittal Kryviy Rih" in Ukraine has received the certificate of Health and Safety management system compliance to international standard OHSAS 18001:1999. OHSAS is one of the leading documents for industrial Health and Safety management systems of different companies all over the world.

(ii) The company also plans to invest 1.7 bn. UAH on modernization and efficiency improvements.

(iii) In 2006 Arcelor Mittal invested USD 1.5 bn. (USD 200 mio. loan from EBRD) in the reconstruction of the Ukrainian steel mill, such as upgrade technology, boost productivity and become more energy efficient.

The important issue for AM Kryvyi Rih is also to keep the positive image of a company. That's why despite the challenging economic situation ArcelorMittal Kryviy Rih has increased the wages for its employees by 16 % from 1 April 2010.

The current CEO is also talking about the importance of following the obligations to the Ukrainian state “our receivables for VAT have never stopped increasing since 2 years<….>Our situation is peculiar since on top of everything, in accordance with our SPA (Sale and Purchase Agreement), we still have certain obligations with respect to income tax payment and other taxes at the levels achieved in 2003-2004. Moreover, AMKR have paid advanced income tax .To make it short, AMKR is subsidizing the state budget for around 3 bn. UAH (around 50 mio. USD) and as of today, we see no forecast for any pay back to come soon[39].”

[39] http://www.arcelormittal.com.ua/

Pro/contra foreign private investor:

- Reduction in number and intensity of shareholder conflicts.

- Improved quality of financial reporting (as usual to suit in reporting system of the parent company establish/integrates international financial standards e.g. IFRS).

- Competitive disadvantages compare to state protected companies (no access to the state subsidiary etc.).

- Inconsistent legal situation restricts company in long term planning.

- Awareness of the positive company image has overall positive influence on the economical situation (e.g. AM kryvyi Rih making efforts to pay VAT to the Ukrainian state even in difficult economical situation, or offers social benefits to its employees) on the contrary to the Ukrainian state rules, which have no incentive to form a long term positive image due to unpredictable political situation.

- More transparency in ownership structure (as a subsidiary of the world largest steel concern KSTL disclosure has to disclosure more information to the public about its management structure, procedure, investors etc.)

- Foreign institutional investors, as controlling owners, are much more inclined to bear research and development expenses than those companies, controlled by Ukrainian financial-industrial groups or executives (AM Kryvyi Rih continuously invest in the technology modernization, energy efficiency and compliancy with the international standards).

- As usual, foreign institutional investors are much more inclined to have an innovative approach to governing the companies they control. (E.g. the integration of the company in the ArcelorMittal group has facilitated the spread of modern management skills at company and industry level. Mittal Steel maintains for all of its operations a knowledge sharing program which enables ArcelorMittal managers to share best practice management experience between plants belonging to ArcelorMittal worldwide.).

- Higher expenses for the innovations. Korpinsky (2000), Head of Management Board of investment company "Kinto" said that "Foreign owners try to manage the companies in the way to be one step ahead to competitors. Almost always foreign owners begin with development of a concept to manage innovation. I think that this is very strong signal to the market".

Chapter V:

The derivation of the fair value of AM Kryvyi Rih employed the DCF modeling and peers comparison and difference in difference method.
First there is brief review company performance in the last years.
As this chart shows AM Kryvyi Rih has been affected by the global economics crisis. Within 2008 – 2009 years the share price was cut more than in half (18 USD in May 2008 until 6.99 USD in Dec.2009)[40].
The overall production decreased to approx. 20% in 2009 compare to 2008[41]. In 2009 OJSC Arcelor Mittal Kryviy Rih has a 42% downward trend in sales of metal products on the domestic markets in comparison to year 2008. Given the difficult economic climate, the company cut prices twice during the year – in April and in May – in order to maintain domestic demand.
With the domestic market depressed, greater emphasis was placed on reaching export markets. In 2009, exports reached only 83% of total sales. The company supplied 61 countries during the year, with the main markets remaining in Africa, the Middle East, the Persian Gulf, CIS, EU, Iran, and Turkey.

It's important to mention that the Ukrainian economy is critically dependent on the world markets, in particular the energy imports, and metallurgical exports
Due to the economic crises and decrease on the steel prices – company financial figures have been impacted respectively. Therefore, there is a challenge to examine company performance and its interdependence with ownership structure and corporate governance under a variety of other factors.

The estimation of the changes of the owner and its influence of the company performance is conducted by using the DCF Model. As Mittal Steel has bought the company in 2005, the real changes in the company performance have started at the beginning of year 2006. That's why the calculation of the discounted cash flows our table shows starts from 01/01/2006. From this date "Kryvorizhstal" moved into ownership of foreign investor here. The data will be entered with for year 2010.

However, it is important to mention that 100% true estimation of changes in company management and its further influence on the "money" index/financial performance is a sensitive process as it can be also influenced by variety of other factors,. e.g. company sales and cost of goods can be influenced by both management actions towards discovering new markets and reduction of "waste" cost, as well as price increase on the company key markets.

[40] Append.7
[41] Append.4

Estimation and DCF model:

Table 1[42] see Appendix.5.

First I examine the changes of the net sales from 2002 to 2009 (historical data), and estimating the net sales increase in the year 2010 (by multiplying the percentage of sales increase in the previous year).
Then I entered the cost of goods sold (CoGs) and estimated the stake of CoGs in liquidation value that we can find out by valuing our historical data and forecasting the realistic maximum, based on this data.
In the next step I calculate the gross profit by discounting net sales by sold cost of goods.
Then I have calculated EBITDA by subtracting Selling, General and Administrative Expenses (SG&A) and Δ between other income and expenses from gross profit.
The following step is subtracting amortization and depreciation from EBITDA. I obtain EBIT for further construction of the DCF model. Other cash flow required for calculation – amortization as percentage from net sales, and fixed capital expenditure (CAPEX) is calculated by subtracting the change in total liabilities from the change in total assets.
To calculate WACC we would need the values of the working capital, ST and LT Interest Bearing Debt, EBITDA margin & amortization & depreciation, which can all be found in the balance sheet.
From the two methods in calculating company value and profitability through the discounted cash flow of the company: Free Cash Flow to Firm (FCFF) and Free Cash Flow to Equity (FCFE), I have chosen the FCFF method as we are more interested in valuing the firm than the equity.
The simple equation used to calculate FCFF is = EBIT(1-t) + NCC - CAPEX - WCinv
FCFF is on an after tax basis and EBIT is before taxes, so I would need to multiply by the firm's after tax rate which is (1-t): EBIT*(1-t). The next step is adding NCC - noncash charges such as depreciation and amortization. Finally, I subtract change in fixed capital investments and change in working capital investments.
Then the main principle of building this model is consecutive discounting of future FCFF by using the formula of firm valuation. Thus, I sum all cash flow and after discounting them to obtain the firm value.
Where CF to Firm t expected cash flow to firm in period "t" and WACC is weighted average cost of capital.

$$WACC = \frac{E}{V} * Re + \frac{D}{V} * Rd * (1 - Tc)$$

(Re- cost of equity; Rd = cost of debt; E = market value of the firm's equity; D = market value of the firm's debt and V = E + D, TC = corporate tax rate)

Weighted Average Cost of Capital is a key component when DCF fair value is calculated.

---

[42] All financial figures data from Ukrainian Securities and Stock Market State Commission and State Securities & Exchange Commission official web pages http://www.smida.gov.ua and http://www.stockmarket.gov.ua

WACC calculation presupposes availability of historical data on yield of a debt instrument and estimation of expected future risk of the company (and its stock). For the estimation of the company's expected future risk normally we get biased betas from statistical investment survey analyses of specialized companies.
But in Ukraine the reliable data is not easily founded that would allow correct definition of the branch risks, so a different method of estimation is necessary:
RE – profitability of the Ukrainian Eurobonds, corporate bond premium, equity premium, company-specific premium[43]

Since the company exists beyond the forecasted period, I would need to take it into account by using Terminal Value (TM) - value of any item at the end of a specified time period, as the second part of the formula.

$$\text{Value of Firm} = \sum_{t=1}^{t=n} \frac{FCFF_t}{(1+WACC)^t} + \frac{[FCFF_{n+1} / (WACC - g_n)]}{(1+WACC)^n}$$

With assumption that FCFF per year n+1 will continuously grow synchronic with g_n by the stabile risk level (WACC) I can calculate future FCFF in perpetuity (in forecasted period) with the numerator of second part of the formula. As the next step I discounted received value in such manner as if I would receive it in the last forecasted year N and add it to the sum of already discounted FCFF in the forecasted period.
In such way **value of the firm** is obtained.
In order to calculate the equity value, we can subtract the net debt from previously calculated firm value.

Peer comparison method:

Mittal Steel Kryvyi Rih has been compared to three groups of peers:
Developed peers (consisting of 19 firms)
Global emerging market peers (consisting of 17 firms)
Russian Peers (consisting of 4 firms)[44]
by three multiples: Enterprise-Value-To-Sales (EV/S), Enterprise-Value-To EBITDA (EV/EBITDA) and P/E) and then an average of implied equity values has been calculated.

These groups consist of listed steel producers similar to Mittal Steel Kryvyi Rih. According to the statement of Concorde Capital, the differences in growth prospects and business risks are diversified away when we take the median of their multiples. This peer valuation is based on commonly-applied assumptions of peer valuation,

---

[43] Data of Institute for Economic Research and Policy Consulting, from year 2006

[44] These peer groups correspond to those used in equity research on steel producers by Concorde Capital. Detailed information regarding peer groups can be found in Append. 6.

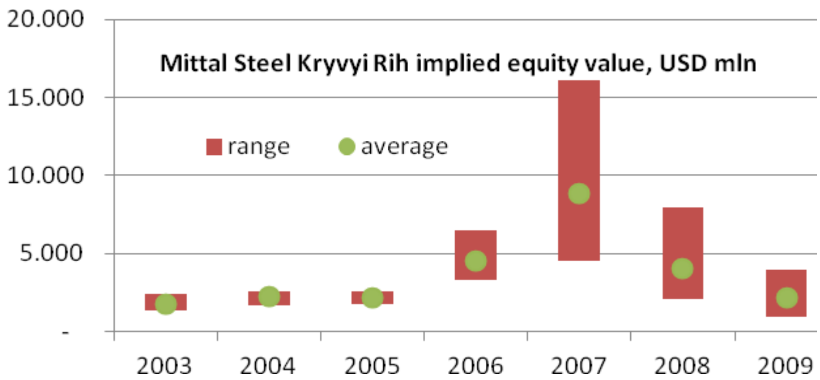
that a peer group is fairly valued by the market on average and that growth and risk prospects of the analyzed company is similar to those of the peer group selected.

Though Mittal Steel Kryvyi Rih is listed on local stock exchanges, the market price of its stock cannot be used as a reliable estimate for market value of the equity. This is due to the fact that KSTL stock is illiquid: few deals take place with this stock, and estimated free-float can be less than 0.5%.

Therefore, instead of Mittal Steel Kryvyi Rih stock quotations, the true value of the company can be fairly estimated through analysis of market prices of comparative firms.

On the table below[45] the implied equity value of AM Kryvyi Rih from 2003 to 2009 in three different ratios and in each of company peer groups to be found. For example, the company value in year 2003 estimated for group of developed peers for multiples EV/S is 1.358 USD mio.

By using three peer groups and measure fair value by three metrics, there are nine values for each year. This chart summarizes the range of implied equity values: bottom is the lowest among nine figures, top is the highest. The average is the simple average of nine values[46]:



According to the peers comparison method, I can also conclude that average company value was significantly higher during the foreign investor ownership (even taking into account the global economic crises and steel price decrease) that also prove our statement about the correlation between company performance and corporate governance/ownership structure.

Difference in difference method:

In this estimation with the average median, we cannot be assured if the changes in higher equity value are implied by the global market situation, steel prices, etc. and

[45] Appendix. 8

[46] Detailed estimation results of AM Kryvyi Rih on firm and equity value implied by EV/S, EV/EBITDA and P/E can be found in the Append. 6

are true for all peers or just for KSTL in particular, therefore in order to emphasize this difference I will use the difference in difference model. This is a basic two-way fixed effects model, that use time series of untreated group to establish what would have occurred in the absence of the intervention (in our case acquisition).
Form the Bloomberg data available on EV/S, EV/EBITDA and P/E I have chosen the EV/S index to compare the companies' values.
This way we cannot use the P/E ratio due to the fact that KSTL stock is illiquid, and that KSTL became open joint stock company only at the end of 2004 in the year of privatization that will impact the clarity/accuracy of our estimation.
Taking into account that ArcelorMittal Krzvih Rih doesn't publish the detailed annual auditor's report about company financial performance and the financial data before the purchase does not give us the reliable figures about the company EBITDA[47].
Therefore, in my opinion, the most reliable option is to compare Sales multiples as these are the most transparent indicators in our case.

	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
KSTL	0.79	1.21	1.32	1.63	3.23	1.21	2.67
Developed peers	0.91	0.76	0.85	1.14	1.22	0.56	1.20
GEM peers	1.21	1.05	0.91	1.31	2.25	0.84	2.36
Russian peers		0.25	1.09	1.50	2.29	0.49	1.58

EV/S	t-2	t-1	t	t+1	t+2	t+3	t+4		
Year	2003	2004	2005	2006	2007	2008	2009		
KSTL	0.79	1.21	1.32	1.63	3.23	1.21	2.67		
Peers (average)	1.06	0.69	0.95	1.32	1.92	0.63	1.71		

As the company has been purchased in the end of 2005, I will compare the first changes in the year 2007.

The purchasing occurs at time period t -1 and the estimation the true effect of $Y_{t+2} - Y_t$ for KSTL is 3.23 – 1.32 = 1.92 and for average peers is $Y_{t+2} - Y_t$ 1.92 – 0.95 = 0.97

From this analysis we may see that for both – KSTL and peers there is a tendency towards sales increase that can be explained also by the global growing steel demand.

Percentage increase 2005 vs.2007:

1.92	KSTL	145%
0.97	Average peers	102%

[47] The lack of transparency in the Ukrainian accounting standard provides various option to the companies manipulate the financial figure in order to decrease taxes payments. Due to the implementation in of financial standards of Arcelor Mittal group that caused correspondingly changes in company accounting methods (e.g. calculation of the depreciation, revaluation of the fix assets etc.), that can lead to the inconsistency in comparing the EBITDA multiples before and after purchasing .

But the KSTL EV/S index is almost one third above its peers; therefore, we can assume that such significant increase was caused by the changes in the company corporate government and measures conducted by the ArclorMittal towards integration of the company into the group.

Conclusions

In this diploma thesis the broad overview of the current situation of corporate governance in Ukraine in the case of AM Kryvyi Rih has been presented.

Some conclusions of undeniable relevance can be drawn from this study:

a) For the main particularities of the Ukrainian corporate governance I can confirm the statement of Biletsky et al., 2001; Guriev et al, 2004; CEFIR[48] , 2006; and IFC, 2003/2005 that in Ukraine, as in other researched countries, corporate environment is characterized **by weak legal institutions** and high ownership concentration. Absence of dispersed equity ownership changes the principle-agent problem in this context. While in the Anglo-Saxon model main conflict is between manager and variety of small shareholders, in transiting countries managers are controlled by one of the group of major shareholders (Lazareva et al., 2007). For this reason, most conflicts arise between major and minor shareholders or between groups of major shareholders. Another problematic issue is from the government and raider's side. Due to weak corporate government it makes a company vulnerable to raiders' attacks and the underdeveloped legal framework creates a risk of state intersection in the business.

b) The corporate governance in Ukraine is at the early development stage. Company owners often are **not ready for transparency and disclosure** in their company due to security reasons (competitors, hostile takeover and management opportunism). The major shareholding allows better monitoring ability for mangers and helps to overcome agency problems, but companies who have few major shareholders face low liquidity problems and have less possibility for risk diversification.

However, I also agree that the efficiency and extent of the influence of the corporate governance to the company performance is also influenced by differences in countries' legal and regulatory frameworks, as well as historical and cultural factors in addition to the structure of product and factor markets[49].

One concludes, in the first place, that there is a positive relationship between ownership structure and company performance.

Summarizing in the case of AM Kryvyi Rih, foreign investor's ownership had the best impact on the company performance and development.

c) Overall research made in transition economies also shows that in comparison with state ownership (management style based on the heritage of regulated economy) **foreign investors have better impact on the company corporate**

[48] Center for economic and financial research in Russia http://www.cefir.ru/?l=eng

[49] Maher M., Andersson T. Corporate governance: effects on firm performance and economic growth, OECD, 1999, pp.3

governance, market value and performance. Also research made for other countries such as (Boardman and Vining) for the U.S. (1989), Gorton and Schmidt (1996), for Germany, and Gugler (1998) for Austria prove that private companies are more profitable and more efficient than state-owned companies.

In the case of KSTL state ownership also brought some essential benefits for the company (e.g. vertical integration, debt and fines write off). These could be explained by the assumption of Boycko, Shleifer and Vishny (1995) that the relation between managers and politicians are really significant especially in Post Soviet countries. In other words, as soon as companies' managers will facilitate politicians in gaining private benefits, the firm can enjoy "state" support, but obtaining private benefits do not have direct correlation with improving of firm performance (e.g. in the case of bribe for involving the intermediate organization for product distribution, etc.).

It is also important to mention that on the macro economical level there is a risk that foreigners steal part of the market from local firms and this may result in a "crowding out" effect of local firms by foreign ones (Caves (1996) and Blomstrom (2000)), especially in less developed countries where the gap between technology of the foreign and domestic firms is higher.

d) **Previous research that examined emerging economies has also found positive effects of corporate governance on operative performance and always on equity return.** Klapper and Love (2002), using firm level data mostly from Asian emerging economies, found that good governance is positively correlated with market valuation and operating performance. Black, Love and Radchinsky (2006), conducting their researches in Russia, also found statistically significant a positive impact of the quality of corporate governance on a firm's market valuation in Russia.

In relevant studies conducted in Ukraine by Zheka (2006) also showed a positive correlation between corporate governance and a firm's performance, though with an absence of reversal causality. There is a positive influence of shareholder right and transparency of the company, but a surprisingly negative effect of the independence of the board chairman on performance. The explanation for this fact is the inability of the independent chairman to build effective communication with management and exercising his power appropriately in transition economies.

e) In the research made in chapter VI, based on the conducted DCF analysis of financial figures of AM Kryvyi Rih, during the foreign investor ownership, where the changes in corporate governance have been made I may argue that **corporate governance does positively influence the value of the company**.

f) The difference in difference analysis based on the peers group comparison shows **significantly higher sales performance** of AM Kryviy Rih since the change of the owner (Arcelor Mittal) **when the changes towards improvement of corporate governance have been made** versus state ownership with very poor transparency and high interference from state rulers.

This study proves the influence of company corporate governance and owner's identity as independent value drivers for Ukrainian companies.

Bibliography:

Barenberg S. (2008): Corporate Governance in der Ukraine: Rahmenbedingungen und aktuelle Entwicklungstendenzen. In Heiko Pleines (Hg.): Corporate Governance in post-sozialististischen Volkswirtschaften, Stuttgart (ibidem-publisher), pp. 69–89.

Bass H., Melchers S, (2004): Transnationale Unternehmen in Ländern niedrigen und mittleren Einkommens: Funktion und Bedeutung. In: Neue Instrumente zur sozialen und ökologischen Gestaltung der Globalisierung: Codes of Conduct, Sozialklauseln, nachhaltige Investmentfonds, Münster, ISBN 3-8258-7926-7, pp. 81-96.

Black B.S. (2001) : Does Corporate Governance Matter? A Crude Test Using Russian Data. In: University of Pennsylvania Law Review, Vol. 149, pp. 2131-2150.

Boycko M., Schleifer A. and Vishny R.W. (1996): A theory of privatization. In: The economical Journal, Oxford, pp. 309 – 319.

Deloitte Touche Tohmatsu (2009): Ukraine. International Tax & Business, http://www.deloitte.com/assets - accessed on 16.04.2010.

Dybrovskyi V., Pashkhaver A., Verkhovodova L., Blaszczyk B. (2007): Analytical report and recommendations for the state privatization program, analytical report, the center for economical and social CASE Ukraine, pp.43.

Estrin S., Hanousek J., Kocenda E., Svejnar J. (2007): Effects of Privatization and Ownership in Transition Economies, the World Bank Development Economics Department, pp.88.

Estrin S., Hanousek J., Kocenda E., Svejnar J. (2009): The World Bank Development Economics Department, world bank Policy Research Working Paper, http://ssrn.com/abstract=1327280 - accessed on 10.04.2010.

Fama E. and Jensen M.C., (1983): Separation of Ownership and Control. In: The Journal of Law and Economics, vol. 26, pp.33.

Fisun K, Klymchuk A. (2008): Straightening up to fly right. In: Ukrainian Corporate Governance research, Concorde Capital, pp. 39.

Fisun K. Piazza N. (2007): From Ape to Man. In: Ukrainian Corporate Governance research, Concorde Capital, pp. 27.

Franks, J. and C. Mayer (1995) : Ownership and Control. In: H. Siebert (ed.), Trends in Business Organization: Do Participation and Cooperation Increase Competitiveness J.C.B. Mohr, Tubingen.

Gray, C. W.(1996): In Search of Owners: Privatization and Corporate Governance in Transition Economies. In: The World Bank Research Observer, Vol. 11, No. 2., pp. 179-197.

Gugler K. & Mueller C.D. & Yurtoglu B.B. (2004): Corporate Governance and Globalization. In: Oxford Review of Economic Policy, Oxford University Press, vol. 20(1), pp. 129-156.

Gugler K., Mueller P. D., and B. B. Yurtoglu (2007): Corporate Governance and the Determinants of Investment, In: Journal of Institutional and Theoretical Economics, JITE 163 pp. 598–626.

Gugler, K. (1999) : Corporate Governance and Economic Performance, A Survey, mimeo, University of Vienna, Austria.

Guriev S., Rachynsky A., (2004): Ownership Concentration in Russian Industry, In: CEFIR, pp.45.

Hrebicek G., Fichtinger M. (2003): Handbuch Corporate Governance, Leitfaden und Praxisbeispiele für transparente, Unternehmensführung und –Überwachung, Publisher Aktienforum, pp.416.

Khoroshilov K. (2003): Leman Commodities cooperates with Kryvorozhstal. In: Delovaya stolitsa, Kyivpress, pp.12-13.

Kostuyk A. (2005): Business innovations and structure of Corporate Governance in Ukraine. In: Corporate Governance: the journal of Business and Society, Vol. 5 Iss: 5, pp.19 – 29.

Kostyuk A., Kostyuk H. (2005): Financial-industrial groups at the markets for corporate control and investments in Ukraine. In: Corporate Ownership & Control, 2, vol. 2, pp. 104-116.

Krakovsky A. (2000): Corporate governance practice in economies in transition. In: Journal of problems of practice and theory of corporate governance pp. 24-35.

La Porta R., Lopez de Silanes F., Shleifer A. (2001): Corporate Ownership Around the World. In: The Jounrnal of finance, pp. 471-517.

Lazareva O., Rachynsky A. and Stepanov S. (2007): A survey of corporate governance in Russia, In: CEFIR/NES, pp. 103.

Libanov M.(2008): Who and why need the new Law of Ukraine on on Joint Stock Companies, In: Zerkalo Nedeli (weekly newspaper), Kiev, pp.20.

Maher M., Andersson T. Corporate governance: effects on firm performance and economic growth, OECD, 1999, pp.3.

Malygina K. (2008): Geldblasen: Auswirkungen der weltweiten Finanzkrise auf die Ukraine. In: Ukraine-Analysen №46, pp. 2-3.

Nellis, J. (1999), Time to Rethink Privatization in Transition Economies? In: Finance and Development 36 (2), pp. 16-19.

Pankratov P. (2009): Gazovyi kancler v belyh noskah (biography of O.Dubina). In: Tema, http://www.tema.in.ua/article/4794.html - accessed on 3.04.2010

Parashchiy A. (2004): Costs and benefits of being affiliated with Ukrainian financial-industrial groups: Case of sugar industry. Thesis submitted for MA degree in economics in Economics Education and Research Consortsium.

Perotti E.C. and Gelfer S. (1998): Investment Financing in Russian Financial-Industrial Groups, working paper number 242, pp.30.

Ruud A. I. van Frederikslust; James S. Ang; P. S. Sudarsanam (2008): Corporate governance and corporate finance: a European perspective, Routledge, UK , pp. 575.

Samoylenko V. (2008): Hostile Takeover – Made in Ukraine www.eba.com.ua/files/Analytical_Reviews/Hostile_Takeover.pdf - accessed on 12.05.2010.

Sell A., Krylov A, (2006): Grundlagen der Corporate Governance in der Ukraine. In: Corporate Governance. Unternehmensverfassungen im Ost-West-Dialog, Peter Lang, Frankfurt a.M., ISBN 3-631-55628-4, pp. 299-306.

Shleifer A. (1997): A Survey of Corporate Governance. In: The journal of Finance, Vol. 52, pp. 737 – 783.

Shleifer, A. and R. Vishny (1997): A survey of corporate governance, In: Journal of Finance, 52(2), pp.737-783.

Smarzynska B.J. (2004): Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In: Search of Spillovers through Backward Linkages, American Economic Association, Vol.94, pp. 3.

Stulz R. M. (2006): Financial Globalization, Corporate Governance and Eastern Europe. In: Financial Development, Integration and Stability: Evidence from Central, Eastern and South-Eastern Europe, National Bureau of Economic Research, U.S. pp. 16-40.

Zheka V (2005): Corporate Governance, Ownership Structure and Corporate Efficiency: The Case of Ukraine. In: Managerial and Decision Economics, Vol. 26, No. 7, pp. 451-460.

Appendixes':

Appendix 1. Types of Corporate Control over Joint Stock Company (Raiders):
Source: Partner Shevchenko Didkovskiy & Partners (2007), Hostile Takeover – Made in Ukraine

1) Relative;
2) Operating;
3) Strategic.

Relative CC over the Target is usually achieved through transfer to the Raider of a block of shares constituting less than 50% + 1 share of the total number of the shares in the Target, which vote at the general shareholders' meeting of the Target. However, therewith exist certain circumstances that allow the Raider to soundly consider that:

1) It will be able to convene a valid GSM (General Shareholder Meeting);
2) Such GSM will, by a simple majority vote of the participating shareholders (that own at least 50% + 1 voting shares), elect the management board of the Target nominated by the Raiders.

Generally, such result can be achieved through:

1) An agreement between the Raider and a number of independent shareholders to tender a consolidated vote on a given item of the GSM agenda;
2) Obtaining by the Raider appropriate proxies for participating and voting at the GSM, issued by a number of independent shareholders;
3) Inertness of independent shareholders (particularly, the State Property Fund or another governmental authority authorized to manage a government-owned block of shares in the Target, if any) revealing itself in a regularly low attendance of the GSM (however, securing a quorum) and/or their passivity in voting at the GSM (however, allowing to achieve SMV).

Operating CC over the Target is achieved through transfer to the Raider of a block of the Target's shares equal to, or exceeding 50% + 1 share of TNS. Provided it can convene a valid GSM, the Raider is guaranteed to achieve SMV in the election of the Management Board nominated by the Raider.

Strategic CC (hereinafter "SCC") may be conventionally divided into:

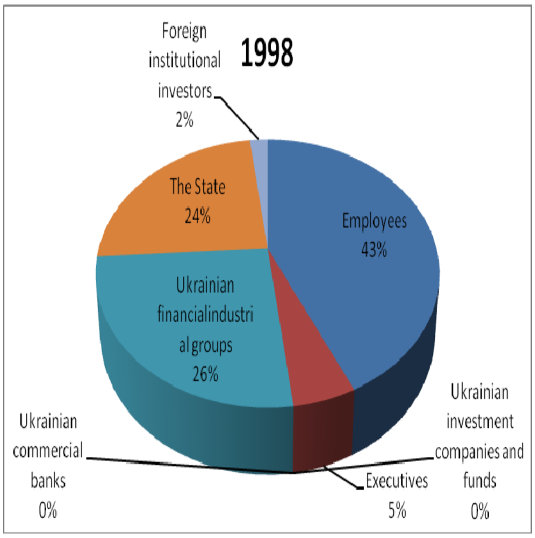
1) Relative;
2) Full;
3) Absolute.

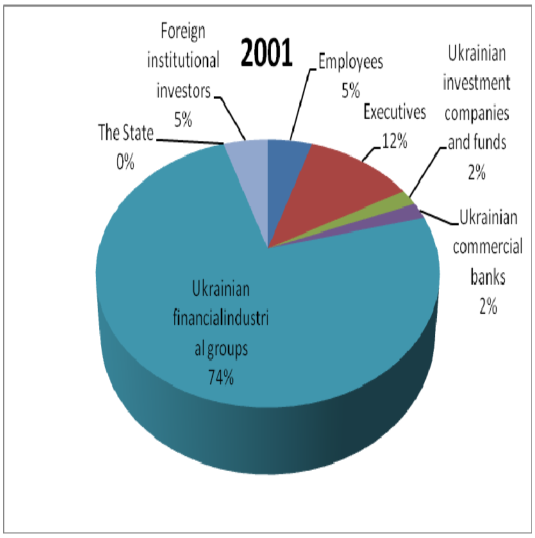
Relative SCC is, as a rule, achieved when a block of the Target's shares equal to, or exceeding 60% + 1 share, however lesser than 75% of TNS, is transferred to the Raider. Therewith, the Raider can implement the following scenarios of corporate management of the Target:

1) Despite of the other shareholders' will, convene a valid GSM and adopt any decisions that require SMV;
2) Block any GSM for an indefinite period of time and thus "conserve" such Target management structure as evolved or was created by the Raiders at previous GSMs.

Full SCC is established when a block of the Target's shares equal to, or exceeding 75%, however lesser than 90% of total number of shares (TNS), is transferred to the Raider. Such equity interest in the Target provides the Raider with an infallible opportunity, despite of the other shareholders' will, to convene a valid GSM and adopt any decisions that require SMV or a qualified majority vote, i.e. not less than 75% of the votes present at the valid GSM.
Absolute SCC is achieved when a block of the Target's shares equal to, or exceeding. 90% of the TNS, is transferred to the Raider. In such case, no one except the Raider (which, naturally, controls the Management Board as well as the Target's supervisory council and the auditing commission, and also benefits from the Target's charter convenient for it) can convene the GSM. But the part 4 of Article 45 of the Law of Ukraine "On Business Associations" No.1676-XII of September 19, 1991 as further amended vests such right, particularly, with shareholders that own the aggregate over 10% of the votes.

Appendix.2 Structure of corporate ownership in Ukraine 1998-2001 (Ownership structure of 41ukrainian companies from the metallurgy and machine-building industries):
Source: Corporate Governance: the journal of Business and Society





Appendix.3. Ranking corporate governance of Ukrainian companies:
Source: Concorde Capital own data, 2007

Name	Rating	Score	Sector
Galnaftogaz	Q	11	Oil&Gas
Astarta	Q	11	Consumer-related
XXI-Century	Q	11	Real Estate
Cardinal Resources	Q	11	Oil&Gas
Forum	Q	9	Banks
JKX	Q	9	Oil&Gas
Regal Petroleum	Q	9	Oil&Gas
Slavutych	AA	8,5	Consumer-related
Nyzhnyodniprovsky Pipe	AA	7,5	Pipes
Ukrnafta	AA	6,5	Oil&Gas
Ukrsotsbank	AA	6,5	Banks
Ukrtelecom	AA	6,5	Telecom
Mittal Steel Kryviy Rig	AA	6,5	Steel
Centrenergo	AA	6,5	Utilities: GenCo
Stirol	AA	6,0	Chemicals
Universalna Insurance	AA	6,0	Insurance
Motor Sich	AA	6,0	Machine Building
Aval	AA	6,0	Banks
Ukrprodukt	AA	6,0	Consumer-related
Khmelnitskoblenergo	AA	6,0	Utilities: OblEn
Megabank	AA	6,0	Banks
Ukrgazbank	AA	5,5	Banks
Yasinovatsky	AA	5,5	Machine Building
Khartsyzk Pipe	AA	5,5	Pipes
MKS	AA	5,5	Consumer-related

Appendix.4 KSTL Production overview 2008/2009:
Source: http://www.mittalsteel.com.ua

Type of product	2008 (tones)	2009 (tones)	2009 compared to 2008 (%)
Ore mining	20 554 083	17 842 801	65,1
Coke	2 635 686	2 364 806	89,7
Concentrate	7 802 766	7 066 157	90,6
Agglomerate	9 652 298	7 943 504	82,3
Pig iron	5 634 554	4 419 455	78,4
steel	6 213 288	5 039 268	81,1
Commercial rolled product	5 440 118	4 502 974	82,8

Appendix.5. DCF analysis KSTL (All financial statements according to Ukrainian Accounting Standards)
Source: financial figures data from the Ukrainian Securities and Stock Market State Commission

Income Statement, UAH mn	2002	2003	2004	2005	2006F	2007F	2008F	2009F	2010F
Net sales		**7,532.9**	**10,099.8**	**11,049.5**	**14,399.0**	**18,810.1**	**22,102.9**	**14,398.2**	**16,557.9**
Change y/y		*N/M*	*34.1%*	*9.4%*	*30.3%*	*30.6%*	*17.5%*	*-34.9%*	*15.0%*
Cost of goods sold		(5,458.9)	(6,929.9)	(8,140.2)	(9,414.1)	(12,109.6)	(14,537.0)	(12,600.4)	(13,743.1)
Change y/y		N/M	26.9%	17.5%	15.6%	28.6%	20.0%	-13.3%	9.1%
% of net sales		*72.5%*	*68.6%*	*73.7%*	*65.4%*	*64.4%*	*65.8%*	*87.5%*	*83.0%*
Gross profit		**2,074.1**	**3,169.9**	**2,909.2**	**4,984.9**	**6,700.4**	**7,565.9**	**1,797.8**	**2,814.8**
Change y/y		*N/M*	*52.8%*	*-8.2%*	*71.3%*	*34.4%*	*12.9%*	*-76.2%*	*56.6%*
% of net sales		*27.5%*	*31.4%*	*26.3%*	*34.6%*	*35.6%*	*34.2%*	*12.5%*	*17.0%*
SG&A		(361.1)	(406.8)	(536.6)	(918.8)	(1,234.7)	(1,765.8)	(1,407.7)	(1,655.8)
Change y/y		*N/M*	*12.7%*	*31.9%*	*71.2%*	*34.4%*	*43.0%*	*-20.3%*	*17.6%*
% of net sales		*4.8%*	*4.0%*	*4.9%*	*6.4%*	*6.6%*	*8.0%*	*9.8%*	*10.0%*
Other operating income/(costs), net		(60.5)	(77.1)	(200.7)	(154.4)	(502.0)	485.5	(249.9)	298.0
Change y/y		*N/M*	*27.4%*	*160.4%*	*-23.1%*	*225.2%*	*-196.7%*	*-151.5%*	*-219.3%*
% of net sales		*0.8%*	*0.8%*	*1.8%*	*1.1%*	*2.7%*	*2.2%*	*1.7%*	*1.8%*
EBITDA		**1,652.5**	**2,686.0**	**2,171.9**	**3,911.7**	**4,963.7**	**6,285.6**	**140.3**	**1,457.1**
Change y/y		*N/M*	*62.5%*	*-19.1%*	*80.1%*	*26.9%*	*26.6%*	*-97.8%*	*938.7%*
EBITDA margin, %		*21.9%*	*26.6%*	*19.7%*	*27.2%*	*26.4%*	*28.4%*	*1.0%*	*8.8%*
Depreciation & Amortization		(171.6)	(248.8)	(309.1)	(266.5)	(289.0)	(380.6)	(446.4)	(463.6)
Change y/y		*N/M*	*45.0%*	*24.2%*	*-13.8%*	*8.5%*	*31.7%*	*17.3%*	*3.9%*
% of net sales		*2.3%*	*2.5%*	*2.8%*	*1.9%*	*1.5%*	*1.7%*	*3.1%*	*2.8%*
EBIT		**1,480.9**	**2,437.3**	**1,862.9**	**3,645.2**	**4,674.7**	**5,905.1**	**(306.1)**	**993.5**
Change y/y		*N/M*	*64.6%*	*-23.6%*	*95.7%*	*28.2%*	*26.3%*	*-105.2%*	*-424.5%*
EBIT margin, %		*19.7%*	*24.1%*	*16.9%*	*25.3%*	*24.9%*	*26.7%*	*-2.1%*	*6.0%*

					1	2	3	4	5
Balance Sheet, UAH mn		**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**	**2010F**
Current assets		**1,781.8**	**3,142.6**	**3,261.6**	**6,422.1**	**9,710.9**	**7,943.8**	**8,042.8**	**8,350.0**
Cash & Equivalents		491.0	1,100.5	1,305.2	1,268.9	1,857.6	1,296.0	252.3	417.5
% of current assets		*27.6%*	*35.0%*	*40.0%*	*19.8%*	*19.1%*	*16.3%*	*3.1%*	*5.0%*
% of net sales		*6.5%*	*10.9%*	*11.8%*	*8.8%*	*9.9%*	*5.9%*	*1.8%*	*2.5%*
Shareholders' Equity		4,029.8	5,847.6	6,417.9	8,828.8	12,564.7	11,447.5	11,314.0	11,450.0
Current liabilities		**975.9**	**640.9**	**608.2**	**828.1**	**1,535.5**	**2,145.6**	**2,573.3**	**2,850.0**
ST Interest Bearing Debt		-	-	-	-	-	-	-	-
LT Interest Bearing Debt		-	-	-	925.8	757.5	898.3	665.4	450.0
Total debt at the end of the year		-	-	-	925.8	757.5	898.3	665.4	450.0
Working capital (WC)	**700.0**	**805.9**	**2,501.8**	**2,653.4**	**5,594.1**	**8,175.5**	**5,798.2**	**5,469.5**	**5,500.0**
Change in WC		*105.9*	*1,695.9*	*151.6*	*2,940.6*	*2,581.4*	*(2,377.2)*	*(328.7)*	*30.5*

				1	2	3	4	5
Others, UAH mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**	**2010F**
CAPEX		311.7	220.7	880.5	1,257.6	1,184.3	724.3	850.0
D/E Ratio	-	-	-	0.1	0.1	0.1	0.1	0.0
# of ordinary shares, mln		3,860	3,860	3,860				

WACC calculation:	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**	**2010F**
Debt/equity e/p	-	-	-	0.10	0.06	0.08	0.06	0.04
weight of debt	0%	0%	0%	7%	4%	5%	4%	3%
weight of equity	100%	100%	100%	93%	96%	95%	96%	97%
Avg. interest rate	**31.2%**	**28.2%**	**26.4%**	**21.1%**	**14.2%**	**12.5%**	**18.4%**	**17.5%**

Ukr Eurobonds (in USD) YTM	6.4%	6.3%	6.2%	6.1%	6.0%	5.9%	5.8%	5.6%
Corp. bond premium	4.8%	4.6%	3.8%	3.2%	3.0%	2.2%	3.8%	4.0%
Equity premium	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Company-specific prem./disc.	1.7%	1.3%	1.0%	0.5%	0.5%	0.5%	0.5%	0.5%
Cost of equity	**16.8%**	**16.2%**	**15.0%**	**13.8%**	**13.5%**	**12.6%**	**14.1%**	**14.1%**
WACC	**16.8%**	**16.2%**	**15.0%**	**14.0%**	**13.4%**	**12.4%**	**14.1%**	**14.1%**

DCF Model					1	2	3	4	5
UAH mln	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
EBITDA		1652	2686	2172	3912	4964	6286	140	1457
EBIT		1481	2437	1863	3645	4675	5905	-306	993
Tax Rate		25%	25%	25%	25%	25%	25%	25%	25%
Taxed EBIT		1111	1828	1397	2734	3506	4429	-230	745
Plus D&A		172	249	309	266	289	381	446	464
Less CapEx		0	(312)	(221)	(881)	(1258)	(1184)	(724)	(850)
Less change in WC		(106)	(1696)	(152)	(2941)	(2581)	2377	329	(30)
FCFF		1176	69	1334	-821	-44	6002	-179	328
WACC		16.82%	16.18%	14.95%	13.96%	13.40%	12.41%	14.06%	14.08%

Discount factor	0.878	0.778	0.704	0.591	0.517
PV of FCFF	-720	-34	4225	-106	170
Sum of discounted CFs	3535				
PV of Terminal Value	12626				
Firm Value	16162				
Portion due to TV	78.13%				
Less Net Debt	343		WACC To Perpetuity		
Equity Value	**15819**		Terminal Value		
Implied share price, UAH	**4.10**		Perpetuity Growth Rate		
			Implied Exit EBITDA		

Appendx.6. Peer groups comparison:
Source: Financial figures from the Bloomberg data

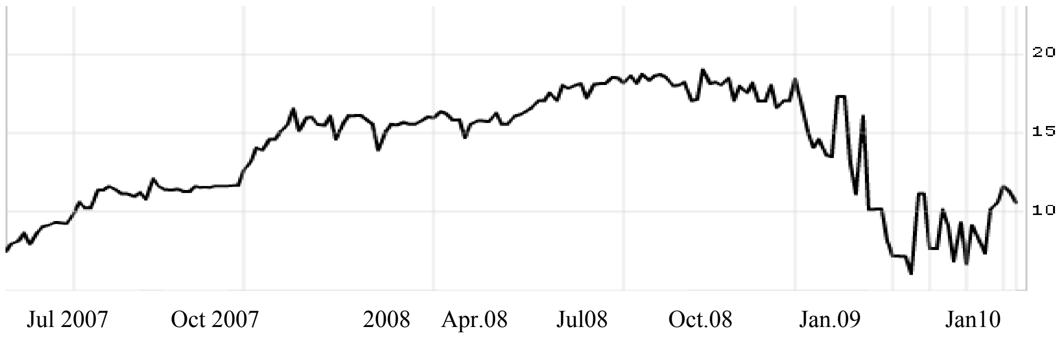
	EV/S	2003	2004	2005	2006	2007	2008	2009
(a)	**Mittal Steel Kryvyi Rih Sales, USD mln**	1,413	1,899	2,155	2,851	3,725	4,337	1,921
	Median EV/S:							
(b1)	Developed peers	0.90	0.79	0.87	1.14	1.17	0.57	1.41
(b2)	GEM peers	1.09	1.03	0.92	1.28	2.08	0.73	2.11
(b3)	Russian peers	-	-	1.06	1.36	2.19	0.47	1.63
	Implied Mittal Steel firm value, USD mln							
(f1)=(a)*(b1)	by developed peers median EV/S	1,276	1,494	1,884	3,251	4,349	2,480	2,699
(f2)=(a)*(b2)	by GEM peers median EV/S	1,540	1,959	1,991	3,656	7,762	3,166	4,058
(f3)=(a)*(b3)	by Russian peers median EV/S	-	-	2,283	3,887	8,167	2,040	3,128
(d)	**Mittal Steel Kryvyi Rih Net Debt, USD mln**	(83)	(207)	(258)	(51)	(168)	(18)	85
	Implied Mittal Steel equity value, USD mln							
(e1)=(f1)-(d)	by developed peers median EV/S	1,358	1,701	2,142	3,303	4,517	2,498	2,614
(e2)=(f2)-(d)	by GEM peers median EV/S	1,623	2,166	2,250	3,708	7,929	3,184	3,973
(e3)=(f3)-(d)	by Russian peers median EV/S	n/m	n/m	2,542	3,938	8,335	2,058	3,043

	EV/EBITDA	2003	2004	2005	2006	2007	2008	2009
(a)	**Mittal Steel Kryvyi Rih EBITDA, USD mln**	342	552	483	827	1,040	1,336	75
	Median EV/EBITDA:							
(b1)	Developed peers	6.75	3.95	4.72	6.90	7.09	3.68	17.76
(b2)	GEM peers	5.16	3.77	3.67	5.32	10.27	5.96	18.62
(b3)	Russian peers	-	-	3.10	4.36	6.99	1.70	13.29
	Implied Mittal Steel firm value, USD mln							
(f1)=(a)*(b1)	by developed peers median EV/EBITDA	2,310	2,180	2,278	5,708	7,374	4,919	1,336
(f2)=(a)*(b2)	by GEM peers median EV/EBITDA	1,764	2,078	1,769	4,401	10,679	7,964	1,401
(f3)=(a)*(b3)	by Russian peers median EV/EBITDA	-	-	1,494	3,610	7,272	2,269	1,000
(d)	**Mittal Steel Kryvyi Rih Net Debt, USD mln**	(83)	(207)	(258)	(51)	(168)	(18)	85
	Implied Mittal Steel equity value, USD mln							
(e1)=(f1)-(d)	by developed peers median EV/S	2,392	2,388	2,536	5,759	7,542	4,937	1,251
(e2)=(f2)-(d)	by GEM peers median EV/S	1,847	2,285	2,027	4,453	10,847	7,983	1,316
(e3)=(f3)-(d)	by Russian peers median EV/S	n/m	n/m	1,753	3,661	7,439	2,288	914

	P/E	2003	2004	2005	2006	2007	2008	2009
(a)	**Mittal Steel Kryvyi Rih Net Income, USD mln**	163	378	312	580	752	937	(15)
	Median P/E:							
(b1)	Developed peers	12.21	6.63	7.92	11.13	11.11	4.18	(6.39)
(b2)	GEM peers	8.37	6.75	6.01	9.12	21.40	7.90	25.69
(b3)	Russian peers	-	-	5.77	6.72	11.78	2.25	40.14
	Implied Mittal Steel firm value, USD mln							

(f1)=(e1)+(d)	by developed peers median P/E	1,911	2,299	2,214	6,410	8,186	3,903	n/m
(f2)=(e2)+(d)	by GEM peers median P/E	1,284	2,345	1,618	5,242	15,930	7,382	n/m
(f3)=(e3)+(d)	by Russian peers median P/E	n/m	n/m	1,543	3,849	8,689	2,089	n/m
(d)	**Mittal Steel Kryvyi Rih Net Debt, USD mln**	(83)	(207)	(258)	(51)	(168)	(18)	85
	Implied Mittal Steel equity value, USD mln							
(e1)=(a)*(b1)	by developed peers median P/E	1,994	2,507	2,472	6,461	8,354	3,921	n/m
(e2)=(a)*(b2)	by GEM peers median P/E	1,367	2,553	1,876	5,294	16,098	7,400	n/m
(e3)=(a)*(b3)	by Russian peers median P/E	-	-	1,801	3,900	8,857	2,107	n/m

Appendix.7 Company stock performance 2007-2010:
Source: Bloomberg, Last 27. Jan.2010 – 10.45 USD



Appendix 8. Mittal Steel Kryvyi Rih implied equity value (USD mio.): Source: Concorde Capital, own data, 2009

	2003	2004	2005	2006	2007	2008	2009
Implied by developed peers median EV/S	1,358	1,701	2,142	3,303	4,517	2,498	2,614
Implied by GEM peers median EV/S	1,623	2,166	2,250	3,708	7,929	3,184	3,973
Implied by Russian peers median EV/S			2,542	3,938	8,335	2,058	3,043
Implied by developed peers median EV/EBITDA	2,392	2,388	2,536	5,759	7,542	4,937	1,251
Implied by GEM peers median EV/EBITDA	1,847	2,285	2,027	4,453	10,847	7,983	1,316
Implied by Russian peers median EV/EBITDA			1,753	3,661	7,439	2,288	914
Implied by developed peers median P/E	1,994	2,507	2,472	6,461	8,354	3,921	n/m
Implied by GEM peers median P/E	1,367	2,553	1,876	5,294	16,098	7,400	n/m
Implied by Russian peers median P/E			1,801	3,900	8,857		
Average	**1,763**	**2,267**	**2,155**	**4,497**	**8,880**	**4,042**	**2,185**