

Kremlin Sidelines Oligarchs in Taking Norilsk Control (Update1)
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(Adds Norilsk downgrade in 15th paragraph.)

By Yuriy Humber

Dec. 18 (Bloomberg) -- Russia auctioned its biggest mining company a decade ago when it was strapped for cash. It's using the global credit crisis to regain control of OAO GMK Norilsk Nickel as economic turmoil forces U.S. and European governments to bail out their own corporations.

Without buying a single share, the government is to appoint its own man as Norilsk chairman this month, replacing the company's largest owner, Vladimir Potanin. The move comes as the economic crisis saps oligarch funds and Kremlin bailouts help Prime Minister Vladimir Putin secure control of industries where Russia can compete globally, such as energy and arms. Norilsk is the Kremlin's candidate in mining.

Potanin, 47, is handing over the keys after ending a feud with Oleg Deripaska, the billionaire owner of United Co. Rusal, that turned the world's biggest nickel producer into a battleground of ambitions. The dispute "irritated" government officials, Potanin said Nov. 26 at a briefing with Deripaska, 40, in Moscow to mark the truce.

"The Kremlin wants to see global champions in the industries most important to the country and the feud lost track of that goal," said Chris Weafer, chief strategist with Moscow-based investment bank UralSib Financial Corp.

Presiding over the only Russian metals maker among the top 200 companies in the MSCI Emerging Markets Index gives the Kremlin a close handle on the supplier of half the world's palladium and a fifth of its nickel, key to the global auto and steel industries. It has also alienated investors.

Shares Fall

"From an investor standpoint, it's basically a big mess," said Kevin Dougherty, fund manager with Pharos Financial Group in Moscow, which doesn't own Norilsk. A weak metals price outlook and the battle with Deripaska, coupled with "deteriorating corporate governance make investing in Norilsk like stepping into a casino."

Norilsk shares are down 40 percent since Nov. 5, when the government approved a \$4.5 billion loan to help refinance Rusal, Norilsk's second-largest shareholder. The Micex Index, a measure of 30 large Russian companies, has dropped 17 percent.

The state took a 25 percent stake in Norilsk as collateral for that loan. When Norilsk shareholders meet Dec. 26 to elect a new board, the remaining intrigue is how many of the 13 seats the Kremlin will win. The bailout also means two government officials will join Norilsk as managers.

Putin, in a Dec. 4 address, said Russia's role in Norilsk is about providing stability and isn't much different from assistance other countries have provided to their troubled financial institutions. Without state aid Norilsk may be unable to support its production, company officials have said.

Yeltsin Era

“There’s no direct policy to de-privatize” Norilsk, said Dmitry Peskov, a spokesman for Putin, who opposed the state’s auctions of the country’s major industries and spent the last eight years reasserting government control. “How this situation will play out, only time will tell,” Peskov said.

Russia is “willing” to buy stakes in companies where owners request aid with the aim of later selling out on fair terms, Putin said on Dec. 4. “This is not a way to nationalize the economy,” he said.

The state sold Norilsk to Potanin’s bank in 1997. Putin’s predecessor as Russian president, Boris Yeltsin, auctioned stakes in the country’s biggest enterprises to help his cash-strapped administration. As then deputy prime minister, Potanin became a Norilsk board director in 1996 and helped organize the auctions.

Reasserting state control at Norilsk revives the potential for it to become a platform for mergers in Russia’s metals industry, with the aim of creating a rival to Melbourne-based BHP Billiton Ltd., the world’s largest miner. It would also assert state influence in an industry that lags behind only oil and gas in terms of export volumes and budget contributions.

Cuba, Venezuela

A state-run Norilsk may help Russia’s government expand ties with anti-U.S. states such as Venezuela and Cuba, which has one of the biggest nickel resources. Norilsk is ready to develop a nickel mine in Cuba should Russia lend the Caribbean island \$1.5 billion for the project, Chief Executive Officer Vladimir Strzhalkovsky, a former officer in the KGB Soviet-era security agency, said Nov. 20.

Norilsk could operate the Cuban mine without taking an equity stake in the project, the CEO said. The company currently only manages mines it controls.

Stock Downgraded

“If Norilsk has aspirations of being in the same league as the likes of BHP Billiton, it should start behaving as such and show the necessary respect to capital markets,” UralSib metals analyst Michael Kavanagh said in a report today. UralSib cut the company’s 12-month price target to \$58 from \$285 per share on a lack of strategy, poor disclosure and weak metal demand. Norilsk traded in Moscow today at \$64.

Uralkali, a potash miner controlled by billionaire Dmitry Rybolovlev, might also be folded into a state mining giant based on Norilsk after Putin’s deputy, Igor Sechin, reopened a probe into a 2006 flood at the company’s mine. Potanin said Aug. 8 that the arrival of Strzhalkovsky at Norilsk was likely to spur mergers with iron ore, potash, coal and copper assets.

Deripaska had opposed Norilsk combinations with companies other than Rusal. After Rusal acquired its Norilsk stake in April, the nickel company’s merger talks with billionaire Alisher Usmanov’s iron ore producer OAO Metalloinvest stopped.

'Invisible Hand'

At the "truce" briefing with Potanin, Deripaska only shook his head when asked if he would block a Norilsk merger with Metalloinvest.

"The invisible hand of the state could have seriously contributed to such an idyllic agreement," Mikhail Stiskin, an analyst at Troika Dialog, Russia's oldest investment bank, said of the settlement between the billionaires. "The state is playing first violin" and will support Norilsk mergers, he said.

Russia's upper hand, with \$437 billion in international reserves built up during Putin's presidency from high commodity prices, is reinforced by the global market turmoil. Deripaska, the country's richest man according to Forbes magazine, ceded stakes in Canadian auto-parts maker Magna International Inc. and German builder Hochtief AG to banks in October after shares used as collateral to finance the acquisitions lost value.

When Rusal's 25 percent stake in Norilsk, pledged against a \$4.5 billion loan from foreign lenders, faced the same risk in October, Russia stepped in. Norilsk CEO Strzhalkovsky, 54, formerly the country's tourism chief with no experience in the metals industry, said that he asked the state to buy Rusal's shares. The Kremlin chose to refinance Rusal's loan for one year and took Norilsk shares as collateral.

Loan Conditions

Among the loan conditions, the state has the right to at least one Norilsk board seat. One of two government nominees is Sergei Chemezov, who like Putin and Strzhalkovsky is a former KGB officer. Chemezov is now CEO of state holding company Russian Technologies Corp., which controls OAO VSMPO-Avisma, the world's biggest producer of titanium, and has 49 percent of Erdenet, Mongolia's largest copper miner.

Chemezov said Dec. 12 that he has already asked Potanin and Deripaska to consider a combination with the copper assets of Russian Technologies, which are jointly held with Metalloinvest. Meanwhile, Usmanov of Metalloinvest has acquired about 5 percent of Norilsk as a prelude to consolidation.

"Norilsk Nickel is creeping toward becoming a state-run entity, in practice if not formally so," Stratfor, a U.S.-based risk advisory group, wrote clients last month.

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