

Convergence & Differentiation

What is
success in
a connected
world?*

Interview transcripts of Maxim Gubiev,
Chief Executive Officer, Metalloinvest,
Russia



Maxim Gubiev is Chief Executive Officer of Metalloinvest

PWC: To what extent are you confident in the growth of your business – in the short and long term – and what is the reason for this confidence?

Gubiev: Our confidence level probably three times exceeds the level for executives in developed economies, because we have had fewer bad experiences in the past, it seems to me. And we have never experienced large-scale crises. We had a small-scale crisis in 1998, which was effectively not a crisis but a clean-up thing. And we do not know what an economic slump is, what real shrinking of the economy is, what real mass unemployment is. We do not have this fear in our genes. And that is why we all are very optimistic. For the last few years we have seen uninterrupted growth and therefore we have all started to believe that this will go on forever. But I believe that economies evolve cyclically, although there is an upward general trend. Therefore, maybe too much euphoria is bad, on the one hand, and on the other, there is nothing to be afraid of because it is true that for the next, say, at least five to seven year period we clearly see that emerging markets, the BRIC countries, will require enormous investments. And that, analysts believe, will be the locomotive of growth. What else gives us the confidence? We understand that these countries are not developed infrastructure-wise, or in any other way. The market is only beginning to develop. We understand what enormous investments need to be made in these countries compared with the developed economies. Indeed, we look at the situation with optimism and believe that we need to work many years to become one of the developed countries, similar to them both internally and structurally, and to become as rationally organized as they are.

PWC: So for you, as well as for the country as a whole, this huge market potential is the main guarantee of success in the future?

Gubiev: Yes, correct.

PWC: Then my next question is about competitive advantages of your business in particular, maybe of the industry. Our surveys show that for a rather long time Russian respondents were saying that they saw exclusive access to natural resources as their main competitive advantage in the global market. This year for the first time technological innovations became the top advantage on the list. So, somehow the view of Russian executives on what would ensure competitive advantage for them in the future has changed. As someone working in a natural resources-based company, I wonder what your opinion is about this.

Gubiev: Yes, I agree that both of these opinions exist. And the level of reserves, of resources that we have and can have access to, and a well-developed infrastructure provide certain advantages. Since added value in Russian companies and emerging markets companies currently is higher than in developed economies, it is obvious that accumulation of funds happens at a faster rate, which makes it possible to invest greater amounts in the development of our own operations. Therefore, the view that you mentioned – that innovations have moved to the top of the list of advantages – also exists.

PWC: And what is this added value due to, for the most part?

Gubiev: Due to a certain set of advantages we have. They include relatively cheap energy resources; access to resources; logistics, e.g., at our own operations we effectively do not bear any costs relating to the transportation of iron ore to processing companies, such as the Oskol Electric Steel Works. These things give us a very strong competitive position. One of the advantages we have always had is the wage level, which has traditionally been lower than in developed European countries, but I can see that we are losing this advantage really rapidly. Wages have been growing very fast, but often do not correlate with any improvement in labour quality or productivity. But there is a range of other advantages such as the highly developed infrastructure that we have inherited from the Soviet Union. This allows us to save effectively hundreds of millions of dollars.

PWC: So, you are saying that in fact your cost structure is a competitive advantage you have today as compared with, say, your competitors in the States, in Western Europe...

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Gubiev: In the States and in Western Europe, yes. But not in the BRIC countries.

PWC: You have mentioned the growth in wages, i.e. we have touched upon the subject of human capital a little bit. In general, how critical are human resources as a business growth resource for your company?

Gubiev: Human capital is absolutely critical. Not just for the development of our company, but I think for the development of any economy. And we sense the lack, the shortage of human resources – both in the market and within the company. We begin, or I would say, life makes us to treat people, human resource with the proper attention, as we grow to realize that it takes a lot of time and effort to develop a skilled specialist. The economic situation makes it possible for specialists to migrate between companies, change employers very fast and make excessive demands in terms of compensation for their work. Young people that come to work for us ask for salaries compared to people with 15-20 years of experience make. If we don't pay them that much they are not interested in joining us. People of the older generation, with wonderful experience, are harder to get involved in any kind of innovative things. There are certain difficulties in this area. Why? Because there is a shortage of workforce of any quality from top executives to ordinary mill operators or turners. This is indeed a significant damper for the development of our economy. I cannot speak for other BRIC countries. But in the Russian Federation this is certainly a significant problem.

PWC: You mentioned the extraordinary growth in wages. It is probably a very dangerous trend. Why does this happen, in your opinion, and will the situation balance out in the future or will the wages grow further?

Gubiev: I think that first of all here there is macroeconomic policy – as part of the state policy. We have had for a very long time and still have a socially-oriented state, where a great number of people work in government, municipal and other similar kinds of organizations and, therefore, there is a program for improving living standards, raising salaries in order to outrun inflation, increasing the real living standards, etc., etc. It seems to me, that this policy influences the private sector also, and makes us to increase wages. As I have already said, the performance trend per employee is often not in line with the trend of incomes that we pay out. But on the other hand we cannot avoid following the general trend, since inflation exists everywhere and unfortunately at this stage it is rather high. We cannot decrease the people's living standards by not paying more, by not increasing their salaries several times a year; we do not have such a right. And once again we return to the fact that human resources are very valuable, that we do not want to lose people, we want to take care of them and in general we position ourselves as a socially responsible company.

The requirements that the company set 10 years ago, just a few years after the collapse of the Soviet Union, are not comparable with the current requirements. I mean, Russia had Soviet-style enterprises, which were just beginning to get involved in the market economy and in essence were rather crude – you could control the situation using very primitive or simple solutions. These enterprises were for instance at that point of reducing personnel numbers or preparing a financial plan that people never knew about, establishing some long-term plans, investment programs, and creating market tools, such as the proper functioning of the commercial service. All these things were new and required specialists to do them, but rather ordinary ones, I would say, not some kind of geniuses: specialists with good, solid education. Now with the market has progressed and systems and procedures are in place in such areas as cost control, sales strategy, and investment, the company cannot consider itself to be immune to competition. And certainly, any company is looking for some additional niches that can help it be stronger and more confident in its normal trouble-free development. Such things require fine-tuning, which can be done only by managers with additional education – on top of the education I mentioned previously. These should be people with some special knowledge or global expertise developed in the managerial and leadership area. Nowadays people who have just a university degree or even talented managers of the post-Soviet era cannot give the necessary additional impulse for the company's development. The people we need are a very special kind of people.

PWC: Is there any difference between requirements for managers in the emerging markets and for their counterparts in Europe or the States?

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Gubiev: All companies, irrespective of where they are based, certainly want to get the best managers. What is the best kind of manager? To my understanding it is first of all somebody who cares. It is a person open for changes. It is a person who is not afraid to learn, first of all, from their own mistakes. It should be an experienced person, but not a stuffy one, not stuck in his ways, with some dogmas that once worked. I think this is a general approach for all the companies, irrespective of whether they are in Russia or in Western Europe, or anywhere else. As for differences, I understand, from talking with executives from different countries, that most of them have long passed the stage we are at now. What is important is what we can learn from Western managers. Most Western companies are public companies and a very important area of a manager's work is work with shareholders, because such companies have thousands or even hundreds of thousands of shareholders. And it is very important to communicate to all these shareholders your thoughts and ideas even though not everyone can correctly and reasonably understand and value them. It is important to be able to convince people that you are right, honest, and transparent. The management should convince the shareholders to trust them and give them the mandate to act, to continue managing the company. In Russia this culture is not there yet. But I see that there are trends leading to it, I see that more and more companies are becoming participants of the free market. And I see that there are more and more internal corporate changes, in this area – working on companies' openness and predictability, starting to make decisions not behind closed doors but instead adopting a collegiate, open, well-thought-out process for decision-making. This change of approach allows both minority and majority shareholders to be confident that an honest open corporate policy is followed, which is, in fact, the kind of policy that is always the winning one eventually. In this area I see clear advantages. But again, we learn really fast and what required more time in the West will take less time in this country.

PwC: Does this mean that the system of corporate governance in your company is now at the stage of development and is moving ahead rapidly?

Gubiev: Yes, that is exactly true. Currently we are a private company. But we are preparing all internal and corporate procedures in order to be ready to do an IPO at any time, when the market situation is appropriate and the shareholders make such a decision. This means that we are creating a number of committees that are required in order for us to be listed at stock exchanges. We are thinking about independent directors to invite, about various control functions. We have been preparing financial statements under international standards for more than a year. Our auditors are leading auditing companies. Therefore we have taken the same route as other companies in order to be able to meet international standards for quality of management.

PwC: Do you plan to become a public company and have an IPO due to the fact that you do not have sufficient capital for further development or to another reason?

Gubiev: Launching at the market has to do with various wishes of our shareholders: first, quitting the business, selling almost 100% of their stakes and keeping some minority stakes; second, being able to raise capital in the market on attractive terms, selling a stake to make other investments, etc; third, getting a valuation in order to be able to establish our value as a company operating in a market community. As a private company, when you invite various independent organizations to perform a valuation you cannot be certain that their valuation is fair. So, getting a valuation by the market is the most objective one. These are the three reasons why companies go to public capital markets. In our case, the shareholders are young, active people who want to be actively involved in the growing Russian market; therefore the first reason does not apply to us. As for raising capital, we are a high-quality, first-rate borrower and we do not have a problem borrowing from banks. However, there are day-to-day operating issues and problems with current liquidity, and rates that banks offer us are somewhat higher than the rates we are used to. But, nevertheless, there is no problem here; we are just trying to find good banks that we find comfortable and convenient to work with, that to the least possible degree limit our freedom in selecting investment solutions. And certainly, the third point I mentioned suits our situation: valuation of ourselves, understanding how much we are worth for the market. That is because we are a company that aims to develop not only internally but also externally, through mergers and acquisitions, finding new partners, new alliances. Here, certainly, we see an IPO as one of the most important reasons to be objectively evaluated by the market.

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- PWC:** Do you have future mergers and acquisitions plans, especially in other markets, outside Europe. I know that your competitors now are actively merging with each other or buying each other.
- Gubiev:** We always have plans. The question is whether we should try to seize every easy target. We are a mining company with a metallurgical division and we are interested in investments in this area. We see great potential in mining. And when we look at some opportunities in mergers and acquisitions, for buying stakes in companies, for the most part it is in mining. We have an investment division, which monitors the market on a permanent basis, every inch of it, but, as I said, we are not interested in buying just anything. We want to buy in a proper way, without any rush, something that would allow us to increase our market capitalisation, which would help to bring our company to a more interesting, appropriate level.
- PWC:** So, given what you've just said and the fact that you are already exporting your products to many countries, can we say that your company has global ambitions?
- Gubiev:** We can say that we have global ambitions. The question though is what place we think we occupy in this market. Yes, we are the 4th top company in the world in iron ore production. And we are number one globally by iron ore reserves. But still, the difference between us, the number four, and the number one globally is enormous. We are very well aware of that and we make a point of positioning ourselves realistically in the market. We are selling the products of our other plants in over 50 countries; we sell products of mining plants to 10 countries and supply roughly one half of the Russian market. It is hard to say to what extent we have global plans. We do have ambitious plans, but we know where we stand and we do not overestimate ourselves. We also try to not underestimate ourselves; our objective is to grow in this market in a planned, systematic manner. Our positioning is based on this.
- PwC:** You have mentioned investments in technologies, and I was wondering to what extent Research & Development was advanced, and to what extent you thought your prospects were related to further breakthroughs in technological innovations and so on?
- Gubiev:** You have touched upon a very interesting and very important subject. We reflect on it very often and understand that growth of a company such as ours – a large player in the international market – is not possible without a scientific basis. Indeed, we have been doing a number of things to revitalize Russian science. The best technological solutions developed in the Soviet Union and the FSU countries. There was time to cast away stones. As you know many research institutes have been closed down. We see it as our mission to gather these stones. I would not like to disclose our near-term plans in respect of this 'stone gathering', but, nevertheless, let me assure you, we are very concerned about how to support Russian science and make it competitive, to ensure that we are among the first to develop innovative technological solutions. We do not want to buy these technologies in the West, but if we do buy them in some developed countries with highly developed machinery-building industry, the design and engineering will be done principally by our engineers. Certain steps are required and we are taking them now. Once we've completed what we want to do, we will be glad to tell you about it.
- PWC:** You mentioned that your transportation is effectively free, is it so?
- Gubiev:** Well, free in a certain sense: using a pipeline is just much cheaper than any other method of transportation. We have a slurry pipeline. The slurry, i.e. the ore mixed with water, is pushed by pumps creating pressure through a pipeline to the Oskol Electric and Steel Works, where they produce pellets, which subsequently are turned into steel. So that is the cheapest way of transportation.
- PWC:** Is that some kind of special know-how or is it implemented everywhere?
- Gubiev:** Back in the Soviet times plants were created – such as Lebedinsky ore mining and processing Plant, Stoilensky mining and processing plant and Mikhailovsky ore mining and processing plant – next to massive ore resources. And near these operations metallurgical smelters were set up to process the ore. The technological solution to link Lebedinsky GOK with the Oskol Plant was developed by Soviet engineers, who came to the conclusion that a slurry pipeline would be the cheapest way to supply the metallurgical plant with raw materials.

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PWC: With regard to your reply and the fact that Metalloinvest a vertically integrated group is the supply chain a problem for you in any way?

Gubiev: You know, in order to prepare the end product you not only need to extract the ore and supply it to the smelter, you need a whole bunch of other components to be able to make good-quality steel. They include power, ferrous alloys, refractory, a number of various ferro-nickel additives, and so on and so forth – hundreds of ingredients that allow to turn ore into the end products. There are over 3,000 organizations that supply us with various kinds of raw and other materials – from equipment to various additives to furnace burden. The situation improves every year and we keep lowering the prescribed levels of stocks at our plants and use the money instead to finance other things; we are less and less worried about late or short deliveries, and less afraid of suppliers dictating their rules to us. I do not see any signs that this situation could worsen. On the contrary, I see that every time, every year the situation becomes more and more of a market, it becomes predictable, commercially justified, and we make our decisions only based on the value and price. We select a supplier, sign contracts, where timing and quality are set out very clearly and we do not have any complaints in this area.

PWC: What is the role of the state in the development of your industry, your company and the economy. There is no secret that many emerging markets can make a big leap thanks to some state efforts to create a certain business environment. In general, the role of the state in the development of capitalism is significant. What does the state do for your company, for the industry? What could it do for further development and the realization of your global ambitions?

Gubiev: This is an interesting question. I would say that there has been a certain evolution in relations between the state and business and a positive one. If you take an objective look at what was happening with the state in the previous years you can see that the state had too many things to take care of other than helping business – it had to keep the country afloat. It is clear that now the situation is stabilizing and it is clear that now there is time and opportunity to pay attention to business. And we experience practical steps in this direction. For instance, state programs are being developed for investment and innovative development for the next 15-20 years. Infrastructural changes are taking place. We are suppliers to various operations of Gazprom, which is now undertaking infrastructural changes, laying pipes, supplying gas to the users. We participate in a number of government-financed programs. We also feel that the Chamber of Commerce is intensifying its work. We see that the first steps are made in business protectionism in a positive sense of the word. The state helps the business to develop, pushing the implementation of global fundamental projects.

Sometimes a number of our suppliers exhibit an attitude to us that is clearly not of market nature – they all of a sudden start dumping investigations blocking supplies of our products. And the state – not exactly turned a blind eye, it is their responsibility to deal with this – but dealt with it in a very passive way. The situation was brought back to the business community to be resolved and we had to resolve some issues. Now the situation has changed considerably. We see the ministries requesting the necessary information from business in order to get their people to work on the issues so they can develop the economy. Here we see that the government gives a certain impulse, which allows us to hope...

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PWC: If we talk about priorities that you would set for the state – let's say improvements in the tax system, development of infrastructure, help with the implementation of technological innovations, help with working in the foreign markets – which of these would be a priority in your view?

Gubiev: All the things you've mentioned are priorities. Certainly, improvement of the tax system is a necessary thing. Certainly, we need a protectionist policy abroad. Nobody relieves the state from the responsibility to ensure that the country and the businesses within it should flourish and prosper.

PWC: What about the importance of human resources for the company and what you do to replenish this resource?

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Gubiev: Well, where can we get without people? Who will mine the ore, smelt it, and make steel? People. One man cannot win or even fight a battle. That is why his army, his people give him the sense of whether he is a winner or a loser. Certainly human resources are the most important resources. The kind of people you deploy to work will govern whether you get the result – or you don't. That is why selecting people, setting up a team, developing it – that is one of the most important aspects of our work. And when we select people, build a team that should be in line with our ambitions, the size of our company, we face great difficulties, because we understand that there are not enough people – the labour market is overheated. The economy is developing so rapidly that it cultivates absolutely unjustified ambitions in people and these ambitions are not supported by anything like experience or knowledge, only by the market, by the market expectations. We face this all the time. But, in our turn, by performing selection, by plunging people into our work, letting them experience the pressure, we pick out those who meet the expectations, who can get the work done and can be considered part of Metalloinvest team.

PWC: Do you have any corporate universities?

Gubiev: Yes, we cooperate with various universities, institutes, vocational training colleges and schools, which prepare specialists for our operations. Moreover, now we are creating a program that will bring together both the research and technology base and the training base – in order to improve the quality of the education process, the process of building a personnel reserve and bringing new specialists to the company. We understand that some people will be leaving us, they already are leaving and we also understand that we won't be able to do without our own educational facility, without training people who can work for us in the future. And we are trying to pay a special attention to this, to invest more. We are trying to be up to standard and somewhat ahead. I understand that we are a big company and we want to be leaders not only in size, but also in the quality of our work and in the quality of a managerial talent in our team.

PWC: By how much has market capitalization grown in recent years and due to what?

Gubiev: Our company's market capitalization grew several times within the last two years. The first and the most objective reason was that the market, the prices for our products grew significantly, which gave us revenues much bigger than before. When I started to work in the industry, at Lebedinsky GOK, the ore price did not exceed \$8 per ton. Now ore costs \$80 per ton. Then, ore mining companies were in collapse; absolutely worn out fixed assets; starving, embittered personnel who went on without pay for months; warehouses stuffed with the products we could not sell and use. And all mentioned blocked the current assets; we were short of money.

Since then the situation has turned around. First of all the market situation has changed because the price now is completely different. But it helped to change the situation inside the industry. The company started receiving cash flow that was used to finance first of all its own development and upgrading. For instance, the wear and tear of our fixed assets was more than 85%. And now I can tell you that this ratio is less than 60%. For our operations it is a very important ratio. We have a strong dynamic of upgrading the fixed assets and that is costly, because our operations are very capital intensive. Every investment in fixed assets we make is hundreds of millions of dollars, if not billions. And investment projects take three, five or seven years. The payback takes decades. Ferrous metallurgy and ore mining are not fast-turning industries. You do not have the breakthrough solutions that can bring a company's market capitalisation from zero to 20 billion – as happened in IT. We see a number of examples where enormous companies with huge capitalization grew out of nothing there.

In our industry it is a completely different story. It includes fixed assets, rolling mills, hundreds of tons of iron, scores of thousands of employees, meticulous and a hard work to extract and process natural resources, to make steel and steel products. The changing market situation allowed us to sell our products at a completely different price than before and it became the driver for innovative development of operations and the renewal and modernization of fixed assets, not only in our company but in the others as well. As a result, the companies grow, demand for skilled and properly educated personnel increases.

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