

A fresh start for Unipetrol

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Unipetrol, the Czech oil refining and petrochemical company ends 2002 without a new private owner for a number of reasons ranging from a lack of time for the transaction to overwhelmingly complex transfer pricing, technical and financial issues. However with the new government's willingness to learn from previous mistakes and if it maintains its current resolve, a privatisation to a consortium led by a financially strong buyer should happen within 12 months after the appointment of an advisor.

However, lessons need to be learned. Last year's privatisations of strategic sectors generally suffered from a lack of consensus and experience necessary to complete such complex transactions within a short time. In the case of Unipetrol, the advisors had only a few months to prepare the transaction and a little over half a year to manage the auction. This would have been enough, had it been a straightforward sale, but it was not enough to prepare and execute the sale of an entire company of such great strategic importance.

As frequently happens in the region, the fundamental fact that privatisations of such strategic assets take years to prepare and execute has simply been overlooked yet again. Specific issues that made the Unipetrol sale very challenging can be divided into the following categories:

The sale structure

It was required that Unipetrol's new owner maintain the current holding structure and the daughter companies be kept within the group for a very long period of time. This disabled future restructuring and forced a formation of unlikely consortia that otherwise would not have been formed. Only after winning the transaction, could such consortia begin resolving internal issues such as the valuation of Czech Refining Company (CRC), and pricing contracts between CRC and Chemopetrol, which should have already been resolved. A single financially strong buyer would handle such issues more easily.

Pricing and technical issues within Unipetrol

The issue of transfer pricing contracts between CRC and other Unipetrol companies (such as Chemopetrol) had, unfortunately, not been resolved prior to the privatisation. The fact that these contracts were up for renegotiation during the sale process, and which resulted in interruption of supply this summer, made the valuation of CRC and companies dependent on CRC highly problematic. It has also made the negotiations between the partners of the winning consortium more difficult.

Financial issues within Unipetrol

Given the risk profile of the chemical and refining industry, and the fact that Unipetrol's debt is approximately two thirds of total capital (on an estimated market value basis), it is clear that Unipetrol is highly indebted. More importantly, a significant portion of the more than K20bn (approximately €600m) debt financing has been lent to Unipetrol's daughter companies. With standard change of control clauses in place, some of this financing can be recalled if Unipetrol's ownership changes. Therefore the purchase of Unipetrol can be carried out only by an entity with sufficient credit capacity to absorb Unipetrol's debt.

Current status

Clearly the above challenges need to be resolved by the new administration. It is encouraging however, that the new administration is acting quite early in its term of office and is prepared for a long and tedious process. Since the elections, two key developments have happened: (1) Privatisation negotiations were concluded and the tender terminated. (2) The administration renewed the discussion as to whether to privatise Unipetrol as a whole or in parts. Even though it is widely accepted that Unipetrol will not continue in its current form, to find an optimal method of sale is not as straightforward as it seems. Over page is an analysis of advantages (marked ✓) and disadvantages (marked ✗) of the two methods of sale.

In summary, the costs (including the complexity of issues, the time associated with the restructuring process, and the capital needed for guarantees and refinancing) seem to outweigh the remote benefit of collecting a break-up premium (which is generally believed to be hidden in the valuation of the Unipetrol shares). It seems highly likely that the administration will choose the more conservative approach and sell Unipetrol as a whole.

Looking forward

As we reflect on how the administration is positioning itself in dealing with the issues that mired the last privatisation, we see the following reasons for optimism.

The sale structure: Through public statements from the ministries of industry and finance, the administration has demonstrated sensitivity to the fact that Unipetrol should be restructured and that it is willing to let a high quality investor do it.

Technical issues within Unipetrol: The negotiations regarding conversion of CRC into a cost center have been announced by CRC in July of this year. Such