Before it happens

One month ago, the administration of CAP, a Chilean steel and iron producer with a US$ 3.6 billion market value, announced the beginning of negotiations with Mitsubishi Corporation to enable this last one to invest in its closely held mining subsidiary CMP. It so happens that the Japanese company already has a 19.3% stake in CAP and owns 50% of the 6 million ton iron ore mine CMH – the other half belongs to CMP -. CMP has the capacity to annually produce 11 million tons of iron, of which 8 million tons correspond to CAP's share. CMP has mineral resources to increase its production to over 25 million tons of iron per year.

The idea for Mitsubishi Corporation would be to exchange its 50% stake in CMH for a participation in CMP at a price to be yet determined and pay for a capital increase in CMP to develop its dormant iron ore mining potential.

Developing its important iron ore resources, possibly the biggest economic asset CAP has, is obvious. But at what price would it be done? A transaction such as this one, with preference for one potential investor under no visible competition from others that could give birth to exchanges of shares privately held between related parties when alternatives do exist, is not necessarily the best option. Furthermore, the whole transaction could be wrongly seen as a tactical move to strengthen a present feeble shareholding control of CAP at the price of partially selling an attractive asset at a discount to one important and friendly CAP shareholder.

Given the above, it defies common sense to even suggest a transaction such as this one in Chile, coming from a company that was - among many others - controversially privatized in the 1980's and in a country where in the 1990's there was a hugely disputed transaction over a similar-in-origin electric company that explosively combined boards' interests, shareholders' interests and inside information. In other words, there must be better ways to move forward, for the benefit of CAP and, no less, for Mitsubishi. Capital markets appreciate this too: their efficiency and competitiveness improve when transactions are preferably built under these same premises.

One alternative starts by dividing CAP into two companies, the iron division and the steel division. Both of them would then be publicly traded and their relative and absolute values could, in principle, be a better guidance to any transaction on each of them or their affiliates. A natural competition process could be started for the effective control of each one. Later, a second phase capital increase under a more focused Chilean iron company could be sold in many markets and remain open to numerous bidders, certainly including Mitsubishi. Interestingly enough, what CMP needs is money, with no names or restrictions attached, to create value over its mineral resources.

This alternative course of action could end up with economic transactions equivalent to the first one, theoretically. But it could also offer better conditions. Having more alternatives is always a better scenario. What would not be understandable is to renounce, a priori, to a feasible scenario where the shareholders of CAP could better defend their interests and so maximize their wealth. Even pension funds could be put into a difficult position.

Many times there are no choices. But when that is not the case, the use of them to get to the best decision is a must. The criticism over the proposed transaction is not over values – which are not known yet -, but over how they are determined. An efficient public market is preferable to all the private economic evaluations one could have, and more transparent. Chile has changed, the world has changed and CAP has to change along with them.

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