

# Restarting the market?

Ukraine is set to restore the aluminium industry through the re-launch of Rusal assets.

By **Vladislav Vorotnikov**

In July 2016, Zaporozhie Aluminium Plant (ZAP) should be back in business after a two-year long downtime. This follows the recently announced joint statement of regional authorities and company management. In its first months, the plant is expected to produce aluminium rod, while in the future, it will expand its product range.

Experts have suggested that this initiative is rather controversial given the current state of the aluminium market. However, it seems that the regional authorities have no choice, as they have to prove the nationalisation of the facility.

The facility was seized by the decision of the Supreme Court of Ukraine in July 2014. It stipulated that 68.01% stake of ZAP should be transferred to the government, due to the fact that the investor had not fulfilled its obligations under the sale contract; in particular to maintain a stable operation of facility. Rusal has already filed the complaint on the decision of the Ukraine authorities to the European Court of Human Rights, but no progress has been made so far in this issue.

"Rusal is a bona fide purchaser of shares of ZAP. The decision of the Supreme Court of Ukraine on the return of a controlling stake of ZAP shares to the state ownership violates the rights of investors. Previously, courts have repeatedly established the absence of ZAP debt, as well as shareholders to the state in the face of Ukreximbank. In order to protect its interests, Rusal appealed to the European Court on Human Rights," says Rusal's Press Service.

In Russia it is believed that the nationalisation of ZAP probably resulted in the worsening of relationships between two countries amid the situation around Crimea and eastern regions of Ukraine. In addition to nationalisation, current management of the facility is estimating

the size of damage from the time of Rusal's ownership of the enterprise. When all estimations would be finished, it should also fill the legal case to Rusal, demanding compensation.

In 2015, Security Service of Ukraine (SSU) stated that Rusal has conduct diversion at the facility, taking away very valuable equipment and 'destroying production potential of the facility'. SSU spokespersons say that overall damage from this diversion amounted to at least US\$ 4.5 million. Russian officials, which are not standing away from this situation say that current actions of company's management and SSU is actually putting pressure on Rusal, with the main target to force the company to abandon any legal trials in European courts.

"Now when Rusal is trying somehow to resist, trying to challenge the decision of the Ukrainian authorities in international bodies, it faces even more pressure in the Ukraine. While accused of sabotage from law enforcement agencies of Ukraine I consider as pressure" – commented Bogdan Bespalko, Member of the International Relations Council under the President of Russia, adding that in the foreseeable future Rusal would not be able to return to the facility.

"Under the current circumstances it is very difficult to do as lawsuits can last for years or even decades, so Rusal in the first place should worry about the fate of Nikolaev alumina refinery, which produces 1.5 million of alumina per year. It may be nationalised as well," he added.

## Old challenges

However, it is noteworthy that Rusal has gradually stopped operation at the facility in the period of 2009-2014 due to one single reason, as ZAP during this period remains loss making. According to official information of Rusal in that period

over net loss of the plant amounted to US\$ 181 million. Despite the fact that new management of ZAP has made new investment in the plant, most experts are concerned if they would really succeed in making the facility profitable.

In March of 2016, the new head of ZAP, Dmitry Lobikov stated that revival of the facility should be started with the production of aluminium rod, as this is the simplest out of all production processes. Rusal stopped it in July of 2014 due to low profitability, while Dmitry Lobikov believes that it may let enterprise to get money for establishing of other production cycles.

"According to our estimations to re-launch the production of aluminium rod we will need to raise UAH 54 million (US\$ 2.05 million), including UAH 41 million (US\$ 1.56 million) for the purchases of raw materials, UAH 8 million (US\$ 304,000) to re-launch production line and the rest for current operation spends," estimated Dmitry Lobikov, adding that the facility also has plans as to how it can attract this amount of money.

"We believe we would be able to raise the necessary amount of money [until July] with the selling to illiquid aluminium production that is currently in our warehouses. Also, a significant amount of money of at least UAH 38 million (US\$ 1.44 million) may be obtained through the return on the state debt to facility on the payment of VAT. Also, ZAP may re-launch its thermal power plant selling the excessive amounts of energy to the population and getting some additional money from this," he added.

ZAP really still has some stocks at the warehouses, most of which has been seized by law enforcement agencies at the time of the nationalisation procedure. In the past year, according to Ukraine's first deputy head of State Fiscal Service Sergey Belan, law enforcement agencies

managed to return to the ownership of ZAP about 1,000 of primary aluminium to the overall value of UAH 37 million (US\$ 1.4 million).

In addition, in the territory of the plant there about 4,000 tonnes of metal of the former electrolyze workshop. According to the management of the facility it is unlikely that the workshop will be really restored in the foreseeable future, but if this metal would be supplied to scrap remelting, ZAP would be able to raise several million hryvnias on this.

At the same time, a representative of the facility refused to comment on two of the most problem issues: Energy tariffs and raw materials. Previously, Rusal has been importing production from Russia. Ukraine has no sufficient raw base, excluding maybe the Nikolaev alumina refinery. Purchasing of alumina from abroad does not seem very attractive due to devaluation of hryvnia to hard currency, while it is hard to imagine that it would be purchased from Rusal's assets.

In addition, energy tariffs for electricity, fuel and gas was one of the main factors that killed any profitability at the time of Rusal management, and since that time its jumped by an additional 2-3 times, within the obligations taking by country's government within IMF loan programme.

At the same time, representatives of ZAP try to remain optimistic about the fate of the plant. One of the former directors Dmitry Ilinka in particular says that alongside the manufacturing of aluminium rod, ZAP may also consider the production of pure silicon.

"It [pure silicon] is used for the production of semiconductors for solar cells and components of solar panels. The plant has six smelters for this production, but initially it studied the possibility to re-launch at least 1-2," says Dmitry Ilinka.

However, experts suggest everything is not clear with this plan, once again because the facility would suffer problems from the lack of raw materials. In 2011, Rusal brought away from ZAP its subsidiary Glukhov Quartzite Quarry (GQQ) in Sumy Oblast of the country. Sales of raw quartzite have been reoriented to the Russian consumers including Sual and the Novolipetsk Steel Plant, while the production cycle for pure silicon at ZAP has been suspended.

Currently, GQQ is developing one of the largest quartzite deposits in the world, but according to the papers it belongs and is managed by one of the offshore companies. From the legal point of view, the country's authorities have no any ability to conduct nationalization of this asset or force its management to sell its production to ZAP. At the same time, purchases of raw materials from

any other place would make any pure silicon production loss making, so without raw materials any development of this direction doesn't make any sense.

#### **Unfavourable asset**

However, despite attempts from Rusal to get ZAP back, it seems that nationalisation of the plant was profitable to the company, as according to a company report from March, 9 of 2016, this case resulted in profit for Russian aluminium giant of at least US\$ 9 million.

This happened due to one simple fact, as the Ukraine government alongside with the nationalization of ZAP also acquired its debts and as of the middle of 2014 their actual size exceeded the actual cost of the facility. This situation has also worsened for Ukraine authorities with the collapse of hryvnia in the second half of 2014, as a large part of debt is nominated in hard currency.

Currently, the regional court of Zaporozie Oblast has a lawsuit of offshore company Judson Trading, which is trying to get back the loan of US\$ 39.1 million from ZAP. In general, according to information from the plant its overall debts are estimated at UAH 3.64 billion (US\$ 138 million).

In 2015, net loss of the facility exceeded UAH 2 billion (US\$ 76 million) and every month debts are currently growing by another UAH 7 million (US\$ 266,000). Most experts say that the only possible way for the facility is bankruptcy, while management under the guise of some activity is just trying to sell the rest of the equipment and metal for scrap remelting.

At one of the meetings of the management of the plant with the regional authorities acting head of Zaporozie Oblast Constantine Blye it was stated that some members of the supervisory board are stealing metal and equipment from the plant. He called law enforcement agencies to deal with this situation. However, there are no further developments so far.

A representative of the plant who wished to stay unnamed says that over the last two years, a large part of equipment has been stolen from the facility, so as a result, there are only several workshops where re-launching of the production cycle still remains possible. However, he really doubts that the re-launching really would take place.

"We may launch the production in July, but only to justify nationalisation. After that, we would not be able to put it back into operation as well as Rusal, and this could be a strong argument in favour of Rusal's position in the European court. However, we would not be able to compete with Russian plants in the past, and can no do this now. So, if you want

my forecast, the facility will be launched in July; will operate for couple of months, than will be closed again. Within a couple of years it will go bankrupt and cease to exist," he said.

"In recent years ZAP has almost constantly appeared in the criminal chronicles of the region, with the report of stealing of equipment for remelting, illegal raider attacks on the facility and other similar things. There were reports that from the former plants equipment it has illegally produced up to 500 tonnes of copper," commented local analyst Leonid Romanovichev.

"Also today the problem of millions of hryvnias of debts, required for resumption of work also added with excessive high energy tariffs. Representatives of ZAP argue that with the current cost of electricity and fuel, the production cost per one tonne of aluminium rod is higher than its actual price at the market," he added.

At the same time, Constantine Blye has admitted that in fact ZAP will not be able to solve its problem fully itself and promised some state support to facility in this issue. According to him, currently at ZAP there are only 100 employees, while re-launching of the production here could bring this figure to several thousands, while the economic effect to the regional budget from tax incomes and other fees in this case would be significant. According to him, as a result, the government in the region is currently considering the revival of ZAP as one of the top priorities for the coming years. ■