

Project Golf – comment on [REDACTED] advice note

22 November 2016

We have considered [REDACTED] advice note dated 16 November 2016 and note that, as set out in our summary paper of 15 November 2016 (Paper) we had highlighted the look through to the underlying transaction as a possible [REDACTED]

[REDACTED] We have also considered the points raised in his subsequent email dated 20 November 2016 (18.10) to DG Economy and his comments at our meeting on 21 November 2016.

We understand that [REDACTED]

With this in mind, there are a number of key commercial terms to the transaction in respect of ScotGov acting as a guarantor of project debt and for ease of reference these are summarised below:

- 1) [REDACTED] is commensurate with the nature of the assets and is in line with market expectations. The requirement of investor equity capital on a first loss basis, and injected into the two project SPVs in year 1 and applied before the use of the guaranteed debt is a key commercial requirement.
- 2) The business of the smelter is forecast to be profitable over the period and there is a commitment from the parent to fund any future losses. However, a funder, acting commercially would expect to provide a guarantee on a fully developed business plan subject to a due diligence process. Such a business plan is absent at this time, therefore, such a plan must be prepared and subjected to diligence prior to the release of the related [REDACTED] for the proposed investment in the manufacturing plant.
- 3) The quantum of debt guaranteed has been determined with reference to a commercial negotiation between SIMEC/Liberty and ScotGov and each parties' legal and financial advisors. It is based on a defined income stream set out in the PPA for 25 years and the exposure can be calculated as the present value of the future cash-flows.
- 4) The guarantee fee has been calculated on a commercial basis and the exposure of the guarantor can be measured.

5) [REDACTED]

■ [REDACTED]

■ [REDACTED]

▶ [REDACTED]

■ [REDACTED]

6) [REDACTED]

[REDACTED]

8) In calculating the fee we have considered the present value of future cash-flows and [REDACTED]

9) Finally, we have proposed that the annual fee payable to ScotGov [REDACTED]

[REDACTED] will comment separately on the legal terms, however, in considering the security package, conditions and undertakings, the key elements which we understand are either agreed or are under negotiation which we would expect to be included in a commercial transaction include:

- ▶ Fixed and floating security over the hydro and smelter – the key asset being the hydro
- ▶ Parent company guarantees
- ▶ Undertaking from the parent to fund future losses of the smelter
- ▶ Clear events of default and a narrow cure period in line with other commercial transactions
- ▶ Comfort – whether via control or escrow- that the funds raised are used for the purpose intended
- ▶ Requirement for a robust detailed business plan to be provided
- ▶ Regular monitoring of trade performance
- ▶ Equity investment
- ▶ An appropriate legal structure for the transaction

We note that [REDACTED] appear to have achieved a comprehensive security package as part of the negotiations and therefore in the event that payments in respect of the capital costs are not found to have been used for the purpose intended there is a mechanism to enforce rights against the secured assets [REDACTED]

[REDACTED] It is our view that SIMEC/Liberty could shorten the time in which a robust business plan is produced, say by 31 January 2017 [REDACTED]

In summary, subject to the final legal and security documentation reflecting the points above and providing the protections expected in a commercial transaction, it is our view that the transaction elements are proposed on a commercial basis for the guarantee.

Transmittal points below should be read in conjunction with this note.

Basis on which comment is made:

In accordance with our proposal dated 4 October 2016, Letter of Appointment of the same date and email between [REDACTED] and [REDACTED] dated 25 October 2016, we have undertaken due diligence on the proposal by SIMEC and Liberty on behalf of Scottish Government, which forms part of the transaction whereby the Group is bidding to purchase the Rio Tinto owned Hydroelectric Power Plant ("the power plant") and Aluminium Smelter ("the smelter") at Lochaber ("the transaction") as part of a Consortium bid for the entire Scottish assets owned by Rio Tinto.

This Paper was prepared on your specific instructions solely to assist you in connection with due diligence on the proposed guarantee linked to the acquisition of the assets owned by Rio Tinto at Lochaber and should not be relied upon for any other purpose. Because others may use it for different purposes, this paper should not be quoted, referred to or shown to any other party (other than your professional advisers acting in that capacity in connection with assessing the transaction provided that they accept that we assume no responsibility or liability whatsoever to them in respect of the contents) unless so required by court order or a regulatory authority, without our prior consent in writing. Ernst & Young LLP assumes no responsibility whatsoever in respect of or arising out of or in connection with the contents of this report to parties other than the Scottish Government. If other parties choose to rely in any other way on the contents of this Paper they do so entirely at their own risk.

In addition to the scope set out in our draft report dated 19 October 2016, and in accordance with the email between [REDACTED] and [REDACTED] dated 25 October 2016, and our draft report dated 6 November 2016, and our summary paper of 15 November 2016, we have been requested to provide comment on the advice note from [REDACTED] dated 16 November 2016 and 18 November 2016 for your use in discussion with ScotGov and the Finance Committee.

We have not been asked to make a recommendation regarding the proposed support by Scottish Government, by provision of a guarantee, but have been asked for our comments for consideration in the decision making process.

The above comments on [REDACTED] note should be read, as appropriate, in conjunction with our prior Paper and draft reports.

