# Project Golf II

## Final report

15 December 2016

EY

Building a better
working world

# Contents

Section 1

# Key findings

# Key findings

- Subject to agreed financing documentation including a final form PPA, PPA guarantee, final security documentation, parent company guarantees and conditions and undertakings committed to by SIMEC/Liberty being fulfilled, we can conclude, based upon work performed to date that there is:
  - An agreed financial model (v101 21 November 2016) and PPA terms;
  - A guarantee fee which works on a market basis;
  - The basis of a robust security and undertakings package;
  - Forecasts which indicate a viable future for the smelter (subject to the points below);
  - MEIP and State Aid compliance; and
  - A benefit cost ratio of the economic benefit of the proposed transaction and a demonstration of Value for Money.
- Further details of our key findings from our review are set out on the subsequent pages. At Appendix B, we have set out points for consideration which would provide additional comfort to ScotGov, together with our understanding of their inclusion in legal documentation.

# Key findings

| Consideration | Conclusions |
| --- | --- |
| Smelter viability | The forecasts received show the **smelter business to be viable over the 25 year period**. However, in the first two years, prior to the manufacturing plant becoming operational, the smelter will be loss making funded by equity.<br><br>The forecasts in respect of the early years of operation of the wheel manufacturing plant are ambitious; they currently assume that the plant will be fully operational in year three rather than reflecting incremental growth. In addition, there is a risk that the manufacturing plant will not be built in time (and on budget); it has not been fully scoped and the market and costs assumptions have not been fully developed.<br><br>However, the parent has committed to fund losses throughout the project in the event that losses are incurred. A formal undertaking is required and is being documented by lawyers.<br><br>In addition, a requirement for a detailed business plan to be completed and presented by 30 June 2017 has been included within the legal documentation. For the purposes of this paper, we have assumed that the project is viable, however, ScotGov will need to give consideration to what happens in the event that the detailed plan is not viable based on reasonable assumptions. We note that this would be an event of default under the GRA. |
| PPA Structure | The PPA is a fixed price 25 year PPA between SIMEC and Liberty for [redacted] total power available from SIMEC. [redacted] The pricing follows [redacted] which is considered to be a reasonable market forecast but it does not have a discount applied. The anticipated connection to the national grid and a requirement to sell unused energy to the market could reduce guarantee exposure in the future. |
| Guarantee | The Guarantee is granted in favour of SIMEC in respect of the obligations of Liberty to make payments in respect of energy used under the terms of the PPA. The Guarantee can be called upon on a quarterly basis in respect of amounts due and unpaid. The annual exposure will be £14m-£32m.<br><br>The highest risk period will be in the early years prior to the grid connection when export power will be expanded from [redacted] However, following the grid connection, the opportunity to mitigate the exposure will be increased. Counter indemnities from parent companies in both SIMEC and Liberty groups plus a comprehensive security package reduce the gross exposure, with the [redacted] This assumes that first ranking security over the hydro is maintained throughout. |

# Key findings

| Consideration | Conclusions |
|---|---|
| Market Economy Investor Principle (MEIP) and State Aid | We have considered whether the project demonstrates an adequate return on investment and whether in similar circumstances, a private shareholder, having regard to the foreseeability of obtaining a return would have invested in this project.<br><br>Liberty/SIMEC are committed to providing equity [redacted] into this project and the estimated IRR for both the hydro and smelter is commensurate with the nature of the assets and is in line with market expectations. Our analysis is detailed on pages 38-40.<br><br>In terms of State Aid we have considered four tests:<br>1) Whether the borrower is a firm in difficulty<br>2) The extent that the guarantee can be properly measured<br>3) The guarantee does not cover more than 80% of the outstanding loan or financial obligation<br>4) Whether the price paid for the guarantee is market oriented<br><br>We have had to make a number of assumptions in considering each of these areas. Based on our analysis, the overall transaction is based on commercial principles and a market-oriented fee will be charged by ScotGov for the guarantee. |
| Value for Money | We have considered three elements in respect of value for money: quantum (both in terms of level of debt support and associated pricing), economic output and the benefit cost ratio (BCR).<br><br>The quantum of debt supported, to a maximum [redacted] can be linked clearly with specific tangible elements of the transaction which would allow development of the site to be undertaken. Based on our understanding of the market, the pricing of this debt should be a [redacted] However, due to the timing constraints associated with the transaction it may not be possible to source debt at this pricing in the time frame required. As such, in order to comply with this timetable, ScotGov could accept the proposed solution at [redacted] In the model (v101) at 21 November 2016, the [redacted] and [redacted] have been used as the basis of forecasting the PPA revenues. Using this forecast, a debt amount of [redacted] can be raised.<br><br>The development proposed at the site may result in additional GVA of [redacted] (direct, indirect and induced) as a result of keeping the smelter open and the addition of the wheels manufacturing plant.<br><br>Based on current information, we have assessed that the BCR will be greater than 1, that is, the forecast benefits are greater than the costs which could arise in the event of a default. |

Section 2

# Overview

# Overview of the transaction

### Background to the transaction

RTA has run a competition to sell it's Scottish based assets, namely Kinlochleven hydro, Lochaber hydro, the smelter and a significant land holding. ScotGov has offered its support, to any bidder, in order to protect operations in the Fort William area (particularly in relation to the smelter).

The SIMEC/Liberty consortium has bid [redacted] the Lochaber hydro, smelter and land. The hydro and smelter assets are intrinsically linked as the hydro currently has minimal capacity to sell to the grid, so all revenues come from [redacted] energy acquired by the smelter.

In making its bid, they have requested a guarantee from ScotGov on the PPA. This guarantees the payment by the smelter (to be owned by Liberty) to the hydro (to be owned by SIMEC) for power to a set level on a pre-determined price. This guaranteed revenue stream will allow SIMEC to raise debt to acquire the sites, undertake capital investment in the hydro asset and fund the investment in a wheels manufacturing plant. ScotGov is prepared to consider a cost of finance at [redacted] therefore funding o[redacted] be raised on the PPA revenues.

[redacted]

### Proposition to ScotGov

Below are the key elements of the guarantee in terms of the PPA, terms for debt raised from the guaranteed revenue stream and resulting ScotGov position:

| | | |
|---|---|---|
| PPA Terms | Pricing | [redacted] |
| PPA Terms | Term | 25 years |
| PPA Terms | Load Factor | [redacted] |
| Resulting Debt | Loan to Value | [redacted] |
| Resulting Debt | Debt supported | [redacted] |
| ScotGov | Annual Exposure | £14m - £32m annually |
| ScotGov | Guarantee Fee | [redacted] annually to ScotGov until 2021 then step down |
| ScotGov | Security Package | Substantive security package provided |

[redacted]

Section 3

# Smelter viability

# The smelter business is shown to be viable over the 25 year period generating [redacted]

**Overview of forecast**

- The graph below summarises Liberty's financial forecast in relation to the smelter business from 2017 to 2041. Broadly, the forecast has been produced on the basis of the following:
  - [redacted] curve forecast and may be slightly greater or less in some years.
- It also shows the forecast for the hydro plant and the combined forecast for the hydro and the smelter on the basis of this pricing.
- The model assumes that the building and integration of an aluminium downstream wheels facility will be complete and operational in 2019.

**Forecast 2017 - 2018**

- Prior to the operation of the wheels facility, Liberty has forecast that the smelter will generate a loss of [redacted] however we understand that Liberty has committed to fund these losses through equity injections to the extent they negatively impact on the combined cash position.

[redacted]

# The smelter business is shown to be viable over the 25 year period generating [redacted]

- For this period Liberty has assumed that the total volume of aluminium slabs and remelt sold will be in line with RTA's forecast. Pricing assumptions used are also in line with Rio Tinto's assumptions and equate to the sum of the London Metal Exchange price of aluminium plus a market and product premium.
- Costs assumed are based on RTA's forecast and have been rationalised by [redacted], a consultant engaged by Liberty to assess the potential of the smelter.

**Forecast 2019 - 2041**

- Liberty has forecast that upon the completion of the aluminium wheels facility in 2019, the combined smelter business will become consistently profitable with [redacted] although we note a decrease in profitability in 2021 and 2022 which is due to an expected decrease in the London Metal Exchange commodity forecast price.
- It is assumed that the downstream facility will produce and sell [redacted] from 2019. Based on advice and the standard size of aluminium wheels, Liberty has assumed that this will utilise [redacted] the aluminium produced by the smelter, [redacted]. We have not had access to Grant Thornton to verify this.
- The sales price in 2019 is assumed to be the same for a comparator " World Class Aluminium" factory. Costs have been derived in line with those incurred by this comparator benchmark with positive adjustments made due to the downstream facility being integrated to the smelter. The basis of the adjustments made have been based on Grant Thornton's view; we have not been provided with supporting analysis to rationalise these adjustments.

**Cashflow**

[redacted]

# A 20% reduction in the volume of wheel sales could reduce EBITDA by [redacted]

[redacted]

### Sensitivities

We have set out across sensitivities to the financial forecast provided by Liberty. Sensitivities 1- 3 illustrate the adjusted estimated EBITDA in the scenarios outlined below:

- Sensitivity 1: A reduction in the volume of wheel sales by [redacted] to [redacted] wheels per annum;
- Sensitivity 2: Gradual growth in wheel sales starting from [redacted] being sold in 2019 and growing by [redacted] per year until sales [redacted] annum; and
- Sensitivity 3: An increase in the cost of Alumina from $319 per tonne to $340 per tonne from 2020 onwards.

### Sensitivity 1

- Liberty's model assumes [redacted] wheel sales will be achieved per annum. This represents [redacted] the UK market demand for aluminium wheels (assumed to be [redacted] wheels per annum) [redacted]. The automobile industry outlook is positive, however, it requires them to displace a number of other suppliers in the market and there is uncertainty due to Brexit (please see page 12).
- A reduction in wheels sales by [redacted] wheel sales per annum reduces EBITDA by [redacted]
- **Sensitivity 2**
- Liberty's model assumes that [redacted] sales will be achieved from 2019, the year the wheels facility is expected to become operational. Sales are forecast to remain constant throughout the forecast period.
- [redacted]. Quality, consistency and timeliness in delivery is critical to the automotive industry. As such, it may be difficult to win customers without producing at volume first to convince OEMs to switch suppliers, although the strength of Liberty's relationships with OEMs may assist with this.
- To measure the impact of gradual growth on EBITDA over the period we have assumed that sales of [redacted] wheels are achieved in 2019 and this grows by [redacted] each year. This reduces EBITDA by [redacted]

### Sensitivity

- [redacted]herefore fluctuations in the price have the potential to significantly impact EBTIDA.
- The cost assumption made for alumina is broadly in line with broker price forecasts; however, they do not reflect the high end of the forecast range. Based on data collated by Consensus Economics Inc. the highest long term price forecast for Alumina at 17 October 2016 is $340 per tonne (the lowest long term price forecast is $261 per tonne).
- An increase in the price of Alumina from 2020 onwards to $340 per tonne reduces EBITDA by [redacted]

# The automotive market outlook is positive, however, there are challenges which suggest that the forecasts are ambitious

- We have outlined below the key considerations in respect of the viability of the smelter business based on our review of the feasibility study produced by Grant Thornton, Liberty's financial model as provided on 21 November 2016 and discussions with Liberty/SIMEC

| Key consideration | EY comment |
|---|---|
| Building and integration of the aluminium downstream wheel facility to be complete by 2019 | ▸ [redacted], a consultant to Liberty and [redacted], has considered the feasibility of the build and integration of a wheel facility.<br>▸ As Liberty/SIMEC have only recently been awarded preferred bidder status in the sale process, a detailed plan has not yet been prepared in support of the build and integration of the downstream wheels facility.<br>▸ This is a significant construction project with a number of execution risks (e.g. melt integration), these have yet to be fully assessed by the bidder.<br>▸ The project could be delayed which would result in losses prior to the opening of the wheels facility. |
| Car production in the UK is expected to grow by 9.6% between 2016 (1.68m) and 2020 (2.3m) | ▸ Car production in the UK is expected to grow; however, the level of growth assumed by Grant Thornton appears to be optimistic compared to the LMC Automotive quarter 3 2016 forecast (a leading automotive production forecast), which forecasts annual car production to be 1.75m in 2020.<br>▸ The LMC quarterly forecast has decreased over the past year from forecast production for 2020 of 1.84m in the quarter 1 LMC forecast. Our sector expert has advised that this is likely to be driven by Brexit uncertainties which have caused car manufacturers to reconsider their production estimates.<br>▸ The Grant Thornton report does not take the impact of Brexit into consideration. It is anticipated that Brexit uncertainty in the short to medium term could impact consumer spending, which tends to then impact on the purchase of new cars.<br>▸ The outlook for the industry in the medium term is positive; however, there is uncertainty due to the possibility that the UK may exit the EU single market due to Brexit, this could cause car manufacturers to leave the UK. The length of the period of uncertainty could also be detrimental to the industry. However, the recent commitment by Nissan to build its next generation of Qashqai and X-Trail is positive for the industry in the UK (Nissan currently accounts for c26% of UK car production).<br>▸ The wheels facility will not be operational until 2019, as such, the sector analysis prepared by Grant Thornton to 2020 is less relevant. |
| The downstream facility will produce and sell [redacted] wheels from it's first year of operation (2019) | ▸ This assumes that the aluminium wheels business will win [redacted] of the UK market for aluminium wheels within it's first year of production. The aluminium wheels market is assumed to be [redacted] based on 2015 car production levels. |

# Further work is required to prepare a build and integration plan and a robust business plan

- We have outlined below the key considerations in respect of the viability of the smelter business based on our review of the feasibility study produced by Grant Thornton, Liberty's financial model as provided on 21 November 2016 and discussions with Liberty/SIMEC

| Key consideration | EY comment |
|---|---|
| Cont… | ► [redacted]<br>[redacted]<br>[redacted] this equates to a possible market of c4m wheels. As a dual supplier it would be challenging for Liberty to secure [redacted]; however, they would offer the advantage of being based in the UK which protects OEMs from adverse currency fluctuations.<br>► To achieve this level of market share, Liberty would need to displace a number of other suppliers. This may require them to be more competitive in terms of price.<br>► The Middle East has the facilities to produce aluminium on a far bigger scale using low cost energy, this could be a significant competitive threat in terms of price.<br>► Quality, consistency and timeliness in delivery are critical to the automotive industry. As such, it may be challenging to win customers without producing volume first (and at a lower sales price) to convince OEMs to switch suppliers. [redacted] |
| Capital expenditure of [redacted] is required to build and integrate the downstream facility | ► This is Grant Thornton's estimate of which [redacted] is supportive, however, it is based on a broad plan rather than a detailed analysis of capital expenditure required. We are unable to verify this number due to the limited detail. We understand from Liberty/SIMEC that a contingency of an additiona [redacted] ([redacted] may be required for this project. |

# The smelter business is susceptible to structural risks due to the nature of the assets

- We have outlined below the key considerations in respect of the viability of the smelter business based on our review of the feasibility study produced by Grant Thornton, Liberty's financial model as provided on 21 November 2016 and discussions with Liberty/SIMEC

| Key consideration | EY comment |
|---|---|
| A comparator benchmark has been used to estimate sales price and costs for the wheel factory | ▶ [redacted].<br>▶ As there are no other wheel manufacturers in the UK, the comparator benchmark factory will be based outwith the UK. Depending on location, the factory may not operate in a comparable commercial environment. These factors could impact sales price and costs.<br>▶ Grant Thornton has made positive adjustments to a number of costs on the basis of synergies from the integration of the smelter and downstream facility. We have not been provided with support for the adjustments made. |
| Environmental status of the smelter | ▶ Liberty has instructed environmental due diligence after being awarded preferred bidder status.<br>▶ An environmental assessment of the downstream business is not within the scope of this engagement and should be considered separately. |
| Condition of the smelter and capital expenditure | ▶ The smelter and hydro are over 100 years old and as such ongoing work is required to ensure the plant remains operational.<br>▶ Liberty expect capital expenditure of [redacted] annum to maintain the smelter.<br>▶ We have had insufficient time to explore the condition of the smelter and the capital expenditure required in depth. Based on limited information (a conversation with [redacted] and site visit notes), the remedial work required relates to the buildings rather than the processing equipment. |
| Foreign exchange risk | ▶ The exchange rates used in the model are considered optimistic post Brexit. As Brexit uncertainty continues it is possible that sterling could weaken further. The model assumes $/£0.76, the rate at the date of this report is $/£0.80.<br>▶ Alumina, is purchased in dollars, and creates exposure to foreign exchange risk. |
| Pension | ▶ We have not been provided with details of the pension but understand there is a defined benefit pension scheme [redacted]. Due to market changes at the next triennial valuation in 2017, Grant Thornton estimate that the movement could result in the requirement for Liberty (or SIMEC) to fund an [redacted] |

# The smelter business is susceptible to structural risks due to the nature of the assets

- We have outlined below the key considerations in respect of the viability of the smelter business based on our review of the feasibility study produced by Grant Thornton, Liberty's financial model as provided on 21 November 2016 and discussions with Liberty/SIMEC

| Key consideration | EY comment |
| --- | --- |
| Reliability of the power supply | ► The smelter and consequently the downstream business are reliant on a continuous power supply from Lochaber Power Station (with around [redacted]<br>► The technical report compiled by [redacted] on the Lochaber Power Station highlights a [redacted]<br>► We have not been made aware of any instances when the water supply has been dry and historic records support that rainfall in this area has been relatively consistent.<br>► [redacted] |

# The smelter business is shown to be viable over the 25 year period generating EBITDA of [redacted]

**EY Comment**

Based on the financial model provided on 21 November 2016 (v101) and the market assumptions made, the smelter business is forecast to be viable over the 25 year period due to the profitability of the new downstream wheel manufacturing facility. However, we note a number of risks to the achievability of the forecast as set out on pages 12 to 15, in addition to the points set out below:

- [redacted]
- We have not had access to Grant Thornton in relation to the feasibility study and as such are unable to verify a number of the assumptions used.
- It has been assumed that the wheels facility will be built and operational by 2019. This is a complex construction project and detailed plans have yet to be prepared and planning permissions obtained, this may therefore be a challenging deadline. Any delays could result in losses in the period prior to the opening of the wheels manufacturing plant.
- From 2019, it is assumed that the wheels factory will produce and sell [redacted] wheels. This assumption would require the displacement of almost [redacted] the market share [redacted] aluminium wheels produced in the UK each year) within the facility's first year.
- The feasibility study does not consider the impact of Brexit. This could impact Liberty's plan in terms of the UK car manufacturing market and consequently the UK aluminium wheel market but also the cost of raw materials with foreign exchange risk.
- Given the risks associated with viability, it is positive that the parent company has committed to fund losses throughout the period in the event that losses, not currently forecast, are incurred; a formal undertaking is required and is being documented by lawyers.
- [redacted]

Section 4

# ScotGov Intervention

# What is the appropriate level of ScotGov support?

**Introduction**

- In assessing the level of appropriate ScotGov support to the transaction, we have focused on the following elements:
  - What is being supported through the guarantee; and
  - The various aspects which result in the total gross quantum.

**Quantum of Support**

- In order to assess the value for money of the transaction, we first need to consider if the total quantum of exposure is justified and represents value. The ultimate purpose of the guarantee is to facilitate the raising of debt, on economical terms, to acquire the hydro, smelter and estate from RTA and provide capital to maintain the hydro and transform the smelter business in Lochaber. Therefore ScotGov's exposure should be limited to the amount required to support this vision.
- In order to assess the quantum of support, we have focused on two elements:
  1. The amount of debt being supported; and
  2. The terms of the debt.
- We have focused on these two elements as key to the overall quantum being supported. Firstly, the initial amount of debt being supported should have a direct link to the purpose of ScotGov support. Secondly, the debt will be raised on an invoice discounting method. This method means that a set of receivable cashflows are discounted on agreed terms to raise capital. In this scenario, ScotGov is guaranteeing the income stream from the smelter to the hydro which will result in improved terms for the debt raise. These terms associated with the debt raise are pivotal in calculating the gross exposure which ScotGov will need to support to ensure it is supporting a level of debt which allows the development of the smelter business and wider site.
- We will consider both elements separately.

# ScotGov will consider supporting [redacted] of debt to allow the development of the site

- The amount of debt being supported by ScotGov should be limited to the amount required to support the vision. The table below reviews the quantum of the debt which ScotGov could consider supporting.

| Element | Amount (£m) | Comment |
| --- | --- | --- |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| **Total** | [redacted] | |

Source: 2016-11-21 Project boots financial model v101

- This table demonstrates that the [redacted] required to allow the development of the site to take place. This quantum can be tied back to specific tangible elements of the transaction[1].
- However, some elements are not required for the initial acquisition, as such, we suggest that, if ScotGov chooses to support the transaction, [redacted]

*Note 1: whilst [redacted] was determined as the supportable level of debt for the purposes of the PPA model, the [redacted] of finance used in the model to derive the [redacted] supported debt is less than the terms offered by the funder. The funding terms offered a [redacted] mean that [redacted] could be raised. Further detail on the following pages.*

# The loan to value ratio of [redacted] is in line with our market expectation, however the pricing at [redacted] is not

**Terms of the debt**

- The request of ScotGov is to provide a guarantee on a PPA between Liberty and SIMEC. This guaranteed revenue stream will allow the parties to raise an amount of finance necessary to acquire the sites, undertake capital investment in the hydro asset and fund the investment in the wheels manufacturing plant.
- As the guaranteed revenue steam is the backbone to the debt raise, the pricing has a direct impact in the amount of revenues ScotGov are required to guarantee and therefore its exposure. The financing will be undertaken by Greensill [redacted]
- The facility offered to SIMEC has a loan to value of [redacted] We have considered these elements separately in terms of the value for money.

**Loan to Value**

- This ratio is related to the risk associated with the transaction in the event that Liberty does not make its [redacted] payment under the terms of the PPA [redacted] and the potential delay of calling up a guarantee. The loan for value ratio of [redacted] appears to be in line with our expectations of the market.

[redacted]

[redacted]

### Expected Pricing

- Below, we have provided indicative pricings which could be achieved for the debt package taking into account the indicative credit profile of the power plant (A level), an A+ as a potential final position and the maximum rating achievable via full ScotGov support (AA equivalent to the UK rating). The ultimate position between these pricing points will be dependent on the level of hydro operational risk being borne by ScotGov.

| | AA rating | A+ rating | A rating |
|---|---|---|---|
| 20-year UK Gilt* | | [redacted] | |
| Credit Risk Spread** | [redacted] | [redacted] | [redacted] |
| Illiquidity Premium*** | | [redacted] | |
| **Total** | [redacted] | [redacted] | [redacted] |

**Source Bloomberg. We have priced off a 20-year as our calculated weighted loan life is 18.8 years*
*** Bloomberg, other relevant market data*
**** EY assessment*

### Timings

- A rated issue on this debt raise would take two months to complete. Based on the discussions with SIMEC, it has been indicated that the deal with Rio Tinto needs to be completed by mid-December.
- There may be flexibility in this date, however, should there be no flexibility, the terms offered by Greensill would raise the required funds in the timescale at the premium built into the price.
- [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]

Section 5

# Proposed PPA considerations

# Comparison of the proposed PPA

- We have outlined below a summary comparison of the proposed PPA structure against our experience of typical commercial PPAs which we have observed in the UK market. Please refer to pages 25 and 26 for further discussion on the key aspects of the PPA.

| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
|---|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | | | | |
| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

- [redacted]

[redacted]

Consultant forecast nominal price

Source: 2016-11-21 Project boots financial model v101

*Note: Typically corporate PPAs are fixed below current wholesale price forecasts over 15 years, although we have identified market precedents of up to 20 years and including RPI indexation*

# PPA terms – key considerations

- We have selected some key points which warrant further discussion with regards to the PPA. Our key conclusions are included overleaf.

| Category | PPA terms | Key considerations for discussion |
|---|---|---|
| **Tenor** | 25 years | ■ [redacted]<br>■ [redacted] |
| **Fixed pricing** | Pricing fixed for 25 years | ■ [redacted]<br>■ [redacted]<br>■ [redacted] |
| **Volume approach** | [redacted]<br>[redacted] | ■ [redacted]<br>■ [redacted]<br>■ [redacted]<br>■ [redacted]<br>■ [redacted]<br>■ [redacted] |
| **Grid dispatch** | Ability to on-sell power | ■ [redacted]<br>■ [redacted]<br>■ [redacted] |

# Key conclusions with regards to the proposed PPA

### Tenor of the PPA

- The proposed tenor of 25 years [redacted]
- For comparison the Renewable Obligation Scheme, which will close to new generating capacity in March 2017, provides support for 20 years and new CFDs typically being offered for renewable energy assets are 15 years in length. That said, for new nuclear capacity the UK Government has signed a 35 year CFD contract.

### Pricing approach

- [redacted]
- [redacted]

### Volume approach

- [redacted]
- [redacted]
  - [redacted]
  - [redacted]

### Dispatch to grid

- [redacted]
- This significantly reduces the overall cost and guarantee exposure under the PPA, for the risk that the smelter closes down in future, albeit limited by the extent the hydro grid connection export capacity is able to be increased in future periods.

**EY comment**

- [redacted]
- [redacted]
- [redacted]

Section 6

# Guarantee

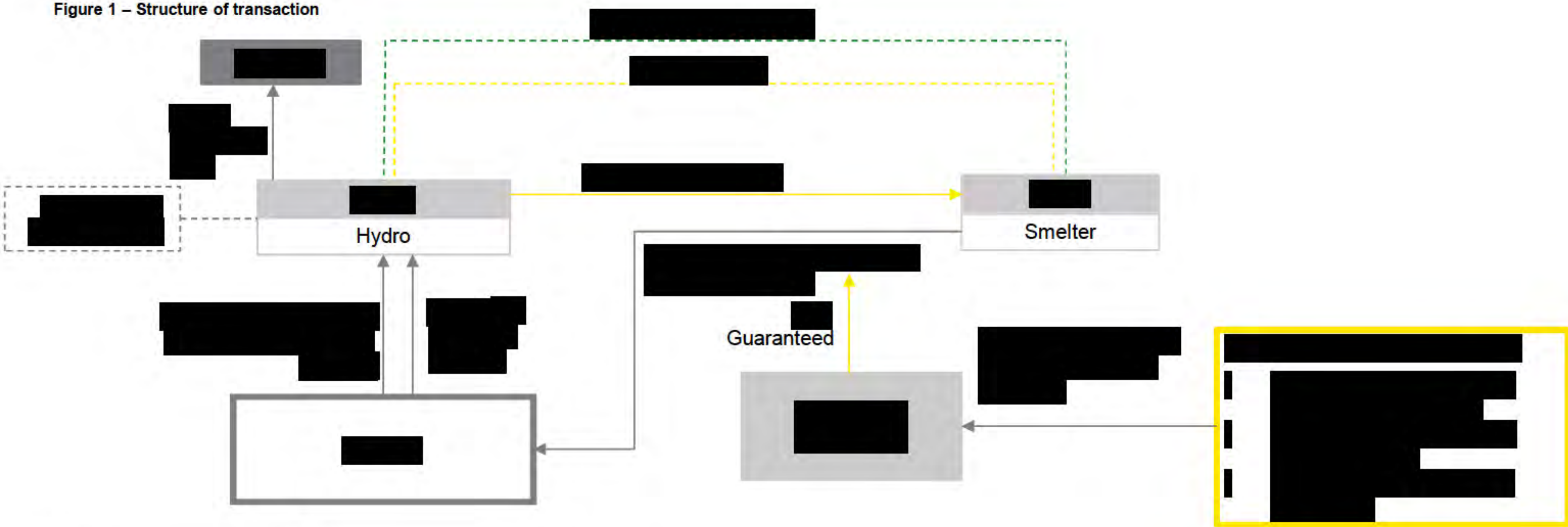
# SIMEC has asked the Scottish Government to guarantee a PPA between SIMEC and Liberty

**Proposed Guarantee**

- The guarantee proposed, granted in favour of SIMEC, will be of a revenue stream under the terms of a PPA between Liberty and SIMEC in respect of a provision of power to the smelter operations.
- The guarantee will be between ScotGov and Greensill.
- The guaranteed revenue stream will be security upon which required funds will be raised to purchase and improve the smelter facilities and related assets. The substance of the transaction could be viewed as being more akin to a form of financial derivative to enable debt to be secured at a lower cost of capital and/or to enable the quantum of debt to be secured.

The key relationships are summarised in the diagram below, and will be described in subsequent sections.

**Figure 1 – Structure of transaction**




[redacted]

[redacted]

# Key aspects of the Guarantee structure

**Key terms of the proposed PPA**

The key terms of the proposed PPA are set out below for ease of reference. Further details can be found on page 25.

| Category | Lochaber PPA terms |
|---|---|
| **Tenor** | 25 years |
| **Fixed pricing** | Pricing fixed for 25 years at [redacted] |
| **Volume approach** | [redacted] |
| **Grid dispatch** | [redacted] |

**Key terms of the Guarantee**

The key terms of the guarantee are summarised below, these are as per the draft Guarantee between ScotGov and Greensill, received on 21 November 2016.

- In the event of default by Liberty of its payment obligations, [redacted], the guarantee may be called upon under a payment demand of the Guarantor as principle debtor by way of indemnity.
- The aggregated liability of the Guarantor under the guarantee in any quarter shall be no greater than the relevant amount (as set out in the schedule in the guarantee document).
- Payment must be made within 5 business days following the Payment Demand.
- If a payment is not paid as it is due it will be subject to interest at [redacted] per annum.
- The [redacted]
- There is a continuing obligation until the ultimate balance is paid regardless of the insolvency of Liberty or any other indemnity, security or guarantee held by the Guarantor being void or unenforceable; or the Generator (the hydro) not enforcing payment from Liberty.
- There is no obligation upon the Generator to enforce or seek to enforce any other security in respect of the obligations of Liberty prior to making demand
- The Generator has the right to assign or transfer rights of the Guarantee

# Security

**Level of Security**

The table below highlights key elements of the proposed security package being requested by ScotGov for providing the guarantee:

| Security | Comment |
|---|---|
| First ranking security over the hydro station | [redacted] No value is attributed to the proposed grid connection, the timing of which is uncertain. |
| First ranking security over the smelter and wheels factory for a nominal amount. | [redacted] |
| Step-in rights over the hydro and smelter | [redacted] |
| Share pledges over the SPVs | Allows ScotGov to take control of the SPVs |
| Counter indemnities | [redacted] |
| First ranking security over the land | [redacted] |

# Guarantee Exposure

**Characteristics of the Guarantee**

The characteristics of the Guarantee are described below:

- [redacted]
- The exposure can only be called on a quarterly basis as it falls due.
- The exposure to ScotGov is only to the extent that the amounts are unpaid and are not subsequently recovered under the counter indemnities (the parent company guarantees). The exposure is mitigated by the ability to call on the full security package should it be appropriate which has an estimated value of [redacted]
- The annual exposure is estimated to be between £14m - £32m [redacted]
- [redacted]

[redacted]

[redacted]

[redacted]

# Proposed guarantee – Risks

**Risks and Mitigations**

Based on this current structure described above, beyond what we have covered in the PPA review, we have highlighted the following as key risks and mitigations agreed with SIMEC/Liberty:

| Risk | Risk status | Risk mitigation |
|---|---|---|
| Smelter fails | Medium | ▪ [redacted]<br>▪ [redacted]<br>▪ [redacted]<br>▪ [redacted] |
| Smelter does not require levels of power guaranteed | Low | ▪ [redacted]<br>▪ [redacted] |
| The hydro does not produce the Fixed Quantity of power guaranteed | Medium | ▪ [redacted]<br>▪ [redacted] |
| Hydro downtime | Low | ► SIMEC is required to have, and follow, an operating and maintenance programme to ensure the functionality is sustained to a reasonable level, expected for such an asset. |
| The business plan is not implemented | Medium | ► SIMEC/Liberty are required to provide a full business plan for the wheels manufacturing plant, [redacted] |
| The wider business plan is not implemented | Medium | ► Include a condition for SIMEC/Liberty undertaking best endeavours to progress the wider plan for the land and surrounding areas. |

# Guarantee Fee - Methodology (1)

**Introduction**

- In return for the Guarantee, due consideration will be provided in the form of the guarantee fee. The level of guarantee fee to be paid is dependent on the underlying credit rating of the entity to which the state is providing the guarantee. [redacted]
- As ScotGov is being asked to guarantee the PPA between SIMEC and Liberty, with SIMEC as the energy producers and Liberty as the energy user, the guarantee fee has been determined from an assessment of the credit worthiness of Liberty as the energy user.

**Review of the credit rating of Liberty House Group**

- [redacted] as completed by rating agency [redacted]. In order to base a guarantee fee from this rating, it must be translated from a local rating to an international rating. For the purpose of this analysis we have used [redacted] credit rating.
- [redacted]

| | [redacted] | [redacted] |
|---|---|---|
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |

- This highlights tha[redacted] credit rating is one notch below the [redacted] rating by the same agency. Therefore, for the purpose of this analysis, we have assumed a maximum international credit rating of [redacted]

**State Aid Safe Harbour Premiums**

- Translating this credit rating across the table of guarantee premiums (as per the corrigendum to the notice on the application of Articles 87 and 88, section 3.3), would result in an annual guarantee fee of [redacted]

[redacted]

# Guarantee Fee – Methodology (2)

**Updating the Guarantee Fee Premium**

To substantiate this fee level of [redacted] we have undertaken the following approach:

- Liberty could be argued to have a credit rating of no higher than [redacted]
- [redacted]

| | 15 year |
|---|---|
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| **Differential** | [redacted] |

Source: Bloomberg

- In reality, for this project, both elements would be subject to an illiquidity premium as they would not be easily traded; however, this would be on both spreads and therefore excluded for the purpose of this analysis.
- This implies that the charge for a guarantee to move between these credit ratings would be [redacted] However, as this does not take into account the specifics of the transaction, we have remained at the initially proposed guarantee fee of [redacted]

**Consideration of the funding package offered**

- The funding package currently available to Liberty/SIMEC is priced at [redacted] which would translate to a spread of c. [redacted], excluding a gilt at around [redacted] for 15 years, compared to the [redacted] a comparable of [redacted] plus [redacted] illiquidity premium) estimated as able to be received above given our credit rating of the transaction.
- If it is accepted that this funding package represents the best deal available in the market, the guarantee fee could be reduced to the differential between [redacted] and the [redacted] curve of [redacted] (plus a [redacted] illiquidity premium), giving a [redacted] guarantee fee.
- Based on our review of the transaction and current market conditions, we believe that the project has potential to achieve spreads of between [redacted] to [redacted] in the market, as detailed in our pricing considerations section at page 20 - 21. As such, we have not updated the guarantee fee percentage for the higher cost of funds (at [redacted] in the project as they do not represent value for money.

# Guarantee Fee – Application

**Application of guarantee fee premium**

- The guarantee fee will be charged against the cashflows less the security which has been granted to ScotGov in return for granting the guarantee. This is detailed in the table below:

| Security | Value |
|---|---|
| First ranking security over the hydro station | [redacted] |
| First ranking security over the smelter and wheels factory for a nominal amount. | - |
| Step-in rights over the hydro and smelter | - |
| Share pledges | - |
| Counter indemnities | - |
| First ranking security over the land | [redacted] |
| Total: | [redacted] |

Source: EY analysis

- Therefore, the guarantee fee premium o[redacted] applied against the gross cashflow less the [redacted] security value offered.

# Guarantee Fee – Results

**Calculation of the annual guarantee fee premium**

The following table details the guarantee fee calculations for years 1-25. This assumes a 25 year guarantee period at [redacted] discount rate [redacted] as per the Green Book guidance, adjusted to reflect the [redacted] inflation) and a [redacted]

[redacted]

Overall, the guarantee fee across the 25 years totals [redacted], which would translate to an annualised fee of c [redacted] However, in order to reflect the additional risk to the grid connection, we have smoothed this fee out across the 25 year period at [redacted]

This fee could increase or decrease dependent on [redacted]

[redacted].

Section 7

# MEIP

# Market Economy Investor Principle and State Aid Guidance

**Introduction**

The purpose of this section is to review the transaction details and comment on the key matters relating to State Aid. This will include:

- Review of this transaction in relation to the Market Economy Investor Principle; and
- Consideration in relation to the provision of the guarantee with reference to State Aid SME guidance *Commission notice on the application of Articles 87 and 88 of the EC Treaty to State Aid in the form of guarantees*.

**Market Economy Investor Principle:**

- In this section we consider the proposal for a ScotGov guarantee with reference to the MEIP. Any support made by ScotGov must be MEIP compliant. The application of MEIP requires analysis of the financial and economic position of the project, taking account of the level of capital investment, the risk profile, the profitability and the future return on investment. It is not sufficient to merely demonstrate that a project generates enough income to cover its ongoing revenue costs.
- A viable project will need to demonstrate an adequate return on the full investment. At its most basic, the test for MEIP is whether in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional-policy conceptual considerations would have subscribed the capital in question.
- We view the requirement of equity to be a commercial fundamental to the project as well as a way to demonstrate that private investors would provide the venture with capital from a MEIP perspective. At 21 November 2016, the agreed sources and use of funds and capital structure is as follows:

**Sources and uses of funds**

| Sources | £m | Uses | £m |
|---|---|---|---|
| Greensill [redacted] | [redacted] | Purchase of Lochaber | [redacted] |
| Equity Injection | [redacted] | Real Estate Land | [redacted] |
| Free cashflow in the Hydro | [redacted] | Additional Capex | [redacted] |
| | | Wheels factory | [redacted] |
| | | Initial Equity injection into Liberty smelter | [redacted] |
| | | Capex Contingency – Smelter | [redacted] |
| | | Capex Contingency – Hydro | [redacted] |
| | | Post Advisory Fee – Hydro | [redacted] |
| | | Operational Funding Requirement - Smelter | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |

Source: EY analysis, 2016-11-21 Project boots financial model v101

# Market Economy Investor Principle

- The required capital is [redacted], with [redacted] being secured via the Greensill [redacted], equity of [redacted] and a minor amount of free cashflow of [redacted] The commitment to provide equity provides evidence of investor investment and is a significant improvement to the original deal structure [redacted]
- In the table below we consider the equity/debt structure across the Hydro and Smelter SPVs.

**Capital Structure – Committed**

| | Hydro SPV | | Smelter SPV | | Combined Position | |
|---|---|---|---|---|---|---|
| Element | £m | % | £m | % | £m | % |
| Debt | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Equity | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | | [redacted] | | [redacted] | |

Source: EY analysis, 2016-11-21 Project boots financial model v101

- The hydro asset is a mature asset and could be considered akin to a PFI/PPP investment. We would typically expect the debt to equity ratio to be between [redacted] and [redacted] this type of asset. The hydro structure is within this benchmark.
- Given the nature of the smelter investment, it is higher risk and a more complex investment. We would typically expect the debt to equity ratio to be between [redacted] and [redacted] for this type of asset. The smelter structure is within this benchmark.
- The table below summarises the return on equity as currently modelled:

**Equity IRR**

| SPV | Nominal IRR |
|---|---|
| Hydro | [redacted] |
| Smelter | [redacted] |
| Combined | [redacted] |

Source: EY analysis and 2016-11-21 Project boots financial model v101

- Broadly, we would expect to see a lower return on equity for the hydro asset compared to the smelter. A typical range for the hydro would be [redacted] The smelter is more difficult to benchmark, however, given the nature of the investment and associated risks a return of [redacted].
- In summary, the debt to equity capital structure in both SPVs and associated return on investment appears to be in line with market expectations.

# Market Economy Investor Principle

- Finally, we set-out below the currently modelled net cashflow after financing position for reference.
- The equity injection is partly required to fund initial losses before the downstream diversification plans are fully operational.

[redacted]

# State Aid Guidance – provision of guarantees

**Introduction**

- ScotGov has requested that we review the provision of the guarantee with reference to the State Aid SME guidance *Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees*. Based on this guidance there are four tests to consider to satisfy the State Aid test.
- The guarantee will fall under the State Aid guidance “Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees”. The four tests are:
  1. The borrower is not in financial difficulty.
  2. The extent of the guarantee can be properly measured when it is granted.
  3. The guarantee does not cover more than 80% of the outstanding loan or other financial obligation.
  4. A market-oriented price is paid for the guarantee.

  These are considered in turn below.

**Condition 1: The borrower is not in financial difficulty**

- We have been asked to consider whether or not the smelter business is a firm in difficulty. The guidance is set out in **OJC 244 1.10.2004 Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (5 July 2016)**. The Commission regards a firm as being in difficulty where ‘it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors to stem losses which, without outside intervention by public authorities, will almost certainly condemn it to going out of business in the short or medium term’.
- The trading results for the smelter business owned by RTA show a positive EBITDA for the years 2013 - 2015. It is the intention of Liberty to acquire this business in order to expand it with substantial investment for the construction of a manufacturing plant. The forecasts prepared by SIMEC/Liberty indicate that sufficient funds will be made available to ensure that the smelter’s cashflows will be at least breakeven from Year 1. [redacted]
- We have set out below the tests under the guidance below together with our comments on whether the test is met, based on available information.
  a. *In the case of a limited liability company where more than half of its registered share capital has disappeared and one quarter of that capital has been lost over the preceding 12 months.*

  The smelter business, prior to acquisition, is part of ALUKL which has other divisions, therefore the test cannot be specifically applied as authorised share capital relates to the whole entity. However, by way of illustration, we have an [redacted]

# State Aid Guidance – provision of guarantees

The authorised share capital in ALUKL is £200m plus a redemption reserve from the purchase of own shares of £16m. A loss of 50% share capital would be the equivalent of £108m with 25% being £54m. The draft 2015 accounts show a net positive movement in reserves for the entity of £29m therefore there is no loss in the period and therefore no loss of capital in the last 12 months.

We conclude that the test is not met.

b. *In the case of a company where at least some members have unlimited liability for the debt and more than half of its capital has disappeared and more than one quarter of that capital has been lost over the preceding 12 months.*

This test is not applicable.

c. *Whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings.*

ALUKL is not subject to insolvency proceedings or CCJs according to Companies House; it therefore appears not to fulfil the criteria.

- Even when none of the circumstances set out above are present, a firm may still be considered to be in difficulties, in particular where the usual signs of a firm in difficulty are present, such as increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cashflow, mounting debt, rising interest charges and falling or nil net asset value.
- This business is subject to the proposed acquisition. It is the intention of Liberty to acquire this business in order to expand it with substantial investment for the construction of a manufacturing plant. The forecasts prepared by SIMEC/Liberty indicate that the smelter business will be loss making in 2017 and 2018 and profitable thereafter. [redacted].
- It is our understanding that Liberty intends to stand behind losses incurred to ensure the continued viability of the smelter following acquisition. [redacted]
- In summary, this is not considered to be a firm in difficulty.

# State Aid Guidance – provision of guarantees (cont.)

**Condition 2: The extent of the guarantee can be properly measured when it is granted**

- This condition requires the guarantee to be linked to a specific financial transaction, for a fixed maximum amount and limited in time. We consider this condition to be met as the proposed guarantee is based on a defined incomed stream set out in the PPA and for 25 years. Therefore the exposure can be calculated as the present value of the future cashflows. This translates to a gross exposure of £586m to ScotGov.

**Condition 3: The guarantee does not cover more than 80% of the outstanding loan or other financial obligation**

- This condition requires the guarantee to only relate to up to 80% of the financial obligation. This principle is important in the context that if a financial obligation is wholly covered by a State guarantee, the lender has less incentive to properly assess, secure and minimise the associated risks.

***PPA***

- The financial obligation, for the purposes of assessing the [redacted] condition, is taken by ScotGov to mean the obligation under the PPA as the guarantee is against the obligation of the smelter to pay the associated cost for the energy consumed by the hydro.
- The current proposal structures the PPA to cover a total of [redacted]W at consultancy curve with the ScotGov guarantee being fixed at [redacted] of this amount.

**Table 4: PPA guarantee proposal**

| Element | Proposal |
|---|---|
| Debt Supported | [redacted] |
| Equity injected | [redacted] |
| Gross Guarantee | £586m |
| First 5 years exposure | [redacted] |
| Pricing | [redacted] |
| Term | 25 years |
| Load Factor | [redacted] |
| Discount Rate | [redacted] |
| Guarantee Fee | [redacted] until year 2021 then step down ([redacted] in total) |

Source: 2016-11-21 Project boots financial model v101

- The annual energy costs consumed being viewed as the underlying financial obligations of which Liberty is required to manage the associated risks. Limiting the guarantee to [redacted] of this expenditure meets both the State Aid [redacted] rule, and maintains a degree of incentive for the smelter owner to manage opex costs efficiently.
- The energy consumption of the smelter is [redacted] of power. The hydro provides [redacted], this can vary annually based on efficiencies, with the remainder, c.1[redacted] being purchased from the grid. The amount of power under the Guarantee is [redacted] this translates to [redacted] of the overall power consumed and [redacted] the power consumed from the hydro.

# State Aid Guidance – provision of guarantees (cont.)

- However, as the power from the hydro which is not covered by the PPA [redacted] the ultimate cost to the smelter needs to be considered. This is detailed in the graph below.

[redacted]

Source: 2016-11-21 Project boots financial model v101

- This graph shows that overall, energy payments under the ScotGov guarantee do not exceed the [redacted] On this basis, it would meet the [redacted] requirement.
- [redacted]
- The proposal caps the guarantee a [redacted] of the forecast revenues for the 25 year duration. It is expected that the hydro has an expected life beyond the tenor and the further potential mitigation in respect of dispatch to the grid from 2021.

**Greensill Financing Agreement**

- It could be viewed that the underlying purpose of the PPA guarantee is to [redacted]

# State Aid Guidance – provision of guarantees (cont.)

**Debt – Committed and uncommitted**
***Combined SPVs***

| Element | Amount | % | Status |
|---|---|---|---|
| Greensill [redacted] | [redacted] | [redacted] | Committed |
| Additional | [redacted] | [redacted] | Uncommitted |
| Total | [redacted] | [redacted] | |

- Basing the 80% test on the PPA as the primary transaction, then the 80% test is met, both with reference to the energy output generated by the Hydro and as a percentage of the overall energy costs payable by the Smelter. [redacted]

**Condition 4: market-oriented price is paid for the guarantee**

- ScotGov should receive due consideration in return for granting the guarantee. In the market, the consideration associated with the provision of the guarantee is based on the benefit received in return and the management of risk in the event of default with reference to the supporting security package and other matters such as step-in rights.
- In determining the guarantee fee we have used the following assumptions:
  - Use a [redacted] spread as the basis for guarantee fee (as per our rating exercise on page 33)
  - The present value of the cashflows will be discounted at [redacted] is based on the Green Book guidance of [redacted] real discount rate, adjusted for the [redacted] inflation assumption in the PPA energy price; and
  - The value of the security package will remain at [redacted]
- This has the following results:

| | Total (£m) | Annualised (£m) | Non-annualised Year 1 (£m) |
|---|---|---|---|
| Guarantee fee | [redacted] | [redacted] | [redacted] |

- We have used the Green Book discount rate as this discount rate assumes ScotGov values the guarantee fee exposure as a set of annual cashflows which will be required to be settled as they full due.

# State Aid Guidance – provision of guarantees (cont.)

- Following discussion with ScotGov, we proposed an annual fee of [redacted] (between the annualised and non-annualised values) for the [redacted] grid connection, representing the key risk period for ScotGov where its mitigations are somewhat limited. [redacted] This is summarised below.

[redacted]

- In summary, the guarantee fee has been determined based on commercial principles.

# EY Summary

The proposal is required to reflect a position which could be taken by a private sector party in the market. With this in mind, there are a number of key commercial terms to the transaction which are summarised below:

- [redacted] into this project and the estimated IRR for both the hydro [redacted] smelter [redacted] is commensurate with the nature of the assets and is in line with market expectations.
- 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. [redacted]
- 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 incomed stream set out in the PPA for 25 years and the exposure can be calculated as the present value of the future cash-flows.
- The guarantee fee has been calculated on a commercial basis and the exposure of the guarantor can be measured.
- [redacted]
  - the guarantee is for [redacted] the PPA revenues i.e. [redacted] has been negotiated by the parties;
  - the debt raised is for [redacted] of the guaranteed revenues i.e. the loan to value is [redacted] with the remaining revenues received by the energy provider
  - In considering the total funds required for the project of [redacted] i.e. debt plus equity, the debt raised is [redacted] of the whole (albeit that the split per each SPV is [redacted] smelter).
  - [redacted]
- [redacted] In our view, by running a funding competition it may be possible to achieve a lower cost of finance of between [redacted] and [redacted] To enable deal completion, there is no time to run a funding competition.
- [redacted]

[redacted]

[redacted]

Section 8

# Value for money

# Economic Output

**Introduction**

- In this section we consider the benefit to the public sector as a result of supporting this bid. The analysis has been based on the Grant Thornton “Initial feasibility assessment of an integrated aluminium wheels facility” calculated economic benefits plus the reference economic consultants report “Economic Impact of the Rio Tinto Smelter Operation in Lochaber”.
- For the purpose of this analysis, we have assumed:
  - No other bid will save the smelter, therefore it would be wound up over a period of seven years. In reality this may be a shorter period, however, we have taken this period as a prudent estimate.
  - The “dis-benefits” associated with this closure have been excluded from this analysis.
- Appendix E details our working and methodology assessing the project.

**Economic benefits**

- As part of our review, we have considered the stand alone investment in the wheels factory, at the levels detailed in the Grant Thornton report, and also the impact of saving the smelter alongside this wheels factory against the seven year counterfactual case as detailed above. In considering the wheels investment, we have assumed it takes two years to build and, as such, does not have an impact until 2019. After this point, we have assumed a three year ramp up to full staff capacity.
- Our annual findings are summarised in the table below:

| | Net Jobs (Direct) | Net Jobs (Indirect + induced) | Total Net Jobs | Net Annual Direct GVA (2016) | Net Annual Indirect and Induced GVA (2016) | Total Net Annual GVA (2016) |
|---|---|---|---|---|---|---|
| Wheels Factory | 290 | 319 | 609 | 13,147,005 | 9,235,336 | 22,382,341 |
| Wheels Factory + Smelter* | 465 | 437 | 902 | 24,078,432 | 15,954,132 | 40,032,564 |
| Counterfactual, only during run down period | 175 | 118 | 293 | 10,931,427 | 6,718,796 | 17,650,223 |

** - Smelter benefits as per the “Economic Impact of Rio Tinto Smelter Operations in Lochaber”*

Source: Grant Thornton analysis included in Project Boots Initial feasibility study of an integrated aluminium wheels facility 3 October 2016, updated for EY assumptions

- Here, the wheels factory contributes an additional £22m per annum to the economy (£13m direct and £9m indirect and induced) and supports an additional 609 jobs. This can be added to the benefits attributed to running the smelter with 293 jobs being supported and contributing £17m to the local economy. However this benefit is only relevant if comparing to the smelter being closed. Therefore, it is key to review the impact over the 25 year period of investment to assess the true additionality of the investment.

# Economic Output (2)

- In assessing these benefits over the 25 year period, we have made the following assumptions:
  - If no intervention, the smelter would be wound up over a period of seven years.
  - The wheels manufacturing plant is built in two years then has a three year ramp-up period (in terms of staff numbers)
- These benefits over the 25 year period are summarised in the table below on a discounted basis ([redacted]

| | Net 25 year discounted Direct GVA (2016), £000 | Net 25 year discounted GVA Indirect and Induced GVA (2016), £000 | Total |
|---|---|---|---|
| Intervention case | 346,551 | 228,143 | 574,694 |
| Counterfactual case | 56,152 | 34,513 | 90,665 |
| **Net position** | **290,399** | **193,630** | **484,029** |

Source: EY analysis, Economic impact of smelter, Project Boots Initial feasibility study of an integrated aluminium wheels facility 3 October 2016, updated for EY assumptions

- This shows that over the 25 year period, the intervention gives a net positive impact to the economy of £484m. However, this may vary based on different assumptions on the counterfactual period. From our discussions, we understand from RTA that rather than seven years to wind down, a more likely position would be around five years period however, we have used at seven years to be prudent.
- In addition to these impacts, the construction of the new wheels factory would also have a positive impact on the economy. This is detailed in the table below:

| | Construction Spend | Construction Jobs | GVA impact, £000 | Discounted GVA, £000 |
|---|---|---|---|---|
| 2 year construction | [redacted] | 359 per annum | 32,023 | 30,797 |

Source: EY analysis

- This shows that the construction of the factory would add an additional £31m to the economy on a NPV basis.

# Cost Benefit Analysis

- In order to assess the impact to the public sector, we need to assess the benefit cost ratio (BCR) of the transaction. The BCR will be calculated on the PPA guarantee. As this is a guarantee, the actual call on ScotGov under the guarantee is unknown, therefore we have run a number of scenarios to illustrate the potential impact to ScotGov. These scenarios are:
  - **Full call**: The PPA guarantee is called in full from day 1, with ScotGov fully subsidising the smelter's energy costs to ensure it remains in operation.
  - **Percentage call**: The PPA guarantee is called at [redacted] during the initial investment period, this reduces to [redacted] whilst the grid connection is underway, reducing again to [redacted] once it is estimated to be installed.
  - **Reduced call**: The PPA guarantee is called above a high-level estimated breakeven price of [redacted] per our 6 October 2016 draft report, as assumed the smelter can pay at this reduced level.
- In reality, there may be other scenarios which ScotGov may wish to consider. The following assumptions are made as part of this scenario:
  - Guarantee fee has been excluded from the analysis as based on the economic impacts.
  - The smelter continues to be operational.
  - There is no export available to the grid on the basis that the smelter continues to be operational.
  - The NPV of the benefits and associated costs are discounted using the real rate per Green Book guidance of 3.5%, adjusted for inflation where required.
- For the benefit to the public sector, we have assumed the re-worked economic benefits, as described on the previous slide, are prevalent throughout the 25 year period.

**Results**

- The table below summarises the effect to the public sector of the above conditions.

| | [redacted] | [redacted] | [redacted] |
|---|---|---|---|
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] | [redacted] |

Source: EY analysis

- These are only illustrative scenarios and ScotGov may wish to consider additional scenarios however this highlights that all scenarios have BCRs of greater than 1, even if the full guarantee is called. However, this is predicated on the wheels manufacturing plant being built and both the smelter and the wheels manufacturing plant remaining operational throughout the period.

# EY summary

- [redacted]
- Based on these benefits, the BCR based on the full exposure is 1.81. In reality this scenario is very unlikely as the investment in the wheels factory is unlikely to be undertaken if the full guarantee is called on day 1.

Appendix A

# Transmittal letter

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Building a better working world

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FAO [redacted]

15 December 2016

Dear Sir/Madam

**Financial Advisory Support for Scottish Government of proposal from SIMEC Group (SIMEC) and Liberty House Group (Liberty) (together "the Group") under Consultancy One Framework RM1502**

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.

**Purpose of our report and restrictions on its use**

This report 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 report 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 report they do so entirely at their own risk.

**Scope of our work**

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, our work for the purposes of this review has encompassed the following:

1. Comments on the updated financial models received on 21 November 2016 (v101), as provided by SIMEC/Liberty, in relation to the viability of the smelter
2. Comments on the draft PPA term sheet between SIMEC and Liberty
3. Comments on the amended draft Guarantee structure as proposed by SIMEC/Liberty and the appropriate market premium to be charged consistent with the Market Economy Investor Principle
4. Providing assistance to the Scottish Government to negotiate the terms of the PPA and Guarantee
5. Liaising with MacRoberts (as the Scottish Government's legal advisor) on the terms of the PPA and Guarantee
6. Comments on the public sector value for money case underlying the proposed PPA and state aid issues
7. Preparing an abbreviated report summarising a 'workable solution' as agreed with the bidder together with the rationale and associated risks
8. Comments on how ScotGov may determine the amount it should record in its statement of Financial Position for the Guarantee.

It should be noted that we provided draft reports dated 6 November 2016 (Part B) and 1 December 2016 (Part C) which have been superseded by this report.

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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.

We have not been asked to comment on the value of the hydro asset and the smelter and for the purposes of this report have assumed that the value is the bid price.

We have not been asked to consider pension matters in this phase of work.

We have not been asked to perform work on tax implications in this phase of work.

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based solely on a review of accounts and other documents available on the Rio Tinto database.

**Basis of our work**

The information contained in this report has been based on the following information received through the course of the project.

- [redacted]

[redacted]

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No letter of representation has been sought from management of SIMEC and Liberty to confirm the factual accuracy of the contents of the report and our key findings.

## LIMITATIONS ON THE SCOPE OF OUR WORK

Our work has been limited for the following reasons:

- Time constraints in relation to collation of data and preparation of the report
- A business plan for the smelter and downstream wheel facility operations has not been received. The Grant Thornton report only provides an initial feasibility study.
- Grant Thornton has declined to speak to us regarding its report and assumptions used.
- We initially received access to the RTA data room on Monday 20 October 2016, our access is restricted to folders 1, 4, 5, 6, 7, 8, 12, 13, 15 and 19.
- The fluidity of the deal structure throughout the project.
- Numerous iterations of the financial model were received, which were significantly different to each other, the first on Friday 7 October 2016, the second on Tuesday 11 October 2016, the third on 25 October 2016, a fourth on 2 November 2016, a fifth on 4 November 2016, various other and the final version (v101) on 21 November 2016. The final model forms the basis of this review. Assumptions were not provided for the models and it has taken several conversations with SIMEC to understand them.
- The acquisition has changed through the course of this project from what was understood to be an acquisition of assets in a particular share structure, which subsequently changed in the final drafts of legal documentation, which may mean that the full consequences may not have been considered.

**Structure of the report**

The report is divided into 8 sections. We stress that, whilst we have identified in the summary and conclusions key issues based on your instructions, there may nevertheless be other issues raised in the appendices and therefore the entire report should be read for a full understanding of our findings and advice.

We would welcome the opportunity to discuss the contents of this report with you and to provide you with such further information as you may require.

Yours faithfully

For and on behalf of Ernst & Young LLP

[redacted]

Appendix B

# Points for consideration

# Appendix B – Points for consideration

If ScotGov chooses to support the transaction, it is our view that in order to further protect its interests and manage exposure, the following should be considered (note some of these have now been accepted by Liberty/SIMEC):

## PPA/Guarantee considerations

### Guarantee fee premium adjustment

- An appropriate mechanism to be implemented to allow for the fee to be adjusted based on certain material events [redacted]. The mechanism is to allow for either an increase or decrease to the fee. This has yet to be agreed, as at the date of this report being issued.

### Non PPA energy agreement

[redacted]

### Minimum asset value

- [redacted]

### Negative pledges

- Obtain negative pledges in relation to land to ensure ScotGov's wider economic and social interests are preserved and to prevent Liberty/SIMEC raising further indebtedness on the Smelter. SIMEC/Liberty have agreed to the first pledge and legal documentation is being drafted to reflect this undertaking. The latter undertaking has not been agreed.

## Business forecasts and monitoring

### Approval of business plan

- ScotGov need to consider what happens in the event that the business plan is not viable based on reasonable assumptions.

*Note – GRA refers to the draft document as at 20 November 2016*

.

Appendix C

# Abbreviations

# Appendix C – Abbreviations

| | |
|---|---|
| CFD | Contracts for Difference |
| DECC | Department of Energy & Climate Control |
| EBITDA | Earning before interest, tax, depreciation and amortization |
| EIA | Economic Impact Assessment |
| EU | European Union |
| FY14A | Audited accounts for the financial year ended 31 March 2014 for Liberty House Group Pte Ltd and 30 November 2014 for SIMEC Group Ltd |
| FY15A | Audited accounts for the financial year ended 31 March 2015 for Liberty House Group Pte Ltd and 30 November 2015 for SIMEC Group Ltd |
| FY16F | Management forecasts for the financial year ended 31 March 2016 for Liberty House Group Pte Ltd and 30 November 2016 for SIMEC Group Ltd |
| FY17F | Management forecasts for the financial year ended 31 March 2017 for Liberty House Group Pte Ltd and 30 November 2017 for SIMEC Group Ltd |
| FY18F | Management forecasts for the financial year ended 31 March 2018 for Liberty House Group Pte Ltd and 30 November 2018 for SIMEC Group Ltd |
| GFG | Gupta Family Alliance |
| GRA | Guarantee and Reimbursement Agreement |
| GVA | Gross Value Add |
| HMT | HM Treasury |
| IRR | Internal rate of return |
| JLR | Jaguar Land Rover |
| LCG | Liberty Commodities Group |
| LEG | Liberty Engineering Group |
| Liberty/LHG | Liberty House Group Pte Ltd |
| LIG | Liberty Industries Group |
| LIH | Liberty Industries Holdings Pte Ltd |
| LMC | LMC Automotive |
| m | million |
| MW | Mega watts |
| NPV | Net Present Value |
| OEM | Original Equipment Manufacturer – producer of vehicle components |

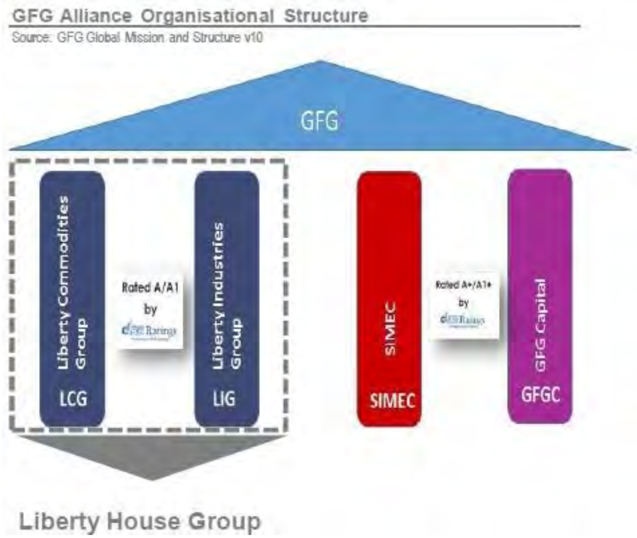
# Appendix C – Abbreviations (Cont.)

| | |
|---|---|
| ONS | Office of National Statistics |
| PBT | Profit before tax |
| PCG | Parent company guarantor |
| PPA | Power Purchase Agreement |
| RTA | Rio Tinto Alcan |
| SABS | Scottish Annual Business Statistics |
| ScotGov | Scottish Government |
| SIMEC | SIMEC Group Ltd |
| the Group | Both Liberty House Group Pte Ltd and SIMEC Group Ltd |
| the hydro | Hydroelectric Power Plant at Lochaber |
| the smelter | Aluminium Smelter at Lochaber |
| UAE | United Arab Emirates |
| YoY | Year on year |

Appendix D

# Parent company guarantees

# Gupta Family Group Alliance (GFG)




**Overview of GFG**

- The Liberty and SIMEC group companies are wholly owned by Parduman K Gupta (father) and Sanjeev K Gupta (son) under the principles and values of the GFG Alliance. Its main focus is to create a resilient supply chain - from liquid steel produced from recycled scrap and renewable energy, to rolled steel and highly engineered products manufactured locally on a global basis.

**Group structure**

- Liberty Industries Group (LIG): Integrated steel producer and distributor – from liquid steel to value added advanced engineering products.
- Liberty Commodities Group (LCG): Comprehensive services provider to the global steel and metal industries.
- SIMEC: International resources group with emphasis on sustainable power, mining and infrastructure assets.
- GFG Capital: Innovative financial services and properties platform. GFG Bank specialises in supply chain finance for UK industry and international commodity businesses. GFG Property Division manages and develops the group property portfolio.

We understand that this transaction will be structured under LIG and SIMEC – these groups are considered further in the following slides.

Liberty – operating from its four financial hubs in London, Dubai, Singapore and Hong Kong with a network of offices spread across 30 countries around the world.

SIMEC – operating from UK, UAE, Singapore and Hong Kong.

[redacted]

[redacted]

# Guarantees from SIMEC Group Ltd and Liberty House Group Ltd [redacted]

[redacted]

[redacted]

[redacted]

Appendix E

# Economic Calculations

# Economic Impact Assessment

### Background

- Grant Thornton has been engaged to undertake an initial feasibility assessment of Project Boots, a proposed integrated aluminium wheels facility utilising the Boots assets. As part of this work, an economic impact assessment (EIA) of the smelter and downstream activity has been undertaken by Grant Thornton. This note reviews the EIA approach, assumptions and methodology used by Grant Thornton to asses the economic benefits the activity to the economy.

### Context

- The transaction concerns the acquisition of two hydro power plants and an aluminium smelter with the potential buyer having plans to deliver viable downstream manufacturing to enhance performance of the assets.

### Project phases

- Project Boots consists of three phases:
  - An initial phase (Phase 1a) which is the integration of an aluminium alloy cast wheel facility in the UK with the Lochaber smelter
  - [redacted]

### Economic Benefits

- It is proposed that this strategy has the potential to result in substantial growth in the local Scottish economy. Specifically:
  - [redacted]

### Assessment Methodology

- To support the case for the investment, and therefore the transaction, the economic benefits of the Phase 1a and the development plans as a whole have been estimated in an initial feasibility assessment by Grant Thornton for Liberty/SIMEC.
- The approach uses a standard input-output / multiplier methodology to estimate the gross economic benefit to the local economy from the investment. Underlying the approach are estimates presented by Grant Thornton on the number of total direct jobs that will be created in the local economy through the transactions and subsequent investment and number of additional indirect and induced jobs that this would created through the facilities' supply chain and increased economic activity resulting from employee spend. Using publically available estimates from HM Treasury (HMT), Office for National Statistics (ONS), and ScotGov, along with assumptions (made by Grant Thornton using additional evidence and professional judgement) about the levels of displacement (economic activity moving from one area to another) that would occur within the local economy.
- The initial feasibility assessment, provided detailed work and estimates for the estimated economic benefits from Phase 1a. In addition, a high-level estimate is presented for all phases of the project. In this review of the economic benefit estimates, the economic impact estimate for Phase 1a is examined in detail. A consideration of the wider benefits of maintaining the assets as a going concern is also made. There is no undertaking to examine or verify the estimate provided for all phases, as this detail is not provided in the initial feasibility assessment.

# Phase 1a – Review of Economic Benefits Calculations

**Assessing the impact of economic benefits of the Phase 1a and Project Golf II**

- An independent assessment of the economic benefits of Phase 1a is undertaken. The underlying methodological approach is consistent with the approaches taken by Grant Thornton in the initial feasibility study, and reflect standard input-output / multiplier approaches to assessing the economic benefits of an investment on its host economy. The independent assessment makes use of publically available estimates from HMT, ONS, and ScotGov, and professional experience to asses the economic benefits Project Golf II to the local economy.

**Appraisal period**

- The Grant Thornton analysis uses an appraisal period of 10 years. In line with Green Book guidance, the independent analysis proposes a longer appraisal period to cover the useful life of the asset and to encompass any contractual arrangements associated with the transaction and flow of economic benefits. A 25 year period is used.

**Counterfactual**

- The Grant Thornton analysis effectively uses a counterfactual where the smelter continues to operate as is over the full appraisal period. On consultation, our analysis assumes the smelter operation winds down after 5 years (current operational guarantee) and to be non-operational from year 8 onwards. As such, a key driver of economic benefits is the continuing operation of the smelter site over an extended period, with overall business viability as a key driver of economic benefits. In addition, based on our understanding of the project a 2 year construction period and 3 year ramp up before the integrated wheels manufacturing plant operates at full capacity.

**Indirect and Induced Job GVA**

- Estimates presented by Grant Thornton assume the GVA per job for indirect and induced jobs is similar to that of the direct jobs. Evidence – including economic impact assessment of the current smelter operations – suggests GVA per job for the direct on-site jobs are significantly higher than host economy average. The latter is used.

**Direct, Indirect and Induced Benefits**

| | Direct Benefit | Indirect Benefit | Induced Benefit | Total Benefit |
|---|---|---|---|---|
| Multiplier * | 1 | 0.6 | 0.5 | 2.1 |
| GVA per job (2016) ** | £60,466 | £38,601 | £38,601 | - |
| Total Jobs (Gross) *** | 290 | 174 | 145 | 609 |
| Net Additional Jobs | 218 | 131 | 109 | 458 |
| Net Additional GVA (2016) | £13,147,005 | £5,037,456 | £4,197,880 | £22,382,341 |
| 25 Year Net Additional GVA, Smelter+Wheels (Discounted) | £290,399,100 | £106,902,309 | £86,728,656 | £484,030,064 |
| 2 Year Net Additional GVA, Construction (Discounted) | | | | £30,796,910 |

Source: * SG input and output tables, ** HIE Assessment – Scottish Annual Business Statistics Local Autonomy Tables, *** Project Boots Initial feasibility study of an integrated aluminium wheels facility 3 October 2016

# Further Assumptions and Sensitivity Analysis

### GVA per job

- The independent model differs from the Grant Thornton approach in that a lower GVA per job estimate for indirect and induced jobs is assumed. Collaborative evidence corroborates the view that GVA per job at the smelter is significantly higher than in the local economy. For this reason, GVA for indirect and induced jobs is assumed to be lower, and in line with the local economy region as reported in regional accounts (also similar across sectors as reported in Scottish Annual Business Statistics (SABS). The model assumes indirect and induced jobs generate GVA equivalent to that of the NUTS3 region at 38,067 in 2014 prices. Note that not all these jobs will be in Lochaber. Therefore, there is scope to distribute some outside the local economy at a GVA per job ranging from £41,902 in Highlands & Islands to £47,414 for Scotland.
- The independent model maintains the Grant Thornton estimate for GVA per job for the direct jobs. This has been checked against other estimates, and has shown to be within the region of estimates for the current operation of the smelter and similar to SABS estimates for similar activities within the Scottish economy.

### Multiplier

- The independent model uses employment multipliers for the relevant sector on the basis the model is built up from job numbers. These are in line with the multipliers used in the Grant Thornton analysis. However, sensitivity analysis was undertaken to consider GVA multipliers which slightly increased indirect job estimates.

### Displacement / Additionality

- The 290 jobs are the additional (new) direct positions created once the investment in the integration of the smelter into an integrated aluminium wheels factory has been completed. These are assumed to be ‘additional’ jobs arising once the integrated wheel factory is fully on-stream and is sourced from the Grant Thornton analysis.
- The displacement assumption impacts the 290 additional jobs (and indirect and induced jobs) resulting from the investment in the integrated aluminium wheels factory, and not the pre-existing smelter operation. There is an element of informed judgement as to the appropriate level for the assumed displacement. Our view is that the new positions will be filled by someone – and, therefore, it is prudent to assume some level of displacement. That is, new positions being filled by individuals already active in the economy elsewhere. To address the question as to the appropriate level of displacement, sensitivity analysis has been undertaken using a range of values from 5%-30%.

### Direct Comparisons with the Grant Thornton Analysis

- It is instructive to consider the independent analysis on a comparable basis with the Grant Thornton analysis. To accomplish this, the first 10 years of the appraisal period of a ‘wheels only’ option is considered, with the differences driven by the ‘ramp up’ and the lower assumed GVA for indirect and induced jobs in the independent analysis.

| | Independent Analysis | Grant Thornton analysis |
|---|---|---|
| 10 Year Net Additional GVA, Wheel Only (Including Construction) (Discounted) | 152,849,998 | £233,793,025 |

Source: EY analysis

- Finally, it is worth noting that the counterfactual does not consider economic dis-benefits that could potentially accompany the closure of the smelter site after year 8.

Appendix F

# Accounting for the guarantee

# Appendix F – Accounting for the guarantee

**Recording the Guarantee in the Scottish Government's financial statements**

- This section comments on how ScotGov may determine the amount it should record in its Statement of Financial Position for the Guarantee. The section gives guidance on the underlying principles that ScotGov may adopt in measuring the Guarantee. Since ScotGov accounts under the interpretation of International Financial commenting Standards (IFRS) in the HM Treasury Financial commenting Manual for 2016-17 (FReM), this guidance follows that interpretation. The guidance is subject to the limitations at pages 73 and 74 and follows a request from ScotGov on or around 9 November 2016 and subsequent discussion with ScotGov. The comment does not apply any additional information beyond that which the rest of this Appendix F applies. In addition, if the actual legal agreements governing the Guarantee when the parties finally implement it differ to this information, the section's guidance may no longer be valid.

**ScotGov's accounting for the Guarantee**

- Our discussions with ScotGov indicate that ScotGov has reached a view that it should record the Guarantee in its financial statements as a financial guarantee contract under International Accounting Standard 39: Financial Instruments: Presentation and Measurement (IAS 39). The FReM applies IAS 39 with no changes or adaptations for the public sector.
- IAS 39 defines a financial instrument as any contract that gives one entity a financial asset and another entity a financial liability. IAS 39 also defines financial guarantee contracts as arrangements requiring the guarantee's issuer to pay amounts due under a specific debt instrument when and to the extent that the instrument's borrower fails to pay any such sums. ScotGov considers that the Guarantee meets this definition because it obliges ScotGov to pay cash to SIMEC when there are any short falls in fixed payments under the PPA not met from other sources; since the PPA is in substance an unconditional obligation on Liberty to pay cash to SIMEC, ScotGov considers it to be equivalent to a specified debt instrument.

**Measuring the Guarantee**

- IAS 39 provides that unless ScotGov determines that the Guarantee is an insurance contract (which this report assumes that it has not done), it should measure the Guarantee at the time it first records it on balance sheet at its fair value. This value is the amount that ScotGov would need to pay to transfer the contract to a third party on an arms-length basis. IAS 39 Paragraph AG4 (a) states that if an entity issues a financial guarantee contract on an arms-length basis to an unrelated third party, the entity should presume that this value equals the amount (if any) that it receives from the third party as a premium for the guarantee, unless there is strong evidence that this amount is not a reliable estimate of the financial guarantee contract's fair value. This guidance assumes that the third party pays an amount equal to the benefit it receives from the financial guarantee contract; in the case of the Guarantee, this amount would therefore equal the present value of the guarantee premium. ScotGov will therefore need to assess whether the guarantee premium's present value is an accurate estimate of the benefit that SIMEC receives for the Guarantee, and obtain agreement from its external auditor on this matter.
- Once ScotGov has determined the Guarantee's opening value, IAS 39 Paragraph 47(c) requires it to record the Guarantee in future years at the greater of the following two amounts:
  - The value it would apply under International Accounting Standard 37: Provisions, Contingent Liabilities and Contingent Assets (IAS 37); or
  - The opening value less any amortisation that ScotGov records under International Accounting Standard 18: Revenue (IAS 18).
- The table overleaf considers these measurement methods further

# Appendix F – Accounting for the guarantee

| Measurement basis | Discussion |
|---|---|
| IAS 37 Basis | ► The FReM applies IAS 37 with no changes or adaptations, other than stating that if an entity needs to discount any cash flows, it must apply the HM Treasury real terms discount rate of 3.5% per annum, or 5.57% per annum if inflation is 2% per annum (this inflation matches that for the PPA energy price).<br>► Of the three items that IAS 37 considers, it only requires entities to measure values on their Statements of Financial Position for provisions; under IAS 37, the other two items (contingent assets and contingent liabilities do not have measurable values. We therefore consider IAS 37's guidance on how to measure provisions.<br>► IAS 37 Paragraph 25 states in effect that uncertainty should not stop entities from estimating provisions because estimation is integral to preparing financial statements and does not make them unreliable. This paragraph also presumes that entities will be able to estimate a range of outcomes except in extremely rare cases and so will normally be able to estimate a provision's value reliably.<br>► IAS 37 Paragraphs 36 – 41 consider how to measure a provision; the basic principle is that this amount is the best estimate of how much the entity expects to pay to settle the obligation; this amount being what the entity would pay rationally to transfer the obligation to a third party. This amount therefore must factor in possible obligations in future years and it is not enough solely to measure the likely obligation within one year. Hence the feature of the Guarantee that it requires potential cash flows to support each quarter's payments under the PPA does not remove the need for ScotGov to consider obligations in future years. This is because meeting a shortfall in a quarter's PPA payment in a single year does not settle the obligation under the Guarantee in full because it will continue to require ScotGov to meet similar shortfalls in future years.<br>► IAS 37 Paragraph 39 also makes clear that if there are a large number of potential obligations, entities should apply an 'expected value' by weighing the respective likelihoods of the potential obligations arising. The Guarantee has a potentially large number of obligations equal to shortfalls in all of the quarterly PPA payments and each of which will have varying present values depending on how far in the future each payment falls due.<br>► In this case therefore, ScotGov will need to form a view on how likely PPA shortfalls are to occur over the Guarantee's term, along with the extent to which the other security measures within the Guarantee (including amounts from selling power to the National Grid) will reduce any such shortfall. It will then need to determine the weighted outcome of these various items, and discount that outcome to the balance sheet date in question applying the relevant real terms discount rate. The resulting ledger entries will therefore generate two opposing effects:<br>    ► Increasing the Guarantee's value as the discount unwinds over the Guarantee term – ScotGov will charge this increase to profit and loss as a finance cost; and<br>    ► Reducing the Guarantee's value as the Guarantee term passes and thus reducing the number of potential future obligations – ScotGov would credit these reductions to profit and loss as a finance benefit. |

# Appendix F – Accounting for the guarantee

| Measurement basis | Discussion |
|---|---|
| IAS 18 Basis | ► The FReM applies IAS 18 with no changes or adaptations. However beyond the statement in IAS 39, IAS 18 contains little or no specific guidance on financial guarantee contracts. We therefore suggest that IAS 18 provisions concerning long term service contracts are relevant. These are in IAS 18 Paragraphs 28 – 28 and in sum provide that entities recognise revenue in proportion to the extent to which the entity has provided the service. This “percentage of completion” approach suggests in turn that ScotGov provides the Guarantee in return for the guarantee premium on a straight line basis over the Guarantee term. This in turn leads us to suggest that ScotGov should match the cost to the revenue and so amortise the opening value on a straight line basis over the Guarantee term. |

**Summary and conclusions**

- This section comments on how ScotGov should measure the Guarantee on its financial statements, assuming that it will account for the Guarantee as a financial guarantee contract. This basis is as follows:
  - Measure the Guarantee initially at fair value, with a presumption that this fair value equals the present value of the guarantee premium discounted at the HM Treasury real terms discount rate. [redacted]
  - Measure the Guarantee in years following its initial recognition at the greater of the following two values;
  - The weighted average impact of the proportions of PPA payments it expects Liberty to fail to pay to SIMEC; and
  - The opening value less the cumulative amortisation on a straight line basis over the Guarantee term – this reduces the opening value by [redacted] per annum if the Guarantee term is 25 years.

**Comment Limitations – financial accounting review and comments**

- Our comment on ScotGov’s accounting for the Guarantee falls under the limitations summarised below.
- This comment is advisory in nature; it is not an assurance comment or opinion, nor is it an audit, review, or other form of assurance, as the Auditing Practices Board identifies those terms. It therefore does not express any form of assurance on accounting matters, financial statements, or other financial information or internal controls.
- The comment does not provide a formal or second opinion on the application of accounting principles as defined in Section 230 of the ICAEW Code of Ethics for Professional Accountants. It does not provide any opinion as to whether DFID’s accounting policies comply with IFRS as implemented in the FReM. It does not constitute any legal opinion or legal advice.

# Appendix F – Accounting for the guarantee

- We direct the comment solely towards addressing the matters stated within it. The issues raised or observations made cannot be considered exhaustive and that there is some risk that had ScotGov asked us to undertake a more extensive exercise, we might have identified other issues or make other observations that would be relevant . The comment's applicability will necessarily depend on the particular circumstances in which ScotGov implements it (of which we might not be aware) and should therefore be viewed accordingly.
- If ScotGov requires a formal written opinion representing the view of Ernst & Young LLP on a specific matter or if ScotGov has already received an opinion from its independent auditor on a specific matter and are asking us for a second opinion on the same specific matter, our firm's policy and professional ethical guidelines require us to consult ScotGov's independent auditor and obtain its acknowledgement of our engagement. If ScotGov denies us permission to consult its independent auditor or we do not get this acknowledgement, we would not be able to accept that specific engagement.
- Our work has excluded procedures to detect fraud or illegal acts, and to identify, address or correct any errors or defects in ScotGov's computer systems, other devices or components thereof ("Systems"), whether or not due to imprecise or ambiguous entry, storage, interpretation or processing or commenting of data. We will not be responsible for any defect or problem arising out of or related to data processing in any Systems.
- While we may provide observations and comments with respect to internal control matters, our observations and comments provide no assurance with respect to the effectiveness of internal controls or compliance with applicable laws and regulations.
- The comment is issued on the basis that the information applied herein is not final and hence if the financial support mechanism's commercial and financial terms subsequently change materially to those envisaged in the information referenced in the comment, any suggested accounting treatment in the comment may not be valid and may require updating.
- The comment is issued on the basis that it reflects IFRS as implemented in the FReM at the date of its issue. We have no obligation with respect to updating the comment for any changes in IFRS or other accounting standards and principles implemented in the FReM subsequent to the date of this comment's issue.
- Notwithstanding any advice or guidance in the comment, ScotGov is responsible for determining the appropriate accounting treatment in any particular case by reference to relevant laws, standards and regulations and ultimately this would be subject to agreement with its independent auditor. ScotGov is responsible for obtaining the concurrence of its independent auditor on the appropriateness of the accounting policies ScotGov selects and the related financial statement disclosures.
- ScotGov alone is responsible for establishing and maintaining adequate internal control over financial commenting and the Services do not replace its responsibility for establishing the effectiveness of internal controls. In addition, ScotGov may not rely on us to draw to its attention matters that may be relevant as to whether or not its system of internal control is effective.
- ScotGov will not, and will not permit others to, quote or refer to the comment, any portion, summary or abstract thereof, or to us or any other EY Firm, in any document filed or distributed in connection with (i) a purchase or sale of securities to which relevant securities laws apply ("Securities Laws"), or (ii) periodic commenting obligations under Securities Laws. ScotGov will not contend that any provision of any Securities Laws could invalidate any provision of this Agreement.
- ScotGov may provide the comment, subject to our consent, to its external auditor, solely to allow it to perform its duties as external auditor, and provided that ScotGov informs its external auditor that it does not acquire any rights against EY and EY does not assume any duties or obligations to ScotGov's external auditor or otherwise, as a result of such access.

Appendix G

# Model extracts: 26-11-21 Project Boots Financial Model V101

# Appendix G – Model extract

Below is an extract from the model received on 21 November 2016 showing the EBITDA of the smelter on a stand alone basis.

[redacted]

# Appendix G – Model extract

Below is an extract from the model received on 21 November 2016 showing the EBITDA of the smelter and wheels business on a combined basis.

[redacted]

# Appendix G – Model extract

Below is an extract from the model received on 21 November 2016 showing the EBITDA of the hydro.

[redacted]

# Appendix G – Model extract

Below is an extract from the model received on 21 November 2016 showing the cash flow for the hydro, smelter and wheels facility

[redacted]

Appendix H

# SIMEC Group – Business Overview

# Project Golf II

## SIMEC Group – Business overview

15 December 2016

Building a better
working world

# Contents

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Scottish Government
Atlantic Quay
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Glasgow
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FAO [redacted]

15 December 2016

Dear Sir/Madam

**Financial Advisory Support for Scottish Government of proposal from SIMEC Group (SIMEC) and Liberty House Group (Liberty) (together "the Group") under Consultancy One Framework RM1502**

In accordance with our proposal dated 4 October 2016, Letter of Appointment of the same date and email between [redacted]l 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.

**Purpose of our report and restrictions on its use**

This report 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 report 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 report they do so entirely at their own risk.

**Scope of our work**

This paper has been requested in addition to our draft reports dated 19 October 2016, 6 November 2016 and 1 December 2016, and in accordance with the email between [redacted] and [redacted] dated 29 November 2016.

Our work for the purposes of this paper has encompassed the following matters:

1. Understand and comment on SIMEC's background and group structure
2. Comment on the named executives within SIMEC Group including current directorships, previous directorships and recent news
3. Understand and comment on the historical, current and future (to the extent possible) financial performance of SIMEC Group

This paper should be read in conjunction with the Project Golf II final report dated 15 December 2016.

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based solely on a review of accounts and other documents available through public records and analytical procedures applied to data provided to us.

Ernst & Young LLP
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London SE1 2AF

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Fax: +44 20 7951 1345
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**Basis of our work**

The financial information contained in this report has been based on the audited financial accounts of Hong Kong-based company SIMEC Group Limited for the year ended 30 November 2015, along with forecasts, management accounts and other relevant information provided by management. We also obtained information during a telephone call with [redacted] of SIMEC.

No letter of representation has been sought from management to confirm the factual accuracy of the contents of the report and our key findings and, accordingly, the report is issued on a draft basis only.

**LIMITATIONS ON THE SCOPE OF OUR WORK**

Our work has been limited for the following reasons:

- Limited detailed financial information available through public records due to residency of companies e.g. in Singapore and Hong Kong
- Limited detailed supporting assumptions in relation to forecasts

.

**Structure of this report**

The report is divided into 4 sections. The first section comprises our summary and conclusions; the second and subsequent sections comprise management, business and financial overviews, and appendices. We stress that, whilst we have identified in the summary and conclusions key issues based on your instructions, there may nevertheless be other issues raised in the appendices and therefore the entire report should be read for a full understanding of our findings and advice.

We shall be pleased to discuss the contents of this report with you and to provide you with such further information as you may require.

Yours faithfully

For and on behalf of Ernst & Young LLP

[redacted]

# Executive Summary

**Background**

- SIMEC is owned and chaired by Parduman Kumar Gupta (father of Sanjeev Gupta). The Gupta family owns two international commodity and industrial groups, SIMEC and Liberty House Group (Liberty). Despite this connection, the two groups appear to be separate legal group structures and we understand, from [redacted] that they operate independently of one another. SIMEC is managed by an advisory board of three members headed by [redacted] and an executive management team including Sanjeev Gupta.
- The two groups work together in joint ventures under a set of principles and values referred to as the Gupta Family Group Alliance (GFG).
- SIMEC is a multi faceted business with a focus on five key industries: Shipping, Industry, Mining, Energy and Commodities with only SIMEC Energy and SIMEC Commodities at this stage generating revenue.
- The other divisions currently reflect SIMEC's ambitions to expand into Shipping, Mining and Industry (manufacturing), which it aims to achieve through an extensive range of acquisitions of businesses and assets globally.
- Notable examples include the proposed acquisition of ABG Cements and the purchase of the Rio Tinto assets at Lochaber. Following the acquisition of the power station at Uskmouth, SIMEC generated its first non commodity trading revenues in 2015.
- [redacted]
- [redacted]

## Conclusions

**Management**

- None of the executives are listed on the UK directors disqualification register - however this would only identify disqualifications for directors active in UK registered businesses.
- All executives appear to have extensive industry experience in the metals, steel and energy sectors, with the exceptions of [redacted] a senior director of several electronics companies.
- At this stage, we are not aware of any other adverse news or conduct relating to the management team.

**Business**

- There is a high level of acquisition interest activity taking place within the SIMEC group both in Scotland, UK and globally.
- This is likely to require significant investment at this stage in terms of resource, focus and attention from the management team and ultimately cash should one or more of the acquisitions be completed.
- There is a risk that with so much activity on acquisitions that focus is lost in relation to the proposed Scottish acquisition either during the acquisition or post acquisition.
- We have not been provided with a detailed business plan for the SIMEC group and therefore have not commented on the future prospects if SIMEC were successful with the acquisition, other than where referenced in the Project Golf final report.

**Financial**

- SIMEC's performance has grown steadily year on year and is forecast to continue to do so.
- The majority of revenue is from SIMEC Commodities and as such the group is at risk of movements within commodity prices, this could impact the group positively or negatively depending on trades.
- Our initial research has shown a relatively volatile market historically, but commodity forecasts suggest a mix of modest growth and decline in the markets in which SIMEC operates – the SIMEC forecasts (although we do not have sufficient detail) assume modest growth which could be optimistic - we would require further information and detail to verify the forecasts.
- We understand that previous debt and equity fund raising was to support investments, working capital and CAPEX requirements but have not been provided details of the reasons for these. We do however understand that the primary investment made was the acquisition of Uskmouth Power Station in Newport, Wales.
- [redacted]

# SIMEC Executive Management

SIMEC

| Parduman Kumar Gupta (Chairman) | |
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# SIMEC Executive Management

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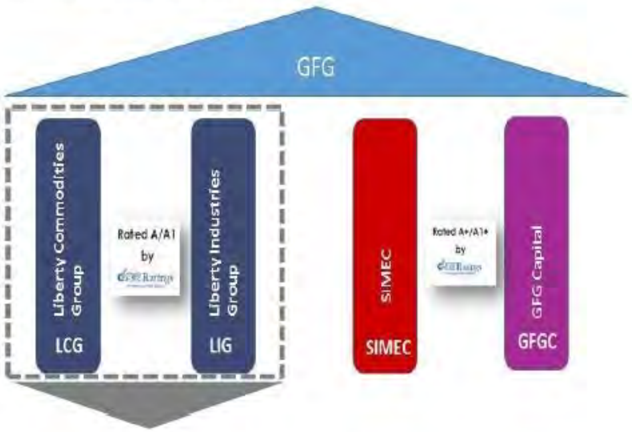
# Gupta Family Group Alliance (GFG)

GFG Alliance Organisational Structure

Source: GFG Global Mission and Structure v10




**Liberty House Group**

Liberty – operating from its four financial hubs in London, Dubai, Singapore and Hong Kong with a network of offices spread across 30 countries around the world.

SIMEC – operating from UK, UAE, Singapore and Hong Kong.

## Overview of GFG

- The Liberty and SIMEC group companies are wholly owned by Parduman K Gupta (father) and Sanjeev K Gupta (son) under the principles and values of the GFG Alliance. Its main focus is to create a resilient supply chain - from liquid steel produced from recycled scrap and renewable energy, to rolled steel and highly engineered products manufactured locally on a global basis.

## Group structure

- Liberty Industries Group (LIG): Integrated steel producer and distributor – from liquid steel to value added advanced engineering products.
- Liberty Commodities Group (LCG): Comprehensive services provider to the global steel and metal industries.
- SIMEC: International resources group with emphasis on sustainable power, mining and infrastructure assets. This is discussed in greater detail in the pages which follow.
- GFG Capital: Innovative financial services and properties platform. GFG Bank specialises in supply chain finance for UK industry and international commodity businesses. GFG Property Division manages and develops the group property portfolio.

[redacted]

# SIMEC Business Overview

## Business description

**SIMEC**

- Global network of companies owned by Parduman Kumar Gupta (father of Sanjeev Gupta), headquartered in Hong Kong. Subsidiary companies are located in Singapore, the UK, India, the UAE, Switzerland and Thailand.
- The network was formed by Parduman Kumar Gupta in 2011 as a consolidation of several of his businesses.
- Despite links with Liberty through common ownership by the Gupta family, [redacted] confirms that SIMEC and L berty are operated independently of one another. However, the two groups collaborate under the GFG Alliance. This is not an incorporated entity, but a framework of shared values and principles which apply when the two groups collaborate. For example, a recent project being delivered by the GFG Alliance is the commissioning of a nationwide network of 'mini-power stations'.
- SIMEC engages in commodities trading and power generation through its Uskmouth power station, acquired from SSE in 2014.
- Power generation and commodities trading at present provide the only two revenue streams for SIMEC; it aims to expand into Shipping, Industrials (predominantly cement manufacture) and Mining through making a range of acquisitions which are discussed briefly below. The recent and forecast financial performance of the companies operations is analysed on page 9.
- As can be seen from the organisational chart opposite, a separate entity has been incorporated for each of these operational areas of SIMEC.

**SIMEC Energy (Energy)**

- SIMEC acquired Uskmouth Power Company Limited from SSE plc on 15 December 2014 and with this a coal fired power plant located in South Wales. This is the only power plant owned by SIMEC. This acquisition was funded with an equity injection of $105m; all new share capital issued at this time was purchased by Parduman Kumar Gupta. Through Marble Power Ltd (ultimately owned by PK Gupta), Energy distr butes its own generated power.
- SIMEC also invested [redacted] in Tidal Lagoon plc, which proposes to develop a large scale tidal power generating unit in Swansea Bay, commencing in 2017. Sanjeev Gupta is a board member of this company.
- Overall ambition is to create a multi-billion pound renewable energy capacity worldwide and apply innovative technologies to provide low-cost power for energy-intensive industries, particularly steel.
- The Lochaber hydro power station will sit within this part of the group.

**SIMEC Commodities (Commodities)**

- Commodities covers the trading of various industrial commodities such as electricity (through Marble Power), coal, biomass, oil, plastic waste and scrap metal. The commodities trading division has subsidiaries in six major locations.
- From information provided by SIMEC, 98% of SIMEC's revenue is generated from the commodities trading division.

**SIMEC Shipping (Shipping)**

- Shipping intends to acquire port facilities in Newport currently owned by Liberty Steel Newport Limited, with the plan of expanding capacity to handle larger and more vessels.
- Longer term plans include acquiring similar facilities in India and Sri Lanka.

**SIMEC Industry (Industry)**

- The main focus currently of Industry is the acquisition of a [redacted] Cements. In July 2016, SIMEC received backing from the New York based private equity house [redacted] which is expected to close soon.
- ABG Cements owns a 6m ton per annum cement plant in Gujarat, India. SIMEC is planning to build downstream plants in Sri Lanka and the Middle East to distr bute the cement.

**SIMEC Mining**

- Acquisitions of particularly coal mining businesses are being evaluated to complement SIMEC's coal trading and power generation operations. Targets in South Wales, Australia and India are being considered.

[redacted]

# SIMEC Group Limited– Financial Overview (Consolidated)

SIMEC

## Financials – Profit and loss account

| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
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[redacted]

## Financial commentary – profit and loss

[redacted]

*Sources: SIMEC Group Limited audited financial statements 2014 and 2015 , management accounts to 31 May 2016, SIMEC Group forecast at 2 September 2016*
*Note 1: EBITDA calculation excludes other income and expenses due to their non-recurring and non-operating nature*
*Note 2: Financials for SIMEC Group differ from those detailed on page 8 due to different sources used*

# SIMEC Group Limited– Financial Overview (Consolidated)

SIMEC

[redacted]

**Financial commentary – cash flow and balance sheet**

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

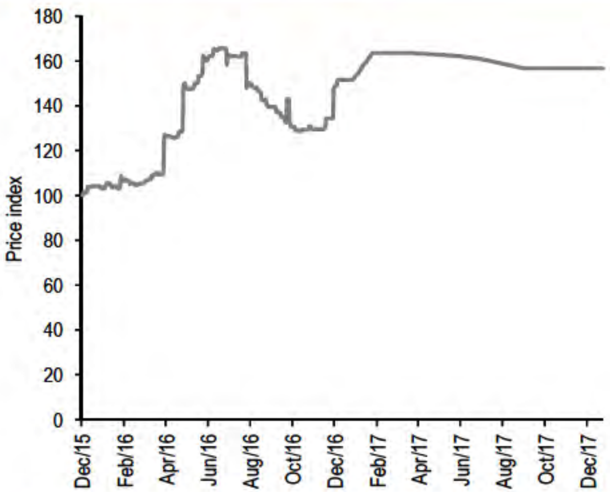
[redacted]

# SIMEC Commodities – Commodity Price Analysis

## Summary

- As commodities trading has provided the majority of SIMEC's revenues since the Group's incorporation, we have completed a high level analysis of recent and forecast (where available) prices of the commodities in which the group predominantly trades.
- The volatility and uncertainty linked with a number of these commodities, in particular Coal, Oil and Gas, as a result of a range of macroeconomic factors, is a potential risk factor to the Group which relies heavily on its Commodity trading operations.

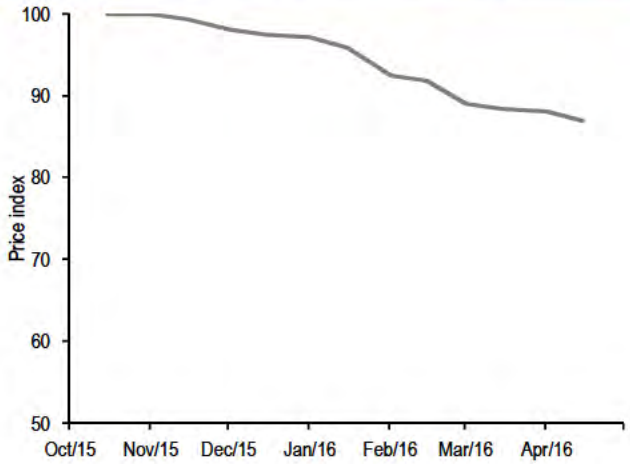
### Steel – (Domestic Hot Rolled Coil)




*Source: Capital IQ*

- According to the World Steel Association the global steel demand decreased by (0.8%) to 1,488 Mt in 2016 following a contraction of -3.0% in 2015. In 2017, it is forecast that world steel demand will return to growth of 0.4% and will reach 1,494 Mt
- Experts believe that steel prices bottomed out in 2015, with expectations of a steady rise in prices through 2019. Much of the recent increase in steel prices have come as a result of a hike in cost of production and the benefits from trade protection measures.
- The combination of anti-dumping measures, Chinese policy to cut 150m tonnes per year of excess steel capacity over the next three-to-five years and lower production has lifted prices in short-term, which in turn is helping to underpin stronger iron ore prices

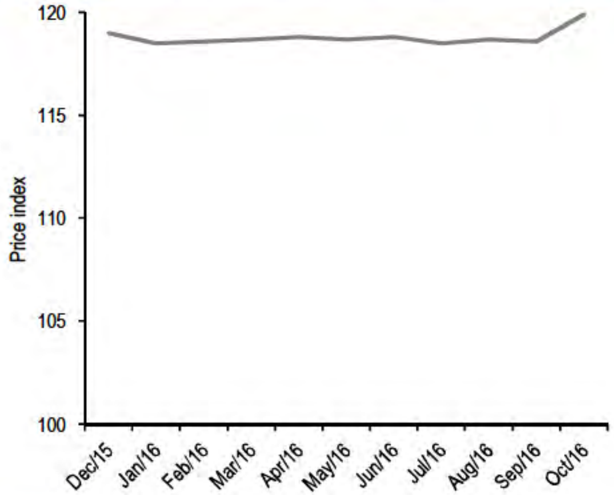
### Biomass – (Wood Pellet price index – cif ARA)




*Source: Argus Media*

- Spot price for wood pellets continued its downward trend with prices reaching at a 12 month low level of $138.8/t
- Lack of bids in the market and little hope among producers of shifting volumes continued to weigh on prices
- With scarce buying interest to attract, sellers wanting to offload pellets in storage– driven by the prospect of summer storage costs –continued lowering their offers and in turn other sellers looking to sell wood pellets not yet in storage felt pressure to match them
- The forward prices are expected to rise with cif ARA forward priced at $150.5/t in Q1-17 and increasing for $156.5/$169.0/$173.5 in 2017/2018/2019

### Cement – (Price index for cement manufactured in UK)

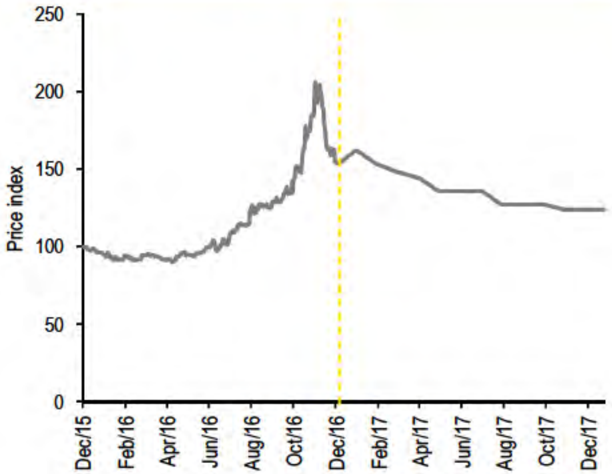



*Source: ONS UK*

- Cement price index, in Oct-16, attained the highest value for 2016 indicating marginal increase in favor of sellers.
- Cement prices have diverged significantly from other building materials throughout the year. As lumber and asphalt prices dipped, cement posted record highs.
- The UK cement market recovered over the past couple of years, with expectations of sound fundamentals and positive forecasts.
- Analysts suggest that after two years of price increases for construction materials and labour, the rate of inflation is levelling off. However, cement appears to have been less subject to inflation than other materials.
- UK government price indices indicate a pattern of stability in 2015 and (provisionally) a slight decline in 2016 with marginal uplift during October.

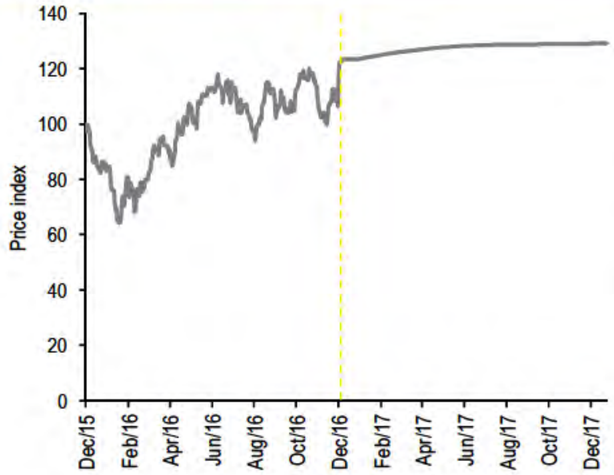
# SIMEC Commodities – Commodity Price Analysis

## Coal – (Newcastle Coal Futures)



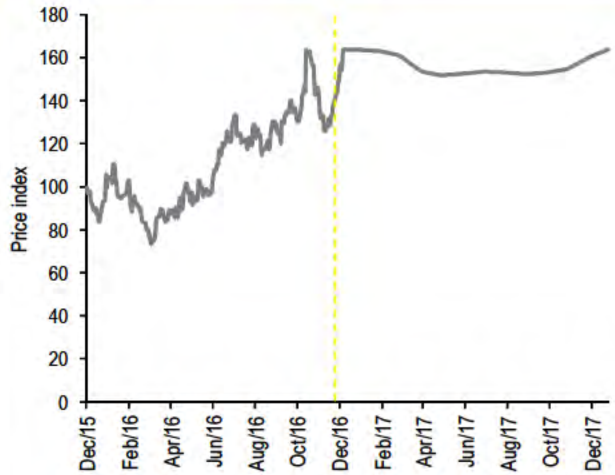

*Source: Capital IQ*

## Oil – (Crude Oil – Brent)




*Source: Capital IQ*

## Gas – (Natural Gas – Henry Hub)




*Source: Capital IQ*

- Coal prices have increased over the past weeks (to its highest level since early 2013), driven by rising Chinese demand.
- China had, in April 2016, placed curbs on domestic coal production; this, combined with heavy rains across coalfields in the northern part of the country, has resulted in increasing Chinese imports of coal (up 12% YoY in the first 7 months of 2016).
- However, the forecasts reflect downward trend in the prices starting Nov-16.
- According to Moody's report dated Nov-16, the ongoing upturn does not appears sustainable given the temporary supply disruptions and operating day restrictions at mines in China, weather events in Australia and a stimulus-driven increase in demand from the Chinese steel sector.

- After declines in oil prices in 2014 and 2015, prices have shown signs of recovery in 2016 and forecast to increase on medium term basis.
- Oil prices surged after OPEC agreed on its first production cut since 2008, aimed at reining in massive oversupply that has seen prices more than halve since mid-2014. The deal expected to see output cut by 1.2m bpd from Jan-17. The agreement to be reassessed after six months with an option to extend for another six months.
- China has also added to increasing demand by importing greater volumes of oil
  - In August 2016, China imported 32.9m tons of oil, the highest level of monthly imports since December 2015 and an increase of 7% YoY
- The outlook has improved in the US with promises of an increased infrastructure spend and the potential for the easing of restrictions on shale oil.

- Natural gas started its recovery in early 2016 and anticipated to increase over the next two years.
- This include a periodic decline in prices between Oct-16 to Dec-16 led by led to lower-than-expected heating degree days and a change in the delivery month from November to December.
- In terms of medium term outlook, as per a news article by Energy Information Administration (EIA) reports, the leading factors for uptrend in the natural gas prices include growing domestic consumption and increasing exports, both via pipelines to Mexico and liquefied natural gas to other markets.
- Also, downside factors also persist including increase in supply with plants in Indonesia and Australia set to offer additional shipments and output resuming from Angola and Nigeria after closures for repairs and maintenance
- There are also major tenders expected in the market, with the largest being from Egyptian Natural Gas Holding (EGAS) to buy 120 cargoes for 2017

# Appendix 1 - Sources

**Source List:**

1. SIMEC Group Limited audited financial statements 2014, 2015, management accounts to 31 May 2016 and SIMEC Group forecast at 2 September 2016
2. ICC - Companies House
3. Capital IQ
4. GIS
5. LinkedIn
6. Factiva

Note: as listed above, despite being limited to publicly available information, we have utilised a number of sources to inform our report. This has included a comprehensive search of press articles, EY knowledge repositories, directors and company documentation from Companies House, and alternative media resources such as LinkedIn. We have also obtained financial information through direct purchase from the Singaporean registrar, and have contacted various personnel within EY (including but not limited to EY Singapore) to obtain further background information on SIMEC and its executive team.

**EY** | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP



Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

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Appendix I

# Liberty Group – Business Overview

# Project Golf II

## Liberty Group – Business overview

15 December 2016

Building a better
working world

# Contents



## Appendices

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Scottish Government
Atlantic Quay
150 Broomielaw
Glasgow
G2 8LU
FAO [redacted]

15 December 2016

Dear Sir/Madam

**Financial Advisory Support for Scottish Government of proposal from SIMEC Group (SIMEC) and Liberty House Group (Liberty) (together "the Group") under Consultancy One Framework RM1502**

In accordance with our proposal dated 4 October 2016, Letter of Appointment of the same date and email between [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.

**Purpose of our report and restrictions on its use**

This report 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 report 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 report they do so entirely at their own risk.

**Scope of our work**

This paper has been requested in addition to our draft reports dated 19 October 2016, 6 November 2016 and 1 December 2016, and in accordance with the email between [redacted] and [redacted] dated 29 November 2016.

Our work for the purposes of this paper has encompassed the following matters:

1. Understand and comment on Liberty's background and group structure
2. Comment on the named executives within Liberty including current directorships, previous directorships and recent news
3. Understand and comment on the historical, current and future (to the extent possible) financial performance of Liberty.

This paper should be read in conjunction with the Project Golf II final report dated 15 December 2016.

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based solely on a review of accounts and other documents available through public records and analytical procedures applied to data provided to us.

Building a better working world

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**Basis of our work**

The financial information contained in this report has been based on the audited accounts of Liberty House Group Pte Limited (the parent company) for the years ended 31 March 2014 and 31 March 2015 and management accounts for the year ending 31 March 2016.

No letter of representation has been sought from management to confirm the factual accuracy of the contents of the report and our key findings and, accordingly, the report is issued on a draft basis only.

**LIMITATIONS ON THE SCOPE OF OUR WORK**

Our work has been limited for the following reasons:

- Limited detailed financial information available through public records due to residency of companies e.g. in Singapore
- No supporting information relating to the security charges listed for LHG

.

**Structure of this report**

The report is divided into 4 sections. The first section comprises our summary and conclusions; the second and subsequent sections comprise management, business and financial overviews, and appendices. We stress that, whilst we have identified in the summary and conclusions key issues based on your instructions, there may nevertheless be other issues raised in the appendices and therefore the entire report should be read for a full understanding of our findings and advice.

We shall be pleased to discuss the contents of this report with you and to provide you with such further information as you may require.

Yours faithfully

For and on behalf of Ernst & Young LLP

[redacted]

# Executive Summary

## Background

- The wider Liberty Group is managed by an Executive Board of Sanjeev Gupta, [redacted]
- We have conducted a directors search on the Executive Board and obtained information based on their education, experience and any recent news.
- We understand that LHG trades and manufactures metallic commodities, and provides services in supply chain management and logistics (e.g. shipping of commodities). This is conducted globally, with primary hubs in Singapore, London, Hong Kong, and Dubai.
- We have conducted an overall review of the business, and a financial review of the parent company, Liberty House Group PTE Limited (LHG).

## Conclusions

From the information available, we have summarised the key points below:

### Management

- None of the executives are listed on the UK directors disqualification register - however this would only identify disqualifications for directors active in the UK.
- All executives appear to have extensive industry experience in the metals and steel sector.
- Sanjeev Gupta is active as a director of more than 50 UK-based companies most of them formed since the beginning of 2015, but based in the UAE, although we understand he spends time in the UK.

### Business

- Commodities trading: LHG trades in both ferrous and non-ferrous metals, including: raw materials, steel, nickel, zinc, copper, and tin. This is the largest part of the group providing 94% of revenues.
- LHG is a large producer of steel, owning steel mills in emerging markets such as India and Ghana outright, and owning stakes in large mills in India with a total combined production capacity of 2.5m MT per annum. LHG expanded this production capacity through the purchase of the MIR Steel plant in Wales which commenced production in 2015, with annual production capacity of 1.5m MT.
- LHG completed its acquisition in April 2016 of the former Tata Steel plate making facilities at Dalzell and Clydebridge in Lanarkshire and in September 2016 re-commenced production at the Dalzell plant. We understand that the acquisitions are part of the wider strategy to build an integrated and sustainable steel business across the UK.
- LHG provides supply chain, logistics and financial services. The logistical component includes shipping of metal commodities on a global scale.

### Financial

- [redacted]
- LHG has grown significantly year on year in terms of revenue and profitability since 2013.
- [redacted]
- It is clear that LHG has been acquisitive and therefore there is a risk of over leveraging the group and consequently constraints on the cash as the acquired businesses are invested in with a view to increasing profits.

# Liberty Executive Management

| Sanjeev Gupta | |
|---|---|
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
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| [redacted] | [redacted] |
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| [redacted] | [redacted] |
| [redacted] | [redacted] |

| Paul Francis | |
|---|---|
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |
| [redacted] | [redacted] |

# Liberty House Group Pte Limited - business overview

LIBERTY

## Business description

**Liberty House Group**

- Global network of companies owned by L berty House Group Pte Limited, headquartered in Singapore. Subsidiary companies and hubs are located in Singapore, Hong Kong, the UK and the UAE.
- The network is wholly owned and was formed by Sanjeev Gupta whilst at college in Oxford to engage in the trading of metal commodities.
- **Liberty Commodities:**
  - is the central trade and supply chain services arm of the wider group providing comprehensive services to the global steel and metal industries.
  - its product offering includes ferrous products such as iron ore, coking coal, scrap, pig iron, billets, slabs, de bar and non ferrous metals such as nickel, zinc, copper aluminium and tin.
  - it provides supply chain, logistics (including shipping services, ports, warehouses, rail and road transportation) and value add services e.g. financing solutions.
- **Liberty Engineering:**
  - comprises specialist engineering companies which include product ranges across precision steel strips, carbon composites and motor racing brakes to super lightweight assemblies for aircraft engines.
- **Liberty Industries:**
  - is an integrated producer and distr butor of steel, owning medium sized mills in emerging markets such as India and Ghana outright, and owning stakes in larger mills with a total combined production capacity of 2.5m MT per annum. L berty has expanded this production capacity through the recent re-opening of the MIR Steel plant in Wales, with annual production capacity of 1.5m MT and the recent acquisitions of the Dalzell and Clydebridge plants in Scotland.

## Recent Developments

- In recent weeks L berty has announced it has entered into negotiations to acquire Tata Steel UK's Speciality Steels business for a total consideration of £100m. The planned deal, in combination with L berty's existing industrial foot print in the UK, would establish the group as one of Britain's most significant steel and engineering employers. *(http://www.libertyhousegroup.com/news/liberty-moves-to-acquire-tata-steel-s-speciality-steels/)*
- Liberty launched a metal recycling business in October 2016, Liberty Metal Recycling (LMR), as a major step towards the achievement of its green steel vision to create a competitive and sustainable UK steel sector. *(http://www.libertyhousegroup.com/news/new-recycling-business-marks-major-milestone/)*
- In May 2016 L berty bought the steel tower production plant which was closed down in September 2015 by Mabey Bridge Renewables in South Wales. The equipment will eventually supply the growing off-shore wind market and turbine casings for Tidal Lagoon power, in which Liberty's sister company, SIMEC, is a major investor. *(http://www.libertyhousegroup.com/news/liberty-enters-steel-wind-tower-market-with-key-investment/)*
- Liberty completed its acquisition in April 2016 of the former Tata Steel plate making facilities at Dalzell and Clydebridge in Lanarkshire in a back-to-back transaction with ScotGov. L berty reopened Dalzell in September 2016 and is investing in the sites as part of its wider strategy to build an integrated and sustainable steel business across the UK. *(http://www.libertyhousegroup.com/news/liberty-house-group-statement-regarding-steel-plate-mills/, http://www.libertyhousegroup.com/news/liberty-saves-steel-plants-in-scotland/)*

[redacted]

# Liberty House Group Pte Limited – financial overview (consolidated)

[redacted]

**Financial commentary**

[redacted]

[redacted]

*Source:* LHG audited accounts for FY14 and FY15 and management accounts 2016

# Appendix 1 - Sources

**Source List:**


1. Liberty House Group Pte Ltd financial statements 2014
2. Liberty House Group Pte Ltd financial statements 2015
3. Liberty House Group Pte Ltd management accounts 2016
4. ICC - Companies House
5. Capital IQ
6. GIS
7. LinkedIn
8. http://www.telegraph.co.uk/finance/newsbysector/industry/12022732/Liberty-saves-350-jobs-after-Caparo-steel-empire-topples.html
9. http://www.bbc.com/news/uk-wales-south-east-wales-34538681
10. http://articles.economictimes.indiatimes.com/2014-07-07/news/51133821_1_proposed-combination-pig-iron-miglani-family
11. http://uk.reuters.com/article/uk-lme-steel-idUKKCN0RM0V020150922
12. http://economictimes.indiatimes.com/nri/nri-investments/indian-origin-family-invests-in-india-uk-tidal-power-project/articleshow/50818281.cms
13. http://www.oanda.com/currency/historical-rates/
14. http://libertyhouseuk.com/about/management
15. http://libertyhouseuk.com/services/value-added-services


Note: as listed above, we have utilised a number of sources to inform our report. This has included a comprehensive search of press articles, EY knowledge repositories, directors and company documentation from Companies House, and alternative media resources such as LinkedIn. We have also obtained financial information through direct purchase from the Singaporean registrar, and have contacted various personnel within EY (including but not limited to EY Singapore) to obtain further background information on Liberty and its executive team.

# Appendix 2 - Sanjeev Gupta Directorships

**Active Directorships**

[redacted]

**Resigned, Dissolved or Dormant**

[redacted]

# Appendix 2 - Sanjeev Gupta Directorships

**Directorships of Companies formed in 2015 or 2016, and therefore not yet analysed**

[redacted]

[redacted]

**EY** | Assurance | Tax | Transactions | Advisory

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