

Usolsky potash, Russia

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Russian project financings were rare in 2014, and are likely to become more so in 2015. International political tensions will make oil and gas financings - the market's backbone - hard to pull off.

But on 24 December 2014 agricultural chemicals producer EuroChem closed its debut project financing, for the Usolsky potash project. The \$750 million debt is designed to minimise the strain on EuroChem's balance sheet while addressing the concerns of international project finance banks and the sponsor's corporate lenders.

The Usolsky resource

Usolsky is located on the Verkhnekamskoe deposit in the Perm region, and is one of two priority potash projects for EuroChem. The sponsor acquired the licence for the project in 2008 for \$172 million, and estimates that it has proven and probable reserves of 420 million tonnes at a grade of 30% potassium chloride (KCl). The first phase of the mine has a planned capacity of 2.3 million tonnes per year (tpy), with a second phase taking the mine's capacity to 3.7 million tpy.

EuroChem has closed structured export finance, corporate loans, export credit facilities, and domestic and international bond issues, and as of September 2014 was subject to Rb101 billion (\$2.73 billion) in corporate debt. It never had a suitable project for a project financing before Usolsky, and the additional costs associated with a project financing discouraged it from looking further.

The developer, however, wanted to free up cash for other purposes, including its other headline potash asset, the \$5 billion VolgaKaliy. But to make Usolsky bankable, EuroChem had to provide sufficient support to its financing - without violating the ability to carve out the debt from its corporate borrowings or having to consolidate it.

Managing construction, offtake and onshore risk

So, EuroChem provided commitments to support any deviations from an agreed, and very conservative, construction budget, without providing a blanket completion guarantee or lender recourse to other corporate assets.

EuroChem gave lenders the ability to approve the credit quality of major construction contract counterparties. It is working with a small number of counterparties rather than a single large engineering, procurement and construction (EPC) contractor to keep costs down, even though using an EPC contractor might have allowed it to work with export credit agencies.

EuroChem also managed to mitigate one of the most important technical risks in a potash project - the risk that sinking a shaft through a layer of water over a potash deposit gets the deposit waterlogged. The company proved, by sinking three shafts, that it could manage that process effectively.

About a third of EuroChem's output, and between 20-25% of its cashflows, comes from its overseas assets. The sponsor operates in Belgium, the US, Lithuania and Kazakhstan, and between 60-70% of its sales are offshore.

EuroChem gave the lenders comfort about volume risk, by assembling a suite of offtake contracts with other EuroChem group entities located overseas. The contract price is indexed to the Industrial Minerals published price, and proceeds of sales are deposited in an offshore account for the benefit of lenders.

One complicating factor for EuroChem was that it does not simply sell basic phosphate, but sells value-added products and compounds, so it must route sales in such a way that it can satisfy lender concerns and maintain operational flexibility.

Assembling the financing

The Usolsky lending club comprises Russian and international banks that had worked with EuroChem before:

- Société Générale (facility and security agent)
- Rosbank (SG's Russian subsidiary)
- ING
- HSBC
- Crédit Agricole
- UniCredit
- Sberbank

The debt has a tenor of eight years, including a 3.5-year construction period, and amortises completely. For that reason the \$750 million project finance facility covers a fraction of the mine's \$2.9 billion cost, and a fraction of its long-term earnings potential.

The lenders stuck with EuroChem and the Usolsky financing even as Russia's political backdrop deteriorated. The US in 2014 imposed sanctions on several Russian banks and on the use of advanced oil technology, which made banks doing business in Russia nervous. EuroChem's diverse global presence and headquarters in Switzerland reassured lenders that the financing could continue uninterrupted.

Russian projects' ability to access international project finance markets shows little sign of improving, however. Gazprom's South Stream pipeline has been cancelled, and sanctions will hit the more ambitious liquefied natural gas (LNG) and offshore oil production projects.

But Usolsky's combination of intensive construction monitoring, and offshore account structure, has wider application in the mining sector in other emerging markets. Potash deposits of Usolsky's quality are rare, but mining developers looking to save on construction and financing costs are much more common.

The legal advisers on the financing were White & Case (sponsor) and Linklaters (lenders), and the insurance advisers were JLT (lenders) and Marsh (sponsor). Wardell Armstrong was technical adviser, and CRU was market consultant, to the lenders.

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