

UKRAINE

By Interfax-M&CN

Last year was one of the most successful for Ukraine in terms of economic growth since the country gained independence, and GDP grew by 6% in 2000. Industrial production rose 12.9% and agricultural output was up 7.6%.

The economy was boosted not only as a result of favourable trends on world markets, but also due to certain budget achievements, improved payment discipline in the energy sector, and an acceleration in market reforms in the agrarian sector. Just the same, economic reforms are not progressing as quickly as the Cabinet of Ministers would like, and while last year's economic indicators were high, they lagged behind other CIS countries.

Ukraine is noted mainly for its iron and steel industry, and the country is the second biggest, behind Russia, in size and output among the former USSR republics. The iron and steel sector has its own mineral resource base and a big export potential. Also, the Ukraine is a major producer of coal, manganese, ferroalloys, ilmenite and alumina. Ukraine is also producing a number of other mineral products, including aluminium, rare metals, nickel, copper, oil and gas, and some industrial minerals, such as dolomite, kaolin, graphite and quartz.

In 2000, Ukraine's mining and metals sector outperformed other industry sectors. Ferrous metallurgy increased output by 20.7%, while non-ferrous metallurgy grew by 18.8%. Exports were an important driving force in the industry's growth in 2000, and Ukraine raised ferrous metals exports last year by 8%, to 28.6 Mt. The exports included 5.5 Mt of long products, 6.7 Mt of flat products, 8.5 Mt of semi-finished products, 800,000 t of ferroalloys, 1.5 Mt of pig iron, 4.8 Mt of scrap metal, 1.1 Mt of steel pipes and 18.8 Mt of iron ore pellets.

Capital investment in the mining and metals sector last year rose 46.9% to H2.45 billion (US\$445 million), of which 90% of the enterprises financed themselves and bank loans financed just 2-3%. However, average depreciation of production capacity in the sector reached 63% and increases by H3.3 billion (US\$600 million) annually. The sector is expected to post pretax profits of about H6.7 billion (US\$1.2 billion) for 2000, with profitability of 18.3%. The proportion of barter operations in the sector decreased to 11% from more than 30% in 1999.

In 2000, Ukraine continued its economic 'experiment' at mining and metals plants. Under legal amendments made for the economic experiment, participating mining and metals companies have been granted a number of tax breaks for the period from July 1, 1999 to January 1, 2002. These include: reduced tax charges and lower contributions to the state innovation fund; an environmental levy that does not exceed 0.15% of gross costs; and an exemption from road levies. Pollution charges are distributed between enterprises and local authorities. The cabinet selects participating enterprises in agreement with parliament's industrial policy committee. About 70 mining companies are currently participating in the programme (none was disqualified in 1999 or 2000).

In February 2000, Ukraine's State Committee for Industrial Policy ordered mining and metallurgical companies that have been benefiting from substantial tax breaks under the government's economic experiment to spend the money they have saved on upgrades. The investments must be equal to, or exceed, those monies that would otherwise have been paid in taxes and other dues to the state.

In March 2001, the Ukrainian Government approved amendments to the Law on State

Regulation of the Mining, Production and Use of Precious Metals and Gemstones and Control of Operations. The amendments are designed to step up control over the mining, production and use of precious metals and gemstones, as well as to bolster budget revenue.

Meanwhile, privatisation in the mining industry continues. State-owned Ukrudprom is preparing to incorporate some of its subsidiaries with a view to privatising them in line with a government resolution. The Krivoi Rog Iron Ore Combine and Dokuchayevsky Fluxed Dolomite Combine would be incorporated, as would Krivbassvzryvrom and also three mine amalgamations (Komsomolskoye, Novotroitskoye and Balaklavskoye). All of the stock in the new joint stock companies will be transferred to Ukrudprom's charter capital. The value of other subsidiaries (including Kirov Mine Amalgamation, Krivbassproyekt and Krivbassshakhtopererabotka) will be taken out of Ukrudprom's charter capital.

In 2000, Ukrudprom registered a first share issue, worth H1.15 billion, and the government is now considering ways to privatise the holding company. The company owns 50% of the Inguletsky and Severny mining and beneficiation plants, and 25.78% of the Yuzhny plant, which are among Ukraine's biggest iron-ore producers.

Iron and Steel

Ukrainian's iron-ore reserves are huge: according to the Ukrainian calculation method, they are estimated at around 30,000 Mt, which will be enough to maintain mining for hundreds of years. Ukraine's iron-ore reserves rank the country second among the former USSR republics, behind Russia.

The ores have a relatively high iron content of 45-55%. The biggest iron-ore basin is Krivoi Rog in Dnepropetrovsk region, where the bulk of the reserves (as well as key iron-ore production capacities) are located. Krivoi Rog's mining and beneficiation plants provide

around 80-90% of all Ukraine's iron ore, concentrate and pellets.

The iron-ore deposits are mined by eleven mining and beneficiation plants. Most of them are open-pit developments. The major strip mines are Yuzhny, Tsentralny, Severny and Inguletsky, all of which are located in the Krivoi Rog basin. Main Ukrainian underground iron-ore mines are Krivbassruda Production Association, Kirov Ore Co., Sukhaya Balka Ore Co. and Zaporozhye GOK.

In 2000, Ukraine increased commercial-grade iron-ore production by 17.2% to 55.65 Mt, and concentrate by 18.2% to 42.36 Mt. Inguletsky GOK (Mining and Enriching Combine) remained the top producer with output of 11.5 Mt (an increase of 6.6%). Yuzhny GOK increased output by 5.5% to 8.35 Mt, and Poltavsky GOK by 31.0% to 6.51 Mt of concentrate. Ukraine's pellet production increased 28.6% to 12.34 Mt in 2000. Agglomerate output was up by 9.1% to 10.18 Mt.

External demand contributed to the growth of output. Ukraine exported 19.48 Mt of iron ore in 2000, up 35.6% year-on-year. Ukraine exported 6.11 Mt of pellets, up 73%, 6. Mt of concentrate, up 49%, and 6.69 Mt of sintering ore, up 6%. Exports to countries outside the CIS rose by 36.2% to 19.45 Mt.

Foreign banks are increasing their involvement in the Ukraine iron-ore industry. In November 2000, Raiffeisen Bank Ukraine, a member of the Austrian Raiffeisen Group, lent Poltavsky GOK US\$3 million to buy equipment. The credit was repayable in three years. The bank opened a revolving credit line of US\$3 million for the GOK in June 1999 to March 2000 to top up working capital. In September 2000, the bank extended the facility until April 2001, and increased it to US\$5.5 million. Poltavsky is Ukraine's biggest pellet exporter to Europe. It supplies to Austria, Poland, Romania, Yugoslavia, the Czech Republic and Slovakia, among other

countries. It is Ukraine's biggest open-pit producer, and has a pellet capacity of 10 Mt/y.

In March 2001, Bank Austria Handelsbank (Austria) bought 60% of shares in Yuzhny GOK. Bank representatives are not releasing the financial details of the deal and the level of possible investment in the company. However, some sources suggest that the bank plans to invest over US\$50 million in the company.

Iron-ore producers also benefited from the growth of Ukraine's domestic metals industry, which boosted output by 17% in 2000. The greatest growth was 41.5% in steel pipe production, which increased to 1.67 Mt. Production rose 11.7% to 25.7 Mt for pig iron, and 14.6% to 31.4 Mt for steel, the highest figure in seven years. Output was also up 11.6% to 19.3 Mt for coke. However, Ukrainian output of ore and coking coal, as well as the quality, are insufficient for the metals industry's needs. Imports of coking coal reached 3.8 Mt in 2000, including 3 Mt from Russia. The remainder came from Poland and North America. The shortage of raw materials remains one of the main reasons why the 2001 production target for pig iron of 26.7 Mt may not be met.

Manganese

Ukraine is one of the biggest manganese ore-producing countries in the CIS. In 2000 it increased manganese concentrate output by 38.0% to 2.74 Mt. The growth was fuelled by strong demand from Ukraine's steel mills as well as foreign steel producers.

Ordzhonikidze GOK, which operates mines and beneficiation facilities in the Dnepropetrovsk region, raised output by 29.8% to 1.83 Mt. It is the country's biggest manganese ore producer, and mines all of its ore by open-pit methods. Marganetsky GOK, a major manganese ore producer from the Dnepropetrovsk region, boosted concentrate output in 2000 by 58.4% year-on-year to 917,000 t. Marganetsky is Ukrainian's only

underground producer of manganese ore, and its main consumers are the Nikopol and Zaporozhye ferroalloy works. In June 2000, the Ukrainian Government put Marganetsky and Ordzhonikidze on a list of mining and metals enterprises that qualify for tax breaks under its economic experiment.

Meanwhile, the government is decreasing its control over top manganese producers. In July 2000, the Ukrainian State Property Fund sold 8.3% of the shares in the Ordzhonikidze GOK on the First Stock Trading System to an undisclosed buyer. In March 2001, state-owned Ukrainian Polymetals, sold 25% of the shares in Ordzhonikidze GOK. The proceeds from the sale will be invested in further exploration and preparations to develop gold deposits in the Ukrainian crystalline shield and the Beregovsky ore province in the Transcarpathian region, and to develop titanium deposits. Ukrpolimetal was set up in 1998 for the Zoloto Ukrainy (Gold of Ukraine) programme, with charter capital of H616 million. The Ministry of Industrial Policy (72%) and State Property Fund were among the founders. Ukrainian Polymetals controls assets of the Volnogorsk and Irshansk state mining and milling complexes, state-owned Izumrud, the Kristall jewelry factory of Lviv, and government shares in Zakarpatpolimetal and in the Poltavsky, Ordzhonikidze and Marganetsky mining and beneficiation plants.

Ukrainian ferroalloy producers (Nikopol, Zaporozhye and Stakhanov ferroalloy plants) increased ferroalloy production 35.5% year-on-year to 1.36 Mt in 2000. Production at the Nikopol ferroalloy plant increased by 56% to 777,000 t; at the Zaporozhye ferroalloy plant by 6% to 379,000 t; and at the Stakhanov ferroalloy plant by 40% to 205,000 t. The growth in production was due to increased demand for this product on the world market, in addition to stable power supplies to the three companies.

The Nikopol works, Ukraine's biggest ferroalloy producer, is exporting 80% of its

output, mainly to Russia and countries outside the CIS. It plans to produce at least 700,000 t of ferroalloys in 2001. The Zaporozhye works produces 47.7% of Ukraine's ferrosilicon, and all of the country's 80%-medium carbon ferromanganese and 90%-metallic manganese. The Stakhanov ferroalloy works in the Luhansk region is the third largest ferroalloy producer in the republic, and specialises in ferrosilicon. It produces some US\$4.5 million in ferroalloys every year and exports about 80% of its output.

In July 2000, Kuibyshev Metallurgical Works of Kramatorsk in Ukraine's Donetsk region became the first company in the CIS to produce silicon manganese in a blast furnace. The first lot of silicon manganese was smelted in the No. 4 furnace, which the works re-commissioned after an overhaul in March 2000. The furnace was unique in that it could not only smelt all types of iron but also ferroalloys. The furnace has a capacity of 1,033 m³ and is capable of turning out about 2,000 t of pig iron and 550 t of ferromanganese per day. The new technology for smelting the alloys in the blast furnace, devised by specialists from a company called Vizavi and the Donetsk R&D Institute for Ferrous Metallurgy, uses cheaper burdening materials and can reprocess waste.

Coal

Ukraine, is one of the biggest coal-producers in the CIS. Ukraine produced 80.28 Mt of coal in 2000. Production of coking coal rose from 34.87 Mt to 38.54 Mt, while production of thermal coal fell from 46.18 Mt to 41.74 Mt. The country had 191 coal-producing enterprises on July 1, 2000.

Ukraine is not self-sufficient in coal and it is estimated that Ukraine's own mines are capable of supplying power stations with 26 Mt/y of coal - less than the 28-30 Mt they require. In recent years, Ukraine has imported an average of 4-5 Mt of thermal coal. Ukraine imported 5.5 Mt of coal in 2000,

16.5% more than in 1999. Imports of thermal coal were up 35.5% to 2 Mt and imports of coking coal by 5.7% to 3.5 Mt.

In March 2001, the Ukrainian Government's Committee for Industrial Policy and Fuel and Energy approved the draft of a programme to reform the coal industry. The new programme, entitled Ugol Ukrainy (Coal of Ukraine), differs from that drafted under the auspices of Yulia Tymoschenko, a former deputy prime minister. Tymoschenko's proposals - to transfer all coal mine accounts to an authorised bank, introduce the mandatory sale of coking coal at auctions, privatise coal mines and sign them over to the trusteeship of corporate bodies and individuals - were all rejected.

The Ukrainian Government budgeted H59.27 million, approximately US\$11 million, for pit closures and H4 million to finance coal industry restructuring this year. In April 2001, the government issued a resolution on the liquidation of 19 loss-making underground mines and two open pits in 2001. The list includes: seven underground mines from the Donetsk region (Oktyabrskaya, N10-bis, Krasnoarmeiskaya, Alexandrovskoye No. 4 mine amalgamation, Fominskaya and Donetskaya); 11 underground mines from the Luhansk region (S.V. Kossiora, Komissartovskaya, Proletarskaya, Annenskaya, F.P. Lyutikova, Maiskaya, Rodina, Raduga, Kremennaya, Almaznaya and Ukraina); and one underground mine and two strip mines from the Kirovgrad region (Morozovskaya and the strip mines Bandurovsky and Verbolozovsky).

The World Bank at the end of 2000 allocated Ukraine the last two tranches totalling US\$70 million of a SECAL coal industry restructuring credit. The closure of uneconomical coal mines is one of the main conditions for the credit.

Meanwhile, in 2001 the government is going to launch its privatisation of the coal industry. Ukraine intends to privatise all of its coal

mines and hand them over to new managers. All coal-producing enterprises will be ranked according to investment appeal. A first group would include profitable mines, the second potentially profitable mines, the third unprofitable mines and the fourth mines slated for closure. Ukraine plans to privatise its profitable mines by selling new stock. Then the mines would be handed over to legal entities and private individuals on the basis of investment programmes lasting for up to 20 years. The unprofitable pits would be privatised by holding tenders for the right to draft development plans, their new managers being allowed to keep some of the profits. The unprofitable mines might be privatised or handed over to managers free of charge provided that they can meet all of the criteria. The government's goal is to bring in powerful professional teams to rejuvenate the sector.

Ukraine also proposes to privatise some of the potentially profitable and unprofitable mines, and mines subject to closure, by selling all of their stock at tenders. Some of the potentially profitable mines and unprofitable mines might be leased out.

Ukraine plans to hold its first auctions for shares in coal producers in the fourth quarter of 2001. The first stage of preparations is currently under way. In October 2001, the coal producers will start to issue shares which will be deposited with the fuel and energy ministry ahead of the auctions. As of January 1, 2001, the ministry controlled 197 coal mines, 70 of which are undergoing bankruptcy proceedings. The Komsomolets Donbass underground mine has already been privatised, and the Zasyadko mine leased out.

Aluminium

Ukraine's Nikolayev Alumina Plant (NGZ), the largest CIS producer of alumina, produced 1.12 Mt in 2000, which was 12% up on 1999 (0.99 Mt). Last year the works also produced 105,000 t of red mud and 1.8 t of gallium (83,552 t and 1.14 t, respectively, in 1999). NGZ's capacity is 1 Mt/y.

The company's financial performance improved due to the regular supplies of bauxite, with 250,000-300,000 t/mth being supplied from Guinea, Australia, Brazil and Guyana. The refinery also managed to carry out technical improvements in full, whereas the company had previously faced a lack of funds for these purposes.

Practically all the alumina produced was supplied to Russia and Tajikistan, with only 2-3% of output being sold on the domestic market. The refinery also sold red mud to Ukrainian cement producers.

Meanwhile, the Ukrainian Property Fund is trying to sell its remaining 10% of the Nikolayev alumina plant. The Fund, which has been trying to sell the shares since last November, has tried (and failed) on no fewer than seven occasions, reducing the starting price from H0.55 to H0.40/share, and breaking the block up into smaller lots. The government said in the past that the block would be entered into the charter capital of the Credit Guarantee Fund for Small and Medium Enterprises if it could not be sold on the exchanges.

Ukrainian Aluminium, a subsidiary of Russian Aluminium, owns 49% of NGZ, and ZAO Trudovoi kollektiv, which is also controlled by Russian Aluminium, owns a further 26.4%. The Baltic investment company, Ukio Bankas, owns 5.33%, the Ukrainian Government and minority shareholders own the rest of the shares.

Zaporozhye Aluminium Combine (ZAIK), Ukraine's only aluminium smelter, produced 103,591 t of primary aluminium, 7.8% less than in 1999 in a drop attributed to reduced power supplies. Capacity of the smelter is about 100,000 t/y.

In August 2000, Kaiser Aluminium of the US completed a feasibility study for the reconstruction of smelting capacity at ZAIK. Modernisation of the electrolysis production at ZAIK (including indirect expenditures) cost

US\$200 million. The modernisation will help increase aluminium output from 100,000 t to 157,000-164,000 t/y, and reduce (self-financed) costs from US\$1,160 to US\$1,002/t. Modernisation will also help reduce the discharge of harmful substances into the atmosphere: from 8,853 t (in 1999) to 5,034 t/y. Modernisation may take five years, while the payback of annual expenses will take an estimated 5.3 years. The project provides, in particular, for construction of a plant for production of burnt anodes at the ZAIK worth US\$54 million, with simultaneous closure of the similar production facility at the Zaporizhia-based Ukrgrafit JSC.

On February 8, 2001, AutoVAZ-Invest signed an agreement with the Ukrainian State Property Fund on the purchase of 68.01% of ZAIK's shares as the winner of a tender invited last autumn. AutoVAZ-Invest plans to launch the production of aluminium foil there before the end of 2001. Around US\$15-17million is needed for this purpose. The funds will be channelled mainly into the contract construction of new workshops. The company had received US\$74 million worth of aluminium foil-producing equipment of the FATA firm under an Italian credit line long ago. However it failed to put it into operation. AutoVAZ-Invest has announced the details of a 'large-scale', ten-year, investment programme. It is aimed at switching to the production of commodities with a higher degree of processing and ready-made components for the aluminium industry.

Others

State-owned Ukrainskiye Polimetally (Ukrainian Polymetals, or Ukrpolimetally), a producer of gold and polymetallic concentrates, increased exports by 50% last year over 1999. Gold production was up by 500%. However, this sort of growth can only

be sustained if the company is able to start mining the deposits of the Ukrainian crystalline shield and increase output at the Muzhiyev gold lode in the Trans-Carpathian region. Ukraine has listed 236 gold occurrences, 10 of which are classed as deposits with reserves of 80-135 t of gold. Ukrainian geologists say the Muzhiyev ores average 5-6 g/t Au, and as high as 8 g/t in places. Grades in complex ores range from 2 to 4 g/t. Ukrainskiye polimetally also plans to develop the Irshansk ilmenite deposits as titanium producers Titan of Simferopol and Sumykhimprom are very low on raw materials.

In December 2000, Ukrainskiye Polimetally approved a strategy for the development of its subsidiary companies in 2001-2010. This calls for the formation of joint ventures with foreign organisations, and the company said that it planned to issue new stock to raise additional investment capital. A joint venture would, for example, be set up at the state-owned Irshansk Mining and Enrichment Plant in the Zhitomir region, which produces ilmenite concentrate for the titanium industry. The Ukrainian State Property Fund will hold a tender for 25% of the Irshansk complex on a date yet to be decided. Another joint venture in which the foreign partner might own up to 75% of the equity will be set up to draw investment into the development of the mineral base of the Irshansk district and to develop the Valki-Gatskivskoye ilmenite deposit.

Private capital will also be involved in the development of Zakarpatpolimetally, which is the country's only gold producer. Its shareholders are currently Ukrpolimetally, Ukrainian Innovation Financial Co., the Trans-Carpathian Regional Administration and the Beregovsky District Administration.