

## Julietta Mine Development Outcome

### Project Description and Rationale

The Julietta project involved the construction of a \$76.5 million gold and silver mine in a very remote area of Magadan Oblast in Russia's Far East. The mining project was developed by OMGC, a Russian company 79-percent owned by Bema Mining Corporation. At the time, Bema was a junior gold mining company listed on the Toronto Stock Exchange. Two Russian companies owned minority shares in OMGC.

The project components included:

- Development of an underground mine with an estimated 4-year life span.
- Construction of a processing plant.
- Construction of infrastructure, including access roads.

The project aims included spurring further regional development, implementing international mining standards, and creating a successful business venture that would bring both jobs and new tax revenues to the remote province. IFC provided a primary loan of \$8.5 million and a secondary loan of \$1.5 million to support the project.

Without IFC's participation, the project is not likely to have gotten off the ground because Bema had no track record of working within Russia, and it is far from clear that the company could have secured all its needed funding. Indeed, IFC served as the lender of last resort, stepping in to provide additional financing in 1998 after one bank pulled out amidst the Russian financial crisis. The project provided almost 540 jobs for local residents and Bema's tax payments for a time contributed one-third of the region's tax revenues—significant benefits that would not have accrued absent this project.

### Summary of Outcomes

The overall outcomes of the project were mixed. Based on the full costs of the project, the overall economic rate of return was unsatisfactory and on a standalone basis it was not a successful business. However, the project did generate tax revenues, jobs and demand for local businesses that benefited local people. The project experienced excellent results on the environmental front, and the company agreed with IFC to include a specific reclamation agreement for addressing mine-closing activities.

Ultimately the project investors profited from their investment because their work with the Julietta mine helped them win the rights to another attractive gold deposit (Kupol) in the same region. This mine is now being developed by Kinross Gold Corporation who took over Bema in 2006.

IFC's investment outcome—the returns to IFC on its loans—were excellent. The primary loan was repaid six months early, and the expected rate of return on the second loan was attractive because of its attached rights to buy equity in Bema.

## Development Results

Specific development results include:

- **Uneven Business Success.** The project had higher-than-expected production costs, due in part to poor quality ore and difficulties in extracting the minerals. Contributing to this, the two-step mill processing technology put in place proved to be inappropriate and not cost-effective. As a result of lower production and the company's gold price hedging policy, even though gold prices were rising during the time that the mine was in operation, the company was unable to take full advantage of the favorable market conditions. Bema, the parent company, had to provide loans to OMGC twice during the project. However, although the project had its troubles, Bema's track record for doing business in Russia helped the company to secure the rights to a large mining project elsewhere in the country. Largely as a result of this, Bema's market capitalization skyrocketed from \$80 million in 2000 to over \$2.1 billion by mid-2004.
- **Mixed Ratings for Economic Sustainability.** The economic rate of return on the project once all the costs, including costs that could be considered as sunk costs at the time IFC entered the project, were factored in was -1 percent, which is unsatisfactory. Excluding these sunk costs, the project's economic rate of return would have been significantly higher at over 18%. The project had a positive impact on the region's tax base: over \$11 million in new monies were paid into local coffers. Several local projects were directly attributed to the new revenues, including construction of a 30-unit apartment building, a new boiler house, and a new day care center. In addition, the project provided employment for almost 540 people at wages that started at five times the country's minimum wage rate. These new hires included 12 indigenous people working at the mine.
- **Excellent Environmental Performance.** The project was implemented in full compliance with IFC and World Bank Group requirements. With guidance from IFC, OMGC put in place a comprehensive plan to address environmental, health, and safety issues at the mine. Some initial problems concerning cyanide management were quickly spotted and addressed. A hallmark of the project was the inclusion of a reclamation agreement detailing both mine closure and subsequent land renovation activities. OMGC also established a mine rehabilitation and closure fund to help pay for ongoing reclamation activities.
- **Satisfactory Ratings for Fostering Private Sector Development.** The project had a positive impact on local suppliers. From 2002-2004, OMGC spending approximately \$27 million along the supply chain, in the process helping other Russian companies to be more efficient and cost-effective operators. For example, a refinery doubled its capacity and hired an additional 50 people (adding to the 110 employees it already had); an explosives company was retrained to more safely blast ore; a fuel supplier doubled its fleet of trucks and improved its loading capabilities.

## **IFC's Work Quality and Role**

IFC's overall performance on the project was mixed based on quality work in three operational areas: screening, appraisal, and structuring; supervision and administration; and role and contribution.

Although the IFC team did its due diligence in screening the project, the financial and economic rates of return calculations overstated the project's viability because they excluded the sunk costs and did not fully weight the risks associated with a short mine life. At the same time, members of the initial project team were able to ensure that IFC was properly compensated for the risks it took by adding a secondary loan to the financing package that included an option to purchase equity in the company. The IFC team was also able to agree with the company to put in place a formal reclamation agreement to deal with mine's closure.

There were some initial problems on the supervisory and monitoring front. A key early challenge was getting accurate documentation on project costs; there were also problems with timely reporting that subsequently delayed some disbursements of funds from IFC to Bema. There were also difficulties in monitoring OMGC's gold price hedging program. Despite these challenges, the IFC team was effective in helping the company put in place good practice environmental standards at the mine, and in taking a pro-active approach to hiring indigenous people.

## **Lessons Learned**

The outcomes of this project demonstrate that short-life mining projects must be designed correctly from the outset in order to be successful overall.

### **Lesson 1: Short-Life Mining Projects Can Work—But There is Little Room for Error.**

While IFC expected that the project's cash flows would easily service its debt, the reality is that Julietta had only one successful year of operation. Errors in the appraisal of the ore quality, and the subsequent selection of a less-than-adequate milling technology, meant costs were higher than expected. The lesson to take from this project is that short-term mining projects have little or no room for error. Despite the problems, IFC was repaid thanks to a project completion guarantee and rising gold prices.

### **Lesson 2: Even Short-Life Mining Projects Can Spur Private Sector Development.**

The Julietta project created direct employment for almost 540 people and led to the creation of at least 130 more jobs with OMGC suppliers in the region. In addition to hiring more employees, some of these companies also upgraded their operations or took other steps to expand and/or become more efficient.

In addition, the mine paid out over \$18 million in total taxes; 65 percent of the revenues flowed directly into the region. These monies went to support local projects. The lesson from this project is that even short-term projects can have a meaningful impact on a community, its people, and its businesses.

### **Lesson 3: Realistic Timeframes Improve Communications and Keep a Project on Track.**

There were a total of eight loan agreement waivers issued during the Julietta project related to delays in establishing project accounts and in obtaining regulatory approvals. The waivers

ultimately delayed disbursements, and led to frustration on the part of both IFC and Bema. Many of the waiver problems could have been avoided had both IFC and Bema done a better job of anticipating what was—and wasn't—realistic and doable. The lesson for future projects is that the parties need to realistically assess upfront both their timeframes and the likelihood of compliance with key requirements. In addition, when problems arise, IFC may at times do better by agreeing a permanent amendment to loan agreements rather than having to manage a series of waiver requests.

#### **Lesson 4: Mine Reclamation Should be Listed as a Separate Item in the Financial Plan**

While IFC expected that a reclamation account would be fully funded from the project, higher than expected operating costs meant that this didn't happen. Reclamation was ultimately funded by Bema because the company was committed to doing this work. The lesson to take away from this project is that, to ensure that funds are available for mine closure activities, this should be included upfront as a separate component of the financial plan.

#### **Post Scrip**

In late 2008 as its expected production life was coming to an end, Kinross Gold Corporation sold the Julietta mine to Yanskaya Mining and Geological Company, a subsidiary of a Russian mining company, Dukat Mining and Geological Company. According to recent press reports, the new company expects to be able to extend the operation life of the mine for the next 10 years. Prior to its absorption by Kinross Gold Corporation in 2006, Bema Mining Corporation began in 2005 the development of the Kupol mine in the same region. This mine, which is now operational, will continue to generate jobs, economic activity and revenues for government the region. IFC has supported the new development. For more information see IFC's Summary of Project Information:

<http://www.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/16cf0e9ffdcd067a8525708c00656f4b?opendocument>