



FLAG MONTENEGRO

CALENDAR YEAR 2001- 4th QUARTER REPORT

OCTOBER 1 - DECEMBER 31, 2001

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SMALL AND MEDIUM ENTERPRISE DEVELOPMENT

Technical Assistance

Based on a survey of SMEs with whom FLAG has worked and a review of official financial records, clients of FLAG have increased revenues on a year-on-year basis by around 13%. However, any employment gains made at SMEs are offset by employment losses at others. Many of these statistics are unofficial because of continuing gray market activity or the lack of access to all records. As relationships develop, however, we are able to gain access to more information about firms and increase our assistance to them. Many still appear reluctant to fully disclose information to us or to Montenegrin authorities because of the continued strength of the gray market sector in Montenegro's economy.

FLAG's SME activities continued to grow in the fourth quarter as we maintained a steady active client base of around 40 SMEs, identified a number of new projects to enhance the SME sector, and introduced a number of new seminars. Currently, we have a total database of more than 200 active and inactive clients. Active clients are those to whom we provide extensive technical assistance (TA) including the recruitment of consultants; development of strategic plans; performance of market research; development or beginning of development of business plans; and the provision of direct consulting advice. Inactive clients include clients we have graduated, those for whom we have researched trade leads without further TA follow-up, or those with whom we are just beginning a relationship.

FLAG offered seminars in business plan training, cost accounting, financial management and organizational development attended by more than 200 people. Most of these seminars are directed specifically at managers and owners of SMEs and, because we encourage interaction of the participants, are kept to a maximum of 25 attendees. This allows us to target specific industries or geographical locations which lead to increased interaction, attendance, and follow-up because of the close ties of individuals in Montenegro within municipalities or across municipalities within specific industries. Often, attendees are inactive clients who have begun to recognize the value in utilizing other services offered to the SME community by FLAG or other groups such as local consultants.

Selected SME Projects

UNA – Tivat, Montenegro

TA Requested & Identified: Cost Accounting
Products/Services: Ropes, Nets, Sea Equipment & Accessories
Industry: Marine Equipment and Services
Status: Executed and Follow-up TA is being administered

Summary: We continued to help UNA establish a cost accounting program so its owner will know what products are profitable and where sales and marketing efforts should be concentrated. Knowing its costs will also help UNA negotiate a profitable arrangement with its Italian partner in the first quarter of CY2002.

DITTA – Podgorica & Kolasin, Montenegro

TA Requested & Identified: Business Plan
Products/Services: Wood profiles
Industry: Wood
Status: Executed and Follow-up TA is being administered

Summary: Ditta currently supplies beech wood profiles to Italy and Sweden -- approximately 95% of its business. Ditta wants to expand not only its volume of production of current products, but also by adding a finishing line to produce parquet floors. Ditta is seeking about 350K USD to make this business plan come to fruition. The final touches of the business plan will be realized in the first quarter of 2002. Ditta has a very good operation and has room to grow. Recommendations have also been made to step up its marketing efforts, as Ditta currently relies on only a few customers.

DUGA DIT – Niksic, Montenegro

TA Requested & Identified: Business Plan
Products/Services: Parquet Floors & Tables
Industry: Wood
Status: Executed

Summary: A small but capable producer of wood products, Duga DIT has a large investment in current operations and wants to expand its current product offering to include finished furniture. The equipment needed to pursue this endeavor is quite different from the existing assets used to produce current products. The owner maintains a tight

rein over operations and finds it difficult to relinquish any of business functions to other individuals even when they have more expertise in a given area, e.g., marketing. Overall however, the company is doing well and will benefit from continued technical assistance.

TRGOPRODUCT – Pljevlja, Montenegro

TA Requested & Identified: Business Plan
Products/Services: Beech Logs
Industry: Wood
Status: Executed and Follow-up TA is being administered

Summary: As a supplier of beech logs to the wood cutting industry, Trgoproduct is a small operator that finds itself competing with the large state-owned operators, which tend to receive favored and discounted supplies. The industry is highly segmented, largely owing to the various sizable public companies dominating the sector. A small business plan is being developed for Trgoproducts current operations.

OKAZION– Pljevlja, Montenegro

TA Requested & Identified: Operations
Products/Services: Unfinished Pine
Industry: Wood
Status: Initial contact meetings, Follow-up TA possible

Summary: Similar to Trgoproduct, Okazion is a small player in the crowded wood industry. Their primary product is pine lumber, and they do not currently produce any finished products. The few meetings we have had with Okazion proved successful in identifying the types of machinery that ought to be purchased to improve their operations. It was suggested that they focus first on a conveyor system, followed by an additional saw and drying system.

CRANGORADRVO – Podgorica, Montenegro

TA Requested & Identified: Business Plan
Products/Services: Trader of Wood Products
Industry: Wood
Status: Currently being researched

Summary: This firm trades wood products and machinery and provides consulting services to the wood industry. Its plans include selling prefabricated housing, which is a

risky venture that requires significant research -- especially as the firm plans on exporting to the U.S. and Canada. The owner/director is ambitious and has many ideas to explore. We are providing initial assistance in keeping the firm focused, producing necessary research to assess the viability of projects, and executing in a thoroughly organized manner.

MIJATOVIC & TRIO – Podgorica, Montenegro

TA Requested & Identified: Strategic Plan & Organizational Management

Products/Services: Marketing Services

Industry: Business Services

Status: Executed and Follow-up TA is being administered

Summary: This small service firm had three owners all vying for control of the daily operations and decisions that affect its client base. The recommendation we initially provided was simple: either the three should collaborate and focus on delivering high value services to their clients or they should part ways amicably. After discussing their internal differences, the owners parted ways. We are continuing to provide guidance to one of the owners by preparing a business plan for a newly organized marketing service enterprise. This plan will be developed during the first quarter of 2002. The owner is motivated and has access to talented individuals who can provide high-quality marketing services.

MAP HGM – Podgorica, Montenegro

TA Requested & Identified: Marketing Plan

Products/Services: Paint

Industry: Construction

Status: Executed and Follow-up TA is being administered

Summary: A small producer of quality exterior and interior paints, MAP is competing with many foreign firms, primarily ones offering products from Italy and Serbia. MAP is also thinking of providing contract-painting services to the construction industry. FLAG formulated a strong marketing plan that will help MAP reach potential clients in Montenegro and foster long-term relationships with potential partners/competitors. MAP has the potential for increasing its business significantly, even though it currently has limited production capacity.

APPPA – Podgorica, Montenegro

TA Requested & Identified: Strategic Plan
Products/Services: Vegetables
Industry: Produce
Status: Being Executed

Summary: The Association of Plant Producers in Protected Areas (APPPA) is comprised of more than 60 members, all of which own and operate their own greenhouses. This highly fragmented industry has great potential in Montenegro. The Ministry of Agriculture and the Agency for SMEs have collaborated and earmarked 1.5 million DM for the purchase and subsequent financing of new greenhouses for the members of APPPA. APPA, the Ministry of Agriculture, and the Agency for SMEs have all have requested FLAG's assistance in developing a strategic plan for APPPA and helping oversee its successful execution. To date, we have prepared a basic strategic outline for them, written tenders for the purchase of new greenhouses, and offered training for the members. During the first quarter of CY 2002, the strategic plan will be finalized and we will administer training in the field of horticulture.

Training

Targeted training included the following:

- Business Plan Conference
- Cost Accounting workshops
- Financial Analysis for the Hospitality Industry
- Horticulture

The Business Plan Conference (BPC) was held in late October of 2001 and attracted more than 100 participants. Individuals attending represented the SME sector in Montenegro, business advisors from government agencies, business students from the faculty of economics, and professionals from the business community. The two-day conference was executed in close collaboration with the Agency for SMEs. Judging from attendant reviews, it was successful in presenting a generalized discussion of effective business plan development and the use of business plans as effective management tools. Plans for 2002 include business seminars on topics that will delve into more detail in fields such as marketing, finance, and sales, all of which will complement the BPC.

In continuing with our targeted training, several cost accounting workshops were delivered before the holiday season. The targeted audience was SMEs and each workshop lasted for about four hours. The workshops were interactive and included active, and at times over enthusiastic, participation. We are planning similar workshops during the first quarter of 2002 and follow-up targeted TA to individual SMEs who have expressed an interest in setting up cost accounting systems.

Private hotel owners, professional accountants, and managers of hotels were invited to a five-day seminar on the Uniform Systems of Accounts – international accounting standards for the hospitality industry. This interactive training exposed Montenegrin businesses to western-style financial statements and how they can be used to manage enterprises. Follow-up TA was provided to individual hotels.

APPPA received some initial training in effective horticulture techniques. More than 30 of the association's members attended and appeared pleased to embrace new ideas related to the growing of their indoor crops. Assistance for this highly specialized field was provided by an U.S. consultant with significant experience in operating greenhouses and an in-depth understanding of the most current technologies and techniques available on the world market. He will offer further training during the first quarter of 2002.

Linkages

Providing business connections, both domestically and internationally, continues to be one of the most helpful services we can provide to the SME sector. This quarter we have had 20 requests for linkage assistance from clients.

One example of a business linkage that evolved into a partnership was when APPPA was introduced to the Agency for SME Development. As a result of this relationship, the Agency, along with the Ministry of Agriculture, has set aside DM 1.5 million for the development of an organized greenhouse association and the purchase of greenhouse equipment for the members of APPPA. This newly found relationship offers real hope for the future development of the greenhouse sector in Montenegro and is a model for future public and private cooperation.

Business Plans & Market Research

The wood processing industry shows much promise for contributing to the economic development in Montenegro. In this quarter, we utilized a volunteer US expert with significant experience in the field of forestry and wood processing to develop several business plans. As mentioned above, each of the clients are pursuing slightly different strategies as each offers different products and service from the wood processing industry.

Another business plan that we worked on during the past quarter, and will complete in the first quarter of 2002, is for a large aluminum recycling plant. This company, Uniprom, is seeking around USD 1 million in working capital to increase its production by 300%. Uniprom is a successful private enterprise that is constrained from growing, largely due to the absence of a financial institution that can or will offer such a sizable loan. Uniprom, with our assistance, is preparing a western-style business plan that will outline plans and strategy for the coming five years. FLAG will work with the firm to acquire financing at the best terms available locally. This SME could provide a significant impact to the local economy in Niksic, primarily in providing much-needed jobs.

Capacity & Institutional Building

We continued developing our relationship with the Agency for SME Development and will work with them to present seminars following up on the business plan seminar and presenting other topics to the SME community. The Agency recently broke ground on its first Business Information Center (BIC), located in Podgorica. This BIC will provide information to local entrepreneurs and business owners on issues relevant to starting a business in Montenegro. During the first quarter of 2002, FLAG, in concert with the European Agency for Reconstruction and the Agency, will define a long-term strategy for the Agency, its BICs, and other planned endeavors. The capacity of the Agency in its present form is limited. To assist the private sector to grow effectively, a strong Agency with the resources to contribute to the growth of the sector by offering sustainable services would be most helpful. Continued training and institution building will be seen at the Agency, with local consultants, and with individual trade associations.

Challenges for 1st Quarter 2002

Next year should bring about some long awaited economic reforms in Montenegro. Many new laws are being written and are expected to be passed by Parliament in the first half of 2002. Some laws, e.g. Adoption of International Accounting Standards, will become law on 1 January 2002, and will steer private and public enterprises toward employment of western reporting standards. Although welcomed by the international community, local businesses will face significant challenges in understanding and implementing such new laws. There will be a large demand for services training business professionals and the public at large in matters relating to these new laws.

The agenda for reform will be overshadowed, however, by the political uncertainty regarding independence, which should come to a conclusion by mid-year when the referendum for Montenegro's independence will be held. In addition to local issues that require action, timely recruiting of specialized experts from international locations, particularly from the US, will continue to present a challenge to smooth implementation of our program strategy.

KOMBINAT ALUMINIJUMA PODGORICA

Overview of 2001 Activities

Upon its initial review of KAP in November of 2000, FLAG discerned that the company was in serious trouble in the area of facility operations, and also lacked sufficient working capital and was burdened with a debt repayment problem. Plans were under way to restructure the debt with hopes that this could help provide the necessary funding for continued operations. This restructuring was to be finalized in January 2001 but was not put in place until April 2001.

After a careful evaluation of KAP's operation, FLAG's team concluded that the company was viable and could make a reasonable profit. It is axiomatic that if an aluminum smelter has low power and bauxite costs, it ought to be profitable under good management. KAP was in this position and had the additional advantages of low labor costs, and a bauxite mine, alumina plant and smelter in one location.

In the prior several years, numerous studies were made of every facet of KAP's operations by outside companies. These studies always seemed to conclude with the following recommendations: invest in modernization at a cost of from USD 80 to 100 million. Because investment capital in this amount was not available to KAP, these studies actually delayed the introduction of a more workable course of action by several years.

FLAG's approach taken over the past year was quite different as the structure of the plant was collapsing because of various factors including economic sanctions, burdensome debt, and employee theft. It was clear that it was essential to invest funds on the refurbishment of KAP in order to bring it back to normal operating integrity, reorganize management, and re-assert management's responsibility to eliminate waste, fraud and theft. Simply to do this and prepare KAP for possible later modernization will cost around USD 20 million over three years. Such a strategy was begun and resulted in KAP's first profitable year since 1995 and a positive cash flow. Approximately USD 5 million was spent on refurbishment during 2001.

Specific Programs Undertaken and the Results:

1. Refurbishment

A priority list was established and included such major items as:

- a) Boiler overhaul.
- b) Rehabilitation of the rectifier station (partially destroyed by fire)
- c) Major crane repairs in cell room (many cranes did not function).
- d) Purchase and installation of major spare parts, the lack of which caused frequent shutdowns, and completion of many other minor but important repairs.

2. Organization

A partial reorganization was introduced and approved by KAP's General Director, which removed layers of management and instructed key personnel to report directly to the Director. This reduction of needless layers actually increased line responsibility at KAP, which contributed significantly to operational improvement.

It was also necessary to reorganize the purchasing, human resources, and financial departments (discussed later in this report), and all operational departments. These reorganizations were facilitated through training of KAP personnel and through the retention of outside consultants to perform specific tasks. Dramatic improvements followed. The reorganization of the purchasing department and introduction of a more transparent system there resulted, for example, in contractual savings for raw materials of about USD 2 million annually while actually increasing the quality and delivery times of raw materials.

3. Operations

All operations were reviewed and specific targets set up in every facet of the operation. Performance was reviewed weekly. Materials consumption, labor productivity, maintenance effectiveness, and output all saw improvement.

4. Financial

Prior to FLAG's intervention, a finance department essentially did not exist, in the traditional sense. Reports being issued were only for the benefit of the Montenegrin government and had little to do with the normal reporting expected of a large corporation. There were no profit and loss statements, balance sheets, or cash flow statements with any credibility. Some control was exercised through a cash reporting system maintained by another department not associated with the financial group. The budget related to past cash expenditures and had no relation to current or anticipated future expenses. The following actions were begun in 2001, but will need to continue in the following year:

- a) A cash management function was established.
- b) A new cost and budgeting group was established.
- c) Key production groups were given their own financial analysts.
- d) A restructuring of other financial departments occurred.
- e) A search was begun for a new Chief Financial Officer.
- f) New budgeting procedures in line with international standards were established and put into effect.
- g) Consolidation of financial functions in the financial department that had been previously scattered across several functional areas.
- h) All invoices now sent to finance department instead of to the purchasing department.

5. Labor

There are approximately 3,000 employees at KAP, and this includes excess staff of at least 1,200. It is difficult, however, to reduce labor numbers, either workers or management, because of government and labor restrictions. At present, KAP's labor cost per ton of metal produced is reasonably competitive with other aluminum producers. Reducing redundant staff would free up funds for use in compensating the most productive staff or other helpful areas. In preparation for this, the introduction of a labor grading system is vital.

6. Management methodology

In addition to the reorganizations mentioned above, it is important to mention two areas of concern within the management structure in which some improvements have been made, but problems continue to linger. These areas are (1) company commissions and (2) advisors to the General Director. Both of the above are carryovers from the prior 25 years of non-market control of the economy and industry.

Commissions have been organized at KAP to resolve important, and even some minor, issues. Usually the chairman of a commission is one of the many advisors to the General Director, and the make-up of a commission's body includes people who are not qualified to speak on the subject addressed. The existence of commissions often tends to diminish individual accountability and initiative. Moreover, commissions often take up to sixty days before recommending any course of action. Needless to say, most management personnel prefer this arrangement because it is a system with which they have been familiar from the beginning of their working days and it permits them to avoid individual responsibility for decisions.

Our recommendations were the following, and have been slowly adopted:

- The chairman of a commission should be the department chief who is directly affected by the subject at hand.
- Membership on the commission should only be granted to personnel qualified to address the subject under deliberation.
- Deliberations should be speeded up.
- It should be understood that the commission advises and does not decide. The chairman decides and assumes full responsibility for the decision.

Regarding advisors, we recommended to the General Director that the number of advisors be reduced to one or two since having more than two at KAP causes delays and confusion in the administration of the company and dilutes both control and responsibility of managers. Progress has been made in this area, but political considerations often stall full implementation.

Financial

Debt Restructuring Agreement (DRA)

A Debt Restructuring Agreement between KAP and its major creditors was originally scheduled for execution effective 1 January 2001 but was not, in fact, signed until 27 April 2001. This had significant implications for FLAG's finance role at KAP.

On arriving in January 2001, it was necessary to resolve an immediate cash crisis and establish an interim reporting system for cash management. This was done, but strong resistance was encountered during implementation. The delayed signing of the DRA meant that considerable effort was channeled into reviewing various drafts and recommending numerous changes to the Agreement. The Cash Management Agreement (part of the DRA) also took considerable time and effort to review. A series of meetings were held with the creditors in order to implement and establish practical working guidelines to effect the legal requirements of the Agreement.

Once rules were set and the DRA signed, the next step was to ensure that the conditions precedent to the Working Capital Facility Agreement were met in order to utilize the facility. With everything in place, the operational and compliance requirements of the Agreement then took priority. With no English speaking personnel in the Finance group at KAP, however, all of these major requirements fell on the shoulders of FLAG's aluminum-industry finance consultant. Considerable effort was required to handle such a burden. The finance expert's effort will continue into 2002, and include:

- preparation of monthly and rolling 3-monthly cash budgets and forecasts;
- serving as liaison with the operator of the facility, Standard Bank - London, and its local agent, CKB Podgorica, on all processing and interpretative aspects of the Agreements;
- management of the complicated Excess Revenue provisions of the Agreement;
- preparation of all necessary reconciliations;

These tasks should be directly assumed by KAP during 2002.

Staffing

Early attempts to recruit a western-trained English/Serbian speaking accountant were, for various reasons, unsuccessful. Such a person was eventually found in May 2001 and funded by FLAG until 31 December 2001. The major function of this position was to focus on and improve KAP's accounting and reporting systems.

Three cost analysts were selected from KAP personnel and seconded to plant positions in order to liaise between the plant and finance areas. Recognizing that these three would be critical for the budgeting process, they were established early in the year. A US consultant was also provided by FLAG for approximately ten weeks in order to provide training and assistance on budget implementation.

Under FLAG's direction and recommendation, six Economics graduates were recruited by KAP in October 2001 to staff its Budgeting and Costing area. Management reporting has been virtually non-existent at KAP, and the reports that were produced were prepared by an engineering adviser to the General Director. Such reports are far from sufficient. With the establishment of the Budgeting and Costing area at KAP, however, the responsibility for such reporting will revert to the more appropriate Finance area. Previously, this had been the responsible department, but the Finance area had prepared no management reports in approximately two years. Fortunately, the Budget for 2002 was prepared on a "bottom up" basis, rather than the "top down" approach of recent years. This was a major achievement that took considerable effort.

Finance Debt Restructuring

Our recommendations were accepted by the General Director and are being implemented. The removal of the CFO from his duties was the first step in this restructuring.

Systems

A major effort is required to implement improved financial and reporting systems at KAP. The groundwork done in 2001 is a good foundation, but it is vital that this work continues in 2002 lest the work already done be lost. With a solid Budget in place for 2002, it is

essential that actual results be measured against budget numbers on a monthly basis. First steps have been taken toward this and must continue.

There is an urgent need to move to an integrated reporting system at KAP. The measurement of monthly results is part of this. KAP currently prepares its financial results, for external reporting, twice per year. Its present system is part mainframe, part manual. We recommend moving to an integrated system on a simple module-by-module basis. With the exception of recently recruited graduates, KAP personnel are far from computer literate. The majority of staff has been with KAP around 25 years and appears very set in their ways. To best deal with this fact, we have chosen a simple Serbian system (Sycon) that will allow the modular approach to integration to proceed. The first module (Accounts Payable) is currently being implemented. We also recommend transferring the current budget module (prepared in Excel because of timing problems) to this system.

CFO Position

An international search was made to find a senior western-trained English/Serbian speaking CFO. More than twenty applications were received for this position, but only four candidates were selected for interview, including one who later withdrew his application. Of the remaining three, two demanded expatriate-level salaries. The remaining candidate, from Belgrade, was selected for a follow-up interview, but the General Director of KAP sees potential political problems if he is retained. Therefore, the situation remains unresolved, though it seems essential that an effective CFO be appointed. If an expatriate Westerner is hired, finding sufficient funds for his or her salary will be an issue needing resolution.

The appointment of a CFO is critical to the success of USAID's KAP project. Once appointed, the transfer of overall responsibility for systems, the DRA, and other operational matters can begin.

Operations

At the beginning of 2001, the 28 pot room cranes, which handle all major pot room activities, could barely move due to a shortage of spare parts. In the alumina plant, a lack

of spare parts made it impossible to keep a sufficient number of rod mills and high-pressure pumps in operation to adequately feed bauxite slurry to the plant. The plant's four boilers produced insufficient steam as a lack of spare parts for their general maintenance resulted in steam leakage in all areas of the facility. Maintenance in all production areas was substandard. Housekeeping and safety matters were, relative to western standards, wholly substandard. Employee morale was low and organizational disarray meant a complete lack of direction for the workforce.

Summary of 2001 Operations:

The Activities of Operations recovery can be summarized as follows:

- Plans for \$11.1 million in refurbishment and major repairs of the smelter and the alumina plant were prepared and a presentation made on January 17th to KAP's senior management.
- The operation of the smelter and the alumina plant was reviewed and improvements implemented where appropriate. Management of these facilities was reviewed. To strengthen the leadership of the alumina plant, the appointment of a new Director was arranged.
- A major reorganization plan for the smelter, alumina plant, and central maintenance was started by FLAG with the help of the respective directors for these facilities.
- A considerable amount of time was spent on identifying potential cost savings areas and possible production bottlenecks. A number of cost saving potentials were identified.
- Anotech, the contractor responsible for the anode carbon production at KAP, experienced serious quality problems. FLAG worked with Anotech to identify the impact Anotech's problems had on smelter production and the consequent costs to KAP. FLAG then we worked on improving the quality of anode production to bring the Anotech factory in line with western standards, maintain consistent quality, and assure it could honor guarantees made to KAP on quality and delivery.
- After the Debt Restructuring Agreement was signed in late May, a revised schedule and budget for May through December were prepared for the refurbishment project. Subject to KAP's cash flow situation, final refurbishment

will be completed during the first part of 2002. The procurement process proved a challenge to both the refurbishment project and to keeping equipment running. The capability of the purchasing department was limited and it was difficult to get timely quotations for parts from Western Europe.

- During the second quarter of 2001, production staff managed to keep equipment running without fully adequate spare parts. Indeed, the alumina plant increased production, and finished the quarter with the highest monthly production for the year. The smelter, however, had production upsets due to Anotech's quality problems and a number of electric power curtailments. The pot rooms managed to increase the number of pots in operation to 517, which was the highest level seen in more than 8 years. If it hopes to improve cash flow, KAP must increase production regardless of obstacles.
- The reorganization of the operations departments was completed by year's end. Initial personnel reductions were made and more are scheduled for the coming year. FLAG conducted on-the-job training throughout the year and, with the personnel changes implemented, created a stronger management group.

- Raw Materials:

A recommendation for a revised bauxite supply contract was submitted to the General Director.
- Anotech has been supplying approximately 75% of KAP's anode requirement. Due to assistance provided, there were gradual improvements in anode quality but, based on R&D Carbon's quality analysis for April and May, 80-100% of the anode production failed to meet the contract specifications. A summary of our report at Anotech pointed to the following:
 1. Anotech anodes are of substandard quality and do not meet contract specifications for chemical and physical properties;
 2. The fundamental cause of this is underbaking of anodes, although high ash content of butts is also a contributing factor;
 3. The baking furnace is in poor condition. It needs major refractory repair and proper fire control; and,
 4. The green mill needs equipment modification and improved operating procedures to produce good-quality green anodes. The low anode

densities are probably caused by too low a mixing temperature, insufficient energy input for the mixer, and a lack of granulometry control.

In a meeting with Anotech to discuss the anode quality problems, we were informed that Anotech has secured a USD 7 million loan to begin major repairs on its baking furnace and to upgrade other processes. The baking furnace repair project is scheduled to be completed in March 2002.

- Refurbishment and spare parts:
 1. In July, August and September, the monthly allocation for refurbishment was USD 950/month. The refurbishment work completed clearly increased production and boosted worker morale.
 2. Boiler No. 1's refurbishment was completed and the unit put into operation.
 3. Boiler No. 2's refurbishment was started.
 4. Rectifier refurbishment is scheduled to be completed by the first quarter of 2002.
 5. In the alumina plant, many smaller refurbishment projects, such as the membrane pumps, rod mills etc. have been completed.
 6. In the pot rooms, the refurbishment of cranes and crane rails was started and work on four cranes completed.

- Production:

In the alumina plant, production was generally good with volumes above or close to planned levels. The calcining kiln was the weak link and had to be shut down for repair. In the pot rooms, liquid metal production was very good and September had a record 9,200 tonnes, equivalent to an annualized production of 112,000 tonnes. During September, the number of pots in operation peaked at 524 pots out of 528 pots installed. Historically, KAP used to have low production in August and September due to hot weather and high absentee rates.

- Lower LME prices:
The sinking aluminum market prices in September made it necessary to reduce the refurbishment and spare parts allocations for October, November and December 2001.

- Red Mud Pond:
A construction project to raise the height of the pond to increase the storage capacity for red mud was completed.

- Butt Cleaning:
KAP has been struggling for many years with getting butts properly cleaned prior to recycling carbon butt material. During the final quarter of 2001, KAP finished a project to improve these processes, which will in turn have a positive effect on anode quality.

- Pot Relining:
The pot relining is now handled by a contractor. KAP is working with plans to directly take over this work as of June 1, 2002.

- PCB:
All transformers more than 25 years old were using PCB oil that is now an illegal material if stored on the plant site. KAP has a program under way to haul this material away and have it safely destroyed according to the Basel Convention, using funding from the Norwegian Government, negotiated by the FLAG team.

- Anotech Anodes:
The quality of the Anotech anodes has shown a small improvement. Outside flues in the baking furnace result in underbaked anodes due to the leaky furnace. The underbaked anodes do not meet contract specifications. The furnace is now scheduled for reconstruction, with work is expected to be completed in March 2002. KAP should have only good anodes after this work has been completed.

Recapitulation of Production and Production Parameters:

- 52,065 tonnes of liquid metal were produced during the first half of year 2001 (37,437 t were produced in the first half of 1998, and 46,361 t during the first half of 2000)
- Electric energy consumption was 16,663 KWh/t in 1998; 15,046 KWh/t in 2000; and 14,888 KWh/t in 2001.
- Calcined alumina production was 97,313 tonnes in the first half of 2001; 94,672 t in the first half of 2000; and 74,164 t in the first half 1998.

- Daily production per pot

- 1998.	529,1 kg/pot
- 2000.	562,0 kg/pot
- January 1. – June 30.2001.	582,6 kg/pot

- Average metal quality

- 1998.	99,54%
- 2000.	99,65%
- 2001.	99,71%

- Anode specific consumption

- 1998.	753,5 kg/t
- 2000.	602,7 kg/t
- 2001.	573,3 kg/t

- Number of operating pots at the end of the year

- Year 1998	390
- Year 1999	408
- Year 2000	477
- Year 2001.....	520

- Average net KAP salaries

- Year 1998	313 DEM
- Year 1999	343 DEM
- Year 2000	503 DEM
- Year 2001 (6 months)	589 DEM

- The alumina plant is projected to finish the year with a production of 221,000 tonnes of alumina and with an alumina inventory of 9,500 tonnes. The Smelter is projected to finish the year with liquid metal production close to 109,000 tonnes and with 520 pots in operation.

Conclusion

Management reorganization at KAP should be an ongoing process and should be finished prior to privatization of the plant. Without this reorganization and necessary refurbishment, the government of Montenegro, and therefore its citizens, will not receive the full value of this facility in any sale. 2001 saw a Debt Restructuring Agreement put in place that significantly reduces KAP's short-term financial burden and forces it into compliance with very strict cash management principles. Furthermore, FLAG's program for KAP resulted in a record production level of 109,000 tonnes of aluminum, cost savings on raw materials contracts of USD 2.5 million annually, and positive cash flows for the first time in its operating history. While this is certainly a good start, much work still needs to be done to ensure that changes enacted in 2001 are maintained, suggested improvements implemented correctly, and refurbishment continued as planned. Such work will ensure maximum value to the people of the Republic of Montenegro.