CLIMATE ENERGY FINANCE

The Treasurer should block any foreign bid for Liontown Resources

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With lithium exports expected to exceed $18.6 billion in 2022–23, up from $4.9 billion in 2021–22 according to the Federal Government's Resources and Energy Quarterly released today, CEF guest contributor Owen Evans and director Tim Buckley review the current bid by US giant Albermarle to take a strategic stake in WA based producer Liontown Resources in the context of the history of the Foreign Investment Review Board (FIRB) and its remit in protecting national interests.

In our view, Liontown does not need financial assistance to develop its key Kathleen Valley, WA, project, and if Albemarle is allowed to gain strategic control of Liontown it could leverage the US Inflation Reduction Act to expand its operations in the US and restrict production in Australia to sustain global price. We recommend that the FIRB and the Treasurer should reject the Albemarle bid for Liontown on Australian national interest grounds.

Prior to 1963, foreign ownership of critical assets in Australia was a non sequitur. Virtually all infrastructure was owned by states (power production and distribution, water, rail and ports) or the commonwealth (airports, telecoms). Much of the insurance and banking industry was government owned. Exports were primarily rural and controlled by state or Commonwealth entities such as the Barley Board, the Wheat Board, the Wool Board or Queensland Sugar.

Australia did not export material quantities of thermal or metallurgical coal. It was illegal to export iron ore. No one produced LNG. There was almost no oil production. The aluminium industry was limited to a tiny government owned smelter in Tasmania. The largest mining centres were Mt Isa and Broken Hill in NSW. Zinc and lead were major exports.

From 1963 through 1978 a number of developments changed this picture dramatically. Oil was found in the Bass Strait. Gas was discovered off Karratha in Western Australia (WA). The bauxite deposits of Weipa in Queensland, Gove in the Northern Territory and Dardanup in WA were discovered. The iron ore deposits of the Pilbara, WA, were finally allowed to be developed. High quality metallurgical coal was found in enormous quantities in the Bowen basin in Queensland while changing global markets meant the undeveloped thermal coal resources of NSW's Hunter Valley and Bowen Basin suddenly had enormous export value.

Australia had neither the capital nor the expertise to develop these projects. Global project finance lending did not really exist. As a consequence virtually every project required foreign equity, often ceding majority foreign control.

Thus Bass Strait was 50% owned by Exxon. The North West Shelf was 83% owned by global oil majors. The Alcoa Australia alumina developments in WA were partially owned by WMC and a number of life insurers (the super funds of the day), the Gove assets in NT were partially owned by CSR and a number of life offices. The Robe River, Hammersley and Mt Newman iron ore assets in WA were owned by Peko Wallsend, CRA/Rio, BHP, CSR and AMP.

Each individual development had some domestic ownership, and some had extremely convoluted structures. The NW Shelf, for example, was split with domestic gas 50% owned by Woodside for 40 years while the LNG phase was owned equally by six companies.

The constant project by project negotiating became too difficult. In 1976 the commonwealth created the Foreign Investment Review Board (FIRB) to oversee international investment in Australian assets. The board is not a statutory body that makes decisions. All FIRB decisions are effectively made by the Treasurer under the advice from the FIRB. If the Treasurer determines a particular acquisition is not in the national interest he (and it has never been a she) has the absolute right to veto the proposed transaction.

Anyone can own 14.9% of an Australian company subject to ASX disclosure rules. To purchase more than 14.9% requires FIRB approval. Any takeover bid by a foreign company is therefore subject to FIRB approval. It is generally believed that FIRB is willing to privately inform both buyers and sellers of potential issues prior to a bid taking place.

Prior to 2009 the national interest veto was used rarely. The two most famous examples were Paul Keating intervening in the proposed bid by the British ICI Plc (Imperial Chemical Industries) for FH Faulding and the 2001 intervention by Peter Costello that vetoed the Shell bid for Woodside.

Post 2009 there have been three major changes to the manner in which FIRB operates:

First, **the historic focus on foreign equity for resources projects has evaporated**. This is primarily because the domestic market can now fund and execute virtually any resources project. If a foreign company wants, for example, to spend billions to build magnetite projects at Cape Preston in the Pilbara or an LNG project at Gladstone in Queensland, good luck. If a domestic producer wants to bring in a customer as an equity owner (eg, Boa Steel, various gas and electric companies in LNG projects), fine. If foreigners want to buy existing copper mines (NorthParkes in NSW) or coal mines (Yancoal's assets in WA, QLD and NSW), go for it. If they want to build or buy the associated rail and port infrastructure (Adani, for its Carmichael coal project in Queensland's Galilee Basin), there is no barrier. These are not really critical assets and no of public focus or concern;

Second, **FIRB has increasingly become involved in workouts** such as Rio Tinto in 2009 or Probuild in 2021. Rio in particular remains a critical part of the Australian economy and allowing a foreigner to control it would not be in the national interest. We suspect workouts will become a more important part of FIRB work as interest rates rise, bringing an increase in corporate distress; and,

Third, **FIRB is regularly involved in asset sales of infrastructure which traditionally was state owned**. The policy here has evolved, and is not always obvious, but it appears that if an entity is associated with a foreign government it cannot own major electricity or gas transmission assets (or leases for those assets) unless they are in WA, or it involves Jemena gas pipelines (jointly owned by China and Singapore government SOEs). Distribution appears to be fine. While there are likely legitimate security issues at stake, from an economic perspective who owns the regulated Sydney-Moomba pipeline or Canberra to Sydney fibreoptic cable is deemed irrelevant.

The **Woodside-Shell decision remains the apex of FIRB rulings**. The Treasurer argued that, left to its own devices, Woodside as a domestic company would develop more LNG assets in Australia to the benefit of the country. Shell as a globalist might block development of Australian assets to protect the value of LNG assets in, say, Russia or Trinidad, nor pay any corporate tax in Australia.

If Woodside were allowed to develop assets our country would develop an expertise in construction of these assets that could be transferable.

The Treasurer was absolutely correct. Subsequent to 2001 Woodside as operator executed two expansions of the NW Shelf, adding 9Mtpa to capacity and doubling exports. It spent US$13bn building the 4.9Mtpa Pluto facility and is in the process of a doubling in capacity at Pluto.

In total, in the 20 years since Treasurer Peter Costello blocked the Shell bid for Woodside exports of LNG have grown by 12.4% pa in volume terms and 17% pa in value terms, dwarfing and undermining the domestic gas market (to our current cost). This year Australia exported $90bn worth of LNG. Australia is a global power in LNG, so much so that mere discussion of changes to gas regulation cause consternation in China, Japan, South Korea and Taiwan, even when the issue is the Australian industry paying anything like a fair royalty (PPRT), despite it having precisely zero impact on these export customers.

We see the market for **lithium** and other new critical minerals having similar strategic potential in the coming decades. The lithium market is immature, but it is growing exceptionally quickly as global demand soars in line with the electric vehicle transformation.

In June 2020 Pilbara Minerals had a market value of $250m. Just two years later in the December half of 2022 it reported an after tax profit of $1.2bn and paid dividends of $330m. To put the scale of this in context, the dividend is more than Santos' accumulated profits over the past decade.

When we look at the listed domestic lithium producers – Allkem (AKE), Pilbara Minerals (PLS) and IGO – they collectively have net cash of $2.7bn on balance sheet and reported EBITDA of $3.2bn for the December half year on sales of $7bn. They can obviously fund whatever is required to grow their businesses and appear to have the capacity to profitably develop and mine lithium spodumene. Western Australia has three of the three largest (outside of China) lithium hydroxide refineries under construction and commissioning.

Domestic lithium production (all of which is exported) is expected to be worth [more than $18bn in 2022/23](), putting it on par with beef and 50% larger than our copper exports. With the joint venture (JV) between Chilean SQM and the Wesfarmers coming online during 2024 it is likely that exports could be worth $25bn annually by the end of this decade. The development pipeline is such that annual value-added exports of $40bn next decade are quite possible.

Liontown Resources, which has grown exponentially from four employees two years ago, does not expect to be in production until mid 2024. It expects its Kathleen Valley, WA, project's capital expenditure to be $895m. It has cash of $384m and undrawn facilities of $300m.

Prior to the bid from US company Albemarle, Liontown had a market cap of $3.3bn. No one would suggest that Liontown requires outside assistance to fully fund Kathleen.

There are no reasons to expect that Liontown will be unable to develop the Kathleen resource. Australia has a very long term track record of mining and beneficiating minerals products, many of which are more complex than a lithium mine. The development of onshore Australian lithium value-adding sector is clearly of national strategic interest.

If Kathleen is as profitable as other producing assets Liontown could comfortably fund expansions to the project, expansions that would add material value to the Australian economy. If Albemarle US is allowed to gain strategic control of Liontown it could leverage the US Inflation Reduction Act to expand its operations in North Carolina or Nevada and restrict production in Australia in order to sustain global prices.

We believe that FIRB should publicly adopt the following policy towards foreign investment in Australia's strategic critical materials:

- If a foreign company wishes to develop a mineral resource or build a beneficiation plant and can meet planning hurdles it can own as many of these assets as it chooses;
- If a domestic company wishes to develop a resource or build a plant in J with a foreign company it can do as it chooses (keeping majority domestic ownership); and,
- If a foreign company wishes to buy a strategic stake in an established domestic asset owner it should be limited to 14.9%.

March 2023 saw Treasurer Jim Chalmers make the call to back the FIRB recommendation to reject a Chinese-linked fund's increased equity stake in an emerging Australian critical minerals developer, ASX-listed Northern Minerals, which is set to mine the rare earth dysprosium, used as an additive in neodymium magnets for electric vehicle motors. This is entirely consistent with Australia's national strategic interest.

In the case of Albemarle it has already developed and owns a significant market share in Australian lithium mining and refining assets. If it wishes to expand its operations by discovering more resources and building more assets that would be wonderful. But there is no obvious benefit to Australian citizens of Albemarle concentrating control in this emerging sector by buying other existing or nascent Australian producers to gain a strategically significant global market share.

We recommend the FIRB and Treasurer reject the Albemarle bid for Liontown on Australian national interest grounds, consistent with its decision on Northern Minerals.

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