FORTUNE HUNTING ON CHINA'S SALT LAKE PLAINS

Resources An Australian minnow has teamed up with a Chinese leviathan on a remote Tibetan plateau where Beijing's renewable energy drive is revolutionising the global magnesium industry, writes the *Financial Review*'s China correspondent, **Michael Smith**, in Qinghai.

We are speeding through the desert in one of China's most remote regions. Grey-tinged plains sprinkled with patches of salt stretch in every direction on this elevated plateau near the Tibetan border.

A spectacular mountain range dominates the horizon to our right. At 2800 metres above sea level, there is no sign of life up apart from the occasional yurt, a traditional tent used by Mongolian herders.

"Whenever I drive out here I think of Marco Polo making his way slowly to Xian," says Nic Andrews, a former Australian investment banker who now counts this part of the world as his second office.

Despite the isolation, you are never too far away from a huge infrastructure project in economically hyperactive China. Our minibus is on a two-lane highway which looks like it was sealed the day before and would be the envy of any Australian city. A rail line runs alongside the road and the landscape is dotted with transmission towers.

Andrews is one of a new breed of fortune hunters trying to capitalising on the area's clear skies, natural resources and the Chinese government's policies embracing renewable energy. He has invited *The Australian Financial Review* out here to reveal the product of five years' work – a joint venture between ASX-listed Magontec and one of China's big state-owned companies.

With the help of his Chinese friends, the former UBS executive wants to turn his tiny Australian company into the world's largest and greenest magnesium alloy producer. But like many things in China, building the infrastructure was the easy bit. Making the economics stack up is a different story.

As well as overcoming China's cultural hurdles, Magontec's future is dependent on its Chinese partner supplying the liquid magnesium it needs to make the alloy ingots it sells to automakers and other customers.

"When I first came here it gave me great confidence that I'm not the only person out there who thinks that magnesium is an industry in need of reaffirmation and is a metal which has a much wider application than it currently has," says Andrews, 61, who started out giving Magontec advice on raising capital and suddenly found himself executive chairman.

"The Chinese government wants to transform this industry and continue to own it."

Andrews is talking about magnesium, a lightweight material most commonly used to make cars. China dominates global production of the rare earth metal at a time when prices are rising due to growing demand for lighter materials in electric vehicles and batteries. Demand has also increased as China shuts down labour-intensive and polluting factories, which means regions like Qinghai – powered almost solely by renewable energy – are thriving.

"It always amazes me that you are in the middle of nowhere in a province with 5 million people and you have a two-lane highway and a railway," Andrews says as we get closer to our destination. The nearest city is Golmud, 40 minutes away, which has a population of 300,000 – tiny by China's standards.

While Mongolian and Tibetan herdsmen still live in the region, there is no doubt this is Communist Party-ruled China. Giant billboards carrying images of Xi Jinping rise out of the desert, the red nationalistic slogans standing out against the blue sky.

The Chinese President visited this part of the world two years ago, which means the huge industrial estate we are approaching has his blessing. The cluster of towers, silos, tanks, hydration units and domes of the 42-square-kilometres Golmud Industry Zone is one of China's most ambitious green projects.

Magontec's cast house – which pipes liquid magnesium alloy between furnaces and casting belts – is a small part of this vast estate owned by its Chinese partner, Qinghai Salt Lake Group (QSLG). Magontec partnered with the Chinese firm in 2013 under an agreement which means the Australian firm takes liquid magnesium from its partner and uses an environmentally friendly process to turn it into alloy.

The Chinese are hard-working, hard-playing and pretty hard-drinking people. China is a whole different culture. That means being here a lot.
Nic Andrews, Magontec executive chairman

QSLG was given Foreign Investment Review Board (FIRB) approval to cross the 19.9 per cent threshold (which usually triggers a takeover bid) and own a 30 per cent stake in Magontec. In return it provided the capital which allowed the company to build its manufacturing facility which opened in April this year.

In Golmud: A salt lake retention pond operated by the Qinghai Salt Lake Group; poster of Xi Jinping near a visitors centre; a relocation village for Tibetan nomads. PHOTO: QILAI SHEN

Magontec takes solid pure magnesium produced by QSLG and converts that into magnesium alloy, a mixture of magnesium with other metals which is the stuff carmakers want to make their vehicles lighter. Magontec's cast house has the capacity to produce 60,000 tonnes a year – 56 per cent of QSLG's 100,000 tonne capacity – which would potentially make it the biggest in the world.

However, its factory has been operating at low volumes since opening because QSLG has been unable to produce the 1000 tonnes of supply per month that Magontec needs for the operation to break even.

"It's taken us longer to get here than I would have liked," Andrews says, but remains optimistic.

"To get this developed we will have access to a continuous flow of liquid pure mag right next door to us, instead of having to buy on the open market for solid magnesium at whatever the price is on that day.

"We will be pushing into the market at a time when the pure manufacturers elsewhere are finding life more difficult."

Magontec's plant in China's Shaanxi province is closing for this reason as the company switches its focus to Qinghai, which has replaced the labour-intensive and polluting Pidgeon process – which helped China dominate the industry years ago – with cleaner technology. It also has operations in Germany and Romania.

Magontec's dependence on QSLG is obvious when you visit the industrial estate that the Chinese firm controls.

Our first stop is to meet Andrews' powerful business partner – QSLG president Xie Kangmin – who informs us over tea that we cannot visit the Magontec plant because of sensitivities there around the new technology. There is also concern about our visit from the local authorities. Bordering Tibet and Xinjiang, the region is home to an ethnic melting pot of Muslims, Mongolians and Tibetans. This makes it highly sensitive for journalists attempting to report on China's treatment of these minorities. There is also more nationalist fervour here than in other parts of China, which is reflected in the patriotic renditions of songs praising the Communist Party in Golmud's town square on summer evenings.

Xie does not want to be quoted for this story but does allow us limited access to the industrial estate he controls.

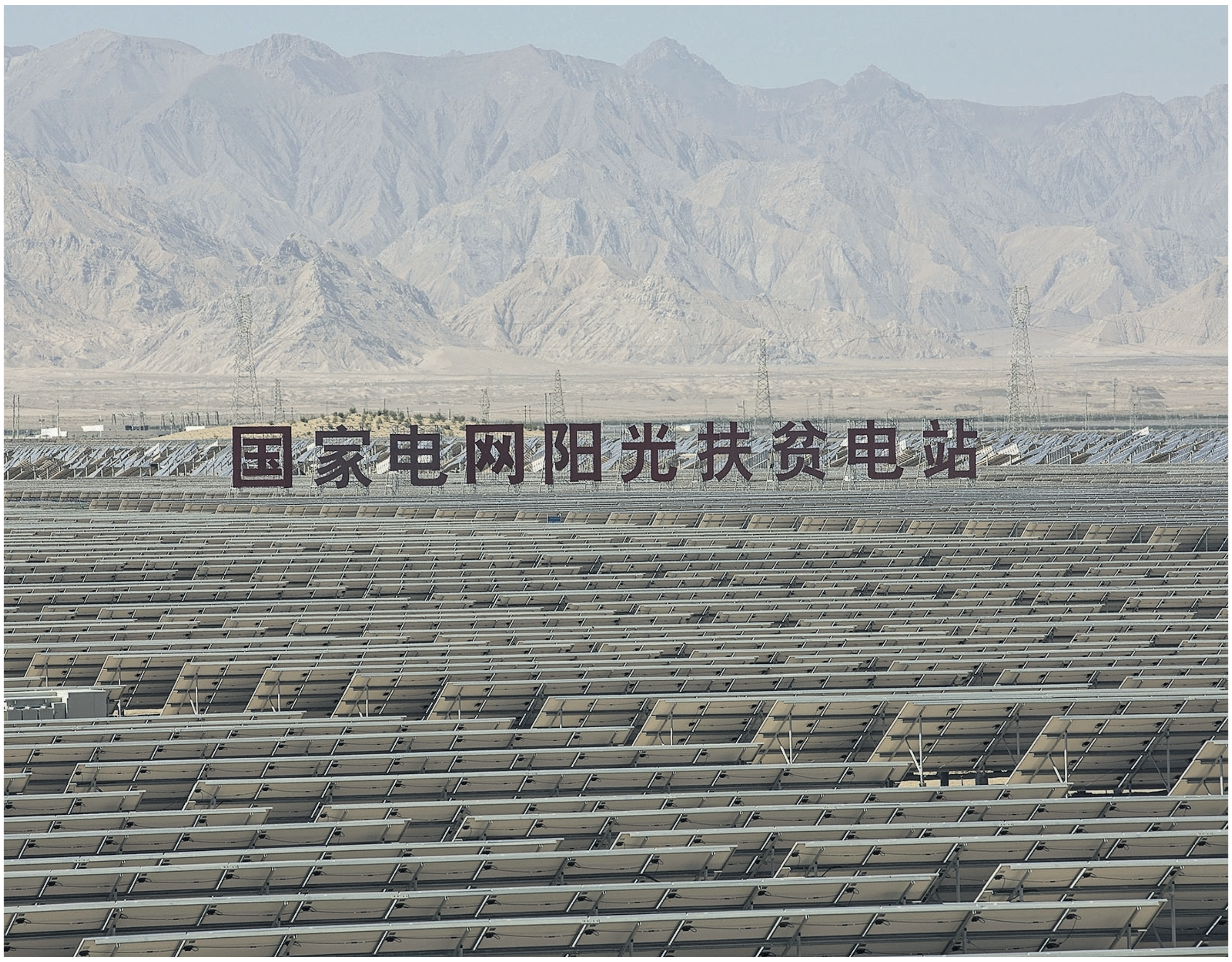
The key to the whole operation is the Qinghai Salt Lake, which sits on an elevated sea bed and channels salt water rich in potassium, magnesium, chloride, lithium and other minerals into enormous holding ponds to evaporate.

When the *Financial Review* visits, it looks like a day at the beach, with tourists posing for selfies next to the turquoise waters lapping up on to beds of salt on the shore. The local authorities plan to commercialise the site by forcing tourists to pay to frolic on the salt beaches in the future. But the real source of profits comes from the barges out on the water dredging the minerals which will be processed by QSLG. Back in the 1950s this was done by hand, an excruciating process which required wading into the stinging water often in freezing conditions to shovel the material out into trucks.

Allan Gray's chief investment officer Simon Mawhinney, a major shareholder, says the company's strategic location next to QSLG's salt-water processing facilities and state-of-the-art electrolytic facility should make Magontec competitive relative to other magnesium alloy producers. But he also notes there are risks.

"If the Qinghai facility turns out to work

A pumping barge floats on a salt lake retention pond at the Qinghai Salt Lake Group in Golmud. PHOTO: QILAI SHEN



A solar farm on the outskirts of Golmud: above, Nic Andrews, executive chairman of Magnotec, in front of the Qinghai Salt Lake Group magnesium production complex. PHOTO: QILAI SHEN

2800 metres up

as designed, it should be very profitable for Magontec and shareholders should be rewarded," he says.

"It's definitely not without risk of course. Projects like these have teething issues, it is already delayed and they are very much reliant on QSLM over whom they have no control. There are language barriers, cultural barriers and several other challenges associated with doing business in China."

Mawhinney says it has been a "difficult journey" for the company's shareholders and management so far but it feels like things are close to a turning point.

Andrews also acknowledges the risks and cultural challenges involved. He relies heavily on several local managers, who get paid up to 30 per cent more than they would for similar jobs in Australia, because they are crucial to the operation. While Magontec also has operations in Germany and Romania, Sydney-based Andrews' position means frequent visits to Golmud where his Chinese partners do not take "no" for an answer at obligatory toasts of a potent Chinese liquor, bijou, at company banquets.

"The Chinese are hard-working, hard-playing and pretty hard-drinking people. China is a whole different culture. That means being here a lot," he jokes.

Andrews, who first visited China in 1994 as a fund manager to see Pacific Dunlop's plants in Shenzhen, acknowledges Magontec is a minnow reliant on a leviathan.

The theory, though, when weighing up the risk is that QSLG wants Magontec to succeed or it wouldn't have funded its operations in China in the first place. If it wants control, it will probably buy it out.

Allan Gray, which owns 15 per cent, is not the only major shareholder. Straits Resources has 13 per cent, AWE has 5 per cent and management own 5 per cent. Andrews has invested several thousand dollars himself. "I'm a paid-up member of the 'waiting for Magontec to come good group'." The small free-float means turnover in the $27 million market cap company is low.

The company and the magnesium industry has had a tough run in Australia in the past.

Magontec first came to Andrews' attention in 2005 shortly after he had left the investment banking world to set up a corporate advisory firm called Pegasus in 2005. One of his clients was the Australian Magnesium Corp, whose portfolio included a range of magnesium alloy technologies. The company was in bad shape and its smelter at Gladstone in Queensland closed after a few weeks of operations. China had entered the magnesium market for the first time, and the price of the commodity halved overnight. "Queenslanders at the time remember it as one of Australia's great industrial disasters," Andrews recalls. "The word magnesium in Australia was a dirty word."

Andrews and his backers saw magnesium as the "metal of the future", though, and figured demand for the lightweight material would increase as the price dropped. Eighteen months after helping the company raise capital, there was little progress and Andrews and Allan Gray were part of a board coup. The company set up a Chinese joint venture to make magnesium alloy and Andrews joined the board.

However, that joint venture made poor progress and the company's financial situation deteriorated. "There was a terrible night in November 2009 when there was $100,000 in the bank, 70 or 80 tonnes of magnesium alloy ingots in the warehouses and a ¥8 million ($1.6 million) grant by the local government [In China] had not been signed."

Andrews, who had planned to join the company to help with the marketing, suddenly found himself propelled into the executive chairman's seat because no one else wanted the job. Shortly after his appointment he took a stroll down Sydney's Bridge Street – an area he knew well from his UBS days – and visited the headquarters of Straits Resources. He convinced the miner to effectively give away its struggling magnesium business called Magontec and the company in its current corporate form was born.

Andrews believed the company needed "another rationale for existence". One of his senior managers in China had a relationship with QSLG and an opportunity came along Andrews believed was too good to refuse.

The two companies signed a co-operation agreement in 2013, enabling Magontec to raise $17 million which funded the Golmud plant. While many of the new technologies acquired when it bought Magontec did not evolve, one "super alloy" showed promise which the company further developed with RMIT and Monash University.

Like many large state-owned companies in China, QSLG is a mysterious beast. It is listed on the Shenzhen Stock Exchange and was having a good run until last year when it lost ¥4.2 billion ($840 million). This included a ¥3.2 billion loss for the magnesium business. Its share price has fallen 57 per cent this year. There have been mixed reports on the company in the Chinese media. The *National Business Daily* in April reported small investors in the company had grown impatient with the magnesium project and were withdrawing their investment.

The plan is to produce 100,000 tonnes of magnesium a year.

Andrews remains confident. "The next piece of news is that they are producing 1000 tonnes a month here, which is our break-even. Then we will be on an escalator. It's not the steepest escalator but look back to 2016 and we've come a long way."

A key reason QSLG probably will not be allowed to fail is that it produces renewable energy without polluting the environment. This is a win-win under Xi's directive to clear up China's skies. Beijing is subsidising companies like QSLG to meet these objectives.

QSLG's Xie, like most corporate chiefs in China, candidly associates himself with Xi at any opportunity. We are allowed to visit a museum his company has set up in the industrial park, which explains the area's fascinating history but is also a shrine to China's leaders past and present who visited the region because of its strategic importance as the gateway to Tibet and now a burgeoning renewable energy industry.

Hydro, solar, thermal and wind provide power to most of Qinghai's 5 million people and the province, which has the luxury of a sparse population and sunny weather, has become a poster child for the green revolution taking place in China despite uncertainties around the economics.

Andrews says Magontec's advantage is that many of its competitors cannot survive in China where labour and energy costs are rising, as are the environmental penalties.

He says the company is immune to a trade war between China and the United States because Washington already slapped 141 per cent dumping duty on Chinese magnesium 13 years ago. "We are immune to Trump. We've seen it all before."

Magontec may also be one of the few Australian companies that directly benefits from China's Belt and Road infrastructure initiative which aims to recreate the old Silk Road with new ports, rail lines, roads and other infrastructure. At the moment, it takes two to three weeks to ship magnesium alloy to customers in Europe as it must first go to Shanghai by road and rail. It could take two to three days in the future, he says.

Despite the challenges, Magontec is one of a handful of brave Australian companies determined to give it a shot in China. If he pulls it off, the company's long-patient shareholders will not be complaining. Asked if he ever imagined he would have swapped the high-rises of Bridge Street for a remote Chinese desert, Andrews replies: "I think I took a left turn, I was supposed to take a right."