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THE UNIVERSITY OF SYDNEY
CHINA STUDIES CENTRE

Demystifying Chinese Investment

China's outbound direct investment in Australia

Update August 2012

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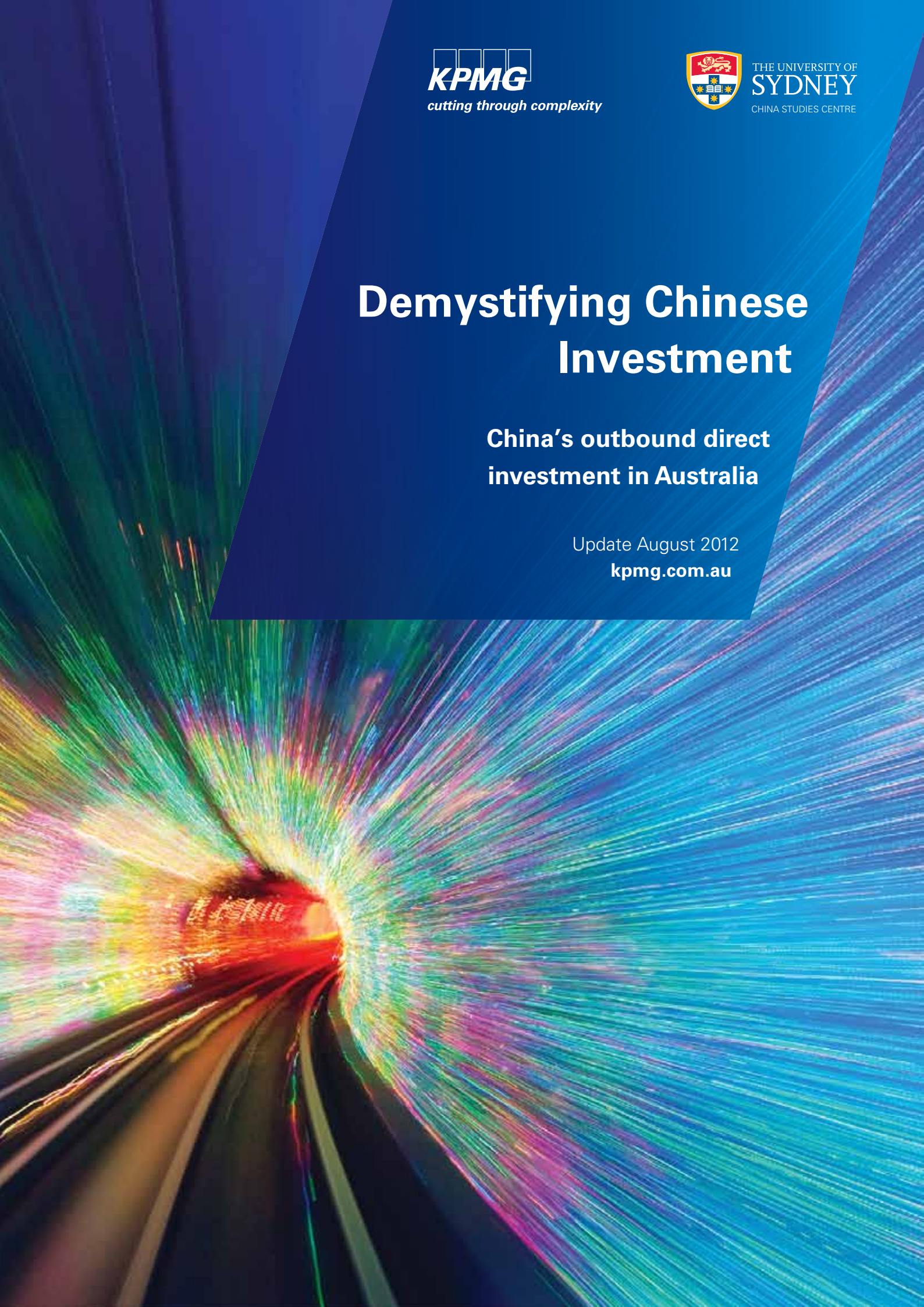

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Foreword

Despite an intensity of interest in China's direct investment in Australia and elsewhere around the world, the nature and distribution of China's outbound direct investment (ODI) in this country is poorly understood.

In-depth analysis has been limited by persistent difficulties in obtaining reliable Chinese data. And a lack of understanding about the characteristics of Chinese investors, their corporate governance structures and deals has affected both policymakers' and public perceptions about Chinese ODI. Consequently, many questions about China's investment profile and motivations remain unanswered, provoking speculation and unwarranted anxieties about the speed and extent of Chinese investment.

KPMG and The University of Sydney China Studies Centre have, in the past 21 months, undertaken a thorough review of Chinese direct investment in Australia. Our assessment method and dataset provide arguably the most detailed and up-to-date information on Chinese ODI in Australia. This report expands on the findings of our business intelligence series for engaging with China[1], extending our analytical coverage to 30 June 2012.

We provide greater clarity and detail on the nature and distribution of China's investment flows to Australia, the types of investors involved, their entry strategies and a more comprehensive and up-to-date analysis than has been recently available in the marketplace.

Informed and constructive discussion by businesses and among policymakers about the nature and extent of China's ODI in Australia is critical for stimulating greater opportunities for engagement between Australian and Chinese organisations and determining our prosperity in the decades ahead.

Doug Ferguson
Partner, China Practice
KPMG Australia

Professor Hans Hendrischke
China Studies Centre
The University of Sydney

1 KPMG/The University of Sydney China Studies Centre: *Australia & China: Future Partnerships 2011* and *The Growing Tide – China Outbound Direct Investment in Australia,* November 2011

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M&A represents the most important form of Chinese ODI in Australia, far outstripping greenfield investment and joint ventures...

Chinese SOEs that have invested in Australia since 2006

1 Aluminum Corporation of China*
2 Anshan Iron & Steel Group Corporation
3 Baiyin Nonferrous Metal Group
4 Baoding Tianwei Baobian Electric Co. Ltd
5 Baotou Aluminium(Group)Co., Ltd
6 Baotou Iron & Steel (Group) Co., Ltd*
7 Bright Food
8 China Architecture Design and Research Group
9 China Coal Import & Export Company
10 China Datang Corporation*
11 China Guangdong Nuclear Power Group
12 China Huanqiu Contracting & Engineering Corp
13 China Investment Corporation
14 China Merchants Group Ltd
15 China Metallurgical Group Corporation*
16 China Minmetals Corporation*
17 China National Offshore Oil Corporation *
18 China National Petroleum Corporation*
19 China Nonferrous Metal Industry
20 China Railway Materials Commercial Corp*
21 China Shenhua Energy Company*
22 China-Africa Development Fund
23 Chonggang Minerals Dev. Investment Ltd
24 East China Mineral Exploration & Dev. Bureau
25 Goldsland Holdings Co Ltd
26 Guangdong Rising Assets Management Co
27 Guangdong Yudean Group Co Ltd
28 Hunan Nonferrous Metals Corp
29 Hunan Valin Iron & Steel Group
30 Jiangsu Shagang Group*
31 Jilin Tonghua Iron and Steel Group
32 Jinchuan Group Ltd
33 Northwest Mining and Geology Group Co,. Ltd
34 Shenzhen Zhongjin Lingnan Non-femet Co,. Ltd
35 Shougang Group Corporation*
36 Sinopec Group *
37 Sinosteel Corporation*
38 The CITIC Group *
39 Western Mining Co Ltd
40 Wuhan Iron and Steel (Group) Corporation*
41 Yankuang Group
42 Yunnan Chihong Zinc & Germanium Co., Ltd
43 Yunnan Tin Group Co Ltd
44 Zijin Mining Group Co. Ltd
45 Shandong Energy Group

Note: * SOEs listed in the Fortune Global 500, 2011

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3. State-owned dominance:

Chinese State-Owned Enterprises (SOEs) dominate investment in Australia, a characteristic that likely gives rise to public perceptions that investment is government-directed rather than commercially motivated. Of the 116 completed deals, 92 were made by 45 SOEs. Based on transaction value, over 95 percent of the investment during our data timeframe involved SOEs. This is notably higher than the 70 percent global average[6], and the 65 percent and 72 percent averages for the United States and Europe respectively[7].

SOE ownership is, however, consistent with the fact that Chinese investment in Australia is concentrated in the energy and resource sectors. As these sectors require high levels of initial capital outlays and their projects often involve longer investment cycles and higher investment risk, SOEs — with their easier access to finance — are still the main players. The majority of Chinese investments are funded by Chinese debt, mostly through the China Development Bank, and to a much lesser extent the big 4 Chinese domestic banks which are rapidly entering the Australian market to support their major Chinese clients.

In addition, SOEs have the advantage of networks and experience accumulated through years of minerals trading with Australian businesses, which inevitably facilitate their investment in Australia.

The table to the left provides a list of the 45 Chinese SOEs that invested in Australia during the period of our analysis. Of these, 15 SOEs are listed in the 2011 Fortune Global 500 rankings of the world's largest companies. In 2011, their total combined global revenue reached USD 935 billion.

4. A preference for investments with listed companies:

The targeted or partner companies of Chinese investors are mostly listed on the Australian Stock Exchange (ASX). Based on our data, excluding a few deals involving projects with private companies owned by Australian mining figures such as Clive Palmer and Gina Rinehart, all other completed deals were made with ASX-listed companies, either directly or indirectly. There are a number of possible reasons for this.

Making direct or indirect investments with ASX-listed companies provides some SOEs with the facilities to raise additional financial capital for expansion. Importantly, like other companies, SOEs aim to identify projects which are more likely to generate profits. SOEs find it a challenge to identify attractive projects — to do so requires the deployment of a variety of screening devices.

An ASX listing may act as one such screening device. By investing in ASX-listed companies, Chinese SOEs are better able to perform due diligence and understand the performance of the company due to continuous disclosure requirements and Joint Ore Reserves Committee Code (JORC) standards for listed companies.

Companies already listed on the ASX may, on average, involve less risk and a higher probability of generating profits[8].

SOEs' sensitivity to potential investment risks is also obvious through their preference for mergers and acquisitions (M&A)[9]. These represent the most important form of Chinese ODI in Australia, far outstripping greenfield investment and joint ventures in terms of the number of completed deals and their value[10].

6 China's Ministry of Commerce (2010 statistics on China's global ODI stock)

7 Rhodium Group (2011, 2012)

8 Companies listed on ASX are required to comply with continuous disclosure rules. In particular, companies listed on the Australian Securities Exchange are required to report publicly on ore reserves and mineral resources under their control, using the Joint Ore Reserves Committee Code (JORC). Non-compliance has criminal and civil liabilities – section 674 of the Corporations Act 2001 (Cth) requires the immediate disclosure of information (to the market) that would have a material effect on the price or value of the company's securities.

9 Outbound foreign direct investment can occur through 'greenfield' projects (building new facilities from scratch) or by buying existing assets through mergers or acquisitions.

10 Based on KPMG/The University of Sydney database

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China's investment by state and industry

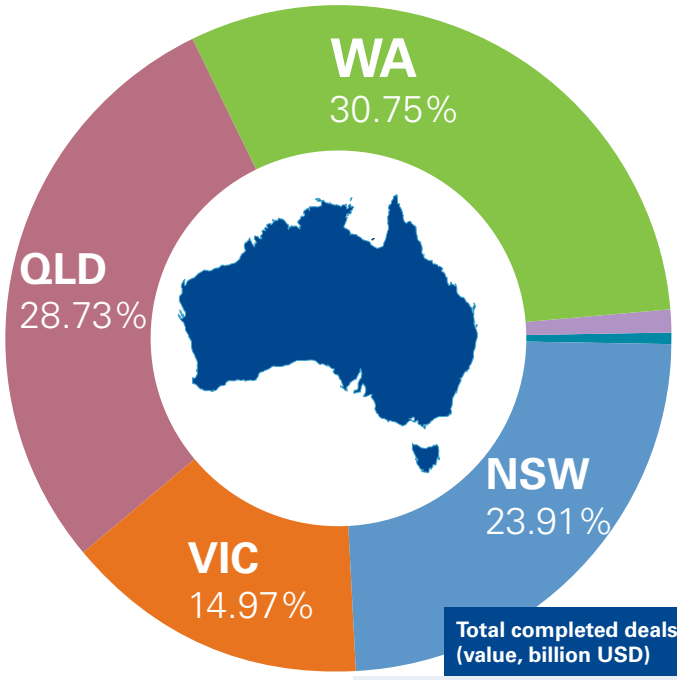
Western Australian (WA) registered firms attracted the highest level of Chinese investment, by transaction value, from September 2006 to June 2012.

More than 30 percent of the total Chinese investment in Australia during that period — or around USD 13.9 billion — was absorbed by WA, followed by Queensland (QLD) with USD 12.95 billion and New South Wales (NSW) with USD 10.8 billion. Companies registered in these three states accounted for over 80 percent of China's investment.

Investment diversity has been greatest in NSW. While more than 70 percent of China's investment volume (USD 7.6 billion) was directed into mining, oil and gas— investment also occurred in real estate, agriculture, architecture, renewable energy and other sectors.

Victoria's (VIC) engagement with Chinese companies was also relatively diverse: although 81 percent of the investment volume (USD 5.47 billion) was channelled into mining, oil and gas, sectors such as logistics and finance also attracted investment.

Investment in WA and QLD is highly concentrated in mining and energy industries, which have commanded around 99 percent of China's investment volume in the two states.



Total completed deals by state (value, billion USD)

NSW	$10.779 billion
VIC	$6.751 billion
QLD	$12.953 billion
WA	$13.866 billion
SA	$0.601 billion
TAS	$0.139 billion

Investment diversity has been greatest in NSW, followed by Victoria.

Note: deals are categorised by target company's registered office
Source: KPMG/The University of Sydney database

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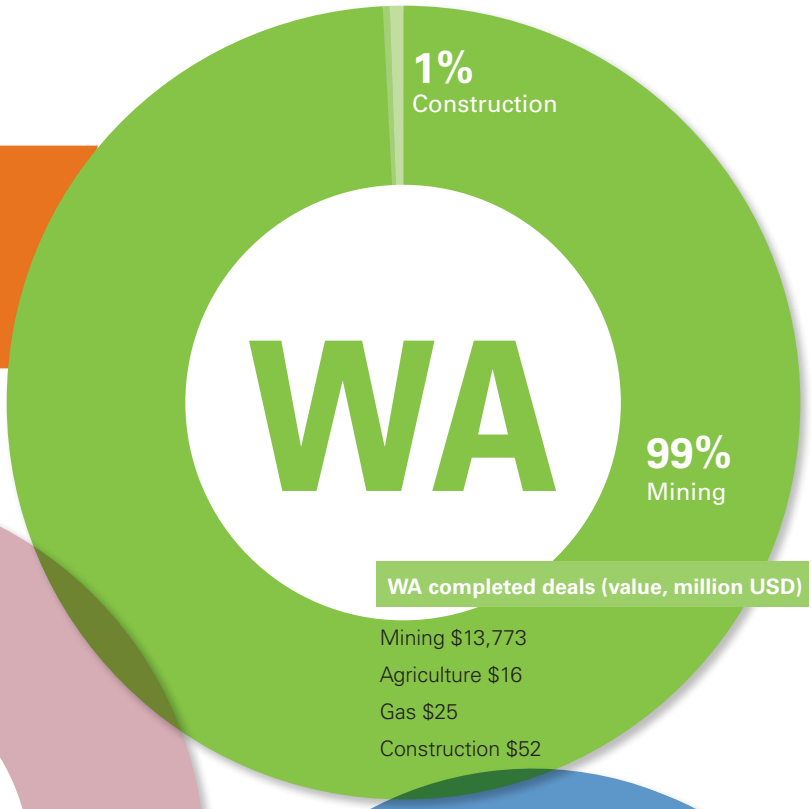
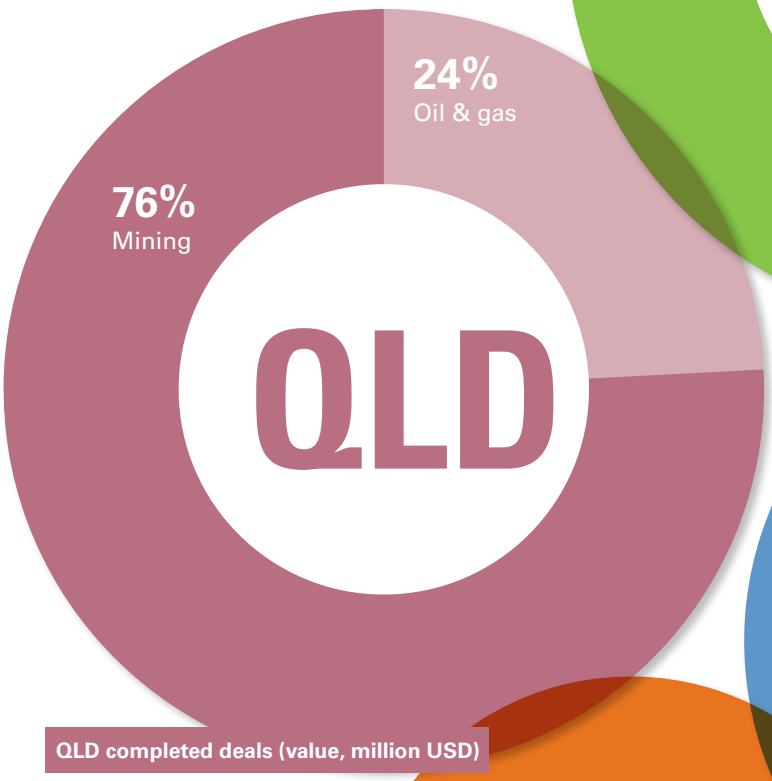
Total completed deals by state and industry



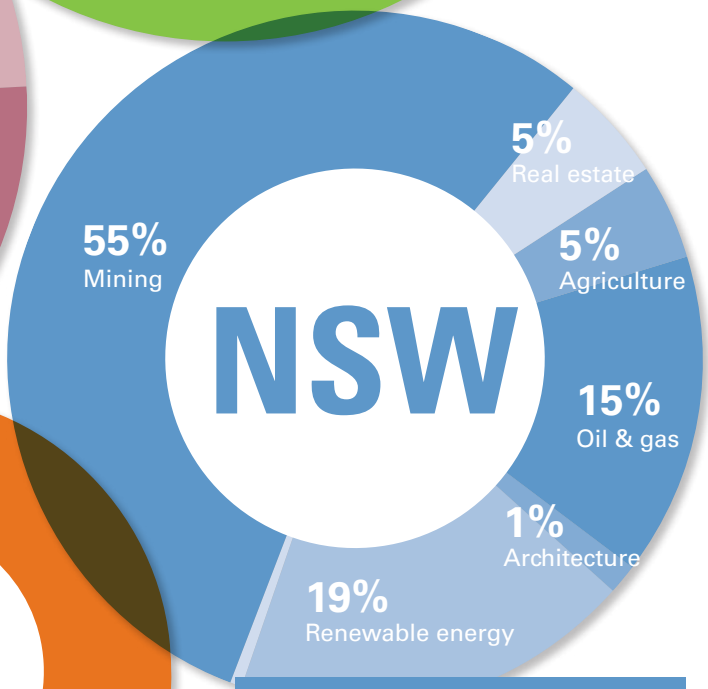
WA completed deals (value, million USD)

Mining $13,773
Agriculture $16
Gas $25
Construction $52



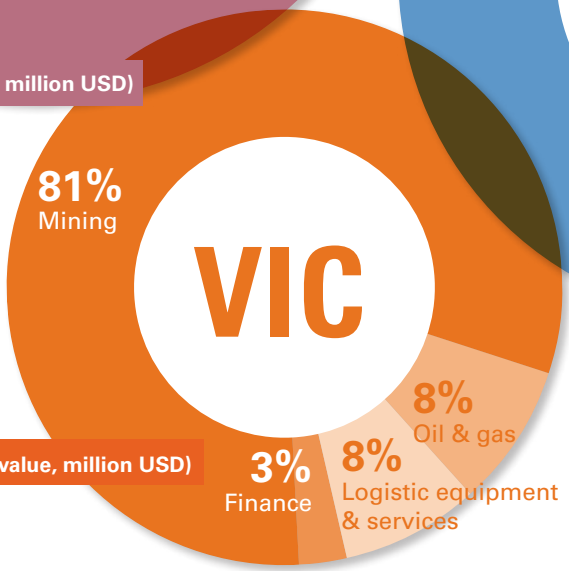
QLD completed deals (value, million USD)

Mining $9,828
Oil and gas $3,126



NSW completed deals (value, million USD)

Mining $5,957
Real estate $514
Agriculture $500
Oil and gas $1,600
Architecture $147
Renewable energy $2,030
Others $30

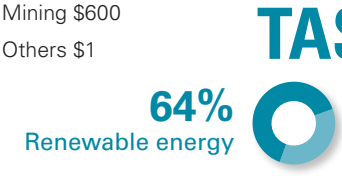


VIC completed deals (value, million USD)

Mining $5,469
Oil and gas $556
Logistic equipment $546
& services
Finance $180

TAS completed deals (value, million USD)

Mining $600
Others $1



TAS completed deals (value, million USD)

Agriculture $51
Renewable energy $89

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SOEs are a powerful force in China's offshore investment push. By the end of 2010, SOEs held 2.66 trillion yuan (USD 420 billion) in assets outside mainland China, up 50 percent from 2009. By November 2011, total profit from overseas operations for the year reached 128 billion yuan (USD 20.3 billion), growing by 28 percent over the same period of the year before[11]. In 2010, China's total ODI flow reached USD 68.81 billion or 5.2 percent of the total ODI flow worldwide - and over 70 percent of this outbound investment was made by SOEs, according to China's official statistics.

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Demystifying state-owned investments: initial views

A more sophisticated understanding of Chinese SOE ownership would be helpful for foreign investment review considerations and government policies given that an overwhelming proportion of China's investment in Australia is made by enterprises with varying degrees of Chinese state ownership. In particular, questions persist about the role the Chinese state plays in the internationalisation process of SOEs and whether their overseas investment patterns and operating behaviours differ from non-SOEs.

SOEs are commonly thought to be driven and subsidised by the Chinese Government to expand abroad, with political goals. This perception is reflected in the different approach to SOEs by the Foreign Investment Review Board (FIRB) in Australia, as well as authorities in other countries such as the United States' Committee on Foreign Investment and the Canadian Government's SOE guidelines in the *Investment Canada Act*.

However, it is less commonly acknowledged that Chinese SOEs abroad have shown strong commercial motivations, similar to those of multinational corporations from developed countries operating in foreign markets. SOE reforms in China have been carried out over the last two decades, aiming to transform them into entities that are viable in a global market economy. Studies have shown that SOEs typically invest and operate not as agents of the state but like any other commercial firm[12].

Accordingly, the number of external parties involved in their investment decisions and processes has ballooned to encompass domestic and international service firms and consultants, foreign investment promotion agencies, a large array of corporate foreign partners and financing partners such as commercial banks, private equity firms and government-backed funds.

In our analysis of SOE investment in Australia, we have utilised our dataset to generate some preliminary insights on how the level of state ownership in SOEs affects the choice of investment entry mode, specifically, the level of shareholding of Chinese SOEs in Australian target companies. We examine the ownership activity of the 11 largest Chinese investors who account for 80 percent of Chinese investment stock in Australia[13].

There are three key preliminary observations:

1. Chinese direct investment in Australia is dominated by relatively few, very large projects funded by China's central state-owned sector. Of the 11 major Chinese investors in Australia, only two are local SOEs — from Shanghai and Shandong. The remainder are long-established central SOEs with a considerable track record of international activities. This concentration of established SOEs in a small number of projects sets Australia apart from other international investment locations for China.

Experiences in the USA and Europe show that with growing diversification of Chinese ODI, Chinese investors can become positive contributors to domestic job creation[14].

2. The variety of entry strategies used by large Chinese SOEs is also notable. This gives rise to the preliminary conclusion that Australia can be considered a safe and stable investment environment in which large SOEs may rapidly gain experience by developing entry strategies and operations for mature market economies, and learn to adapt their investment structures according to sectors and target companies.

Strategies may comprise different forms, ranging from pure offtake to joint ventures, strategic alliances, creeping acquisitions and control.

3. SOEs abroad are behaving more like international corporations. While we recognise there are some fundamental differences between SOEs and other foreign corporate investors, SOEs operating away from home are also behaving in a fundamentally similar manner to many international companies. For example, they are interested in making capital investments to secure high quality, stable supplies of natural resources, acquiring companies to secure technology and new brands, exporting Chinese brands and accessing new markets. Increasingly, they are recognising the importance of having strong local Australian partners, employees and stakeholder relations. SOE senior management are also assessed based on financial/shareholder returns.

11 KPMG Global China Practice

12 For example, Peterson Institute for International Economics (2012), *Chinese Investment in Latin American Resources: the Good, the Bad, and the Ugly*

13 Total accumulated Chinese ODI

14 Rhodium Group (2011, 2012) on the US and Europe

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State ownership in the 11 SOEs and their Australian projects

Company name	Level of state ownership	Other owners	Managing owner	Listed	Australian projects			
					Name	Date	Equity	Comments
Sinopec Corp.	75.84	19.35% + 4.81%	Sinopec Group (100% SASAC)	HK, NY, London, Shanghai	Australia Pacific LNG	2011 2012	15% 25%	
					AED Oil	2008	60%	
Minmetals Resource Ltd	71.56%	28.44%	China Minmetals Corp. (100% SASAC)	HK	Havilah Resources	2011	<5%	
					Anvil Mining Ltd	2012	100%	
					OZ minerals Ltd	2009 2010		
Yanzhou Coal Mining Company (Yancoal Australia)	52.86%	47.14%	Yankuang Group (Shandong SASAC 100%)	HK, NY Shanghai,	Felix Resources	2009	100%	
					Syntech Resources	2011	100%	
					Gloucester	2012	78%	
China Merchants Group	100%	0%	China Merchants Group (SASAC 100%)	n.a.	Loscam Ltd	2010	<100%	
PetroChina Company Ltd	86.5%	13.5%	China National Petroleum Corp. (100% SASAC)	HK, NY, Shanghai	Arrow Energy	2010	100%	50% Shell joint venture
Shanghai Tangjiu Group	100%	0%	Bright Food Group (100% Shanghai SASAC)	n.a.	Manassen Foods Group	2011	75%	
Taurus	100%	0%	Guangdong Nuclear Power Group (100% SASAC)	n.a.	Extract Resources	2012 2012	91.34% 100%	
Sinosteel Corp.	100%	0%	Sinosteel Corp. (100% SASAC)	n.a.	Midwest Corp.	2008	100%	
China Metallurgical Corporation Mining Pty, China Metallurgical Corporation Holding Pty Ltd	64.18%	35.82%	Metallurgical Group Corp. (100% SASAC)	HK, Shanghai	Western Australia SINO Iron Ore Project			CITIC Pacific as partner
Chinalco (Shinning Prospect Pte. Ltd)	100%	0%	Chinalco (100% SASAC)	n.a.	Rio Tinto	2008 2009	9.3% 9.8%	
China Datang Corp Renewable Power Co	88.4%	11.6%	China Datang Corp. (100% SASAC)	HK	CBD Energy Ltd	2011	63.75%	Baoding Tianwei as partner (12.5%)

China National Conference Hall in Beijing.

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The National People's Congress, held in the Great Hall of the People, Beijing.

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China's new regulations for outbound investment

Major Chinese companies generally operate within a framework established by China's State-owned Assets Supervision and Administration Commission (SASAC). In April 2012, SASAC issued a directive that appeared to some observers to enforce new restrictions on the expansion of Chinese SOE investment abroad.

This interpretation is incorrect — the aim of the recent ODI regulations is to achieve a better sustainability of ODI projects over the long-term, rather than to reduce capital outflows from China. Similar new regulations have also been issued for domestic investments.

According to the new regulations, centrally controlled SOEs planning to invest overseas in areas outside their core businesses will be required to lodge details of their investment and financing sources with SASAC and obtain approval before the actual investment is made. The regulations took effect in May 2012. In addition, the enterprises must also register with SASAC before making major investments in their core businesses. SASAC has issued similar policies in past years that define the regulatory regime for overseas investments by centrally-controlled SOEs, including post-investment governance.

Such policies are attempts by SASAC to control risks surrounding SOEs' investments abroad. Past negative experiences have informed the process including high profile cases in which investments made by SOEs suffered huge losses due to imprudent business decisions, risk management, lack of experience, and sometimes, adverse business conditions. The new regulations should be regarded as the latest effort by SASAC to ensure rational investment abroad. They do not represent any substantial policy changes by the Chinese Government to outbound direct investment.
The new rules should help regulate Chinese SOEs' overseas investments and contribute to a more sustainable overseas investment effort for all Chinese enterprises in the long run[15].

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Our future

Australia should enjoy a very long and fruitful economic relationship with China. China has enormous needs for energy, building materials, food, environmental protection, specific technology, and healthcare and Chinese companies have a strong desire to access new markets for growth.

Managing concerns and perceptions about Chinese investment in Australia requires better data and sophisticated analysis on the nature of investment flows, investors' motivations, strategies and ownership structures, how investment decisions are controlled and where investment is being channelled.

The strong presence of Chinese SOE investors in the Australian energy and resources sector is an advantage in that it signals long-term commitment to industries which rely on international investment.

Chinese long-term commitment to this core sector and the confidence building that comes with involvement in local infrastructure create potential for spill-over effects into other industries.

More comprehensive information should contribute to a better understanding of China's outbound investment drive and its potential for diversification. Policymakers, regulators and the public need information to allay some concerns and allow Australia and China to work together optimally on the opportunities presented by China's increasing business expansion.

Notes:

KPMG/The University of Sydney dataset and research methodology

The original dataset was compiled by a joint KPMG-University of Sydney team and covers investment into Australia made by entities from the People's Republic of China, through mergers and acquisitions, joint ventures, and greenfield projects. The dataset also aims to track down Chinese investment facilitated by subsidiaries or special purpose vehicles based in Hong Kong, Singapore or any other third countries. The data, however, does not include portfolio investment, such as the purchase of stocks and bonds, which does not result in foreign management, ownership, or legal control. In addition, deals with completed values under USD 5 million are excluded from our analysis because these deals lack consistently detailed information on the actual investment arrangements, and the acquirer company and target company are usually difficult to identify.

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KPMG and the University of Sydney China Studies Centre have formed a strategic relationship to publish research and insights on doing business with China. The first product of the relationship was *Australia & China: Future Partnerships 2011,* published in September 2011. In November 2011 we published *The Growing Tide: China's outbound direct investment in Australia.* We hope you enjoyed this further investment update.

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KPMG's China Practice

KPMG's Global China Practice is a network of 50 countries providing high quality, consistent services to China inbound and outbound investors globally. This represents a long-term commitment and sustainable advantage to KPMG and our clients.

In Australia, KPMG's dedicated China Practice acts as a priority gateway advising on inbound and outbound investment transactions between Australia and China. We assist our clients to develop truly regional strategies to help mitigate risk, improve performance, create value and most importantly capitalise and realise the business and investment opportunities arising from China's growth.

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THE UNIVERSITY OF SYDNEY
CHINA STUDIES CENTRE

University of Sydney China Studies Centre

The China Studies Centre was established by the University of Sydney in 2011 as a major initiative of the University's 2011-2015 Strategic Plan. The China Studies Centre represents a commitment by the University to cross-disciplinary research and public education including cooperation with external partners. The Centre's open research architecture facilitates interaction between Australian researchers working on China, Chinese academics and external partners with specific expertise.

The Centre's China Business Development team works on projects concerned with new and changing markets emerging from China's deepening marketisation and privatisation of public services and state monopolies. These projects anticipate new trends and create new knowledge for Australia China cooperation.

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