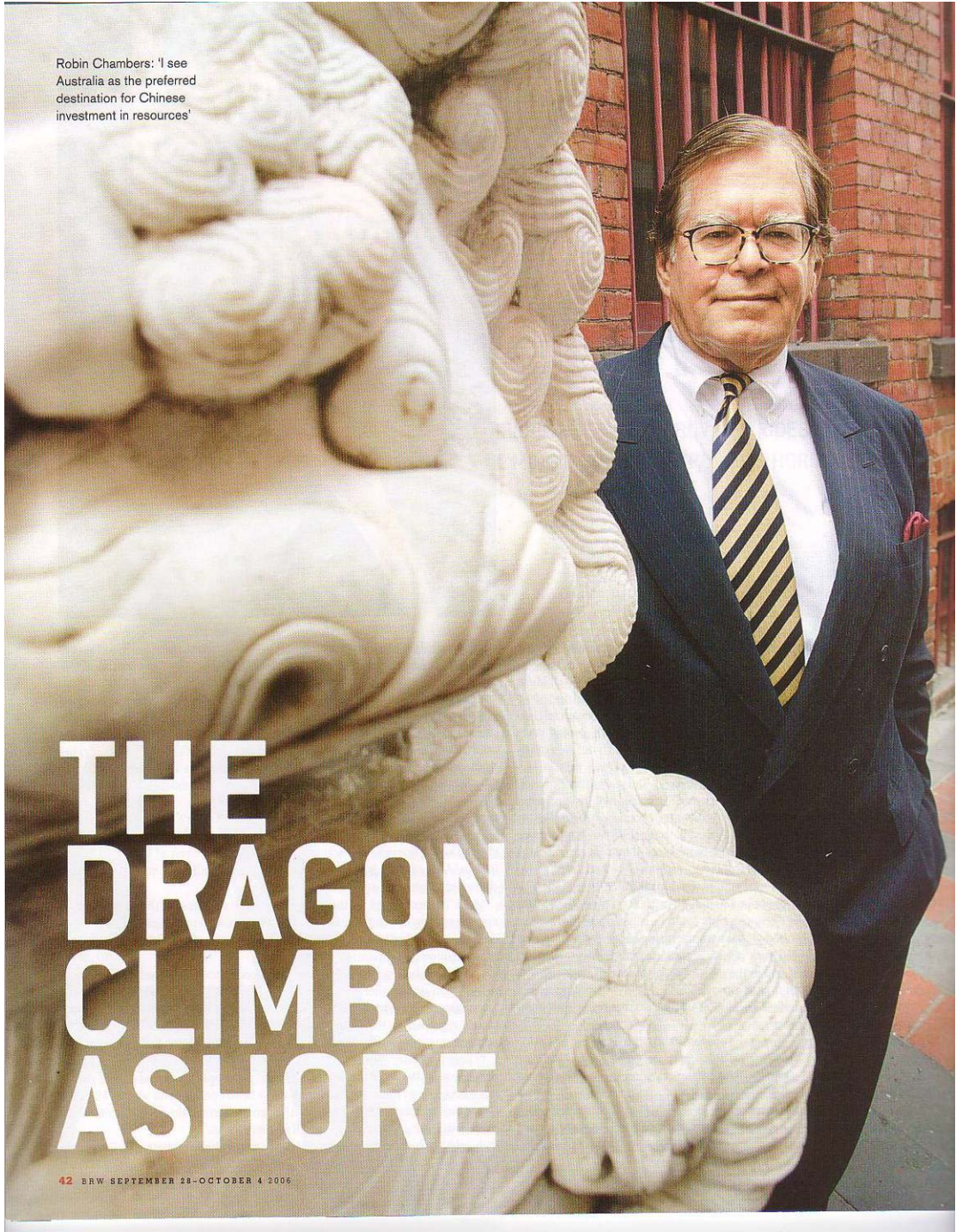


Robin Chambers: 'I see Australia as the preferred destination for Chinese investment in resources'

THE DRAGON CLIMBS ASHORE

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THE CASHED-UP CHINESE ARE LOOKING TO ENSURE THEIR GROWING MANUFACTURING CAPABILITIES, BUT THEY WILL AVOID A BIG SPLASH IN AUSTRALIAN INVESTMENT AS THEY QUIETLY SOLIDIFY THEIR RESOURCES.

CHINA'S SURGING ECONOMY has had such an effect that Australia is becoming a two-speed economy consisting of regions, mostly in the West, that are benefiting from the surge of demand for commodities, and regions that are not. The Chinese are also beginning to buy into the Australian resources industry, the most notable recent foray being initial moves to purchase a \$160 million controlling stake in the Crocker Well uranium field by Sinosteel. Many iron ore projects have been attracting Chinese investment interest, including Mineralogy, Mt Gibson and feasibility studies with Sinosteel at Midwest and Ansteel at Gindalbie. Sinosteel has a long standing 40 per cent stake in the Channar iron ore project. The Jinchuan Group has interests in nickel and copper projects at Musgrave and West Whunda in Western Australia and Avebury in Tasmania. In coal, China has had more limited success, except for CITIC's involvement in Macarthur Coal.

China's latest focus is on base metals and heavy metals. Plans are in the early stages for the Chinese potentially to acquire a "large Australian mining company", but any such moves will not be hostile. "No major mining company will be off the agenda in the next 10 years," one source says. With the country's foreign exchange reserve nearing \$US1 trillion, the cash will definitely be available.

The burst of activity all makes for arresting headlines, but so far China's investment is comparatively modest, even if it is unlikely to remain so. According to Invest Australia, the stock of Chinese overall investment in Australia actually fell between 2001 and 2005 by 27 per cent to \$2.03 billion, or 0.2 per cent of Australia's total investment stock, down from 0.4 per cent in 2001.

These investment figures may say more about the collection of statistics than anything else (Invest Australia is unable to give reliable statistics on foreign direct investment out of China). One reason for this low level (officially) is that much of China's investment comes through Hong Kong. Yet even Hong Kong's investment stock is not especially large: \$31.26 billion, or 2.6 per cent of the total. Meanwhile, Australia's investment into China is rising, albeit from a small base. Between 2001 and 2005 it rose by 8 per cent to \$2.04 billion.

Robin Chambers, principal of law firm Chambers & Company and a veteran of China's first joint venture in Australia (or anywhere), Rio Tinto's mid-1980s Channar project, says the level of interest in Australian commodities is growing. "I see Australia as the preferred destination for Chinese investment in the resources industry, and especially for iron ore to secure supplies for the burgeoning Chinese steel industry."

Unlike the Japanese in the 1980s and 1990s, who typically took 10 per cent stakes in Australian companies to ensure a reliable flow of information, the Chinese are more likely to take 50 per cent, or controlling, stakes in an effort to secure supply. Japan's arbitrating approach suited the mercantile nation, buying in raw materials for their manufacturing base that was mostly aimed at the West. But China is a continental economy that cannot afford to rely on exports for its economic wellbeing and must ensure domestic supplies. As the

nation industrialises, putting intense pressure on world commodities markets, it is suffering from negotiating weakness because of its own economic strength.

The chief executive of cable manufacturer Nexans' Shanghai operations, Doug Anderson, says: "China's major aim is to secure enough of world resources to meet its medium-term needs. This covers petroleum, iron ore, metals such as copper. The reason is that generally, the US excluded, the resources are accessible and buyable. The resources are well developed.

"China resources, some of the richest in the world are yet to be developed, and they are guarded by a complex web of rules and regulations and under which any foreign invested developer would be reluctant to operate. In short, they are protecting themselves and their future needs."

Anderson says there is a heavy focus on African nations and other developing countries. The Chinese are offering special deals on equipment and other items in exchange for access to these countries' mineral resources. "Examples are in Pakistan, Iran and the Congo where copper and other metals and minerals are made available for Chinese aid in varying forms. From the acquisition of foreign assets the Chinese can learn as well as gain from this experience and later develop their own assets. It's very clever and long term."

Although China has large foreign exchange reserves, and last year would have increased its outward foreign direct investment more than fivefold if the bid for the American oil company Unocal had been successful, it is still struggling to become a truly capitalist economy. There is almost a total dependence on bank debt and only a nascent understanding of equity investment. This creates the potential for significant mispricing. Like the Japanese in the 1990s, the Chinese have a tendency not to observe the strictures of the cost of capital – scarcely surprising for a country only just emerging from communism.

In theory, Chinese debt, with the base rate below 6 per cent, is cheaper than equity in the mining majors. BHP Billiton is on an earnings yield of 9.25 per cent and Rio Tinto on 10.3 per cent. And it is not just the foreign exchange reserves that are flush. Almost half of China's gross domestic product is investment. Of that, over two-fifths is accounted for by company's retained earnings, which could easily be directed into overseas investments.

But there are many barriers. One is China's inexperience. Another is concern over sovereignty. America's hostile reaction to the Unocal bid has also taught the Chinese a lesson about the West: the admonition to keep markets open to investment tends to go only one way.

Much more likely is that China will seek to diversify by making investments in new projects in Australia that are below the radar, but which give them limited leverage. The big beneficiaries are still uncertain. In iron ore, Andrew Forrest, chief executive of Fortescue Metals Group has sought to market the company as the fourth force in iron ore, but many analysts believe it is more likely that the Hope Downs or Mineralogy projects will achieve that status.

Chinese investment will have a transformative effect on the Australian economy, comparable with previous waves of investment from Britain, the United States and Japan. But so far the amounts have been small.

Jim Short, executive director of the Australia China Business Council (Victoria), says: "The way they are going about it is sensible. I think they are taking a long-term view; they are obviously here for the long haul." ●