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The Chinese are coming... and they're all cashed up

Rowan Callick
Asia-Pacific editor

"Prospects for the rescue of the Doha Round of trade negotiations improved yesterday as trade ministers from 32 countries met in the Chinese city of Dalian." – Colleen Ryan, page 12

"The growth of China's energy requirements only fortifies America's need to reduce its dependency on oil." – Joshua Frydenberg, Opinion, page 63

Chinese businessman Huang Tianwen is the face of Australia's future. He lives in Beijing. He talks like any Western tycoon. He even lived for a few years in New Jersey in the US. As he shuttled around Australia last week, he advanced his involvement in four iron-ore projects, in each of which his corporation may invest several hundred million dollars, with a fifth at the ready.

Huang is president of Sinosteel Corp, a state-owned company that turned over $4 billion in 2004 and has a war chest of about $3 billion for acquisitions, funded by the China Development Bank and the Export-Import Bank.

The global focus is on the $25 billion bid by China National Offshore Oil Corp for US company Unocal. However, China's rush to tie up access to resources – and management, technology and brands – is under way in Australia as well.

Huang is part of a coming wave of Chinese investors who will multiply several times over the $2.2 billion injected so far into Australia.

As Beijing continues to cap investment at home due to concerns about its overheating economy, it is encouraging its companies to make use of China's $US660 billion ($880 billion) foreign exchange holdings to invest offshore in mergers, acquisitions and joint ventures.

Shanghai-based Australian lawyer and business adviser Michael Wadley says: "This is what I call the era

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The Chinese are coming

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of the "reverse joint venture" – the reverse of the strategy the Chinese used to ensnare Western capital in the first couple of decades of its opening to the world. Now the Chinese companies are cashed up and looking to expand offshore.

"Beijing wants them to do that, and they don't need to be told twice. They are looking for technology, know-how, access to markets and brands – all of which we rarely value on our balance sheets, or in our share prices. Now is the time for Western businesses to grab a Chinese partner who can give them access to their markets."

This drive to set Chinese capital to work overseas is reinforced by the looming demographic crunch, as the one-child policy produces an army of pensioners dependent otherwise on a thinning workforce at home. The National Council for Social Security Fund announced a couple of months ago that it would funnel hundreds of millions of dollars into overseas stocks, out of its $US20.5 billion in assets.

Last year, the number of Chinese merger and acquisition deals, both inside the country and overseas, increased 30 per cent to 642, worth $US27 billion.

While in Australia with his executive team – cosmopolitan, English-speaking Chinese, mostly in their 30s – Sinosteel boss Huang:

- Signed a framework agreement with Midwest Corp to develop, on a 50-50 basis, its West Australian iron-ore deposits near Geraldton.
- Advanced discussions with Mount Gibson Iron in WA's mid-west, with a view to obtaining magnetite ore and converting it into pellets in Nanjing, even though steel-mill group Shougang has also signed up with Mount Gibson.
- Talked with entrepreneur Clive Palmer about taking a major role in the second of three stages – involving exporting iron – of planned development of iron-ore prospects by his Mineralogy Pty Ltd.
- Registered a continued interest in Andrew Forrest's Fortescue Metals Group's iron-ore project in the Pilbara, despite a stand-off between Forrest and one of Huang's Chinese peers, China Metallurgical Construction group president Shen Heting.

Sinosteel was also set to join Hong Kong-based Noble Resources in participating, via Consolidated Minerals, in Gina Rinehart's $2.16 billion Hope Downs project. But Rio Tinto – Sinosteel's partner in the Channar joint venture – beat off the rest of the field.

The joint feasibility study that is framing the talks on an Australia-China free-trade agreement (FTA) says the aim is to remove restrictions and enhance transparency in each country's foreign investment regimes, streamline application processes and provide stronger protection to investors in each others' countries, "including the right to repatriate profits and capital . . . and improved mechanisms for handling post-establishment disputes".

It says economic analysis suggests investment would "expand strongly" under an FTA, including in agriculture in both countries (in food processing, dairy and live cattle trade) and in the textiles, metals, communications, chemicals and financial services.

Chi Changhai, vice-president of the China International Contractors Association (comprising engineering firms licensed by Beijing to operate overseas), indicated the pressures that may come with such growing investments while addressing a conference in Sydney in May. He urged the two governments to "have positive discussions about project-related labour services by Chinese enterprises in Australia" – in other words, permitting more Chinese workers at joint ventures in Australia.

China's first major investments in Australia were in resources: the Portland aluminium smelter in Victoria ($100 million) and Sinosteel's Channar joint venture in the Pilbara with Rio Tinto-owned Hamersley Iron ($120 million).

Sinosteel's Huang – who travels constantly, including in the business entourages of China's President Hu Jintao and Premier Wen Jiabao – is chasing reliable sources of supply everywhere, to feed China's insatiable industrial machine; but in future, he says, this might also supply industry in Europe, Japan or elsewhere.

Sinosteel has a big chrome ore joint venture in South Africa, and is looking for deals in places such as Mexico, Peru, Indonesia and Russia.

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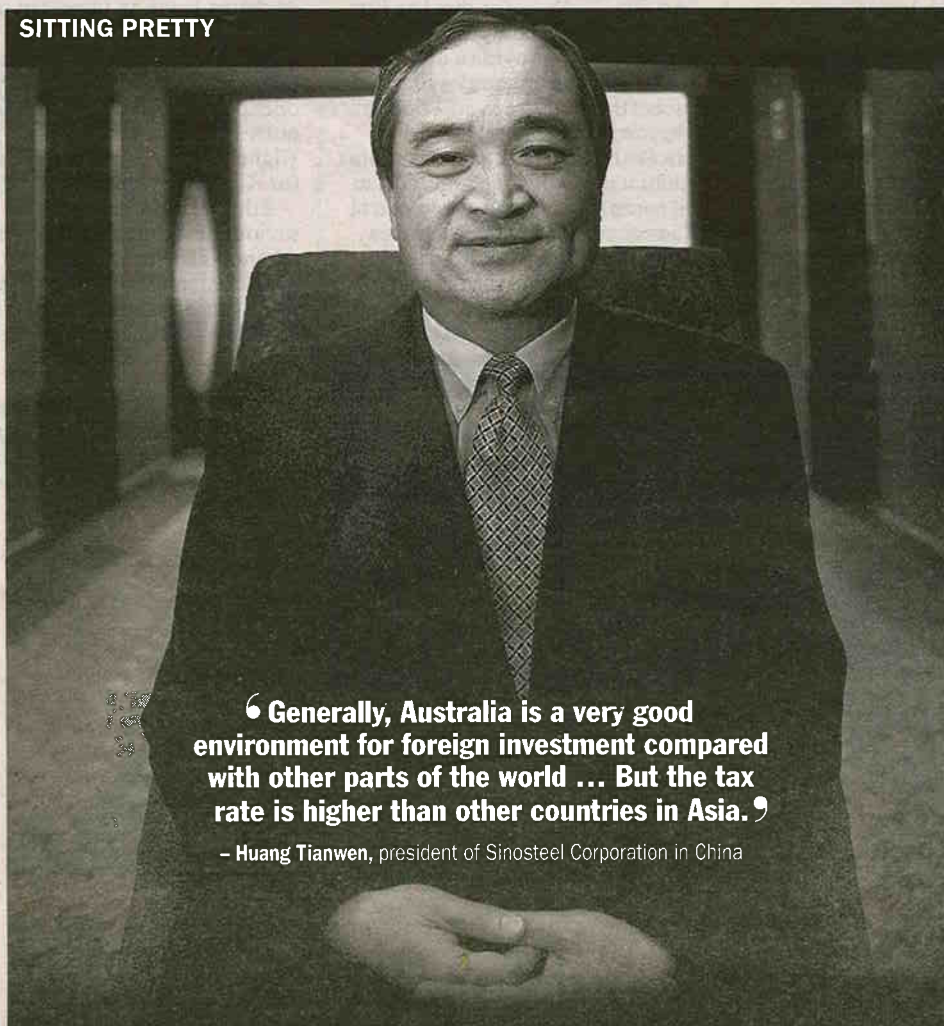
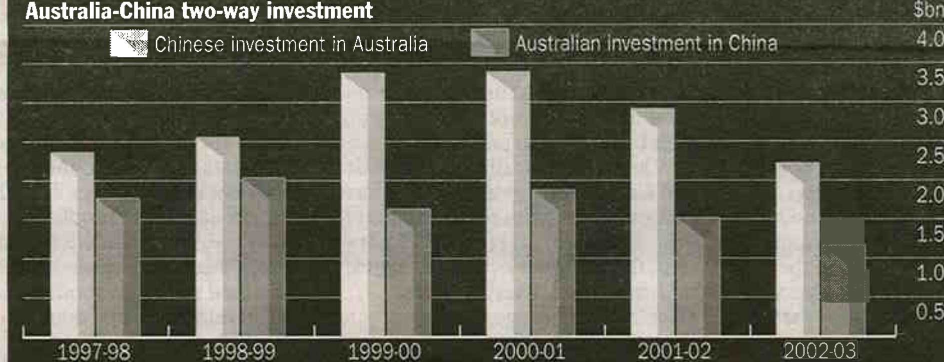


Australia-China two-way investment



China's share of world demand

Source: Lowy Institute, ABS, Rio Tinto

Huang says: "Generally, Australia is a very good environment for foreign investment compared with other parts of the world, with a good legal system and government services, and strong company reputations and social security. It's an ideal place for investment.

"But the tax rate is higher than other countries in Asia. Much higher. And the government needs to give more support to investors, especially during disputes." Sinosteel has had some experience of this, most recently with Hamersley at Channar (now resolved).

Other big mineral and energy tie-ups include BHP Billiton's $11.6 billion Jimblebar joint venture in WA with four Chinese steel mills; Hamersley's joint venture with Baosteel; Shougang's 5 per cent of Rio's HIsmelt project at Kwinana; and the Huaneng Group's $227 million purchase of 50 per cent of OzGen, owner of the Millmerran and Callide C power plants in Queensland, providing the group with experience of operating assets in a deregulated power market.

The Chinese bidder for Unocal, CNOOC, has already acquired 25 per cent of the North-West Shelf project that is supplying $25 billion of gas, starting next year, to China's first LNG terminal at Shenzhen.

Mark Qiu, chief financial officer and senior vice-president of CNOOC, a former investment banker in the US with Salomon Smith Barney, visited Australia last year and stressed the link between supply and investment.

"Our criteria in selecting appropriate suppliers are availability, reasonable transport and logistics, price and security of supply that comes from a capacity to establish a long-term relationship based on trust" – ideally reinforced by equity ownership. "The last is probably the most crucial in deciding contracts."

The flagship for Chinese investment in Australia for 15 years has been the China International Trust and Investment Corp, which is listed on the Australian Stock Exchange and operates similarly to the great Japanese trading houses such as Mitsui and Sumitomo.

It holds China's stake in the Portland smelter, and despite some problematic investments – such as Metro Meats, for which it paid $73 million – it has paved the way for what is likely to be a much bigger corporate wave to come. CITIC, like Sinosteel, also has a fast-thinking young executive chairman, Chen Zeng.

As of two years ago, 66 Chinese firms had invested, more modestly, in manufacturing in Australia. And much more activity is happening below the radar, as the number of Chinese business migrants grows rapidly.

Despite the focus on the big-picture deals, much of China's investment is likely to enter Australia through the migration program, typically via small investments in property.

Chinese entrepreneurs usually start conservatively, assessing a market and building a network of contacts – Australian "guanxi" – before making bigger plays. By this time, the protagonists, both the individuals and the companies, may well have become Australian.

Australian economist Ross Garnaut says: "It's a very natural development that China will invest more in Australia – as Japanese businesses did as they were becoming international. But in this, as in other areas, China will do it on a bigger scale.

"There will be a lot more cultural adjustment associated with foreign investment than with trade – on both sides. In the many countries in which China becomes a major investor, there will be a lot of learning on both sides on how to work productively with the other."

Richard Tsiang, Hong Kong-based Asia vice-president of US logistics giant Cendant Corp (and originally from Melbourne) says: "The most striking example of Chinese overseas investment so far is that of Lenovo's $US1.25 billion takeover of IBM's personal computer division. Most pundits reckon it was for the brand name. I understand from Chinese insiders that the real value, although the brand is a benefit, is the management know-how and the logistics, the just-in-time technology. Most Chinese enterprises are not yet efficient, and they know it.

"Clearly Chinese corporations have the wherewithal to do something major, as we see with the CNOOC bid for Unocal. There is a demand-supply imbalance in the resources sector, and inevitably such companies are coming into play.

"The services sector will follow. Airlines and telcos will also be targets. As such, strongly regulated industries go through deregulation, foreign investors will see opportunities" – as Hong Kong's Li Ka-shing and Singapore's vast pension fund Temasek have – in buying big stakes in Australia's utility market.

"I can see China Mobile taking a strategic stake in Telstra, for instance. Australia has significant capabilities and efficiencies in services, and these are the sectors China will also be looking at. Many of its big companies are well cashed up. They will just go and cherry-pick."

He says the two countries most vulnerable to such a wave of money are the two most efficient markets in the Asia-Pacific region: Australia and Singapore.

"Other countries have not yet worked their businesses to a scale where they're efficient enough. Chinese businesses don't want to invest in developing technology. They want proven technology and proven expertise. Hard assets and strong businesses."

Taking that expertise back to China, they can make it pay many times over in an economy of such great scale. The concept of shareholder return is also different.

Robin Chambers, the Melbourne lawyer who represents Chinese resource interests on a number of boards, is helping Huang assemble an international advisory board.

He says that until a decade ago, Sinosteel – then a different entity, CMIC – was the corporate arm of the then Ministry of Metallurgical Industry, with monopoly control of all international activity in the sector.

In the mid-1990s the dynamic premier Zhu Rongji shifted China towards a mixed economy, and freed the major mills to import their own supplies and make their own investments.

"Even though its whole framework of operating changed, along with its name, Sinosteel never faltered in its joint-venture agreement to Hamersley to guarantee a market for 10 million tonnes a year," Chambers says. "That's a very good example of China's fairness in business. A pretty good country-risk example."

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