

ISSN 2203-2037

29/10/2013



Demystifying Chinese investment in Australian agribusiness

October 2013

Important choices to be made

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About our reports



KPMG and The University of Sydney China Studies Centre have formed a strategic relationship to publish research and insights on doing business with Chinese investors. Our first report was published in September 2011, with *Demystifying Chinese Investment in Australian Agribusiness* representing the sixth report in our series.

Despite strong public interest, little detailed factual information has been previously available about the actual nature and distribution of China's outbound direct investment (ODI) in Australia. This specialist report continues our comprehensive reporting of China's ODI into Australia.

The dataset is compiled by a joint University of Sydney and KPMG team and covers investments into Australia made by entities from the People's Republic of China through M&A, joint venture and greenfield projects. The dataset also tracks Chinese investment by subsidiaries or special purpose vehicles based in Hong Kong, Singapore and other locations. The data, however, does not include portfolio investments, such as the purchase of stocks and bonds, which does not result in foreign management, ownership, or legal control. For consistency, the geographic distribution is based on the location of the Chinese invested company and not on the physical location of the actual investment project. Completed deals which are valued below USD 5 million are not included in our analysis, as such deals consistently lack detailed, reliable information. Unless otherwise indicated, the data referred to throughout this report is sourced from KPMG/University of Sydney database, and our previously published reports¹.

The University of Sydney and KPMG team obtains raw data on China's ODI from a wide variety of public information sources which are verified, analysed and presented in a consistent and summarised fashion. In line with international practice, we record deals using USD as the base currency.

We believe that the KPMG/University of Sydney dataset contains the most detailed and up-to-date information on Chinese ODI in Australia.

¹. Includes Australia & China Future Partnership, September 2011; The Growing Tide: China ODI in Australia, November 2011; Demystifying Chinese Investment, August 2012; The Energy Imperative: Australia-China Opportunities, 25 September 2012; Demystifying Chinese Investment in Australia, March 2013.

Introduction

China is not only Australia's largest trading partner, but also the largest trading partner of approximately 123 economies², many of which are competitors for agricultural trade and investment, including New Zealand.

Chinese investment has contributed enormously to Australia's relative prosperity – both as our largest agricultural trade customer (AUD 6.6 billion p.a. in 2011³) and having invested over USD 50 billion into our economy through direct investment across many sectors in the past 6 years⁴.

More recently, we have witnessed intense debate within mainstream Australian society about the merits

or otherwise of foreign investment into Australia's agriculture and agribusiness sectors, and the potential for Australia to become the 'food bowl of Asia'.

The topic is polarising. For many in the business community foreign investment is positive and essential to securing the long-term health of the sector.

However it's also a very complex and confronting issue for many in the industry, government and broader society.

As a result of this focus, Chinese companies feel cautious about engaging with Australian agribusiness – even where investments would lead to benefits for both sides.

This report, the sixth in our KPMG/ Sydney University China Insights series, provides clarity on the current scale and composition of Chinese large scale commercial investment into the Australian agricultural and agribusiness sectors. It analyses the realities facing China's food demand patterns and addresses some of the most critical issues of the debate. It identifies key growth opportunities for the sector and concludes with some pragmatic recommendations for Australia's agricultural and agribusiness leaders in building an Australia-China agribusiness model.

This is an important debate that we must have. And now is the time to have it.



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2. China Daily, China continues to increase influence on global trade, http://www.chinadaily.com.cn/cndy/2013-01/11/content_16104315.htm

3. DFAT, Australia's exports to China 2001 to 2011, <http://www.dfat.gov.au/publications/stats-pubs/australias-exports-to-china-2001-2011.pdf>

4. KPMG and The University of Sydney, Demystifying Chinese Investment in Australia, Update March 2013.

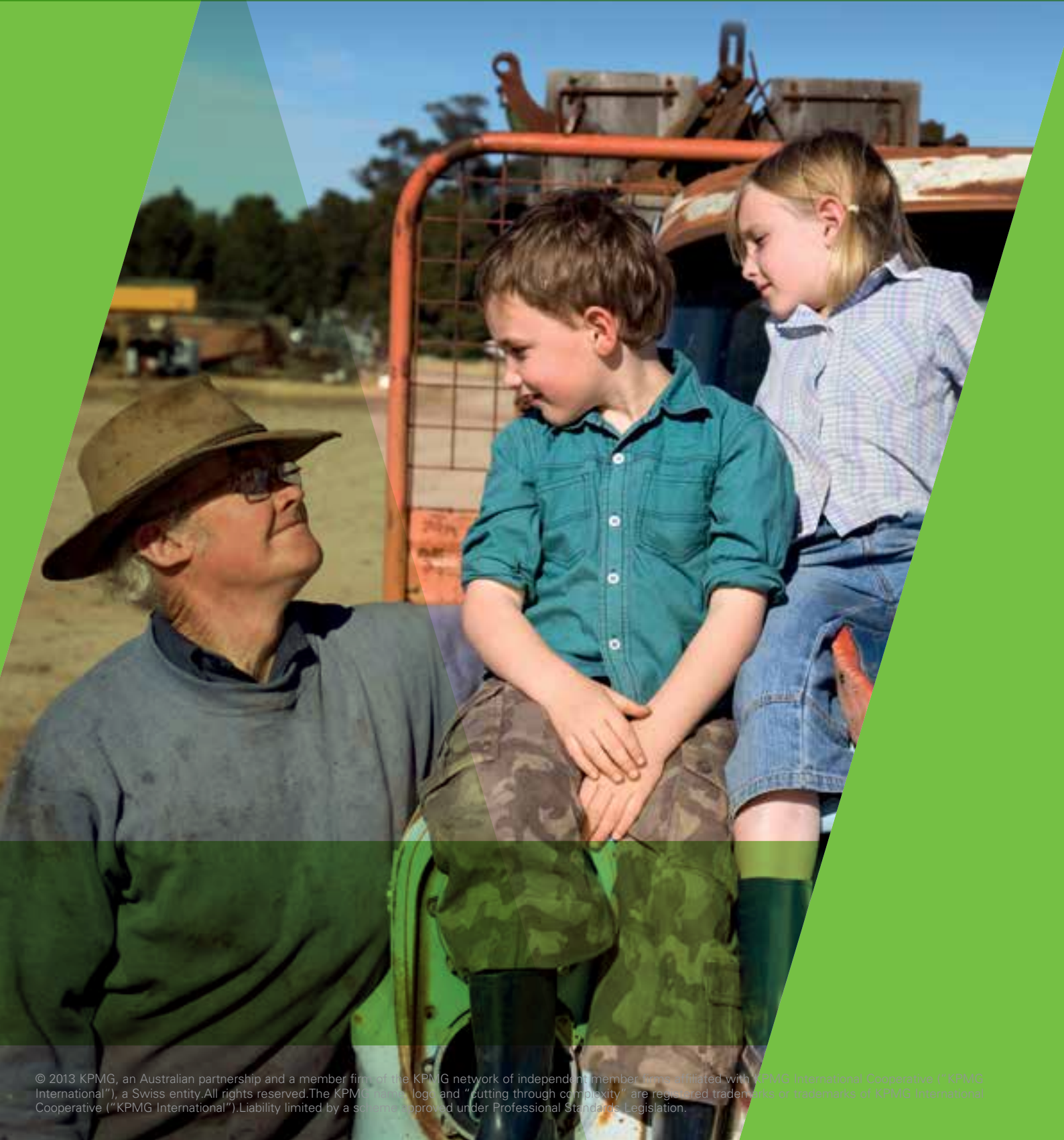


**This is an important debate
that we must have. And now
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You are getting older and are worried that your business – your family's wealth base – is devaluing. Is there another way?



A hypothetical scenario

Imagine that you are the owner of a large, vertically integrated Australian family farming enterprise that has grown over a number of generations to be a multi-million dollar business operating in a highly mature and competitive market where large corporate competitors are emerging and suppliers and customers are dominant.

Your business has developed a great brand and intellectual property (IP), produces the highest quality produce, employs from the local community and pays tax.

At the same time, the costs of doing business have increased. Your profit margin is eroding and there is not much hope of a profitable trade sale to a local buyer because of oversupply in the real estate market and recurring drought conditions.

You need capital to fund operations and capex; the local banks are very selective in lending and local equity investors are more excited about other, higher growth sectors.

You are getting older and are worried that your business – your family's wealth base – is devaluing. As much as you'd love to see your family business succeed under the next generation, you start to encourage your children to pursue other more lucrative careers in banking, professional services or mining.

Is there another way?

You have one customer that accounts for approximately 25 percent of your sales revenue and who keeps increasing their orders each year. Imagine if one day that customer came to you with a proposal to invest in your business, provide capital, technology and more importantly, direct access to an international customer base on a scale that could transform your entire business.

The investor realises that investment in agricultural land is strategically important for the integrated agribusiness investment thesis, but is also interested in the IP and food processing aspects of the business. The investor has decided that they don't just want a trade relationship anymore: they want equity participation in a vertically integrated business, they want to invest capital to build huge scale operations and they want to acquire your brand, IP and industry knowledge.

The investor comes from China, a country with language and cultural traits that you don't really understand. They are taking their time to proceed, but you feel they are genuinely committed to building an integrated model which enables your family to sell down equity and continue to manage the business operations without a huge amount of direct interference.

How would you feel about this? How would you treat that customer and potential investment and business partner?

What happens if you learn that the investment is subject to government approval delays, which frustrate the Chinese investor; or you succumb to fears or criticisms from your peers and you reject the investment offer? Do you risk losing not only an investment partner but also your largest customer?

Now what happens to the family business?

THE FACTS

Chinese investment in Australian agribusiness

Commonly Held Belief: China is one of the largest foreign investors in Australia's economy

The facts: Although Chinese companies have invested over USD 50 billion directly into Australia over the past 6 years, China still ranks ninth in accumulated investment – the US has invested nearly ten times more.

Commonly Held Belief: China is buying up large areas of Australian farmland

The facts: Chinese investors may own less than 1 percent of Australian farmland. For assets over AUD 5 million which we track in our database, there have only been 10 significant investments completed with a total value of just over AUD 1 billion in Australia's agribusiness sector since 2006. Agriculture represents only 2 percent of Chinese investment into Australia.

Commonly Held Belief: Chinese SOEs are the most active investors

The facts: In mining, gas and energy this is true – but for other sectors including agribusiness, privately owned Chinese companies are more actively investing (by number).

Commonly Held Belief: Australia offers an abundant pool of attractive agricultural sector assets for Chinese investment

The facts: Australia's family farming dominated sector is highly fragmented. Chinese investors are mostly interested in very large scale investment opportunities and the largest companies are already largely foreign owned or not easily acquired. To date, we have not observed large scale aggregation strategies successfully applied on behalf of Chinese investors.

Commonly Held Belief: Food security is China's main priority

The facts: China is committed to pursuing self sufficiency in core bulk food commodities and is a net exporter in certain foods. Global trade will manage any shortfall. Australia's opportunity lies in meeting China's food safety objectives – providing premium, fresh safe foods: meats, dairy products, vegetables and wine.

Commonly Held Belief: Australia has an exclusive opportunity to supply China with food

The facts: China is our largest trade partner but 123 other countries claim China to be their largest trade partner. We have a great platform and opportunity but it is extremely competitive, with New Zealand in a very strong position.

Commonly Held Belief: A Free Trade Agreement (FTA) is absolutely essential

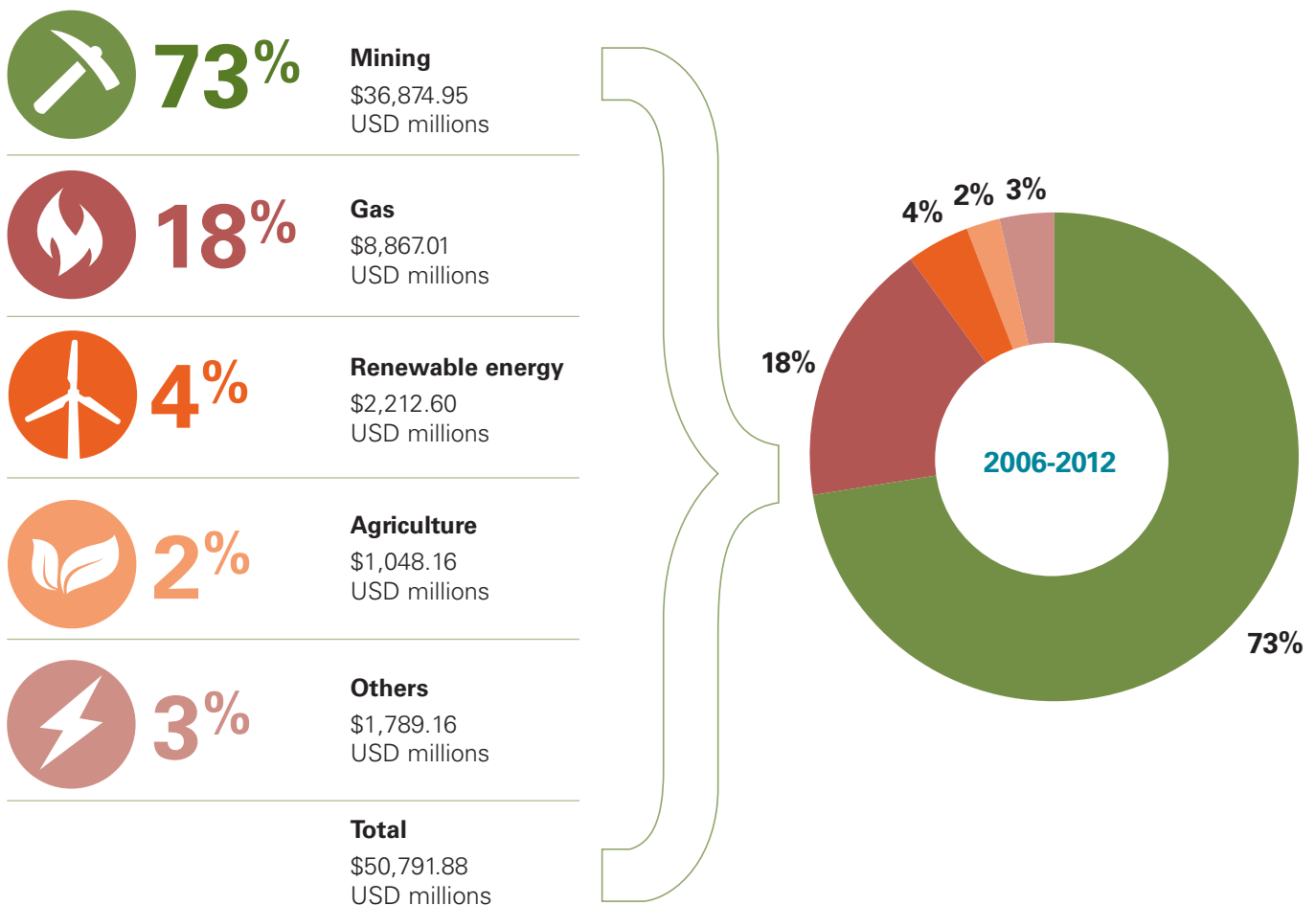
The facts: It is important because Australian imports into China are currently taxed at a higher level than competitors and this indirectly impacts Chinese investment into Australian companies. However, there are existing avenues for Australian companies which offer great opportunities to access China, including state government Memorandums of Understanding (MoU).

China's investment inflows to Australian agribusiness – very early days

China is not yet a major agricultural investor in Australia.

Unlike very large scale investment into the mining and LNG sectors, Chinese investment in Australia's agricultural sector commenced only quite recently and has been relatively small in total value and transaction volume.

Chinese investment in Australia by industry 2006-2012



Source: KPMG/The University of Sydney database.

Despite concerns that Chinese investors are ‘buying up Australian farms and land’, our database currently shows a total of only 10 completed deals, with an accumulated value of USD 1.05 billion invested in the Australian agricultural sector ⁵.

A selection of major completed Australia-China agribusiness deals (2006-2012)

Chinese investor company	Australian company	State	Industry	Year	Value (million USD)
Bright Food Group	Manassen Foods	NSW	Food logistics	2011	500.00
China National Cereals, Oils and Foodstuffs Corporation	Tully Sugar	QLD	Sugar	2011	146.00
Shandong Jining Ruyi Woolen Textile Co., Ltd	Cubbie Group Ltd	QLD	Cotton	2012	277.00
Beidahuang Group	Dennis Joyce's family companies	WA	Crop farming	2012	23.00 (est.)
Ferngrove	Tianma Bearing Co.	WA	Vineyard	2012	15.5

Source: KPMG/The University of Sydney database.

Chinese companies may own less than 1 percent of Australian land.

In 2012, Chinese investment into Australian agriculture accounted for less than 3 percent of the total Chinese overseas direct investment (ODI) inflow, including the Cubbie Station deal. Overall, between the period 2006 and 2012, only 2 percent of Chinese investment has gone into agriculture.

By the end of 2012 China ranked the ninth largest foreign investor in Australia, based on accumulated historical foreign investment into Australia, at 3 percent of the total ODI. This is well behind the US (at 24 percent or nearly 10 times larger than China's investment), the UK (14 percent), Japan (10 percent), and even behind Singapore at 4 percent⁶.

Foreign companies are estimated to own 11.3 percent of Australian land⁷. Based on our understanding of major Chinese investment transactions, Chinese companies may own less than 1 percent of Australian land.

Smaller investments not recorded

Our KPMG/The University of Sydney database applies a minimum threshold of USD 5 million per project. Based on anecdotal background information, we are

aware that private Chinese investors have purchased agricultural assets below this amount (including farms and vineyards) across Australia. Detailed public information on such deals is nearly impossible to obtain as, while each Australian state and territory has detailed land and title records, the true identity of the land owner is often unclear as deals are structured through individual/corporate/trust structures. Until we have a national record of foreign ownership of Australian land that looks through the corporate veil, it will be difficult to establish the extent of Chinese ownership below USD 5 million.

However these investments are of less relevance to the business debate, not only because the size of these landholding investments is small and will not (alone) have a major commercial impact on market dynamics; but also because such investments often seem to be made for personal investment and lifestyle reasons. Unlike for some other foreign investors, to date we are not aware of successfully completed large scale farmland aggregation/roll up projects being undertaken on behalf of Chinese investors.

5. Shanghai Zhongfu's proposed investment into WA's Ord Scheme not included as it is only a lease arrangement by 2012.

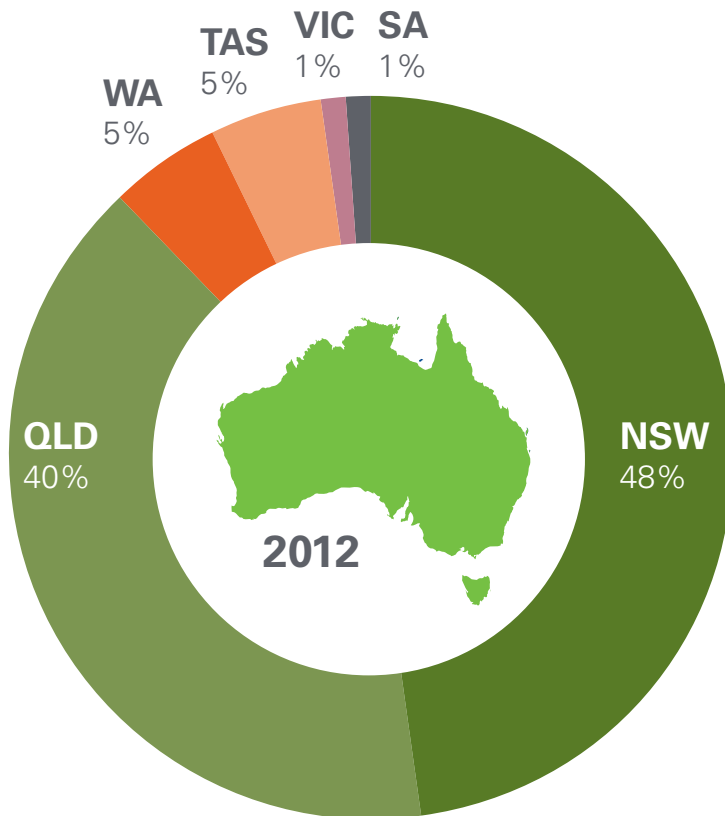
6. Australian Bureau of Statistics Cat. No. 53520 – International Investment Position, Australia: Supplementary Statistics, 2012 (Released 2 May 2013); Table 2. Foreign Investment in Australia: Level of Investment by Country and Country Groups by type of investment and year; Austrade.

7. Australian Bureau of Statistics, Agricultural Land and Water Ownership Survey, 2013.

Geographic distribution

New South Wales has attracted nearly 50 percent of the Chinese agribusiness investment from 2006-2012, followed by Queensland (QLD) 40 percent, Western Australia (WA) 5 percent, and Tasmania (TA) 5 percent.

Chinese ODI in Australian Agribusiness by state (2006-2012)



State	Transaction value (million USD)	Share %
NSW	500.00	48
QLD	423.00	40
WA	48.50	5
TAS	50.66	5
VIC	15.00	1
SA	11.00	1
	1,048.16	100

Source: KPMG/The University of Sydney database.

Australia's largest cotton farm, Cubbie Station, purchased by Chinese investors in 2012.



Characteristics of Chinese ODI in Australian agribusiness

The demand for safe and high quality agricultural products drives Chinese investment in Australian agribusiness.

Based on our analysis of investments from 2006-2012, there are at least four characteristics that distinguish Chinese ODI in Australian agribusiness from those of other countries:

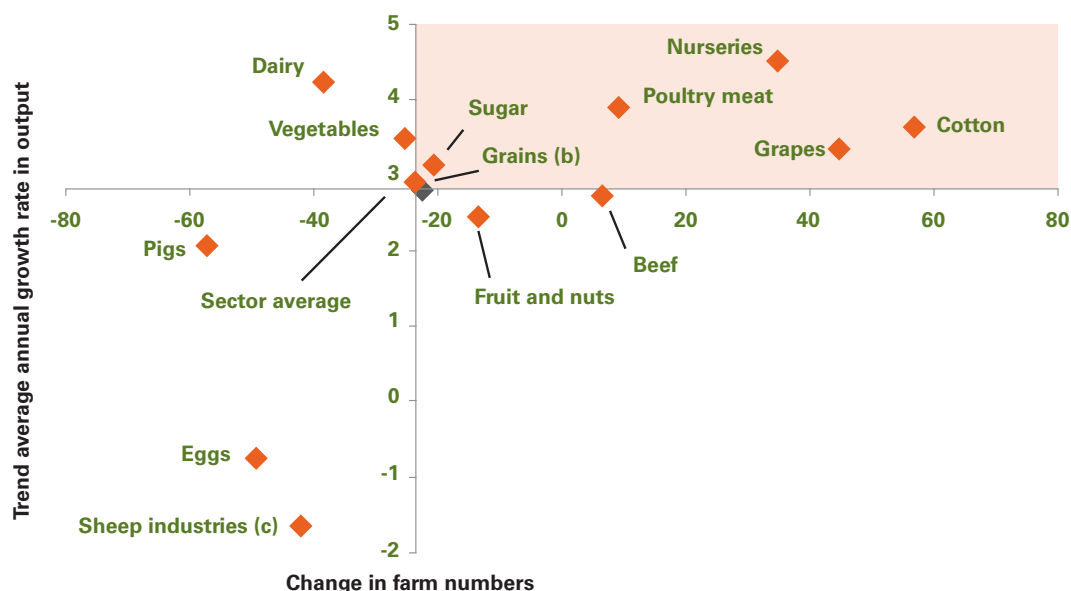
1. Food safety over food security

We have observed that the underlying driver of Chinese ODI in Australian agribusiness is the market demand for diverse and high quality agricultural products, rather than to fulfil long-term food security objectives.

Since September 2006, Chinese investment has been recorded in the following subsectors: sugar (eg COFCO's acquisition of Tully Sugar), cotton (eg Shangdong Jining Ruyi Woolen Textile Co., Ltd's acquisition of Cubbie Group Ltd), vineyard (eg Tianma Bearing Co.'s acquisition of Ferngrove), and food logistics (eg Bright Food's acquisition of Manassen). These are sectors where Australia's agricultural industry has competitive advantages and is able to supply safe and premium products such as meat, dairy, wine, and vegetable, as well as other processed, branded goods.

These subsectors that are of greatest Chinese interest are also ones that have experienced an increase in output growth above the sector average. A report published by the Australian Productivity Commission in 2005 (still quoted by the Australian Bureau of Statistics in 2012) found that sugar, cotton and grapes all ranked among the top contributors to overall output growth, reflecting their ability to establish the trends for the sector (as shown opposite). These subsectors are also areas that exhibit high growth trends in both Chinese and international markets.

Agricultural industries, growth in the value of output and changes in farm numbers, 1985-86 to 2002-03 (percent)



Source: Australian Productivity Commission, Trends in Australian Agribusiness, 2005.

2. Exploratory approach

Chinese investors in Australia have been taking an exploratory approach to Australia's agribusiness sector. On the one hand, they are exploring opportunities and modes of cooperation and integration across a variety of agribusiness industries. On the other hand, Chinese investors are currently in the stage of accumulating necessary experience to better manage the complexity of investing and operating Australian agribusinesses.

Besides major Chinese agri/food companies, including Bright Food Group and COFCO, there are a limited number of experienced Chinese companies investing internationally in this sector. Based on the KPMG/University of Sydney database, only three of the 10 Chinese enterprises that have made investments had meaningful prior operational experience, combined with international investment experience, in the agribusiness sector.

However, cross-industry investment by Chinese investors is not unique to Australian agribusiness. It is also true for Chinese enterprises investing in other countries who are increasingly competing to attract Chinese investment, as evidenced in recent years with Chinese investing into New Zealand's dairy industry (such as Bright Food, Yili, Yashili, Pengxin); fruit sector investments in South America and various South-East Asian countries; olive oil projects in Mediterranean countries and wine sector investments in France and new world wine countries.

Investment motivations are diverse. Based on our findings, Chinese investors seek to:

- integrate Australian primary production and early stage processing operations into their value chain, eg Shandong Ruyi, China Textile

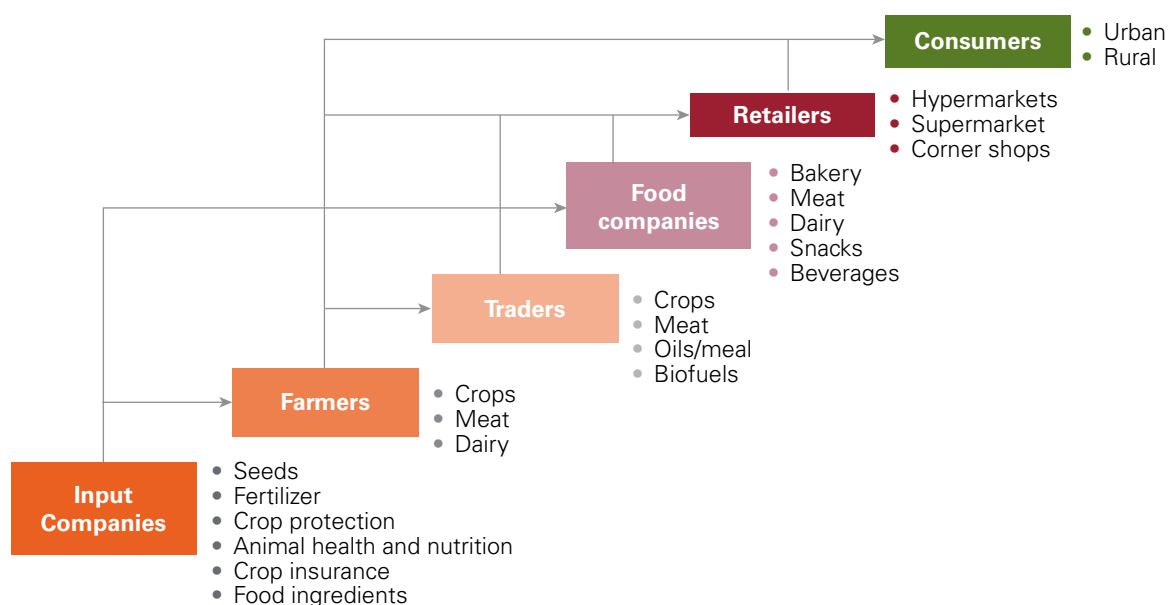
- obtain access to local knowledge, IP and create synergies within their value chain, eg Bright Foods
- achieve capital growth and risk diversification – Chinese conglomerates investing across sectors.

When considering these investments into the agriculture and food value chain (as shown below), we observe that Chinese investment to date has been concentrated in the lower part of the food production value chain, namely 'Farmers' and 'Traders', where risks are higher due to seasonality but where profits can also be highest. This is consistent with first and third investment drivers noted on the previous page and reflects a preference to process, package and market finished food products back in China.

Similar to many other foreign investors involved in Australia's food sector (from the US, the UK, Europe and New Zealand), we expect Chinese investment to eventually seek to follow Shanghai Bright Food's lead and move into the 'Food Company' sub-sector where profit margins are also attractive and stable.

This year we witnessed a USD 4.7 billion investment by Shuanghui International, China's largest meat processor, into Smithfield Foods in the US which was motivated by a desire to not only increase the volume of premium safe pork to be exported back to China but also to acquire valuable processing, packaging and brand and marketing assets and knowledge from a very well established western company.

The agriculture and food value chain



Source: KPMG, The agricultural and food value chain: Entering a new era of cooperation.

The Changing Farm Landscape

Although our agribusiness sector is slowly consolidating as family farms are sold and aggregated, there is currently a very limited supply of very large scale assets in the sectors that Chinese are mostly interested in.

The 2010-11 Agricultural Census conducted by the Australian Bureau of Statistics found that there were 135,000 farm businesses across Australia and over 55 percent of these farms had an estimated

value of agricultural operating value (EVAO) of less than AUD 100,000⁸. Only a small number (7,000 or 6 percent) of large farms offered estimated agricultural operational value in excess of AUD 1 million (as shown below).

Many of the largest and most attractive businesses in the dairy, grains, sugar and food processing sectors are already owned by foreign investors.

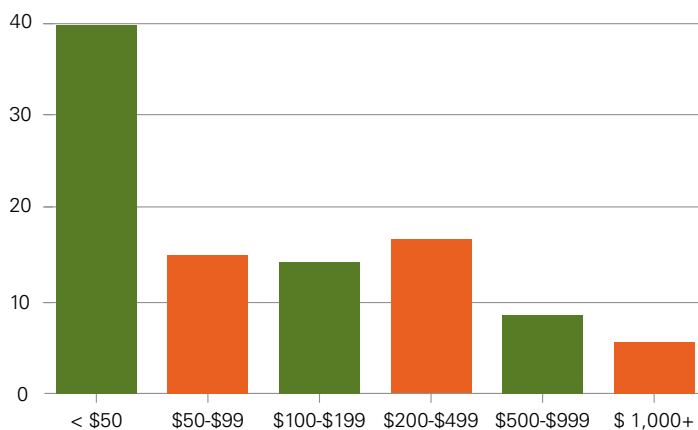
For example:

- Meat processing – JBS (Brazil), Cargill (US) and Nippon Meats (Japan).
- Sugar production – Sucrogen / Wilmar (Singapore), Finsucre (Belgium), MSF Sugar (Thailand).
- Milk and milk powder – Fonterra (New Zealand), Kirin (Japan).

There is not a large pool of wholly Australian owned agribusiness organisations of global scale that may be considered for investment by Chinese companies. The cooperative ownership structures of some of Australia's largest companies (dairy, cotton, sugar) are complex and Chinese are still learning about major listed company takeovers.

Recent proposals to increase Australian Competition and Consumer Commission (ACCC) scrutiny and reduce the FIRB approval threshold from AUD 248 million to AUD 53 million (agribusiness) and AUD 15 million (agricultural land) are other hurdles, particularly for Chinese State Owned Enterprises (SOEs).

Size of Australian farm businesses – 2011



Note: Based on estimated value of agricultural operations.

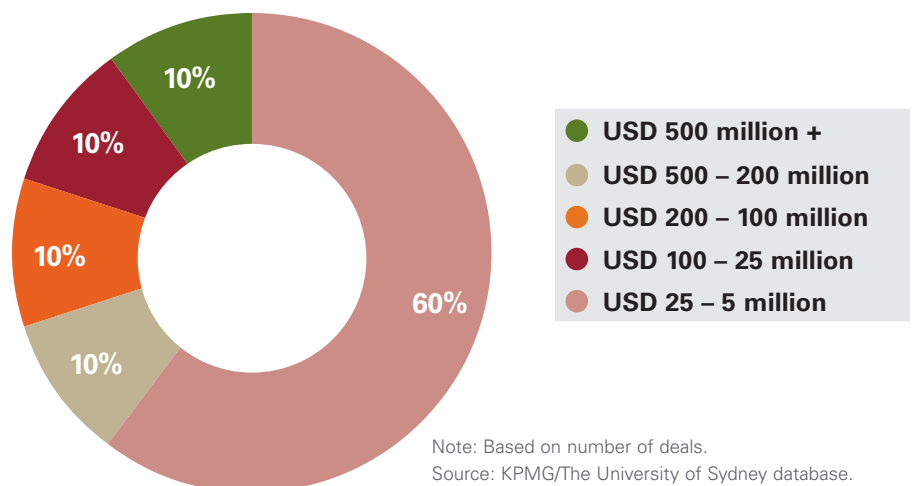
Source: ABS agricultural Commodities, Australia, 2010-11 (cat. no. 7121.0).

Size of Chinese investment deals in Australia's agriculture sector (2006-2012)

Smaller deal sizes

Based on our database, there was only a small proportion of deals completed by Chinese investors with transaction values over USD 200 million and no completed investment deals in the Australian agriculture sector exceeding USD 600 million. This is very different to the overall experience with Chinese investment across other sectors in Australia between years 2006-2012, where nearly 50 percent of the all completed deals had a transaction value of over USD 200 million and 19 percent had a transaction value of over USD 500 million.

Percentage of deals by size



Note: Based on number of deals.

Source: KPMG/The University of Sydney database.

8. According to the Australian Bureau of Statistics, the Estimated Value of Agricultural Operations (EVAO), is an aggregation of commodity values which takes into account (without double counting) the area of crops sown and numbers of livestock on holdings at a point in time as well as the crops produced and livestock turn-off during the year. It should be noted that EVAO is applicable only for industry coding and size valuation purposes. It is not an indicator of receipts obtained by units or of the value of agricultural commodities produced by these units.

Private Chinese investors are relatively more active than SOEs in Australian agribusiness.

3. Diversity of ownership

Another characteristic of Chinese investment in Australian agriculture is that private Chinese companies are playing a more active role compared to other sectors such as mining and gas, where SOEs have dominated.

By accumulated deal value, private investment accounted for 35 percent. By volume of transactions however, private investment accounted for 67 percent of the total number of deals. If we were to include smaller sized investments (below AUD 5 million) made by private

enterprises, the participation of Chinese private investment is likely to be even larger.

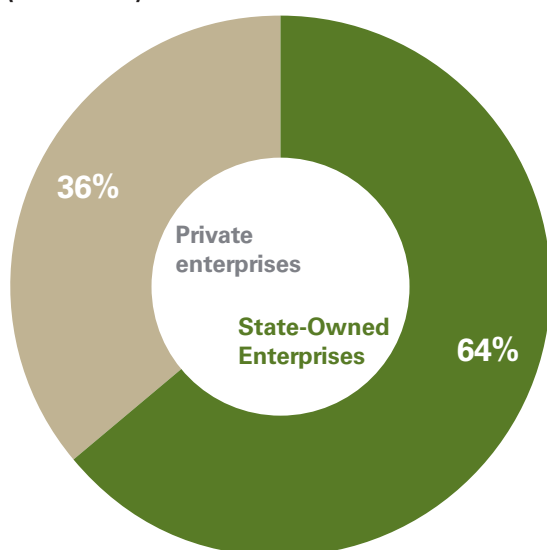
The advantage of private over State-Owned investors needs to be assessed in the light of their market strength within the Chinese domestic market. In general, Australian partners are most likely to benefit from cooperation with Chinese investors who provide access to the Chinese domestic market and can integrate Australian produce into their value chains.

Chinese agricultural deals in Australia by ownership (2006-2012)

Ownership	Investment Value (USD million)	%	no. deals	%
SOE	669.00	64	3	30
Private	379.16	36	7	70
	1,048.16	100	10	100

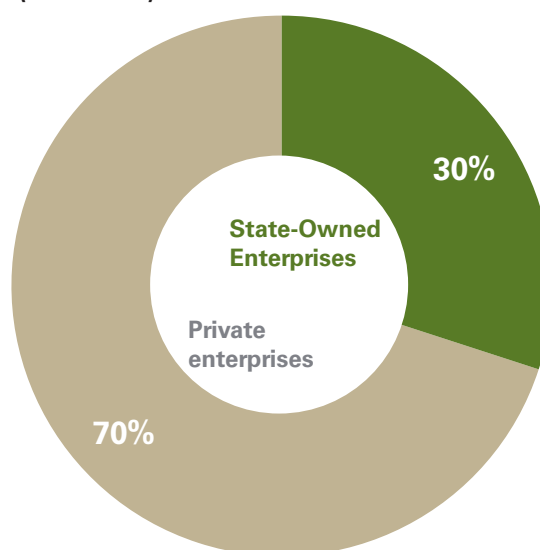
Source: KPMG/The University of Sydney database.

Chinese agricultural deals in Australia by ownership, in terms of investment value (2006-2012)



Source: KPMG/The University of Sydney database.

Chinese agricultural deals in Australia by ownership, in terms of deal volume (2006-2012)



Source: KPMG/The University of Sydney database.

4. Tendency for majority stakes

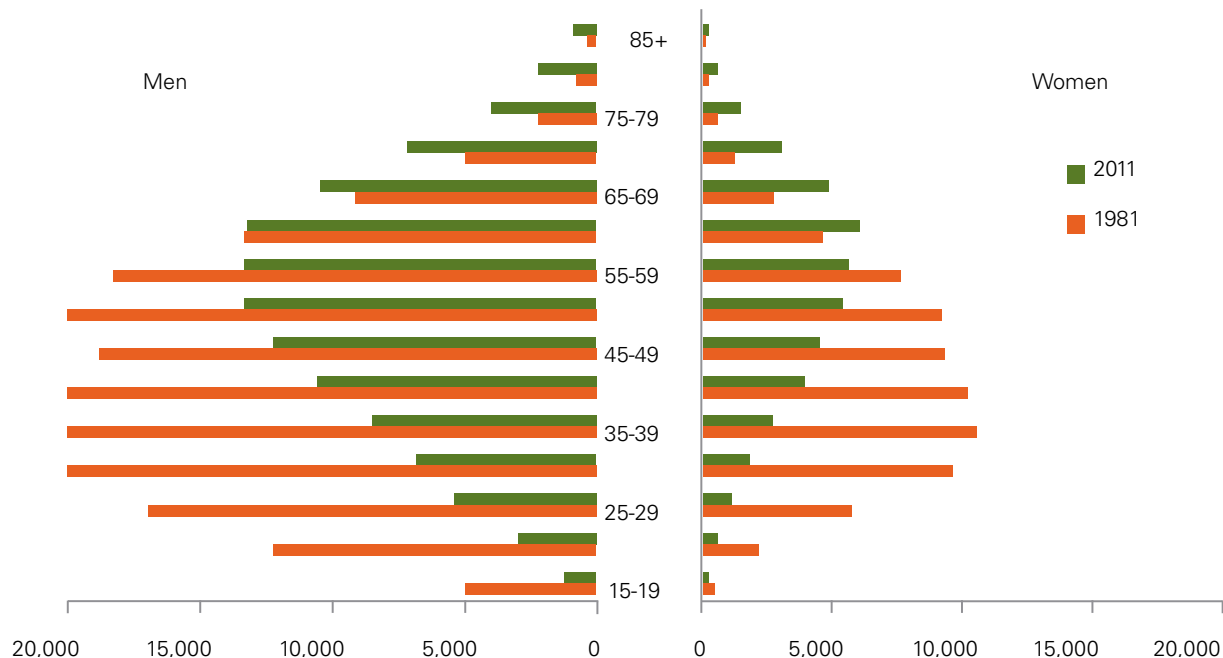
Although anecdotally we understand Chinese investors may be willing to take minority positions in primary production assets, to date Chinese investors in the agricultural sector have demonstrated a higher tendency to take majority stakes when investing in agribusiness in Australia. There are several possible explanations for this, including the fact that compared to mining, gas and energy projects, smaller scale agricultural assets are seen as more 'affordable'. (As mentioned earlier, only 6 percent of Australian farms offered estimated agricultural operating value in excess of AUD 1 million⁹).

Another possible explanation for Chinese investors taking controlling stakes is the family ownership model and an ageing workforce in the Australian agriculture sector.

The increasing attraction of higher income employment away from farming for Australians who would otherwise be next generation farmers means that Australian owners have less incentive to retain controlling equity. This is particularly true for small and medium-size farms. Between 1981 and 2011, for example, the number of farmers declined by 106,200 (40 percent), equating to an average of 294 fewer farmers every month over that period¹⁰. Meanwhile over the same period, the median age of farmers increased by 9 years and the proportion of farmers aged 55 years and over increased from 26 percent to 47 percent, while the proportion of farmers aged less than 35 years fell from 28 percent to just 13 percent¹¹.

To date, Chinese agri investors have tended to take majority stakes.

Age profile of Australian farmers – 1981 and 2011



Source: ABS Census of Population and Housing.

9. Australian Productivity Commission, Trends in Australia Agriculture, research paper, 2005.
http://www.pc.gov.au/_data/assets/pdf_file/0018/8361/agriculture.pdf.

10. Australian Bureau of Statistics, 4102.0 – Australian Social Trends, Dec 2012.

11. Australian Bureau of Statistics, 4102.0 – Australian Social Trends, Dec 2012.

From food security to food safety: China's basic food requirements and diversifying market demand

Food security is a core objective of the Chinese Government, and China will not outsource food security.

It is important that we understand the future food needs and realities which the broader Chinese population faces as the growing new middle class changes its dietary consumption habits. Some important facts about the size and strength of China's food production industry are helpful in predicting Chinese corporate and government strategies.

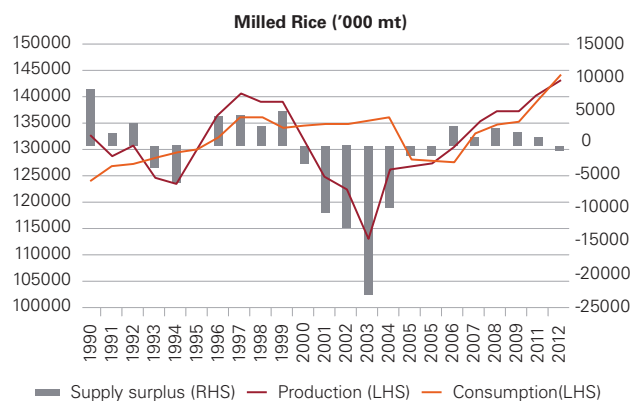
Agriculture has always and will always play a vital role in China's domestic economy:

- Domestic agricultural production still accounts for more than 10 percent of China's GDP.
- China's rural population is still 695 million people. Seventy percent of rural workers are employed in agriculture.

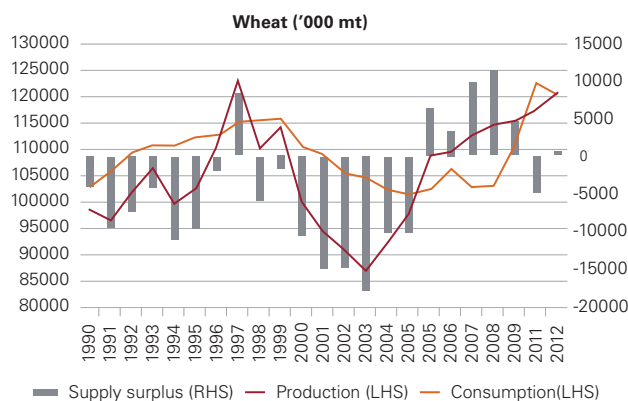
- China has the world's third largest land area and arable agricultural land accounts for 12 percent of China's total land area.

Food security is a core objective of the Chinese Government, and China will not outsource food security. China is largely self sufficient in core food commodities including wheat, rice, coarse grains and meats. The Food & Agricultural Organisations of the United Nations (FAO) believes China will remain largely self sufficient for the next 8 years, with the exception of dairy, fruit and vegetables, oil seeds and meat.

China's milled rice production and consumption, 1990 to 2012



China's wheat production and consumption, 1990 to 2012



Sources: Bloomberg Professional Service: Agriculture Supply and Demand.



At this year's Bo'ao Forum, President Xi Jinping announced China would invest AUD 500 billion in overseas markets in the next 5 years.

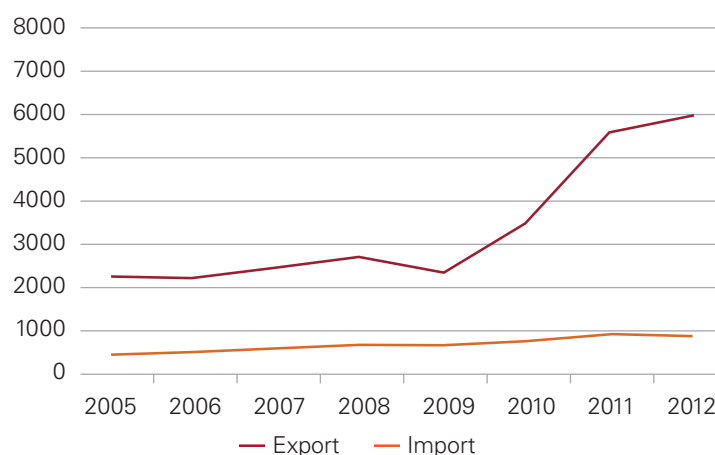
However, China faces a number of challenges:

- China is home to 21 percent of the world's population, but only 8.5 percent of the world's arable land and just 6.5 percent of the world's water reserves¹². China's emerging land and water issues, coupled with higher labour costs and increasing rural-urban migration, are key challenges to China's future food security.
- Due to the size of China's population, rapid urbanisation, desertification and environmental degradation, 20 percent of China's arable land has been degraded. China lost approx 9 million hectares (6.2 percent) of the country's farm land between 1997 and 2008¹³.

- While China's total water supply ranks fourth in the world, on a per capita basis it was only one quarter of the world average. Agriculture consumes 60 percent of total water usage in China and the overuse of nitrogen based fertilisers (combined with pollutants from heavy industries), has already severely restricted China's clean water supplies.

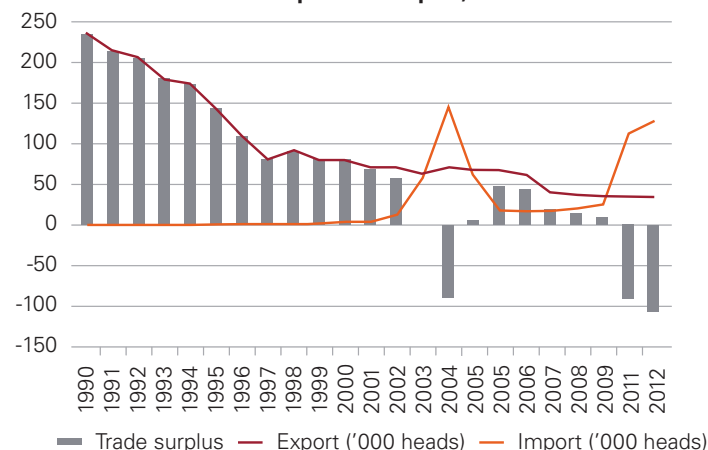
Trade will continue to play an important role. Since China joined the World Trade Organisation in 2001, the value of agricultural trade has increased from USD 27.9 billion to USD 155.7 billion, with an average annual growth rate of 17 percent¹⁴. Australia has benefitted directly from this trend.

Australia's agricultural trade with China, 2005 to 2012



Sources: Ma, X and Li, X2009, *Chinese Agricultural Exporting Market Guide 2009: Australia*, Ministry of Commerce PRC and Australian Bureau of Agricultural and Resource Economics (ABARES) 2012, *Agricultural Commodities: March Quarter 2012*, ABARES.

China's cattle export and import, 1990 to 2012



Sources: Bloomberg Professional Service: Agriculture Supply and Demand.

12. KPMG 2012, *Opportunities for China and Australian in Food Security*, KPMG Australia, p. 4.

13. OECD/Food and Agriculture Organisation of the United Nations 2013, *OECD-FAO Agricultural Outlook 2013*, OECD Publishing, 'Chapter 2 Feeding China: Prospects and Challenges In the Next Decade', p. 65.

14. OECD/Food and Agriculture Organisation of the United Nations 2013, *OECD-FAO Agricultural Outlook 2013*, OECD Publishing, p. 11.

Investment is also key to China's success in maintaining food security. China's food production industry grew by 3.8 percent p.a. between 1978-2011 as a result of government policies to increase investment in machinery, infrastructure and R&D. China's 11th and 12th Five Year Plans commit to ongoing heavy investment in science and technology acquired both domestically and internationally to resolve problems and boost domestic production, rather than being overly reliant on trade and foreign investment.

Australian agricultural science companies with leading IP and deep experience in environmentally sustainable farming, soil and water conservation, animal and crop genetics can play a major commercially-driven role in assisting China to address and resolve both its challenges (land and water related) and objectives (science and technology driven sustainable growth).

However this is not without some challenges including finding the right commercial partner and protecting IP for sustainable commercial benefit.

A woman in a white lab coat and safety glasses is working in a laboratory. She is holding a small white object, possibly a piece of equipment or a sample, in her gloved hand. The background is slightly blurred, showing laboratory equipment and shelves. The image is overlaid with a green triangular graphic on the left side.

Australian agricultural science companies can play a key commercial role in addressing China's land and water-related challenges.

Australia's opportunity: premium, safe food

Tremendous growth opportunities for Australia's food industry lie in supplying safe, premium meat, dairy, wine, vegetable and processed, branded product to China's growing middle class.

With a population of 300 million today¹⁵ – estimated to rise to 630 million by 2022¹⁶ – these households have annual earnings between USD 9,000 to 16,000. This group will represent 45 percent of China's population and is expected to consume goods and services of USD 3.4 trillion.

This target market for Australian food shows rapidly developing westernised consumption habits and diets. Consumers have choice and are concerned about the safety of their food. They prefer foreign produced and imported processed food, as levels of trust in certain Chinese processed foods (after recent high profile public scandals in meat and milk) are low.

However, Chinese middle class consumer demands need to be understood. For example, China meat imports are expected to reach 1.7 million tons by 2022 and meat consumption will increase from 47 kg per capita in 2012 to 54 kg per capita in 2022. Pork will account for 66 percent of this additional meat consumption and chicken will be the fastest growing meat consumed. Australian suppliers have to be careful not to assume that all growth will be in bovine meat and miss other opportunities or shifts in trends¹⁷.

Australian agricultural exports to China over the last decade show growing diversification and a shift towards processed food with much higher long-term growth rates than unprocessed food items¹⁸.

The consequence of the shift from food security to premium, safe food is a shift in commercial strategies. Food security was served by export of bulk agricultural commodities and was heavily reliant on government-to-government policy initiatives. Premium, safe food is market driven and reliant on industry initiatives and niche strategies which leverage off government policy platforms that support and facilitate integration into Chinese supply chains and which provide flexible responses to changing demands in the huge and dynamic Chinese domestic market.

Meeting China's food safety requirements goes well beyond clever marketing and branding and requires absolute transparency and traceability across the entire Australia-to-China supply chain process – from crop, livestock, soil and water management systems in Australia, to food processing and production stages in both countries, to logistics to retail markets in Chinese supermarkets.

15. The Chinese Dream: Rise of the World's Largest Middle Class and What it Means to You," Helen Wang.

16. "Half a Billion: China's Middle Class Consumers," Dominic Barton, McKinsey & Company.

17. OECD/Food and Agriculture Organisation of the United Nations 2013, OECD-FAO Agricultural Outlook 2013, OECD Publishing, 'Chapter 2 Feeding China: Prospects and Challenges In the Next Decade', pp. 78-80.

18. Source: DFAT, Australia's Export to China 2001 to 2011, <http://www.dfat.gov.au/publications/stats-pubs/australias-exports-to-china-2001-2011.pdf>.

Challenges for Australian agribusiness

Australia's fragmented family owned farming model, and rural Australia more generally, is coming under increasing financial and social pressures which may restrict our ability to fully capitalise on growth opportunities.

The core issue of farm profitability needs to be addressed.

Farm profitability

The core issue of farm profitability needs to be addressed. Key concerns around major retailer pricing pressure, high operating costs, relatively high commercial borrowing costs, water access and costs and delays associated with access to infrastructure are all well documented.

Reducing tax, improving labour market productivity, reducing bureaucratic red and green tape and speeding up investment and project approvals are all mainstream issues which Chinese investors are watching very closely before committing to new investment projects.

Infrastructure

The ANZ Insight Report 2012, *Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand* suggests that around AUD 600 billion in additional capital will be needed to generate growth and profitability in Australia between now and 2050.

While large Australian cities benefit from major infrastructure funding allocations, regional Australia – the food production arm of the Asia Century food supply plan – is under invested in water, transport and important civil infrastructure such as hospitals and schools, which are critical for sustaining regional communities.

Labour

A common complaint of primary producers is the lack of agricultural labour at critical times in peak seasons and the affordability of this local labour pool. Australia's response to skills shortage has over the past decade facilitated opportunities for Australian companies to obtain temporary labour from outside the local labour market, where the skills have not been readily available in Australia. A growth in the use of 457 visas, in particular, has been key but other initiatives have encouraged the use of young, working holiday makers to take part in farming.

Australian companies need Chinese partners with strong domestic links who can help reach these new customer markets quickly and profitably.



Is Chinese direct investment a solution?

Chinese investors can and should play a major role in the solution.

New consumer markets

Rather than selling the production off take into Australia's domestic food production / wholesale / retail system (which is cited as a major cause of declining farm profitability), Australian companies need Chinese partners who understand complex market dynamics and rapid changes in demand in the Chinese consumer markets and with strong local links to reach those markets quickly and profitably.

Investment capital for growth and infrastructure

Australian agribusinesses need capital partners to co-invest in Australian primary production and integrated food processing industries to realise economies of scale. This model should drive Australian partners further up the value chain beyond primary production.

Australia requires capital for new regional infrastructure and China has the capital and proven, deep experience to co-fund and co-deliver new road, rail and airport / shipping port assets which could transform our food production industry in existing and new regions throughout Australia. Chinese investors are interested to partner with strong Australian partners to develop strategically important and commercially viable infrastructure projects.

Skilled labour

We clearly need to educate and incentivise more young Australians to consider a return to agricultural careers. However this may not resolve key concerns around affordability and availability at peak times.

Experts predict agriculture will soon require 6000 tertiary-qualified graduates per year – in 2011 NSW universities produced 311. In the US the percentage of farmers with a degree is in the high teens. In Australia it is less than 10 percent. Strong specialisation opportunities (in areas such as plant breeding, environmental management, soil science, hydrology, plant science, agronomy, animal production, economics and rural sociology) should exist alongside an acceptance of the interdisciplinary nature of agriculture¹⁹.

China can provide university qualified, skilled agri-science graduates on appropriate working visas to supplement local talent and ensure we can meet demand at peak seasonal demand periods. These graduates, of which Chinese universities graduate 120,000 per year, are extremely hard working, keen to work in Australia and further learn from our dry land, highly safe and efficient farming and food production methodology and in most cases have adequate English communication skills to perform their duties²⁰.

Australian agribusiness needs capital partners to realise economies of scale and move up the value chain.

19. Michael Spence, "Education needed to make most of agriculture's big chance", The Australian Financial Review, 21 October 2013.

20. KPMG 2012, Opportunities for China and Australian in Food Security, KPMG Australia, p. 27.

A role for government - but industry must drive commercial activity

The newly elected Coalition Government has announced a range of policy initiatives that address many of the major concerns for foreign investors – namely in relation to profitable growth, speed of government approvals and an intention to finally complete one or more Free Trade Agreements (FTAs) with China which will be transformative in the trade and investment relationship. A very detailed timetable of measures has been released, designed to send a strong signal that Australia is “open for business” for foreign investment.

The Coalition Government has announced its intention to produce an Agricultural White Paper within 12 months of the election and we would expect that the China-Australia FTAs and the 2030 Vision for Developing Northern Australia to be core components.

It remains to be seen which specific initiatives from the ALP policies previously announced in the three main reports: *Australia in Asian Century White Paper* of October 2012, the *Feeding the Future* Report of December 2012 and the *National Food Plan* of May 2013 will be prioritised, progressed or revisited by the Coalition Government.

The specific recommendations in *Feeding the Future* in relation to increased co-operation between state and Federal governments to reduce regulatory duplication, potential migration schemes to address labour shortfalls in Australia and the establishment of a joint China-Australia research centre with a robust commercialisation capability and a focus on demonstration projects and increased ministerial and peak industry body meetings and delegations were some of the most important projects which the Coalition Government should robustly take forward.



Australia is “open for business”.



Free Trade Agreements (FTAs)

Australia and China have been negotiating possible terms for a comprehensive FTA since May 2005, without success. Last May, FTA talks stalled, partly due to China's request to lift Australia's threshold on reviewing the purchase of assets by foreign states from zero to AUD 1.078 billion and for China to be treated in manner that is consistent with US and New Zealand companies²¹. Chinese negotiators are meanwhile also concerned about the impact on their domestic producers if large volumes of high quality wheat, canola, barley, wool, meat and dairy were to flood in.

A FTA is very important to our agribusiness future with China. Unlike New Zealand, our primary producers still face China tariffs of 16.9 percent of meat products, 12.2 percent for dairy products and 13.8 percent for vegetables,

fruits and nuts²². This is hurting not only trade, but also foreign investment decisions as the Chinese investors who invest or own Australian food production companies are also faced with these Chinese import tariffs for raw or semi processed foods sold back to China.

The newly elected Australian Government has signalled its intention to complete a FTA with China within 12 months which is not expected to be as comprehensive as originally envisaged and appears focused on securing an agriculture-based free trade deal.

Australia may be looking to New Zealand's farm focused FTA as a model to guide this new agricultural direction for the Australian FTA. The free-trade agreement New Zealand signed with Beijing led to a tripling of its exports to China, which is mainly dairy led.

Applied tariff barriers to major trading commodities

Sector	AUSTRALIA	CHINA
Paddy rice	0.0%	1.0%
Wheat	0.0%	1.0%
Cereal grains	0.0%	1.5%
Vegetables, fruit, nuts	0.6%	13.8%
Oil seeds	0.5%	7.5%
Sugar cane / beet	0.0%	2.0%
Animal products	0.3%	11.3%
Raw milk	0.0%	0.0%
Wool, silk-worm cocoons	0.7%	8.9%
Fishing	0.0%	11.2%
Meat products	0.6%	16.9%
Vegetable oils and fats	1.3%	10.5%
Dairy products	0.7%	12.2%
Sugar	0.0%	18.4%
Beverage & tobacco	2.1%	22.8%
Textiles	0.7%	9.8%

Source: Centre of International Economics (CIE) 2009, Estimating the impact of an Australia-China trade and investment agreement 2008 economic modelling update, Australia China Business Council, Sydney, p. 3.

21. Kitney, G 2012, 'China demand could disrupt trade talks', Australian Financial Review (AFR), 21 May.

22. Centre of International Economics (CIE) 2009, Estimating the impact of an Australia-China trade and investment agreement 2008 economic modelling update, Australia China Business Council, Sydney, p. 3.

Other options: MoU's

Memorandums of Understanding (MoU) are becoming an increasingly popular vehicle to open commercial opportunity where FTAs are not available. Some examples include:

- In 2011, WA Premier Colin Barnett and NDRC Chairman Zhang Ping signed a MoU between the Western Australian Government and China's National Development and Reform Commission (NDRC) covering bilateral trade and investment co-operation. It covered a number of sectors including resources, resources-related technologies, energy (including renewable energy), agriculture and food, machinery, chemicals and infrastructure. More recently, Premier Barnett has concluded another MoU to supply potentially very large volumes of live cattle to Zhejiang province.
- In 2012, South Australia signed a MoU with Fujian Province in South-East China targeted at trade and investment in premium food and wine.
- In April this year, Australia and China signed a new agriculture agreement in Queensland to expand co-operation on science, investment and trade in agricultural products, where more specifically China agreed to accredit 28 Australian cold store facilities and four red meat plants for export, which will allow Australian exporters to save money by consolidating large shipments of meat²³.

A FTA is very important to our agribusiness future with China.



23. 'Australia-China agreement to boost agricultural opportunities' 2013, Australian Business Consulting & Solutions (ABS) Group, 24 May.

FIRB and making Chinese investors feel welcome



The issue of consistency should be addressed so all foreign investors are treated equally by Treasury and FIRB.

Post election, we now expect some important changes to FIRB rules which may impact not only FTA negotiations but future Chinese direct investment in our agribusiness sector.

- For most foreign investors in Australian agricultural land, the threshold for foreign investment approval by FIRB will drop from AUD 248 million to AUD 15 million.
- For most foreign investors in Australian agribusinesses, the threshold for foreign investment will remain at AUD 248 million for the total value of the business but a new investment threshold of AUD 53 million will apply.
- New Zealand and US investors are exempt from both thresholds and the new Government appears likely to maintain a zero threshold for investors linked to foreign governments and sovereign wealth funds. This issue remains one of great sensitivity with the Chinese who feel that this is inconsistent and prejudiced against them.

Although we are seeing far more privately owned Chinese agri sector investors emerging, the SOEs remain important players in their home markets and therefore internationally. Much of the problem lies with the lack of understanding in Australia about SOE's which requires more extensive analysis.

The issue of consistency should be addressed such that all foreign investors are treated equally by Treasury and FIRB and it is time to reconsider the need for the zero threshold to investors linked to foreign governments and sovereign wealth funds. In a recent report delivered by The Business Council of Australia (BCA), called *Action Plan for Future Prosperity*, the BCA has recently called for:

"Action 6.3

Australia should aim to become a world leader in attracting foreign direct investment. We should have a goal of extending the higher foreign investment screening threshold that applies to investors from the United States and New Zealand – currently set at around AUD 1.1 billion – to private sector investors from all other countries.

Action 6.4

Australia should revisit and further clarify the foreign investment policy for investment by sovereign wealth funds and state-owned enterprises."²⁵

25. Business Council of Australia (BCA) 2013, *Action Plan for Enduring Prosperity: Summary Report*, BCA, p. 33.

Corporate Social Responsibility is important

It will be important for investors from China, like all foreign investors, to abide by Australia's very high tax regulatory standards and demonstrate to local communities that they are good corporate citizens.

Paying a fair share of tax in Australia

There is now greater focus by the Australian Taxation Office (ATO) on tax governance and transparency to ensure foreign companies with investment and trading activities in Australia have the systems and resources in place to ensure compliance.

Tighter anti-tax avoidance rules are now in place to control any shifting of profits to foreign owned groups through transfer pricing practices. This requires compulsory documentation with a greater onus placed on foreign investors to demonstrate that an appropriate commercial arm's length profit is declared which will bear tax in Australia.

In addition, new laws commenced from 1 July 2013 requiring the ATO to publish limited tax payment information of large and multinational businesses to 'name and shame' those with low effective tax rates. Ultimately, if increased foreign investment in agriculture increases Australian output and profits, this should equate to increased tax revenues – which is good for all Australians.

Investing in regional communities

Beyond commercial investment, Chinese companies in Australia have already demonstrated a willingness to invest in local regional communities.

Shenhua Watermark established the Shenhua Watermark Community Fund in 2009 and committed up to AUD 5 million to support the development of Gunnedah's regional economy, environment, local public facilities and training and development.

This sort of initiative builds stronger relationships with local rural communities and should be encouraged.



The way we feel about Chinese agri sector investment must change to be more pragmatic and objective. This takes much work on both sides.



The way forward

We believe that Australian food industry companies and representative bodies must unite, agree and specifically identify key priorities and work constructively with Federal and state governments to deliver meaningful, pragmatic outcomes for enhancing Australia's brand and safe food reputation.

The way that we feel about Asian investment and trading partners must change to be more pragmatic and objective. This takes much work on both sides.

For Australia, a huge public education program which sets out the facts, explains the realities of Australia's future with Asia and China (in a way that everyone can clearly understand) and encourages a new respectful, positive approach is critical.

Chinese investors meanwhile need to appoint and retain business leaders who are willing to explain their strategies and long term objectives, integrate with Australian workers and communities, ensure high levels of governance and compliance, demonstrate that a fair share of tax is being paid and avoid actions that increase public concerns and perpetuate negative views.

There are a number of areas that Australia's food industry can consider to better leverage the market activity and initiatives relating to agri-food opportunities, including:

Don't wait for complete Government policy – While the FTA is important, Australian agribusiness may already be able to leverage one of the many MoUs and take advantage, at a commercial level, of existing relationships forged between

governments, states and provinces. Austrade, state government trade and investment bodies, agriculture sector industry representative bodies, and Australia China Business member bodies all engage in a meaningful way with China-Australian agribusiness. Through active networking, taking advantage of the information and joining trade delegations to Asia, the chances of meeting a Chinese partner will increase.

Get to know your target market – China is a vast market with very significant variability between provinces, cities and companies (both state and privately owned). Developing an individual approach to this market is critical to long term success. Australian and Chinese participants may leverage government research which has been commissioned, use Austrade or consult other industry experts in China advisory services, including professional services firms.

Build your own trade and investment partners – In the past 2 years there has been a large increase in number of Chinese companies who are visiting Australia and looking for attractive trade and investment targets and strong partners. They are looking for large scale processing capability, access to strong and reliable local management, science and technology and famous brands.

The current preference is beef, sheep, dairy, wine, sugar. So if you have an attractive business model, you need to build the networks with advisors and government bodies to introduce yourself and start a process that may lead to a transformational outcome.

Become more culturally aware and skilled to address the new Asian customers – Australian businesses need to up-skill in Chinese cultural awareness and business practices. There is a large and under-utilised pool of Chinese born, Australian educated graduates who have the necessary language, business and social cultural skills to help Australian agribusiness companies. Having a senior Australian face in the meeting room in Australia or China is important but you also need a mix of skills and knowledge in order to communicate and progress any opportunity.

Australian leaders must be open minded, culturally aware, respectful, committed to building long term relationships and making regular visits to China. They must be well briefed on how to handle negotiations, accessing and handling key decision makers and working privately and patiently through disputes.



**We need specific commitment to action
and follow through by government
and Australia agribusiness.**



Conclusion


Australian agribusiness has some important choices to make. The industry can remain as it is, hoping that domestic profitability recovers and trade continues to grow and seeking investment from western companies. Or it can proactively position itself as a premium, safe food provider, in business and in politics, to take advantage of investment from Asian and Chinese companies who bring capital and direct access to Asian consumers but who need strong local Australian partners.

Given the influence of Chinese business communities throughout South East Asia, a joint Australia-China agri-cooperation model could assume a regional leadership role in satisfying Asia's rising middle class' quest for the highest quality, safe food over the next 20-40 years, and maximise the commercial agri-food opportunities for Australian farmers, agribusinesses and Australia's regional rural communities that come with it.

Government policy is very important to establish the right platform. However real change will come from our agribusiness industry and broader rural communities taking a proactive and pragmatic view on changing mindsets towards value chain integration with Chinese business partners and investors; building stronger relationships around new trade and investment opportunities and making full use of Australia's competitive advantages by investing in our own future.



This requires the joint, long term commitment of Australian and Chinese governments, educational institutions, the corporate sector and general public.



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October 2013. QLDN11393MKT.