



Demystifying Chinese Investment in Australia

May 2017

kpmg.com.au

ISSN 2203-2037
1/5/2017



About our reports

KPMG and The University of Sydney formed a strategic relationship to publish research and insights on doing business with Chinese investors. Our first report was launched in September 2011 and this is the twelfth *Demystifying Chinese Investment* report in our series. This report examines Chinese investment in Australia for the calendar year 2016.

The catalyst for our report series is the historic lack of detailed factual information about the nature and distribution of China's outbound direct investment (ODI) in Australia. Without this information, there is misinformation and speculation. Our reports seek to set the record straight and debunk the myths associated with Chinese investment in this country.

Methodology

The dataset is compiled jointly by KPMG and The University of Sydney Business School and covers investments into Australia made by entities from the People's Republic of China through M&A, joint venture and greenfield projects. Knight Frank has provided data and analysis on real estate transactions. 'Real estate' referred to in this report does not include residential apartment and home sales. Powell Tate Australia has also provided analysis on gaining a social licence to operate.

The dataset tracks Chinese investment by subsidiaries or special purpose vehicles in Hong Kong, Singapore and other locations. The data, however, does not include portfolio investments such as the purchase of stocks and bonds which do not result in foreign management, ownership or legal control.

Our database includes direct investments recognised in the year in which parties enter into legally binding contracts and if necessary, receive mandatory FIRB and Chinese Government investment approvals. In certain instances, final completion and financial settlement may occur in a later year.

For consistency, the geographic distribution is based on the location of the Australian 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.

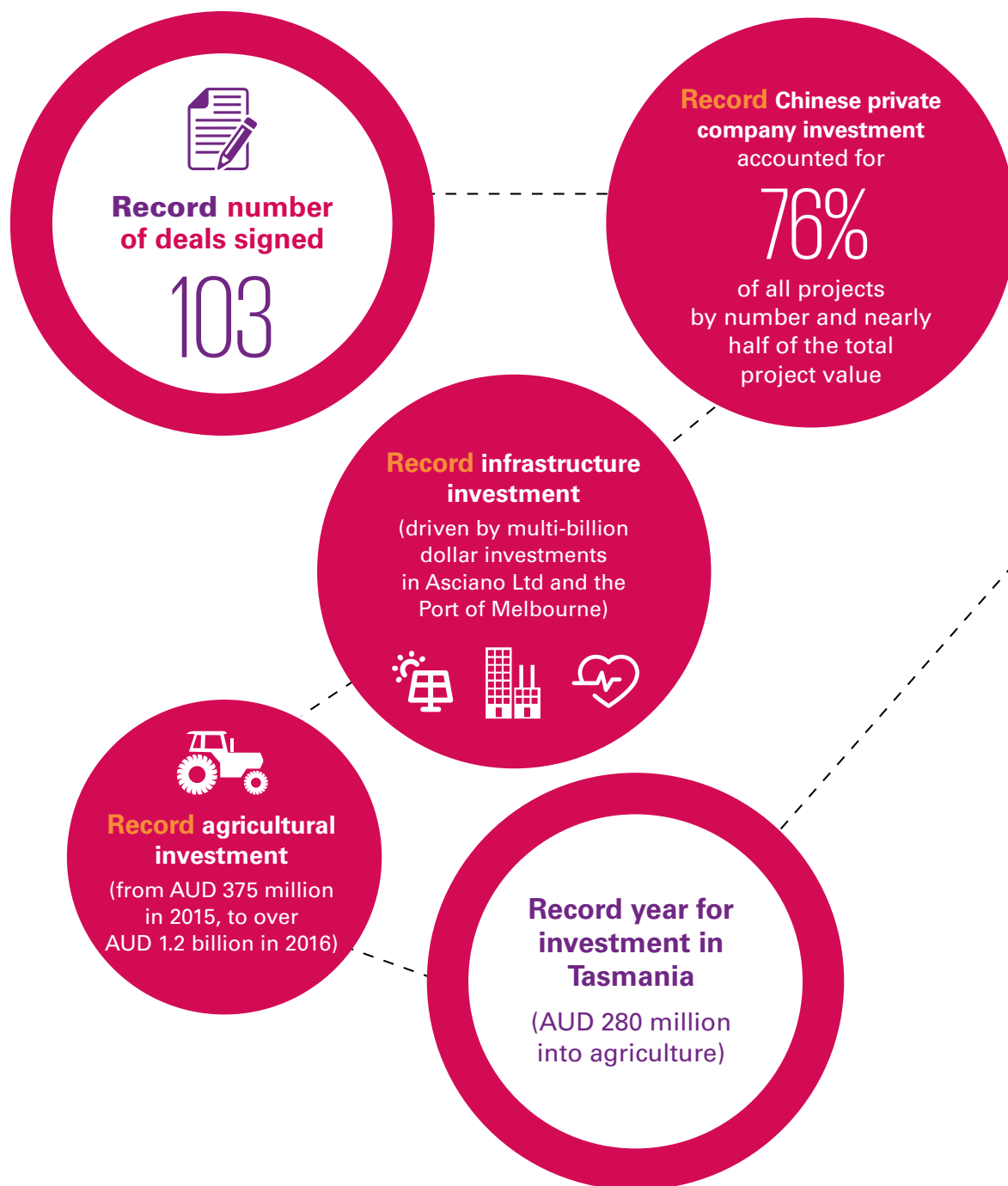
Unless otherwise stated, the data referred to throughout this report is sourced from the KPMG/University of Sydney database, and our previously published reports¹. KPMG and The University of Sydney team obtain raw data on China's ODI from a wide variety of public information sources which are verified, analysed and presented in a consistent and summarised fashion. Our sources include commercial databases, corporate information, and official data from Australian and Chinese sources including the Australian Bureau of Statistics, Foreign Investment Review Board and Ministry of Commerce P.R.China.

Our data is regularly updated and continually revised when new information becomes available. In line with international practice, we traditionally record deals using USD as the base currency. However, for 2015 and 2016 we used Australian dollars for our detailed analysis given the effect of exchange rate fluctuations.

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; *Demystifying Chinese Investment in Australian Agribusiness*, October 2014; *Demystifying Chinese Investment in Australia*, March 2014; *Demystifying SOE Investment*, August 2014; *Chinese Investors in Australia Survey*, November 2014; *Demystifying Chinese Investment in Australia*, May 2015 Update; *Demystifying Chinese Investment in Australia*, April 2016.

Key findings – 2016 a year of new records





Australia remains the second largest recipient country for accumulated Chinese investment

...but is falling behind in growth

Australia retains its position as the second largest recipient of Chinese ODI with data showing close to USD 90 billion of accumulated new investment since 2007. The United States ranks first with accumulated new investment surpassing USD 100 billion².

While 2016 saw continued investment growth in Australia, by international comparison the relative growth of Australia's inbound Chinese direct investment has fallen behind other countries and regions which recorded unprecedented growth rates for 2016.

Chinese direct investment in the United States in 2016 tripled to USD 45 billion and featured broad sector diversity including commercial real estate, information and communication technology, health and biotechnology as well as financial and business services.²

The European Union registered a 77 percent increase in Chinese ODI to EURO 35 billion³ (USD 37.6 billion). Chinese investment in the European Union targeted advanced manufacturing, information and communication technology, energy, utilities and infrastructure and entertainment.

Brazil joined the major recipient countries of Chinese ODI with a four-fold increase from USD 3.2 billion in 2015 to USD 12.1 billion⁴.

² Thilo Hanemann and Cassie Gao, Record Deal Making in 2016 Pushes Cumulative Chinese FDI in the US above \$100 billion, Rhodium Group, December 30 2016; <http://rhg.com/notes/record-deal-making-in-2016-pushes-cumulative-chinese-fdi-in-the-us-above-100-billion/>; (source includes investments valued under USD 5 million).

³ Thilo Hanemann and Mikko Huotari, Record Flows and Growing Imbalances, Rhodium Group, January 2017; http://rhg.com/wp-content/uploads/2017/01/RHG_Merics_COFDI_EU_2016.pdf.

⁴ AEI, China Global Investment Tracker, March 2017, <https://www.aei.org/china-global-investment-tracker/>.



Chinese investment in Australia increased 11.7 percent

For the calendar year 2016, the KPMG and The University of Sydney's database shows a continuation of the growth trend that started in 2014 – with 2016 the second largest year on record (behind 2008) for Chinese direct investment.

From 2015 to 2016, Chinese ODI in Australia increased 11.7 percent in Australian dollar terms from AUD 13.75 billion (USD 10.14 billion) to AUD 15.36 billion (USD 11.49 billion)⁵.

2016 was a record year by number with 103 deals signed. Significantly 2016 was also a record in number and value of deals signed with Chinese private company investors. Chinese private company investors accounted for 76 percent of all projects by number and nearly half of the total project value.

Commercial real estate remains the largest sector with 36 percent followed by infrastructure with a record 28 percent driven by multi-billion dollar investments in Asciano Ltd and the Port of Melbourne.

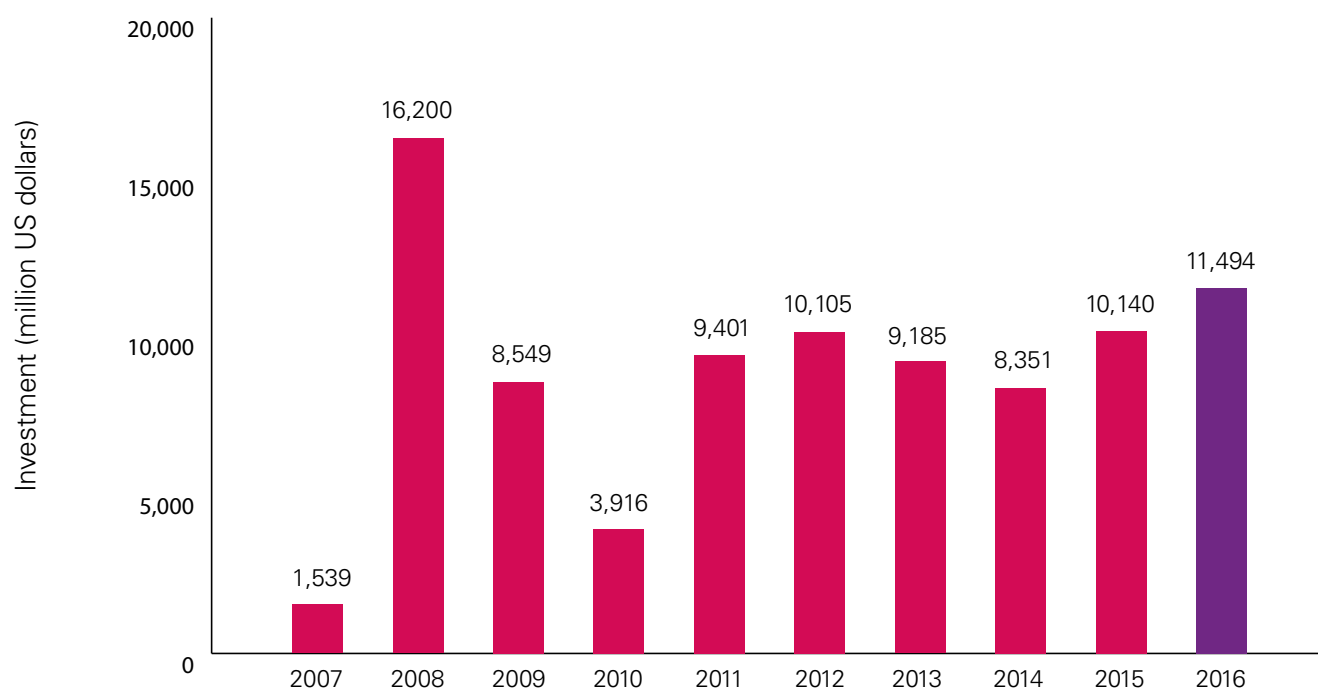
This year saw a significant change in real estate investment with residential development sites now accounting for 51 percent of value, a significant increase compared to just 27 percent in 2015.

Agribusiness grew from AUD 375 million in 2015 to over AUD 1.2 billion in 2016, the largest year on record, attracting larger investment sums from China as the ChAFTA export benefits are realised.

Controversy surrounded two very large Chinese investment projects in 2016: Ausgrid and S Kidman & Co Limited. In both cases, the Treasurer rejected the initial proposed deals on the grounds of national interest and national security. The shareholding structure of the Kidman deal was later modified and approved as an Australia-China joint venture. These investments are analysed as case studies further below and foreshadow changes in the approval processes under the Government's Foreign Policy White Paper, with a stronger consideration of security interests in large infrastructure projects in sectors where China is building up regional and global capacities, with a stronger consideration of security interest in critical infrastructure projects.

There are signs of a growing maturity by Chinese investors in the Australian market. The number of joint ventures is increasing with more repeat investments by established Chinese companies. This has set a foundation for growth in future investment.

⁵ We adjust our database to reflect newly available information. These figures reflect the latest revisions of our database based on the most recent available information.

Figure: Chinese ODI into Australia by value (million USD)

Source: KPMG/University of Sydney database

Note: Annual figures are adjusted as information is updated

Selected major Chinese investments in Australia in 2016

Target Name	Acquirer Name	Industry Sector	State	FINAL Value (AUD m)
Asciano Ltd	Consortium including China's CIC Capital	Infrastructure	NSW	2,400 ⁶
Port of Melbourne	Consortium including Future Fund, QIC and China's CIC Capital	Infrastructure	VIC	1,940 ⁷
Santos Ltd ⁸	ENN Ecological Holdings Co., Ltd.	Energy (gas and oil)	SA	990
W Hotel & Ribbon Residences, Darling Harbour	Greaton via Tianlong Robbon Property Unit Trust	Commercial real estate	NSW	700
Homebush City Garden, Lidcombe	Yunnan Metro Construction Investment	Commercial real estate	NSW	660
Kwinana Lithium Plant	Chengdu Tianqi	Mining	WA	400
Genesis Care	China Resources (Holdings) Co Ltd & Macquarie Capital Group Pty Ltd	Healthcare	NSW	383 ⁹

⁶ estimated investment based on CIC's equity (16%).

⁷ estimated investment based on CIC's equity (20%).

⁸ 11.72% stake.

⁹ estimated investment based on conservative assumption that China Resources holds 50% equity in the JV which acquired 45% of Genesis Care.

Source: KPMG/University of Sydney database

Chinese investment in Australia by industry

Commercial real estate and large scale infrastructure continues to fill the gap left by declining Chinese mining sector investment, with commercial real estate (36 percent) and transport, renewables and infrastructure (33 percent).

Commercial real estate remains the largest sector, attracting AUD 5.6 billion of Chinese investment with a modest decline from 2015. Infrastructure was the second largest sector with investment of AUD 4.3 billion in 2016 (a record year for infrastructure investment).

As we saw in 2015 and predicted for the year ahead there was continued Chinese investment demand for consumer related sectors, particularly in agribusiness, healthcare (17 percent) and sectors relevant for Chinese tourism and education.

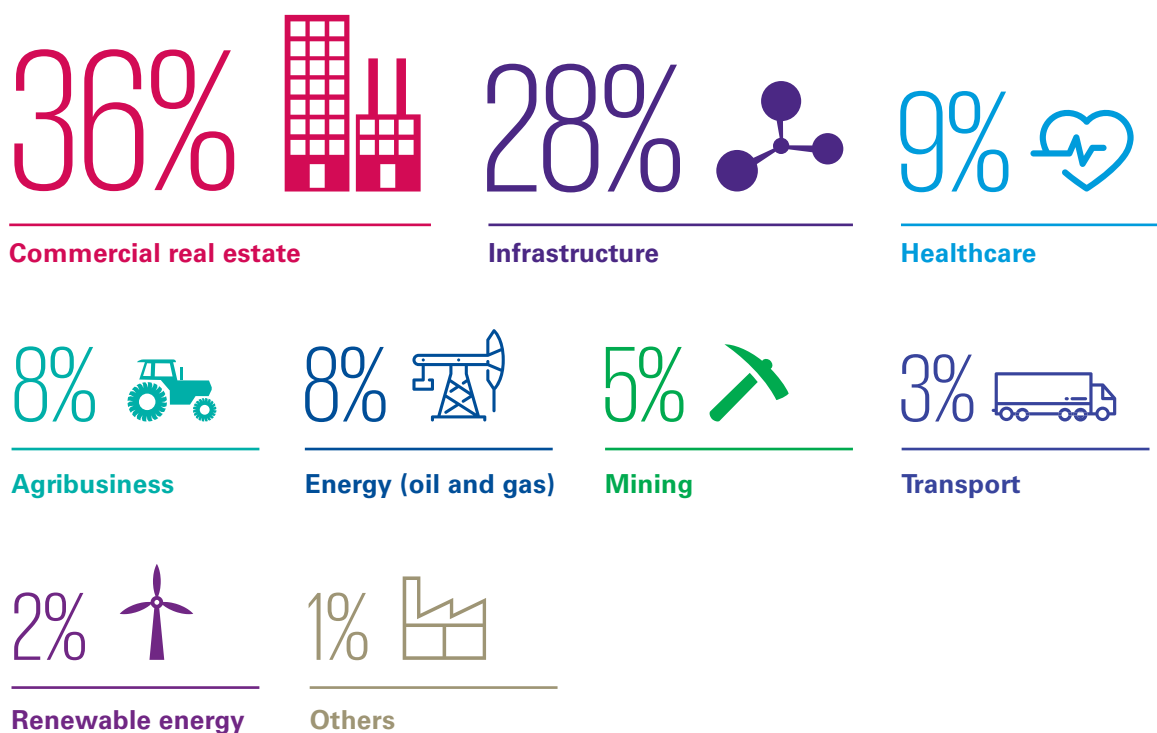
2016 was a breakthrough year for agribusiness, moving from seventh into fourth place with an increase from 3 to 8 percent of total investment. Investment in agribusiness accounted for Tasmania returning to the mix with a AUD 280 million investment.

However the mining sector is not dead. In 2016 there remained Chinese interest in non-ferrous metals and oil and gas (13 percent).



Chinese tourists take in the sites of the Sydney Harbour Bridge and the Sydney Opera House from Mrs Macquarie's Chair in Sydney.
Source: AAP Image/Dean Lewins.

Chinese ODI by industry in 2016 (%)



Source: KPMG/University of Sydney database

Industry	Value (million AUD)	%
Commercial real estate	5,549	36
Infrastructure	4,340	28
Healthcare	1,354	9
Agribusiness	1,202	8
Energy (oil and gas)	1,149	8
Mining	839	5
Transport	391	3
Renewable energy	343	2
Others	195	1
Total	15,361	100

Source: KPMG/University of Sydney database

Industry sector analysis



Real estate



*Data and analysis contributed
by Knight Frank Australia*

Mainland Chinese investment outflows into international real estate continued to strengthen during 2016 with approximately USD 31 billion invested offshore, a significant increase on 2015 levels. The USA attracted 33 percent of these capital outflows as buyers sought trophy assets before the anticipated US dollar appreciation against the Renminbi. Australia accounted for 14 percent of 2016 investment, a slightly lower proportion than the previous two years of 21 percent and 19 percent. The UK fell to 6 percent from 9 percent in 2015 as there was increased investment closer to home with Hong Kong investment allocation increasing to 22 percent from 6 percent in 2015 and the allocation to Malaysia doubling to 6 percent.

Chinese investment into Australian real estate (excluding residential dwellings) was AUD 5.55 billion in 2016, down marginally from 2015. The focus of investment changed over the past year with major office investments, particularly in the gateway cities of Sydney and Melbourne, becoming more difficult to secure. This resulted in the investment allocation for offices to fall from 47 percent in 2015 to 23 percent in 2016, with major investments in Perth (AUD 198 million) and Sydney (including 140 Sussex St AUD 130 million).

Over the same period Chinese investment in residential development sites increased further, accounting for 51 percent of investment during 2016 as Australia became further entrenched as a destination for Chinese developers. Branching out from inner city high rise developments to encompass major medium density and greenfield developments, the average potential yield for Australian sites purchased by Chinese developers in 2016 was 502 dwellings, as opposed to only 103 dwellings per development site acquired in 2012.

With 2017 announced as the China-Australia Year of Tourism the already strong inflows of Chinese tourists will further accelerate. Tourism Research Australia indicates that mainland Chinese visitor numbers were

1.1 million in the year to September 2016, an increase of 22 percent, resulting in spending of AUD 9.1 billion, up by 18 percent. Although second to New Zealand in terms of total tourist numbers, Chinese visitors have by far the greatest expenditure levels, followed by the USA and UK at AUD 3.7 billion each.

As a highly aspirational destination, Australia is attracting investment in direct tourism assets and the retail sector. Chinese investors acquired some AUD 1.7 billion of hotel assets over the past two years, with expectations that this level of investment will continue to accelerate over the coming year. Greator's major acquisition of the AUD 700 million W Hotel & Ribbon Residences development in Sydney is an example of this significant investment. Equally greater penetration of retail spending in Australia (it is estimated that Chinese visitors spent some AUD 1.1 billion on items to take home in the 12 months to September 2016) has also been reflected in Chinese investment in retail assets of AUD 550 million in the past two years.

While Australia is undoubtedly a desirable holiday location for Chinese tourists, visitor numbers are also boosted by stays for educational purposes – accounting for AUD 4.1 billion in annual expenditure. Visitors accessing education is also a large factor in the long average stay of Chinese visitors at 39.5 days. Education is therefore an important sector for fueling the tourism and education markets, and for familiarising visitors with Australian business opportunities, which is a known driver of future investment and economic activity.

With trophy office assets remaining tightly held across the major Australian cities we expect to see further broadening of Chinese investment into tourist infrastructure and retail assets over the course of 2017. Residential and mixed use development sites will also remain highly sought after with further penetration into the house and land market expected.

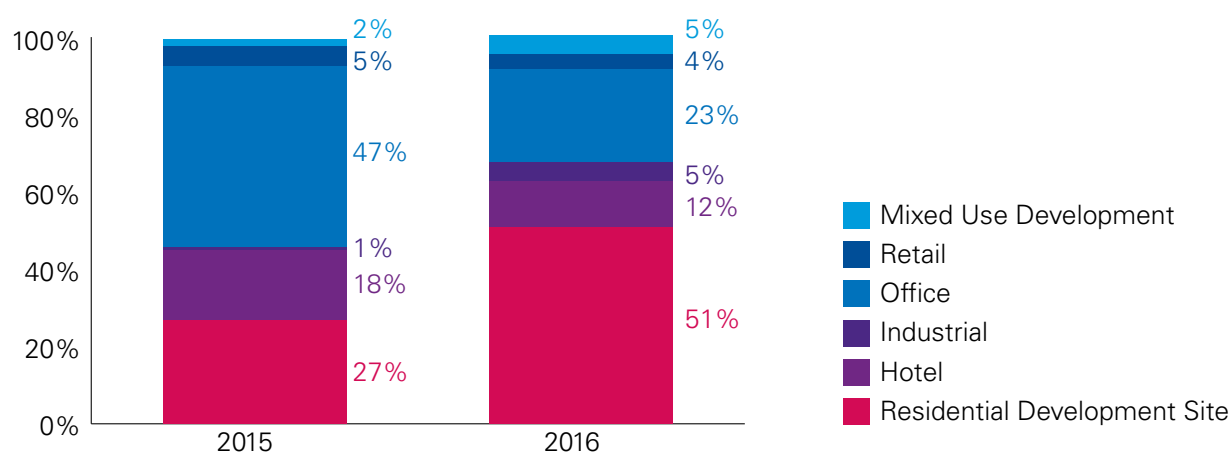
Top real estate transactions for 2016

Property	Location	Type	Purchaser	AUD million
W Hotel & Ribbon Residences, Darling Harbour	Sydney	Hotel/ Serviced Apartments	Greaton via Tianlong Robbon Property Unit Trust	700
Homebush City Garden, Lidcombe	Sydney	Residential/ Mixed use Development	Yunnan Metro Construction	660*
Hacketts Rd, Point Cook	Melbourne	Residential Development	Dahua Group	353*
165-175 Mitchell Rd, Erskineville	Sydney	Residential Development	Greenland Group	260^
221 St Georges Tce, Perth CBD	Perth	Office	YT International	198
Yarraville Gardens Maribyrnong	Melbourne	Residential Development	Changsheng China Prop Co	172
61 Lavender St, Lavender Bay	Sydney	Residential Development	Aqualand	140
1270 Richmond Rd, Marsden Park	Sydney	Residential Development	Cyan Stone/Boyuan	139
203 Castlereagh St, Sydney CBD	Sydney	Residential Development	Visionary Investment Group & United Investment Australia	135
140 Sussex St, Sydney CBD	Sydney	Office	Bank of China Group Investment Limited	130

* estimated

^60 percent share

Source: Knight Frank Research/RealCapital Analytics



Source: Knight Frank Research/RCA

S. Kidman & Co

A joint bid by Australian and Chinese investors for S. Kidman & Co was approved in December 2016 after two previous foreign offers were rejected by the Foreign Investment Review Board (FIRB) on the grounds of 'national security' and 'national interest'.

The previous bids in November 2015 and May 2016 were rejected by the Treasurer who initially cited the proximity of S Kidman & Co's Anna Creek station to the Woomera Prohibited Area as a reason for blocking the application.

The Treasurer subsequently identified the scale of the Kidman property portfolio in his decision, stating that it was the largest by land size, with 1.3 percent of Australia's total land area and 2.5 percent of Australia's agricultural land.

This decision came in spite of previous foreign acquisitions and consolidations of large agricultural assets such as that of the Consolidated Pastoral Company, a 90 percent foreign owned company with a herd size double S Kidman & Co's.

To overcome the obstacles faced by previous bidders, the final AUD 386.5 billion deal proposed by Outback Beef involved significant compromises. Outback Beef, which is 67 percent owned by Hancock Prospecting Pty Ltd and 33 percent owned by Shanghai CRED Real Estate Stock Co Ltd, avoided the contentious Woomera Prohibited Area by selling Anna Creek and its outstation The Peake to an Australian family. This increased the percentage of Australian ownership from 66.1 percent to 74.7 percent.

The deal ensured that control of the board and the day-to-day operations would remain Australian, while also committing Outback Beef to increase herd size by 20,000 and invest AUD 19 million in capital improvements for increased efficiency and carrying capacity.

The S. Kidman & Co sale illustrates the value of communication with FIRB throughout the review process and partnering with Australian shareholders and management. Familiarity with government priorities is key for Chinese investors to understand.



2016 saw a record annual amount of Chinese investment in agribusiness. A total number of 12 deals worth AUD 1.2 billion was invested by Chinese firms, marking a three-fold increase from the value in 2015.

Investment concentrated in the dairy, meat, seafood and wine sectors. Major investment deals included S. Kidman & Co selling to a joint venture between Hancock Prospecting and Shanghai CRED Real Estate, Van Dieman's Land by Moon Lake, and the 79 percent stake in Burra Foods acquired by a consortium led by Inner Mongolia Fuyuan Farming.

Chinese investment in Australia's agribusiness sector is driven by the rapidly rising demand for premium quality food, as China's middle class population continues to expand. The 2016 result is a clear sign of flow-on effects from the China Australia Free Trade Agreement (ChAFTA) and its positive impact on raising the competitiveness of Australian agricultural products in the Chinese market.

While investment in agribusiness has increased in 2016, we have observed Chinese investors taking a more mature and rational approach to investment.

Many of these Chinese investors have been considering buying assets in Australia for more than a year, doing lots of planning and due diligence. The long pre-investment phase of projects is often due to the need to build up matching supply chains in China. Increasingly, Chinese firms appreciate that post-acquisition management of rural properties is key for their investment. More Chinese companies are engaging with experienced local management before completing their acquisitions. Chinese investors often cite Shandong Ruyi's acquisition of Cubbie Station and New Hope Group's various investments as good examples of large scale Chinese investment to enable market expansion and create community benefits.

In addition, we also noticed further investments in agribusiness by established Chinese companies in Australia. Five of the twelve agribusiness investments in 2016 were made by established Chinese investors that have previously made investments in Australia.



Obtaining social licence is key to successful Chinese agriculture sector investment

Contributed By Alistair Nicholas, Powell Tate Australia

Powell Tate Australia undertook a qualitative survey during the past year to better understand the concerns Australians have about Chinese investment into Australian agriculture. What we learned has application across the spectrum of Chinese investment into Australia. It essentially came down to the need for Chinese investors to obtain a 'social licence' to operate in Australia.

Investors need to demonstrate a commitment to Australian society that goes beyond earning profits in order to succeed. Even where an investment is providing an economic benefit to the nation, there is a need for investors to demonstrate commitment to the national common good beyond their contributions to the balance of trade and gross domestic product.

The public seems to be concerned about poorly conceived and executed approaches to investment in Australia by Chinese parties. Although these may be few in number, their examples echo loudly around the country and are dredged up by opponents when a new investment proposition is put forward.

Many of those interviewed by Powell Tate pointed to the example of a Chinese dairy group in discussing what not to do. They said the Chinese company had "got it wrong from the outset" of its purchase of five farms in Gippsland in Victoria.

The group hadn't connected with the local community "to see if they were on board with [its] plans" to place 1,000 milk producing cattle into barns and build a bottling plant, according to one of our interviewees. Not surprisingly, the plans were unanimously rejected by the Bass Coast Shire Council in August 2015 after it received 400 submissions from the local community and other interested parties opposing the group's plans.

The Chinese group assumed that federal and state government approvals for its initial investment were sufficient to move forward with aggressive expansion plans. Its lack of understanding of Australian politics, political institutions and structures, of the importance of local government, and of local community sensitivities, made it a fearful juggernaut. It found it had few if any supporters when it most needed a local advocate.

A number of interviewees pointed to the investment by Shandong RuYi into Cubbie Station and the New Hope Group's investments into a number of rural properties as examples of successful approaches to investment into Australia. The secret to these successes might be described as the 'joint venture' partnership approach.

In the case of Cubbie Station, success lay in the fact that it retained the local management of the station after its buyout and agreed to sell a minority 49 percent share to a local partner, which it is still seeking. As one of our interviewees said, "By keeping the Australian management structure in place the Chinese buyers had first ensured the success of their FIRB approval but, more importantly, retained the property's connection to the local communities of St George and Dirranbandi".

New Hope Group's business investment success in Australia (more than four projects to date) has been due to partnering with the local owners – investing in their businesses rather than total acquisitions – as well as retaining local management and a connection to the community. One interviewee closely associated with New Hope Group's acquisition of the Moxey Farms in 2015 said its FIRB approval was smooth because there was no suggestion of a restructure of the business post-investment.

Beyond maintaining the local management structure, Shandong RuYi succeeded in obtaining an ongoing social licence despite initial apprehension from local communities. Factors that changed initially negative local perceptions included AUD 30 million invested to lift cotton production and more into upgrading irrigation at the property, and strong commitment and action on environmental issues, water management and sustainability in the area surrounding the property – all important matters in the Darling Downs region. Additionally, the company contracted local businesses to supply Cubbie Station and committed to hiring from the local area, including for its seasonal casual workforce. These actions together have made a considerable social impact in the region.

It is important that Chinese investors understand that there is no federal and state government authority that awards social licences to foreign investors. It is not a physical licence but an 'acceptance' by the community where the investment is made. It is amorphous. It cannot be defined in any one way, or obtained by any particular set of actions. What works in one instance may not work at another. In fact, social impact actions to obtain a social licence need to be dynamic, constantly adjusting to changing circumstances and fickle stakeholder perceptions. Success depends on understanding what needs to be done to win the hearts and minds of local community groups and other stakeholders in each situation, and on understanding the ever changing atmospherics¹⁰.

Successful investors will have a plan and mechanisms in place to monitor changing circumstances and perceptions to ensure they make appropriate adjustments to actions. They also need continuously to communicate changes in strategies and plans that affect stakeholder groups.

Chinese investors in agriculture need to engage with local communities, understand the needs of those communities, and contribute to solving their problems, as the Cubbie Station investors have done. As many of our interviewees put it, Chinese investors need to demonstrate that they are "bringing more to the table than just money." It doesn't matter that you have invested millions of dollars and are getting higher prices for Australian milk in China. That's your business. But how many jobs have you created directly and indirectly? Do you support local businesses? Do you pay your taxes? What are you doing for the environment? What's your broader social impact?

Investors that have a story to tell on these social impact matters need to tell it and tell it often. This will get them their social licence. And, more importantly, these positive stories will start to balance the negative ones that are raised by the opponents of Chinese investment into Australia.

Eight suggestions to help gain a social licence

- 1 Undertake full and appropriate due diligence before making an investment to ensure expansion/development plans will be approved.
- 2 Undertake stakeholder mappings and audits to better understand concerns of stakeholders and address them through appropriate stakeholder engagement strategies.
- 3 Communicate your story and what you bring to the Australian market through a comprehensive communications strategy, including through the media.
- 4 Ensure Australian managers are retained and appropriately empowered – and that their advice is heeded.
- 5 Engage with employees and local suppliers.
- 6 Become involved in the local community – support local causes for example local charities, schools, sports teams, etc.
- 7 Engage professional advisors who can assist with all of the above.
- 8 Learn from successful Chinese investments, such as Cubbie Station and New Hope.

¹⁰ The definition of "social licence" used in the study is based on the work of Ian Thomson and Robert Boutilier on their website SocialLicense.com.

Australian Ports

Ports are a vital component of Australian trade infrastructure, underpinning 20 percent of Australian GDP¹¹. With 135 million tonnes of imports and 1.2 billion tonnes of exports in 2014/15 alone, ports are highly productive assets set to grow as Australia expands its trade ties in the region¹². This has been recognised by Chinese investors in recent years, attracting significant investment into the economy.

The sale of the Port of Newcastle for AUD 1.75 billion in 2014 saw the China Merchants Group take 50 percent ownership of the lease. The following year, the Port of Darwin was sold for AUD 506 million to Landbridge Group, owned by Chinese billionaire Ye Cheng. These are crucial assets for Australian trade, with the Port of Darwin exporting 35 percent of Australian livestock and the Port of Newcastle exporting 40 percent of Australia's Coal¹³.

2016 saw similar interest, with the Port of Melbourne sold for AUD 9.70 billion to a consortium that included a 20 percent holding by China Investment Corp (CIC), China's AUD 200 billion sovereign wealth fund. The sale has added significant value for the State and Federal Government and for the investors who are expected to tip AUD 6 billion into upgrading the facility over the life of the 50-year lease.

The Port of Melbourne is Australia's largest container port, vital for incoming manufactured products as well as Victorian exports. It accounts for 13.3 percent of Australia's AUD 3 billion a year Australian port industry and is expected to grow at an above-average 8.5 percent annually.

CIC's investment in 20 percent of The Port of Melbourne lease attracted significantly less attention than the wholly Chinese-owned Landbridge Group when it bought 100 percent The Port of Darwin lease in 2015. This reflects the nature of the asset, which is less critical for the Australian Navy. It also reflects the virtue of a diversified ownership structure in a consortium that is only 40 percent Australian-owned.

The Port of Melbourne sale is the first Chinese deal over AUD 1 billion since FIRB rejected the offers of State Grid Corp and Cheung Kong Infrastructure for the New South Wales Ausgrid network.



Infrastructure

Chinese investment in large Australian infrastructure assets continued in 2016 at a record level. Chinese companies with technical expertise and financing capabilities are keen to work with Australian and international partners in infrastructure provision. China's comprehensive and global "Belt and Road" Initiative ties into their investment activities in Australia.

Chinese investment in infrastructure comprised two very large deals with minority shares taken by Chinese investor CIC Capital in Asciano Limited and the Port of Melbourne. CIC Capital followed the example of China Merchants (i.e. Port of Newcastle 2014 co-investment with Hastings Funds Management) in joint venturing with Australian and international partners.



Mining

We recorded eight Chinese mining investments totalling AUD 839 million in gold and other non-ferrous metals. Compared to 2015 we observed a decline of 35 percent and mining fell to sixth position of investment sector priorities.

¹¹ Bernard Salt, "Ports deliver wealth as Australia remains a trading nation" The Australian.

¹² Ports Australia, "Total Throughput for 2014/2015" <http://www.portsaustralia.com.au/aus-ports-industry/trade-statistics/>.

¹³ Bernard Salt, "Ports deliver wealth as Australia remains a trading nation" The Australian.

NSW Electricity Network Privatisation

In June 2014, the NSW Government announced its intention to sell 49 percent of NSW electricity networks through the partial privatisation of the leases for Ausgrid, Endeavour Energy and Transgrid.

The first deal was announced in November of 2015, when the NSW Government successfully sold 100 percent of Transgrid on a 99-year lease. The electricity transmission operator was bought for AUD 10.258 billion by a consortium of Canadian, Middle Eastern and local investors. The Premier noted in his announcement of the deal, "I think we've been very clear that we welcome foreign investment, we welcome participation in the global economy"¹⁴.

The positive start to the NSW privatisation plan stalled in August 2016 when the Federal Government blocked offers for Ausgrid from the Chinese Government-owned State Grid Corp and Hong Kong-listed Cheung Kong Infrastructure. The Federal Treasurer, on the advice of FIRB concluded that the AUD 16 billion deal was contrary to Australia's national interest due to "national security reasons". The denial came in spite of a prior decision by FIRB that allowed State Grid Corporation, in partnership with Macquarie Infrastructure, to bid for Transgrid in 2015.

50.4 percent of the Ausgrid network, which powers 1.7 million homes and business throughout Sydney, the Hunter and Central Coast, was sold in October 2016 to two Australian pension funds for AUD 16.189 billion.

The final component in the Government's privatisation plan, Endeavour Energy, was opened for expressions of interest in December 2016 with 50.4 percent of the company's 99-year lease on offer to prospective investors.

The Ausgrid sale also demonstrates the virtues of diversified ownership structures when complying with FIRB's investment approval criteria. The success of a foreign consortium in the Transgrid sale and failure of individual foreign bidders in the Ausgrid sale demonstrates FIRB's aversion to the consolidation of essential Australian assets by foreign owners.

¹⁴ Sarah Gerathy, 2015, "NSW power asset privatisation: Consortium wins bid for TransGrid electricity 'poles and wires' lease" Australian Broadcasting Corporation.



Healthcare

Investment in healthcare was dominated by the Genesis Care deal in which China Resources Holdings invested AUD 383 million. Other projects included health care providers and pharmaceutical companies. Biostime bought the remaining 17 percent share in Swisse Wellness.

Industry analysis

Healthcare & vitamins

Healthcare is a growing industry with global spending on medicine alone estimated to reach USD 1.4 trillion by 2020¹⁵. The global profit pool in healthcare is predicted to grow at 4 percent to reach USD 740 billion over the same period¹⁶. Australia is poised to profit from this growth in both the local and international markets. The growth of Australian medical companies, such as ResMed and Cochlear, in the Chinese healthcare industry has demonstrated the opportunities created by growing international demand for medical technology.

As a major importer of healthcare and medical products, Chinese demand greatly influences the returns that investors receive from Australian medical companies. The perception of Australian medical products as high quality and rigorously tested is vital for exporters looking to tap into the demand of China's growing middle class. With an aging population, rising obesity, high pollution levels and high smoking rates, China's consumption of Australian health products will continue to provide returns for investors in Australian healthcare and vitamin exporters in the future.

The 13th Five-Year Plan released in March 2016 has reinforced China's commitment to growth in the healthcare industry. The focus on regulatory reform and development of advanced medical equipment in its 'smart healthcare' plan bodes well for Australian healthcare companies¹⁷.

Chinese investors are attracted to Australia's research infrastructure, expertise, product testing capabilities and export opportunities. Australian business are increasingly drawing the interest of multiple Chinese bidders, sometime attracting over a dozen in the initial offer stage. Prospective Chinese investment funds are also collaborating with A-share and H-share companies in a trend towards the use of consortiums to reduce risks and increase synergies.

This focus on healthcare has been manifest in Chinese investment in the Australian medical technology industry, headlined by the AUD 1.7 billion investment in GenesisCare, Australia's leading provider of radiation oncology, cardiology and sleep treatments. The consortium formed by Macquarie Capital and the Hong Kong subsidiary of China Resources Group received approval from FIRB to proceed with the deal in October 2016. The deal will give GenesisCare greater capability to expand into regional Australia and the Asia Pacific.

China-based genomics company BGI also made a significant impact in the industry by reinforcing its research and development ties with Australia in August 2016, investing in R&D in an agreement with Australia's Commonwealth Scientific and Industrial Research Organisation (CSIRO). BGI recently opened its Asia-Pacific headquarters in Brisbane with BGI President and Co-Founder Professor Jian Wang stating his company aims to collaborate with the world's best.

Australian vitamin companies have attracted similar attention from investors. Melbourne-based vitamin supplier Swisse Wellness was sold to Hong Kong company Biostime for AUD 1.67 billion in 2015, whilst Blackmore's share price surged from AUD 35 at the start of 2015 to a peak of AUD 217 in early 2016 on the back of Chinese demand.

Australian health and vitamin companies are well positioned to capitalise on current market conditions. Continued investment from China should be seen as an opportunity for Australia to bolster its research infrastructure and export capabilities.

¹⁵ IMS Institute for Healthcare Informatics, 2015 *Global Medicines Use in 2020*.

¹⁶ Bain & Company, 2012 *Healthcare 2020*.

¹⁷ KPMG Global China Practice, 2016, *The 13th Five-Year Plan – China's transformation and integration with the world economy*.

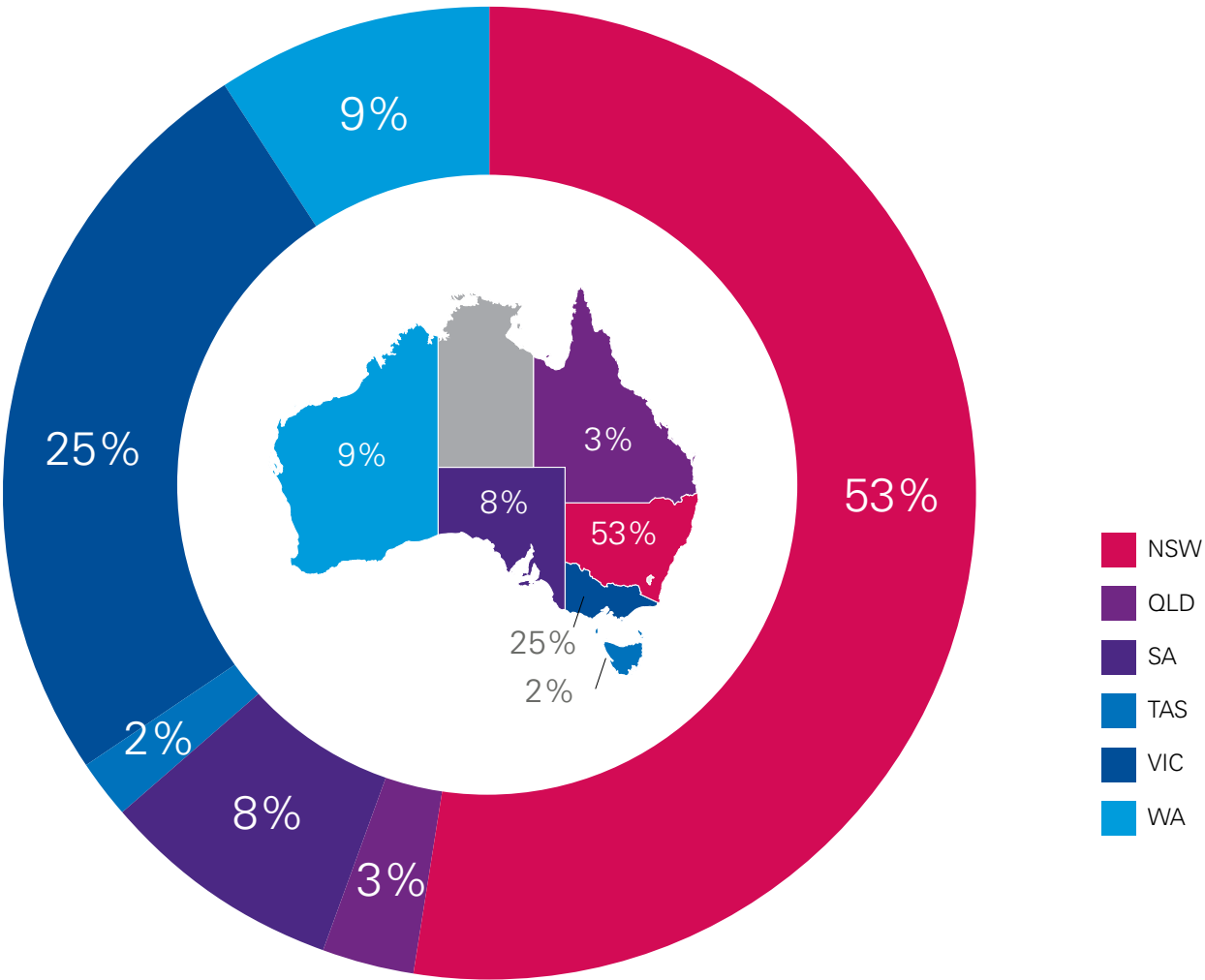
Chinese investment in Australia by geography

New South Wales continued to be the priority state for Chinese investments at 53 percent, on the back of commercial real estate, followed by Victoria at 25 percent. The remaining states each accounted for less than 10 percent.

Chinese ODI by state and territory in 2016 (AUD)

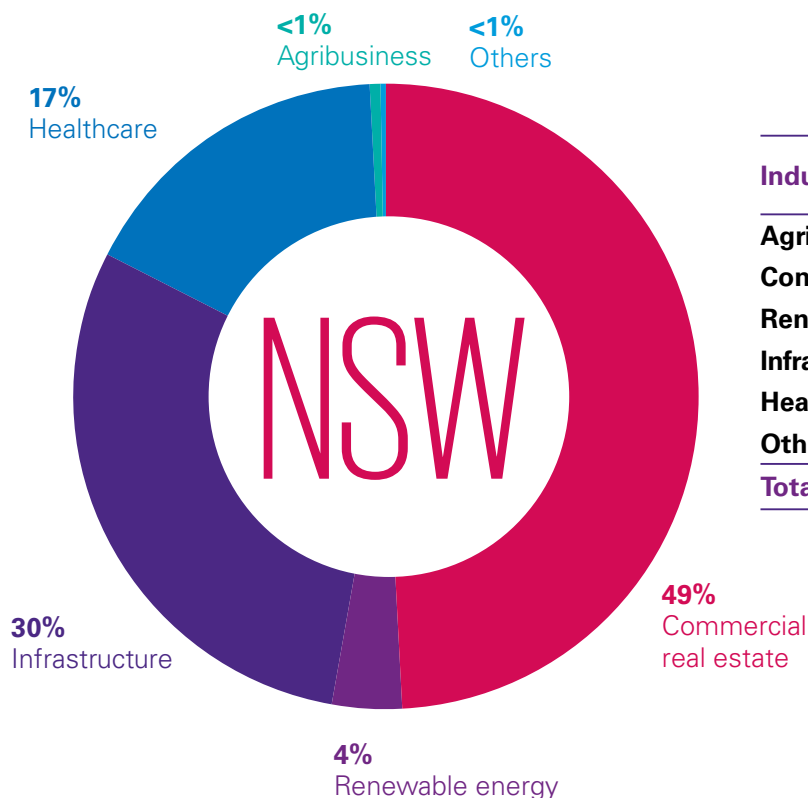
	Value (million AUD)	%
NSW	8,063	53
QLD	508	3
SA	1,274	8
TAS	280	2
VIC	3,857	25
WA	1,380	9
TOTAL	15,361	100

Chinese ODI in Australia by state in 2016 (AUD)



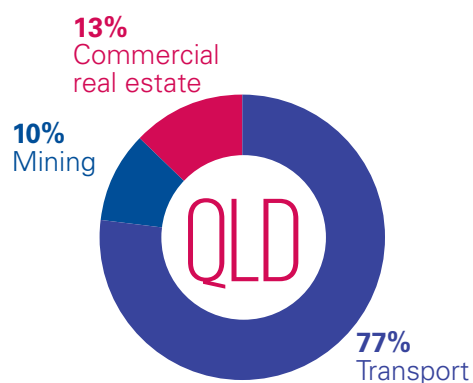
Source: KPMG/University of Sydney database

Total completed deals by state and industry



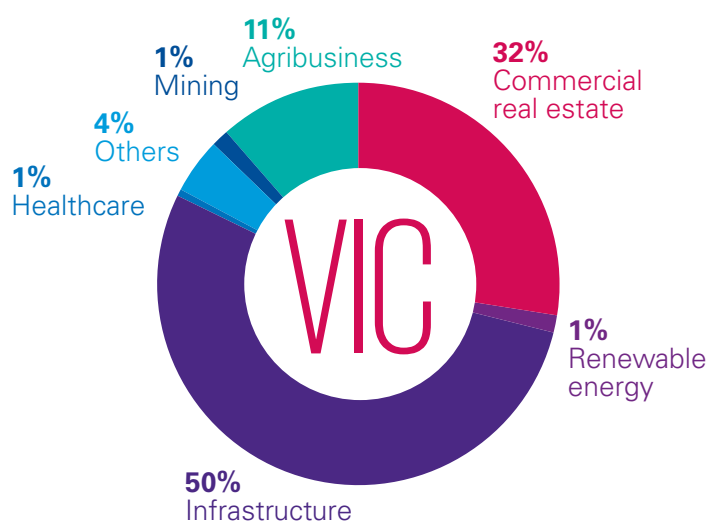
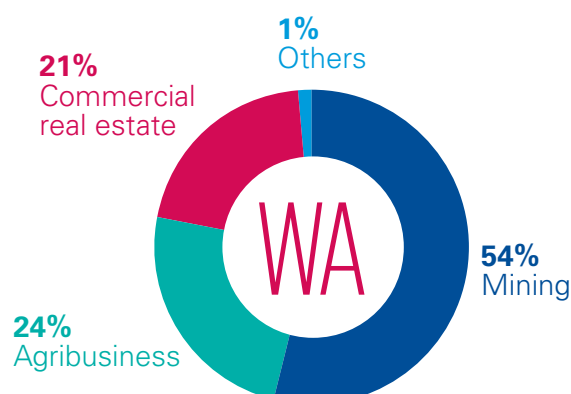
Industry	Transaction Value (AUD million)
Agribusiness	51
Commercial real estate	3,964
Renewable energy	300
Infrastructure	2,400
Healthcare	1,328
Others	20
Total	8,063

Industry	Transaction Value (AUD million)
Mining	52
Commercial real estate	65
Transport	391
Total	508



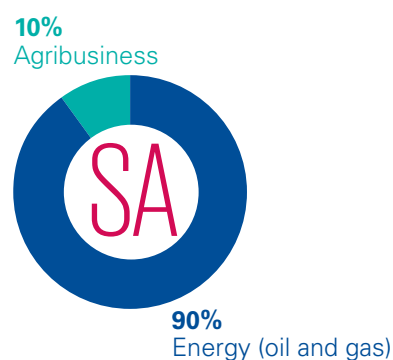
Industry	Transaction Value (AUD million)
Agribusiness	280
Total	280

Industry	Transaction Value (AUD million)
Mining	745
Agribusiness	333
Commercial real estate	285
Others	17
Total	1,380



Industry	Transaction Value (AUD million)
Mining	42
Agribusiness	413
Commercial real estate	1,235
Renewable energy	43
Infrastructure	1,940
Healthcare	26
Others	158
Total	3,857

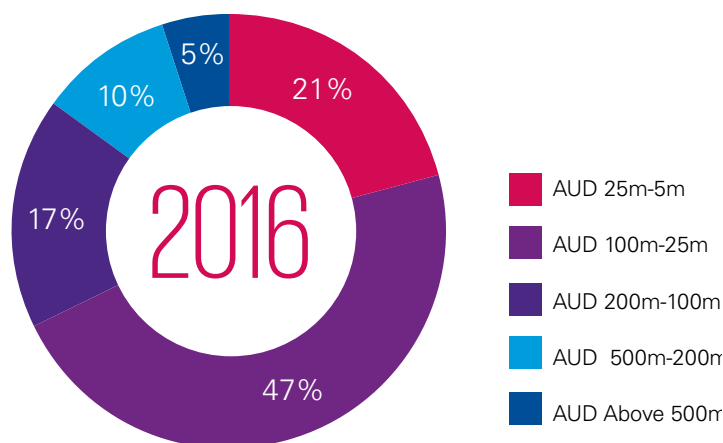
Industry	Transaction Value (AUD million)
Energy (oil and gas)	1,149
Agribusiness	125
Total	1,274



Chinese investment by deal size

Unlike previous recent years, there has been a fairly even spread of deals by deal size in 2016 ranging between AUD 100 to 500 million (27 percent) and AUD 25 to 100 million (47 percent).

2016 saw a few mega sized infrastructure deals however the commercial real estate, agribusiness, health, energy and mining deals have been below AUD 500 million and largely fallen into the AUD 25-200 million range.

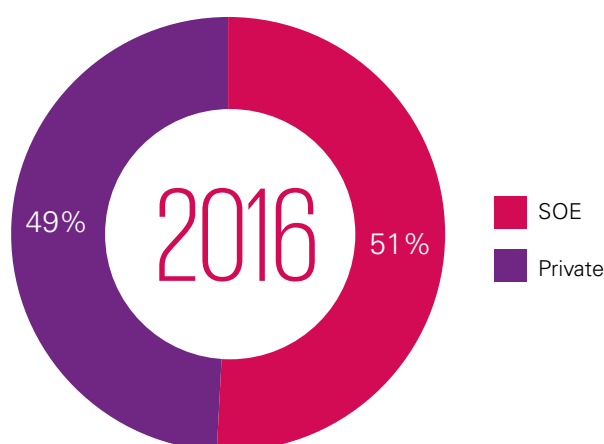


Size of deal in 2016	Number of deals	%	Value (AUD mil)	%
AUD 25m-5m	22	21	376	2
AUD 100m-25m	48	47	2720	18
AUD 200m-100m	18	17	2669	17
AUD 500m-200m	10	10	3075	20
AUD Above 500m	5	5	6522	43
Total	103	100	15,361	100

Chinese investment in Australia by ownership

2016 was a year of significant records: the largest number of deals overall and the largest number of deals by private Chinese company investors. Private investors signed up 78 deals with a total value of AUD 7.6 billion, slightly lower than the value of AUD 7.8 billion achieved by Chinese state-owned investors.

Private investors are the most active in the commercial real estate, agribusiness and healthcare sectors which have dominated in 2016. CIC's investment in infrastructure was the major SOE investment.



Deals by ownership in 2016	Value of deals (AUD mil)	%	Number of deals	%
SOE	7,778	51	25	24
Private	7,584	49	78	76
Total	15,361	100	103	100

Outlook

The 13th Five-Year Plan (2016-2020) and implications for future investment flows¹⁸

The 13th Five-Year Plan (FYP) provides a framework for the design and implementation of policies to guide and facilitate China's transition from an investment-intensive, export-led growth model to one driven by consumption and innovation.

The messages in the report by KPMG's Global China Practice *The 13th Five-Year Plan – China's transformation and integration with the world economy* are first, that the 13th FYP period represents an important turning point in China's attitude towards utilisation of inward foreign direct investment as a catalyst of innovation and an enabler of China's economic transformation. And second, that provided the ambitious and comprehensive program of reforms are implemented, China's 13th FYP has the potential to usher in a "golden age" of inbound and outbound investment activity that will present important new investment opportunities for Chinese and foreign businesses.

Sectorial investment implications

Agriculture & food

Chinese overseas investment in the agriculture and food sector has grown rapidly in recent years. In 2014, Chinese overseas investment in the agriculture, forestry, livestock and fishery industries reached USD 2.04 billion – 6.5 times the 2009 amount – and, based on historical data, we expect it to continue increasing at more than 15 percent over the 13th FYP period.

To support the development of the agriculture and food sector, the 13th FYP calls for China to:

- actively pursue agricultural cooperation overseas and establish scaled-up bases of production, processing, storage and transportation overseas
- nurture transnational agricultural corporations to become internationally competitive
- expand the scope of international cooperation in agriculture
- support the development of bilateral and multilateral technical cooperation in the sector.

In line with these objectives, Chinese companies will be encouraged to develop collaborative trade and investment activities with developed countries that have rich agricultural resources; participate in the development of the broader agricultural sectors in those countries; and contribute to the building of global supply chains in order to increase the effective supply of safe and green agricultural products to China.

Efforts to modernise China's agriculture sector will also encourage more Chinese overseas investment in agriculture-related high-end equipment. Specifically, the 13th FYP calls for the development of "core technologies" for modern agriculture, such as high-horsepower tractors, food crop equipment, cash crop management and harvesting machinery.

Food safety is also an important priority which will drive Chinese ODI, especially as the Chinese Government looks to address several of the issues that are affecting the domestic food inspection industry, such as:

- low inspection efficiency and a lack of advanced inspection technologies
- geographically dispersed upstream raw material production for food products that hinder oversight
- inefficient government regulation and lack of coordination between agencies
- sluggish enforcement that weakens the impact of penalties and undermines deterrence.

Given these needs, Chinese businesses can work with leading overseas food inspection and safety companies to co-develop technologies and services.

Healthcare, pharmaceuticals and medical devices

China's healthcare industry is also experiencing a period of rapid development. Given China's large and fast-growing ageing population, recent technological breakthroughs, as well as the implementation of the "Internet Plus" action plan and healthcare system reform, it is estimated that by 2020, the value of the country's healthcare industry will exceed RMB 8 trillion.

¹⁸ The contents of this section are based on KPMG's Global China Practice report *13th Five-Year Plan – China's transformation and integration with the world economy* which can be downloaded through this link: www.kpmg.com/cn/13fyp-report2-en.



Deputies attend the opening session for the fourth session of the 12th National People's Congress (NPC) at the Great Hall of the People in Beijing, China, 5 March 2016. Source: Copyright AP/Wei yao.

That said, China's healthcare industry is still in a nascent stage, making up only 4-5 percent of GDP, as compared with 15 percent in the United States and more than 10 percent of GDP in countries such as Canada and Japan.

Five main sectors have emerged in the healthcare industry:

- medical treatment
- pharmaceuticals
- health supplements
- health management services
- aged care.

At the same time medical tourism, research, development and manufacturing of health supplements, and high-end medical equipment R&D are also growing.

In terms of industry structure, the pharmaceutical sector is still the largest component of the healthcare industry, but its share may gradually decline as the aged care sector grows. Forecasts show that by around 2025, over 20 percent of China's population will be aged 60 or older, and about 14 percent of the total population will be 65 or older.

Not surprisingly, the 13th FYP calls for the implementation of action plans that improve welfare for senior citizens, as well as for the building of more and better aged care facilities such as nursing homes. Information service platforms will need to be developed to support community- and home-based care, and efforts should be made to promote "smart" aged care and expand service coverage.

Driven by China's continued efforts to advance the development of its healthcare industry, Chinese firms will be able to leverage their home advantage and collaborate with leading international companies in areas such as technology and operations, thereby increasing their competitive advantage.

With regards to the pharmaceutical sector, the 13th FYP emphasises the development of China's biopharmaceutical capabilities. Currently, this sector faces several practical constraints, including a shortage of core technology, a subpar industrial structure, weak R&D, low resource efficiency, and disorderly markets. Its development is further constrained by high barriers to entry, high risk of investment, long investment cycles and a deteriorating macroeconomic environment.

The 13th FYP aims to double the scale of the biopharmaceutical industry through the broad application of genomics and other biotechnologies; networked application demonstration; and the scaling up of a new generation of biotechnology products and services, including personalised treatment and innovative pharmaceuticals.

With policies in place to encourage technical cooperation, FDI and R&D outsourcing, multinationals will be able to participate in joint R&D, undertake national biopharmaceuticals development projects and play a role in shaping the Chinese biopharmaceuticals industry into an ecosystem of innovation. We expect to see Chinese companies looking to acquire new products, core technologies, manufacturing licences and sales channels as they begin a selective process of overseas M&A and equity investment with the goal of building global networks in research, development, production and sales.

China's high-performance medical equipment market potential is also significant. The 13th FYP looks to advance the development of diagnostic and treatment devices, including nuclear imaging devices, superconducting magnets (for magnetic resonance imaging (MRI)), non-invasive ventilators; and in vitro diagnostic equipment, including fully automated biochemical analysis and high-throughput genome sequencers.

Maternal and infant care

Since foreign maternal and infant care brands dominate the Chinese market, relaxation of the family planning policy stands to benefit international companies. Among different market segments, the universal two-child policy will likely push up consumption of infant formula and other infant foods, disposable nappies, milk bottles, childcare equipment, and other infant-related supplies, as well as children's medicine, clothing and toys.

By "going out", Chinese firms can increase the technological sophistication and quality of their products through joint ventures with leading international companies and brands, or by establishing product R&D and manufacturing centres abroad, as well as by sourcing raw materials overseas.

The reputation for high quality products and rigorous safety checks has made Australian companies particularly attractive for foreign investors.¹⁹

¹⁹ KPMG, *Demystifying Chinese investment in Australian agribusiness*, October 2013, p. 19.

Natural resources

With respect to China's ODI, the natural resources industry is one of the key cooperation areas highlighted in the "Belt and Road" Initiative. According to the *Vision and Actions on Jointly Building the Silk Road Economic Belt and the 21st Century Maritime Silk Road*, China needs to:

- strengthen global cooperation in natural resources
- promote collaboration in on-site or local processing and conversion of energy resources
- form integrated energy resource supply chains and have cooperation activities which cover both the upstream and downstream.

Under the 13th FYP, the Chinese Government will encourage Chinese investors to "go out" and develop natural resource bases abroad. This will not only create significant opportunities for expanded investment in extraction projects overseas, but also provide support to those companies looking to extend their offshore natural resource value chains. At the same time, the Chinese Government has clearly indicated the need to work with leading foreign companies to promote the development of overseas natural resource bases and jointly develop third-country markets. This approach will create important opportunities for businesses from all over the world to participate in China's development of overseas resource bases.

Specifically with respect to Australia, the trend towards increased consolidation of the natural resources industry has positive implications for inbound Chinese investment, as Chinese companies look for acquisitions that can assist in the development of more productive mining and refinement processes. This has become a feature of the Australian resources industry as it has strived to stay profitable in spite of low commodity prices.²⁰

Traditional manufacturing

We expect that outbound investment from China's equipment manufacturing industry will grow more than 40 percent annually during the 13th FYP period, which would amount to over USD 122 billion in total.

According to the 13th FYP, China needs to expand its multilateral and bilateral mechanisms for capacity cooperation, and proactively work with developed countries to jointly develop third-country markets – this includes, for instance, the establishment of a number of overseas demonstration zones. In line with this, Chinese companies are encouraged to work with foreign counterparts that have advantageous branding, technology and market positions, which means that leading foreign companies will have opportunities to participate in the internationalisation of China's traditional manufacturing industry.

²⁰ KPMG Australia, *A continuing focus on efficiency and productivity*, August 2015.

Chinese regulatory decisions may impact 2017 Chinese investment in Australia

Chinese Government agencies are taking steps to strengthen their oversight of overseas investments by Chinese companies. The main considerations behind these policies are understood to be:

1. Mitigating excessive capital outflows, which are having a negative effect on the value of the RMB
2. Reducing financial risks caused by outbound investments that have not undergone appropriate due diligence, that are overly leveraged, and/or that do not make sense from a business and/or financial perspective.

Real estate, hotels, film, entertainment and sports clubs are among the industries singled out for a tendency for irrational overseas investment, according to a statement jointly released by the National Development and Reform Commission, the Ministry of Commerce, the People's Bank of China and the State Administration of Foreign Exchange.²¹

In January 2017, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) released "Measures for Supervision and Administration of Outbound Investment by Centrally Administered Enterprises" which strengthen supervision and administration of outbound investment made by centrally administered SOEs. According to media reports, SASAC is working on a "negative list" for SOEs' outbound investments, and while no draft has been released yet, a SASAC official mentioned mining, energy and heavily polluting industries as sectors in which investments by central SOEs would be strictly monitored.

On the other hand, SOEs would be encouraged to invest in fast-growing sectors including high-speed railway, nuclear power and high voltage projects in overseas

markets, as well as infrastructure and manufacturing projects such as roads, waterways, telecommunication and high-end industries.²²

Expected impact

Efforts to increase oversight and accountability for overseas investments are expected to have an impact on investment flows, particularly for non-SOE acquirers (at least in the short-term) and in sectors which are being targeted for "irrational" overseas investments.

That said, strengthening regulatory oversight and *ex ante* and *ex post* risk management of overseas investments by companies should lead to better, more value-accretive transactions for China and host countries. As such, in the longer-term, steps to promote and maintain the quality and sustainability of China's overseas investments are seen as positive.

Notwithstanding reasonable measures being implemented to manage corporate and systemic risks, we believe that over the long-term China's ODI will continue to exhibit robust growth (measured on a CAGR basis over the period since 2006), and especially into sectors and markets whose development is necessary to achieve the goals laid out in the 13th FYP. This is because outbound investment is critical for China to transform its economy and become a 'moderately prosperous society' by 2020.

The Chinese authorities have said that new measures do not signal a change in China's "going-out" policy, and that they remain supportive of non-speculative transactions undertaken by "capable and qualified" acquirers to participate in the "Belt and Road" Initiative and International Production Capacity Cooperation, to promote transformation and upgrading of the domestic economy, or to further mutually beneficial cooperation between China and other countries.

²¹ http://news.xinhuanet.com/english/2016-12/06/c_135885408.htm.

²² http://www.chinadaily.com.cn/china/2017-01/19/content_27993966.htm.

This bodes well for Australia which remains a very attractive destination for Chinese investors looking to acquire technology, expertise and high-quality products and services in sectors in which Australia has comparative advantages, such as health, tourism, education, food, services and technology. These are sectors which are seeing increasing demand from China's growing middle class and are among the key sectors whose development the Chinese Government is encouraging under the 13th Five-Year Plan.

Final word

There are already well over 500 large Chinese companies invested in Australia, with funds offshore and which continue to show interest in high quality, large scale investments and projects.

Australia also has major infrastructure investment needs across rail, road, conventional and renewable power which Chinese SOEs are still encouraged to bid for under the revised regulations.

Recent comments by visiting Chinese Premier Li Keqiang reassure us that Australia remains on good terms and is a strategically important partner for China.

Australia has a strategic opportunity to grow and diversify its already strong economic partnership with China through structural reform.

Clarity will be key for any new investment regulation that emerges from the upcoming Foreign Policy White Paper. Specific and transparent policy guidance will encourage investment and ensure partnerships between foreign and local companies continue to drive cooperation with Chinese investors.



(L-R) China's Foreign Minister Wang Yi, Premier of the State Council of the People's Republic of China Li Keqiang, Australia's Prime Minister Malcolm Turnbull and Deputy Prime Minister Barnaby Joyce at a signing ceremony in Canberra, Friday, March 24, 2017.

Source: AAP Image/Mick Tsikas.

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May 2017. OLDN15186LOBS.