

## China's Prospects Towards 2013

### - Implications for the Australian & Global Resources Sector, Australia and Australia-China Relations

www.thebeijingaxis.com

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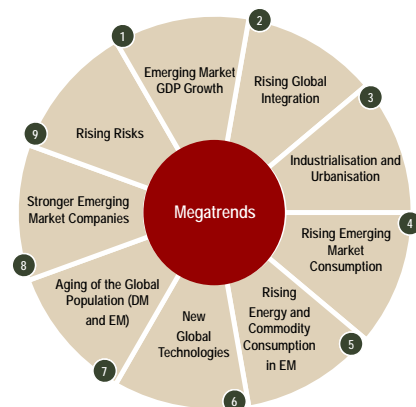
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## The Beijing Axis - China-focused International Advisory and Procurement



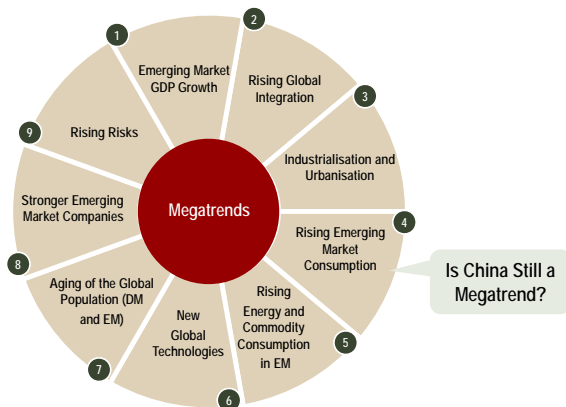
- Founded in 2002; has successfully worked with many small to large international and Chinese MNCs
- Operates in four synergistic, cross-border China businesses
- Provides services across various sectors, with a core focus on the MINING, RESOURCES, INDUSTRIAL ENGINEERING and OTHER SERVICES sectors
- Provides solutions to international firms as they act in unfamiliar territory in China/Asia and to Chinese/Asian firms as they venture out and 'go global'
- Committed to safety and sustainability, with solutions emphasising 'actions and transactions'

## A number of megatrends are reshaping the global landscape



Source: Deutsche Bank, The Beijing Axis Analysis

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Source: Deutsche Bank, The Beijing Axis Analysis

## Key global factors

### The backdrop

- China's rise ... labour market and supply shock as a producer ... engine as a consumer ... investor
- New competitive lines and forces, winners/losers – the rise of Asia, BRICS, etc.
- A two-speed global economy over the medium and long-term
- A lasting GDP trajectory in Africa, Asia and Latin America – governance, growth, stability, infrastructure, confidence, etc.

### The issues now

- Europe broken ... fragile developed markets – and knock-on effects?
- China's landing – soft or hard? Implications for growth and resource demand?
- Tapping into the China story vs. over-reliance on China and need to diversify economic ties
- Strategic intelligence – to make decisions in boardrooms around the world in order to reposition

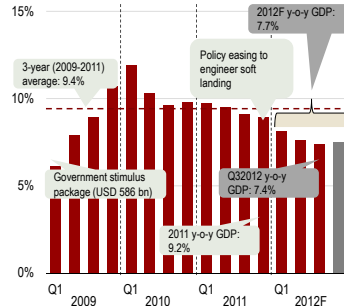
Source: The Beijing Axis Analysis

## Agenda

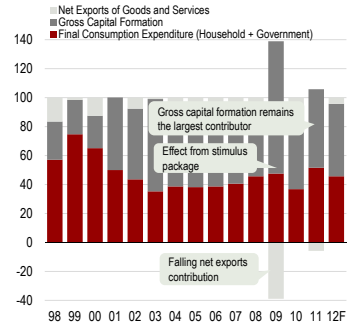
1. China's Current Growth Momentum
2. China's Changing Commodity Landscape
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## China's economy is heading for a soft landing, with the long-term trend 'more moderate and more sustainable growth'

China's Quarterly Y-o-Y GDP Growth Rate (%; 2009-2012F)



Contribution to China's GDP (%; 1998-2012F)



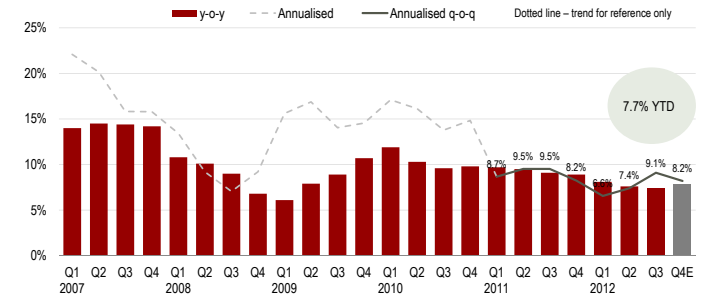
## The worst could be behind us, but do not look for a sharp rebound

### What Does Today's Data Tell Us?

Elements	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12
China Quarterly GDP (y-o-y) growth	-	-	8.1%	-	-	7.6%	-	-	7.4%
China Quarterly GDP (annualised q-o-q) growth	-	-	6.6%	-	-	7.4%	-	-	9.1%
Industrial Production Growth (y-o-y)	-	11.4%	11.9%	9.3%	9.6%	9.5%	9.2%	8.9%	9.2%
Consumer Price (y-o-y) growth	4.5%	3.2%	3.6%	3.4%	3%	2.2%	1.8%	2.0%	1.9%
Producer Prices for the Industrial Sector (y-o-y) growth	0.7%	0.1%	-0.3%	-0.7%	-1.4%	-2.1%	-2.9%	-3.5%	-3.6%
Fixed Asset Investment (excluding rural households) (y-o-y) growth	20.5%	21.5%	20.5%	18.9%	19.8%	21.0%	20.6%	20.2%	20.5%
Investment in Real Estate Development (y-o-y) growth	13.2%	14.2%	13.1%	13.7%	12.9%	13.5%	13.1%	13.2%	-
Retail Sales Growth (y-o-y)	14.7%	14.7%	15.2%	14.1%	13.8%	13.7%	13.1%	13.2%	14.2%

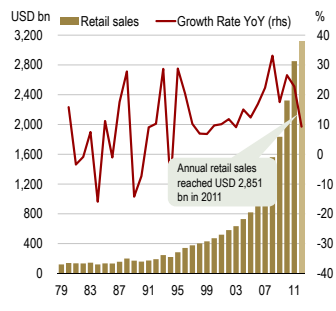
## Despite global market conditions, both the y/y and sequential annualised q/q GDP growth rates are holding up, indicating that a stabilisation is underway

China's Quarterly GDP Growth (y-o-y & annualised q-o-q\*, 2007-2012)

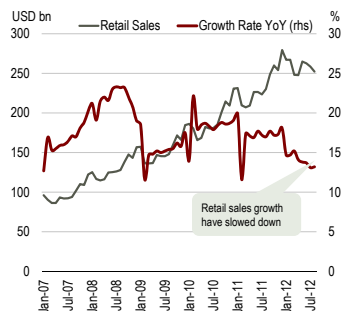


## Increased domestic consumption remains a goal of the 12<sup>th</sup> Five-Year Plan. The sharp increase in retail sales over the past decade still falls short of China's goal of making domestic consumption a key pillar of the economy

China's Annual Retail Sales (1979-2012F)

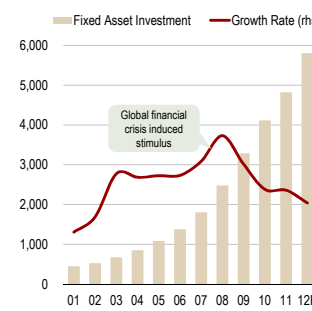


China's Monthly Retail Sales (2007-Aug 2012)

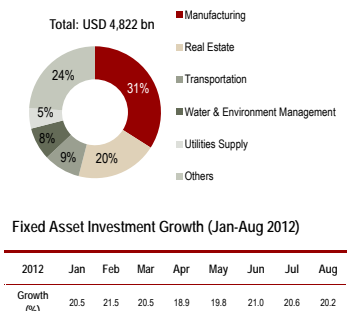


## Fixed asset investment growth has moderated but remains solid. Despite government's tightening measures aimed at the property sector, the real estate sector contributed 20% of China's FAI in 2011

Fixed Asset Investment (USD bn, %; 2001-2012F)



Fixed Asset Investment by Sector (2011)



Fixed Asset Investment Growth (Jan-Aug 2012)

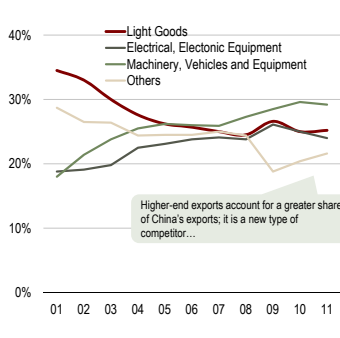
2012	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Growth (%)	20.5	21.5	20.5	18.9	19.8	21.0	20.6	20.2

China's exports have been declining due to the persistent impact of the global slowdown – Exports have been shifting towards heavy industrial goods

China's Monthly Exports & Imports (USD bn, % 2010-Sep 2012)



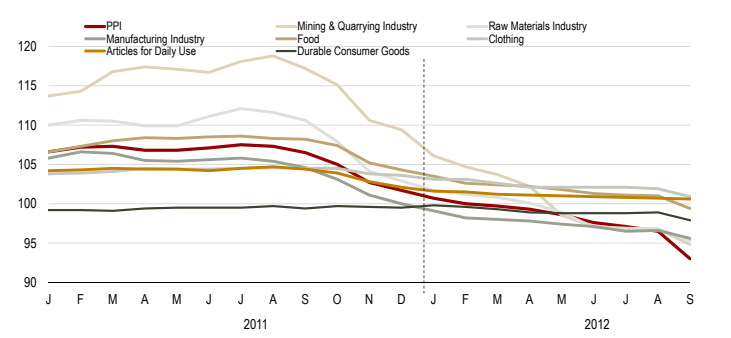
Composition of China's Exports (% 2001-2011)



\*Note: Light goods includes items such as toys, footwear, apparel, and furniture) Source: China Statistical Yearbook, China Monthly Economic Indicators, National Bureau Statistics of China, The Beijing Axis Analysis

Falling producer prices have led to renewed calls to support growth. However, there is great emphasis on the need to 'fine-tune' such policies in order to prevent an overcorrection

PPI Breakdown by Industries (2011-Sep 2012)



Source: China Monthly Economic Indicators, The Beijing Axis Analysis

After seasonal adjustment, the still-weak PMI suggests the manufacturing slowdown persists, but it has started to stabilize as the effect from policy loosening has fed through

Seasonally Adjusted PMI (Jun-Sep 2012)

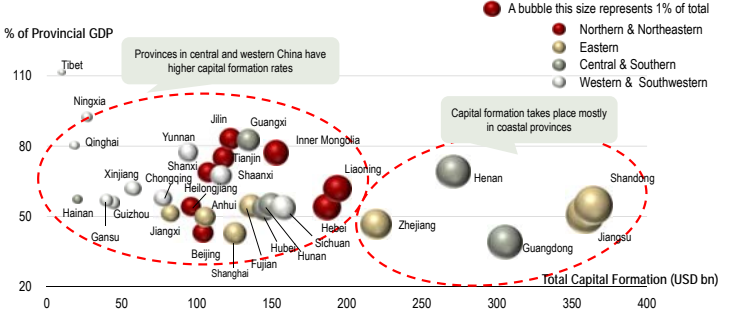
Elements	Jun-12	Jul-12	Aug-12	Sep-12
Mfg. PMI SA (weight)	50.7	51.0	50.1	49.8
New Order (30%)	50.4	51.1	50.1	49.9
Production (25%)	52.3	53.4	52.5	51.8
Employment (20%)	49.7	49.0	48.6	47.9
Supplier Delivery (15%)	49.4	49.0	49.7	49.4
Raw Material Inventory (10%)	48.3	49.3	46.4	47.0
New Export Order	47.2	46.7	47.1	47.8
Purchases	48.6	48.7	50.3	49.8
Finished Goods Inventory	50.4	48.0	49.0	48.5
Input Price	44.2	43.1	45.5	49.6
Imports	47.1	46.4	47.3	47.0
Overstock Order	44.7	43.7	45.4	45.2

- Inventory dynamics indicate destocking process likely to approach an inflection point
- Labor market remains strained
- Price pressure is intensified further
- Recovery in demand and restocking process will eventually contribute to manufacturing acceleration over coming months
- Newly started FAI project rebound and the initial positive signals from cement and other raw material sectors
- Potential reversion of de-stocking in upstream sectors lends further support to growth view for 2012

Source: Morgan Stanley, The Beijing Axis Analysis

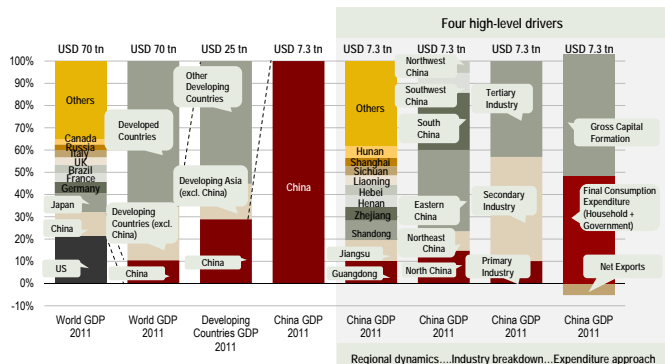
China's gross capital formation remains concentrated in coastal provinces – expect this to change as China focuses on inland/western mining and infrastructure investments – opportunity?

China's Gross Capital Formation (2011)



Source: China Statistical Yearbook, The Beijing Axis Analysis

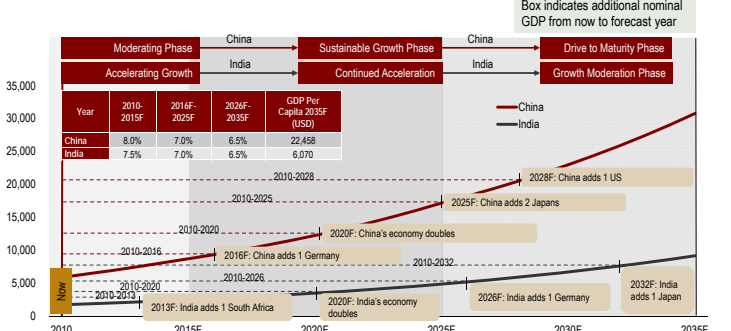
With a GDP of USD 7.3 tn, China now accounts for more than one-tenth of the world economy – and heading higher



Source: IMF, UNCTAD Statistics, China Statistical Yearbook, The Beijing Axis Analysis

China and India will add significant nominal GDP over the next 10 years and beyond, yet the type of growth will differ

China's and India's Forecast Nominal GDP (USD bn, 2010-2035F)

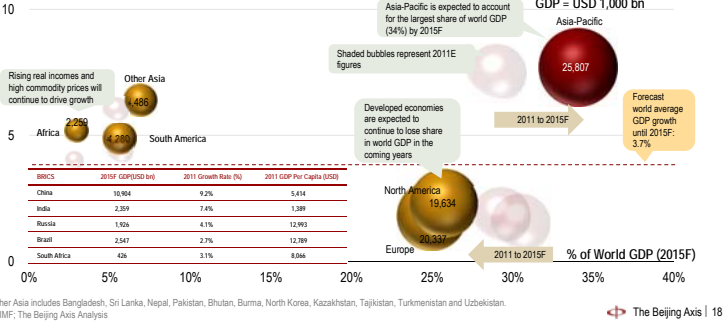


\*Note: Forecast GDP growth rate for each period listed in the graph above Source: IMF, The Beijing Axis Analysis

## Emerging economies are outperforming the developed world. The Asia-Pacific region is expected to account for one third of world GDP by 2015

### Regional GDP Comparison (2015F)

#### GDP Average Growth Rate (% 2011-2015F)



## The upshot

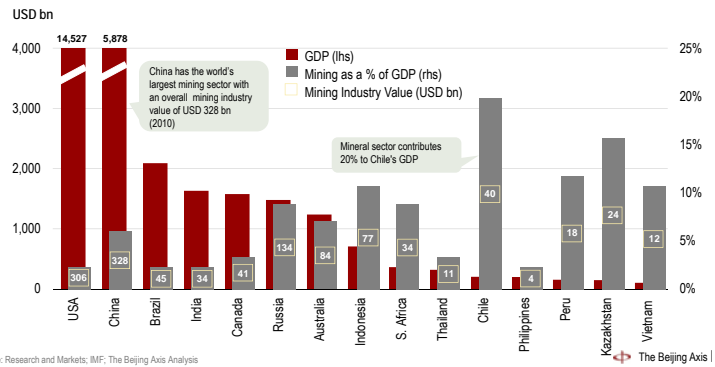
- A China slowdown has been expected and is desirable
- The current moderation makes the China growth story more sustainable
- The wildcard is the developed world – in particular Europe
- China has a long term growth trajectory ahead of it – the fundamentals are conducive to strong growth over a long period
- Investment concentration and weakened exports are putting pressure on China to expedite its move away from an investment and export-oriented growth model
- China will face the toughest policy challenges 'ever' in the next 5-10 years
- Asia occupies a far more crucial role in the global economy – the world has changed and is changing still, with many far-reaching implications
- Heightened market volatility and redistribution of global influence require a more informed and strategic decision-making process – Mexico 1994, Asia 1997, SARS 2003, GFC 2008
- Complexity and change means that resources industry becoming increasingly 'competitive'

## Agenda

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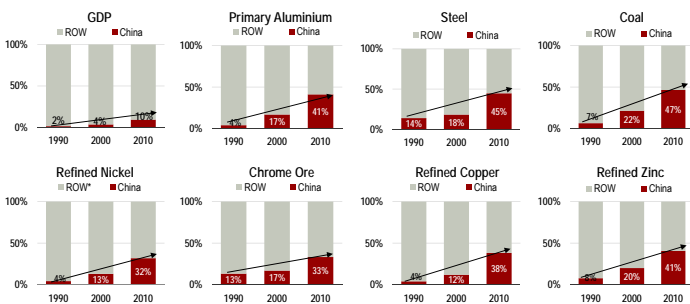
## While China's mining industry only accounts for 6% of its GDP, it is the world's largest in absolute terms

### GDP and Mining Industry as a % of GDP of Top Mining Countries (USD bn, %, 2010)



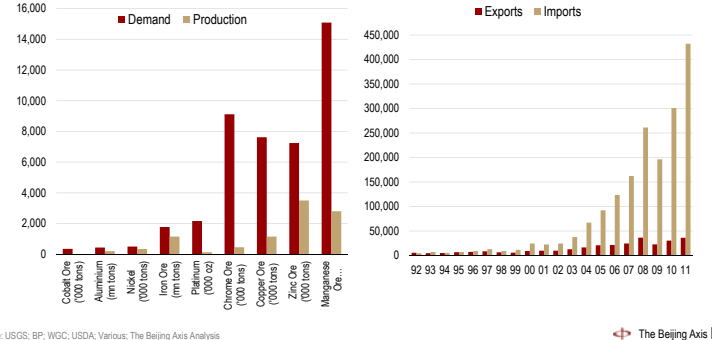
## China has dramatically increased its share of world consumption of key metals and minerals over the past two decades. Despite the economic slowdown, resource demand is expected to remain solid

### China's Share of Global GDP and Consumption of Selected Commodities (% 1990, 2000, 2010)

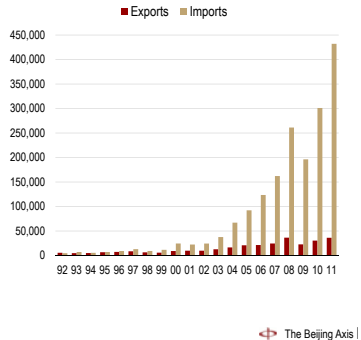


## China's demand outstrips domestic supply across a number of commodities. As a result, imports are needed to compensate for the deficit

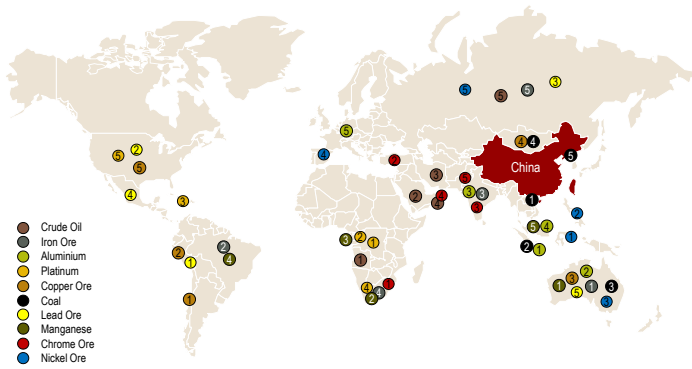
### China's Implied Demand and Domestic Production of Selected Commodities (2011)



### Mineral Product Imports and Exports (USD mn, 1992-2011)

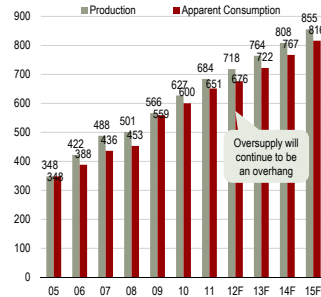


Raw material producers around the world are benefiting from this trend – Australia and Africa are key suppliers of these raw materials to China

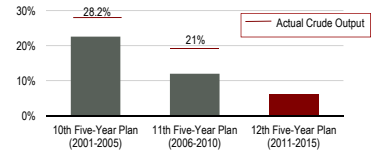


Steel consumption in China is moving towards a sustainable growth rate - Lower growth does not mean no growth. In 2012, crude steel output is likely to reach a new high even as steel prices and margins slide

China Steel Demand/Supply Forecast (mn tons, 2005-2015F)



China's Crude Output Target Growth Rate



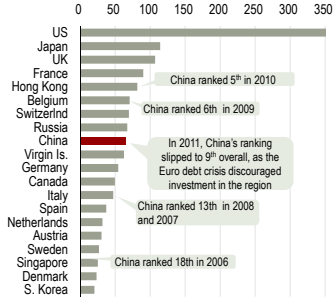
Crude Steel Production (Jan-Aug 2012)

2012	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Production (mn tons)	56.7	55.8	61.5	60.5	61.2	60.2	61.6	60.5

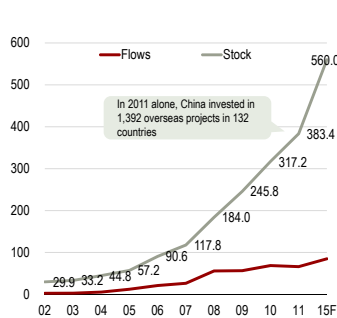
In Jan-Aug 2012, crude steel output rose to 478.5 mt

China was the world's ninth-largest investor in 2011, ahead of other Asian economies, except for Japan. China's OFDI stock is expected to reach USD 560 billion by 2015; annual outflows as high as USD 150 billion by 2015-16

World's Top 20 Outward FDI Originators, Flows (USD bn, 2011)

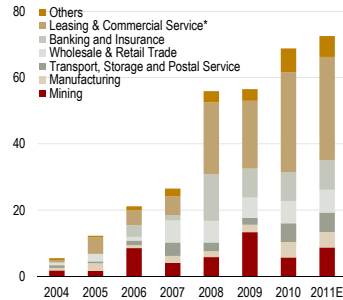


China OFDI Stock and Flows (USD bn, 2002-2015F)

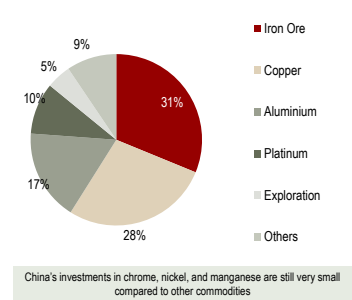


Resources occupy a key position in China's OFDI story – Taking into account the SPVs, the mining industry ranks high in overall investments

Breakdown of Overseas Investments by Sector (USD bn, 2004-2011)

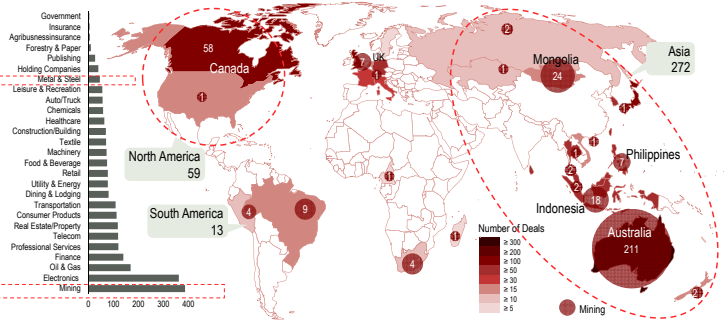


Value of China's Mining and Metals Investments by Commodity (2011)



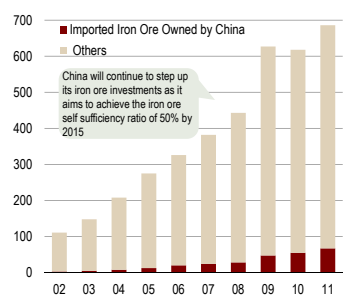
Digging down to the country level provides a more accurate picture of China's OFDI flows. Mining and oil & gas are the key targets, underlining the prominence of Australia, Canada, Africa and more recently LatAm

CHN/HK Outward Deals for Top 30 Target Countries and Target Sectors (2000-2011)



So far, China's overseas investment in mineral resources is small – China is far from being self-sufficient for the supply of key commodities

Share of Imported Iron Ore Owned by China (mn tons, 2002-2011E)



- Going forward, China Iron Steel Association announced that China would seek to derive 40% of ore imports from Chinese-invested sources by 2015 and 50 percent by 2020 driven by:
  - Over-reliance on high priced imports of the mineral
  - Shrinking profit margins for Chinese steel companies
  - Reduce its reliance on the big global miners
- It is estimated that Chinese-invested overseas sources will bring in 100 million tonnes to 200 million tonnes of iron ore annually in the coming three to five years
- Australia and Africa will remain as the key focused markets for Iron Ore investments

## The upshot

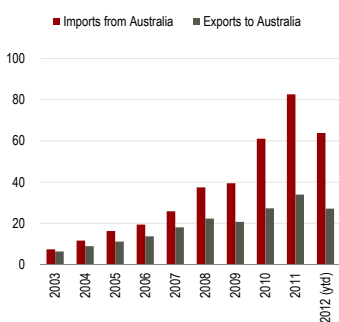
- China's demand drivers remain intact, but there are clearly more risks in the supply/demand picture
- Continuous and robust domestic consumption will drive growth moving forward – China will still be the key influence in global resource demand even at lower growth
- China's outbound capital will continue to hit the headlines – Australia has not yet seen the full impact of this
- Overseas investment is moving beyond trade facilitation and natural resources, driven by an increasing need to reach high-growth markets, brands, technology, etc. - Link and align these trends to the existing strategy
- Chinese investors proceeding more cautiously and are becoming more selective about asset quality. Valuation, cost escalation, operations in unfamiliar jurisdictions, and operational risks are the major concerns
- Resources sector will become more 'competitive' – players must out-market, not just out-produce peers – strategic marketing will be a differentiator

## Agenda

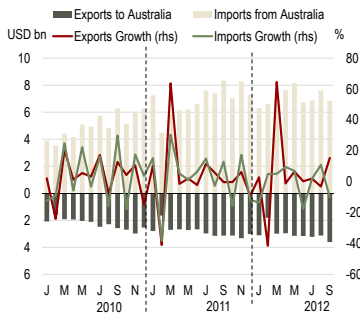
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## Australia's 2012 exports (to Sep) to China has already exceeded 2010 levels, but saw some commodity inventory build up in major ports of China

China's Annual Trade with Australia (USD bn, 2003-2012 ytd. (Sep))

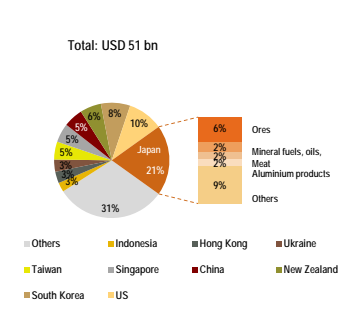


China's Monthly Trade with Australia (2010-2012 ytd. (Sep))

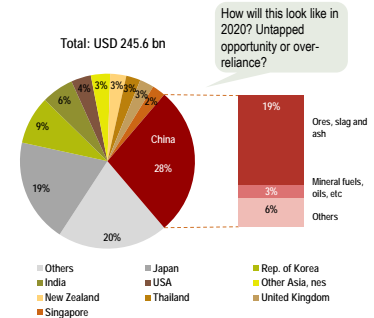


## In the last decade, China replaced Japan as Australia's largest export destination – ores make up the bulk of Australia's exports to China

Australia Export Structure (2000)

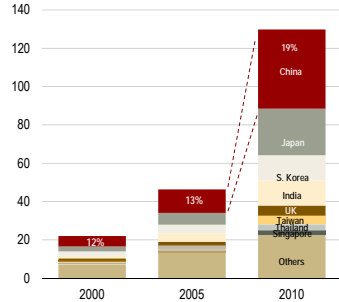


Australia Export Structure (2011)



## China plays a crucial role in Australian resource exports; similarly, Australia is ranked number one in terms of the origin of China's resources

Australian Mineral Resource Exports (USD bn, 2000-2010)

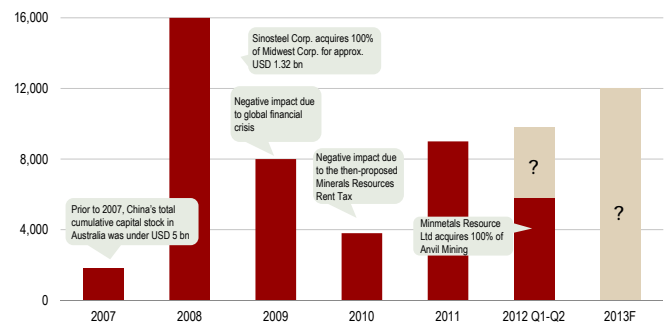


Sources of China's Mineral Resource Imports

Rank	2000	2005	2010
1	Oman	Saudi Arabia	Australia
2	South Korea	Australia	Saudi Arabia
3	Angola	Russia	Angola
4	Iran	Angola	Brazil
5	Saudi Arabia	Iran	Iran
6	Australia	India	Russia
7	Indonesia	Brazil	India
8	Singapore	Oman	Indonesia
9	Russia	South Korea	Oman
10	Vietnam	Yemen	South Korea

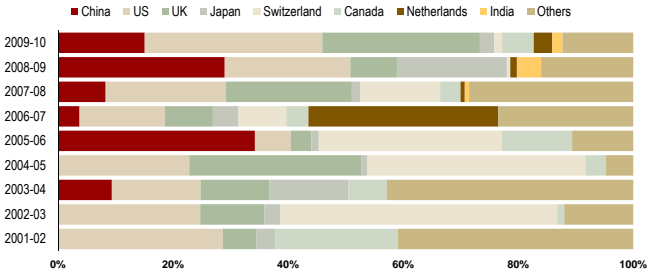
## Investment flows from China increased markedly over past 5-7 years – especially since global financial crisis – but is there push-back?

Chinese Investment in Australia by Year (USD mn, 2007-June 2012)



China is prominent in terms of FDI in Australia's resource sector. In 2010, China became the third-largest investor in Australia's mining sector, outperforming traditionally strong players Japan, Switzerland and Canada

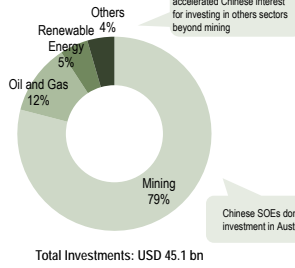
Australian Natural Resources M&A Inflow by Buyer's Nation (% share of total, 2001-2010)



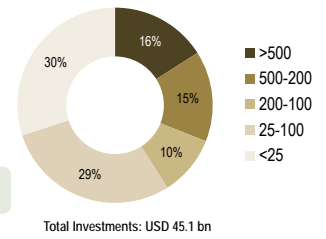
Source: FIRB, The Beijing Axis Analysis

Chinese OFDI deal sizes in Australia have been large and primarily concentrated in the mining and energy sectors

Chinese Investment in Australia by Industry (Sep 2006-June 2012)



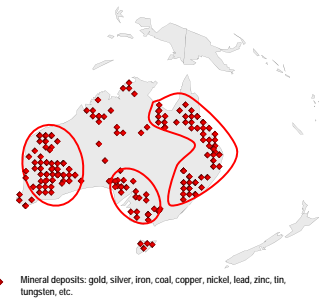
Percentage of Deals by Size (USD mn, Sep 2006-June 2012)



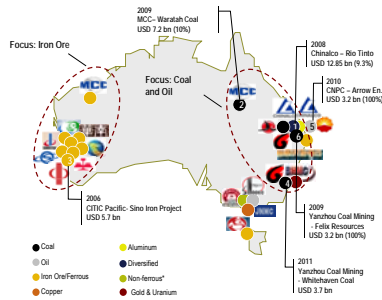
Source: Various; FIRB, KPMG, The Beijing Axis Analysis

While major Chinese mining investments by value have taken place in Eastern Australia, Western Australia plays a fundamental role in China's iron ore investments

Australia's Mineral Deposits



Major Chinese Investments in Australia (2007 - present)



\*Note 1: Zinc, nickel, lead and copper, China Minerals - OZ Minerals deal  
 Note 2: Top six deals by value are highlighted on the right hand side chart  
 Source: Geoscience Australia, The Beijing Axis Analysis

China appears among top three investors for three out of four key 'resources' in 2011

Top Buyers and Top Targets of Key Resources in 2011

Key Resource	Geographies (Headquarters) <sup>(1)</sup>		Average Deal Value	Key M&A Themes
	Top Buyers	Top Targets		
Coal	Australia (26%)	Australia (24%)	USD 871 mn	Mass consolidation in the Americas and Australia Very few transactions outside of the pure coal sector observed Coal miners remain hesitant to diversify
	China (12%)	Russia (19%)		
	US (12%)	US (17%)		
Copper	Canada (46%)	Canada (42%)	USD 193 mn	Bidding wars for high grade projects Deals to achieve vertical integration Politically charged post-deal environment
	Australia (19%)	Australia (14%)		
	China/US (6%)	US (7%)		
Gold	Canada (49%)	Canada (36%)	USD 41 mn	Consolidation in the intermediate sector Share exchanges and business combinations common Although not being among top three, China demonstrates a strong appetite for gold deals, for the first time in recent history Strong bias for politically stable jurisdictions
	Australia (15%)	US (13%)		
	US (14%)	Australia (12%)		
Iron Ore	Australia (26%)	Australia (21%)	USD 219 mn	Broadening buyer universe, inclusive of industrial conglomerates, private equity and steelmakers Commitments to build infrastructure in exchange for exploration opportunities/rights extremely prevalent Emerging market players willing to make "bigger bets" in iron ore
	China (16%)	Canada (18%)		
	Canada (15%)	China (11%)		

Note: (1) expressed as % of total buy side volumes  
 Source: PWC, The Beijing Axis Analysis.

## Australia in the future world

- Australia and China are economically inter-dependent but politically divergent – makes for a special relationship; geo-strategic and regional posture important for both sides; must think globally – about US & European alliances, but also Asia/developing world – and develop an appropriate body language
- Slow growth does not mean no growth - China will reengineer itself towards a more moderate growth phase with a different set of drivers – Commodity demand over long term remains solid albeit with risks
- Australia must tap China's large demand for commodities, energy, food, high-end manufactures, services, tourism, education and technology, etc.
- Anticipate Chinese companies' strong desire to access new growth markets, technology and brands
- Australia is in Asia – think strategically and long term about Indonesia, India, Japan, etc. Also engage with Africa, Latam – but US/Europe still important. Carefully recalibrate international economic relations portfolio...
- Australia's achievements are remarkable. What has driven that? Now double it!

Source: KPMG, The Beijing Axis Analysis

## Agenda

- China's Current Growth Momentum
- China's Changing Commodity Landscape
- Future of China-Australia Relationship
- Final Word**



## Final word

- There are new markets that matter – a new competitive landscape is unfolding. China, India, Asia, Latin America and Africa to be central in this reconfiguration
- This new world brings about key trends, new realities and strategic issues – all actors are now (re)interpreting this future to understand the drivers of 1) broad trends and 2) exceptions – get close, be informed and strategic
- Australia Inc's overall 'China-position' is solid, and will only expand. More China investment inevitable – focus on win-win, shape and quality
- This implies the need for a new strategic approach – generally 'ignoring' Asia/China (and India, Indonesia et al), Latin America (and Africa) is no longer possible or wise – in fact, there is an opportunity
  - Must see China/Asia for its full potential:
    - Sell into new, unfamiliar high-growth markets
    - Seek capital and partners
    - Find new areas for growth and project development
    - Access new technology, services and talent
    - Can we combine these forces in more deliberate collaborative models?
  - Appreciate the 'outward-looking' stance of Asian players – new global leaders are emerging in Asia and they will act in global markets
  - Win-win possible? Only if there is a different form of engagement
- Australia must drive the engagement – exploit China/Australia synergy; form a strategic China view; 'unite'; negotiate hard
- Strategic intelligence and active engagement the key in shaping the China opportunity for Australia



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### China-focused International Advisory and Procurement

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THANK YOU!

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