

China and the Global Resource Sector

China's Prospects, Impact on the Resource Sector and Implications for Boardrooms around the World

www.thebeijingaxis.com

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China-focused
 International Advisory and Procurement

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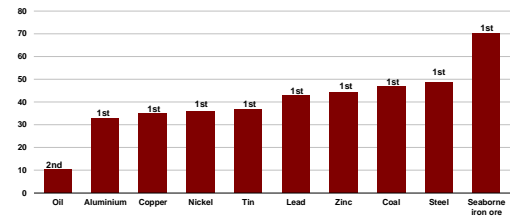


- Founded in 2002; has successfully worked with many small to large international and Chinese MNCs
- Operates in four synergistic, cross-border China businesses
- Provides services across various sectors, with a core focus on the MINING, RESOURCES, INDUSTRIAL ENGINEERING and OTHER SERVICES sectors
- 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'

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China continues to be the world's top consumer of many resources

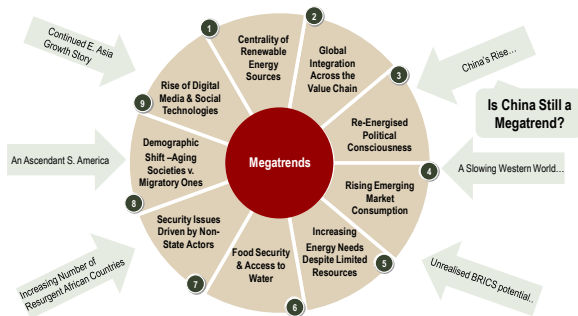
China's Consumption of Commodities as a Share of World Total (%), World Ranking, 2012



Source: BP, WBMS; Barlow Jonker; IEA; BP; Macquarie; The Beijing Axis Analysis

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A number of megatrends are reshaping the global landscape



Source: Various; The Beijing Axis Analysis

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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

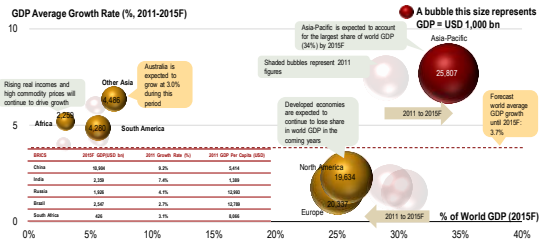
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Agenda

1. China's Prospects and the Global Context
2. China and the Global Resource Sector
3. China-Australia Relationship
4. Final Word

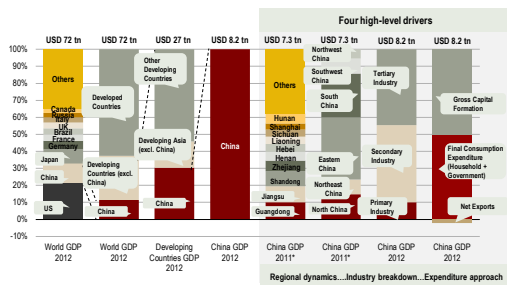
Emerging economies are outperforming the developed world. The Asia-Pacific region is expected to account for one-third of world GDP by 2015

Regional GDP Comparison (2015F)



Note: Other Asia includes Bangladesh, Sri Lanka, Nepal, Pakistan, Bhutan, Burma, North Korea, Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan and Australia. Source: IMF; The Beijing Axis Analysis

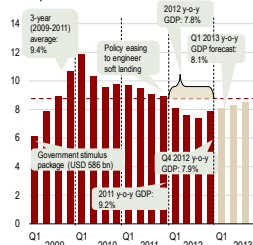
With a GDP of USD 8.2 tn in 2012, China accounted for around one-tenth of the world economy – a proportion that will keep increasing



Note: *The data for 2012 has not been released. Source: IMF; UNCTAD Statistics; National Bureau of Statistics of China; The Beijing Axis Analysis

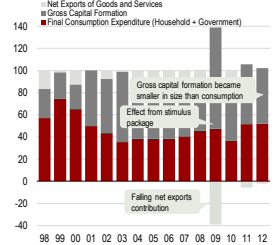
Following a soft landing, China's economy will now be characterised by more moderate and sustainable growth in the long-run

China's Quarterly Y-o-Y GDP Growth Rate (% 2009-2013F)



Source: National Bureau Statistics of China; World Bank; IMF; The Beijing Axis Analysis

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



China will experience further consumption and investment growth in 2013, buoyed by government's previous policy easing measures, but net exports will remain a drag

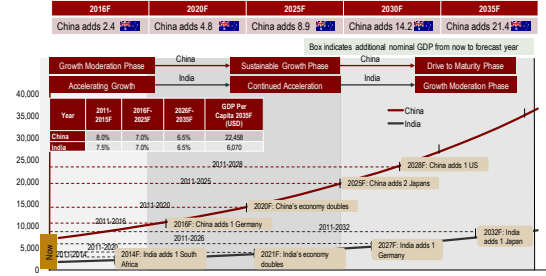
Key Indicators of China's Economy (2011-2013F)

Indicators	2011	2012	2013F
GDP Growth (%)	9.2	7.8	8.2
Consumption (%)	10.1	9.3*	9.4
GCF (%)	10.5	7.5*	8.9
Contribution to GDP (pts)			
Consumption	4.9	4.5*	4.6
GCF	4.9	3.6*	4.1
Net Exports	-0.5	-0.4*	-0.5
Foreign Trade			
Exports Growth (%)	20.3	7.9	8.8
Imports Growth (%)	24.9	4.3	12.3
Trade Balance (USD bn)	155.1	231.1	-
Current Account (% of GDP)	2.8	3.0*	1.9
CPI (%)	5.4	2.6	3.3
Retail Sales Growth (%)	17.1	14.3	14.6

*Note: 2012 Forecast. Source: National Bureau of Statistics of China; Morgan Stanley; The Beijing Axis Analysis

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

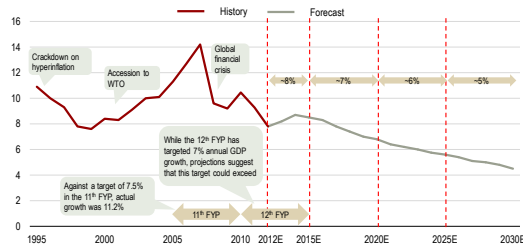
China and India's Forecast Nominal GDP (USD bn, 2011-2035F)



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

While GDP growth is likely to slow down, China will maintain solid growth momentum by transitioning from an investment-led economy into a consumption-driven and services-driven economy by 2030

China's GDP Growth and Further Projections (% 1995-2030E)

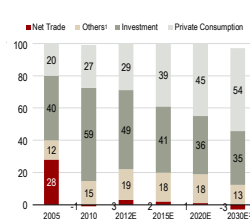


Source: McKinsey Global Economics Intelligence; The Beijing Axis Analysis

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China's investment-driven model is expected to gradually convert to a consumption-driven one

Real GDP Growth Decomposition (% 2005-2030E)



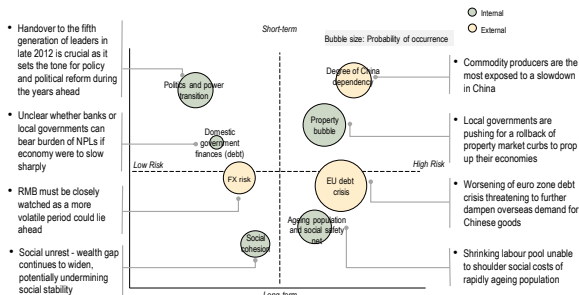
Note: Others include government consumption and inventory
Note: Numbers may not sum to 100 due to rounding
Source: Global Insights; McKinsey Insights; The Beijing Axis Analysis

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Imminent Changes

- China is starting to turn the corner to becoming an economy where private consumption will replace investment as the major driver of GDP growth
- Within the next five years, the consumers' contribution to GDP growth will gradually accelerate. In contrast, investment share of GDP growth will continue to decline
- Acceleration of growth in private consumption will result in it becoming the largest contributor to GDP growth by 2020. By around 2025, private consumption will overtake investment as the largest share in overall GDP

China faces a number of important risks on the domestic front. Similarly, the world faces a set of variables and risks as China's rise unfolds



Source: The Beijing Axis Analysis

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The upshot

- Asia occupies a far more crucial role in the global economy – the world has changed and is still changing, with many far-reaching implications
- A China slowdown has been achieved – was expected and desirable
- The wildcard is the developed world – in particular Europe
- In the meantime, a growth acceleration is visibly underway in China
- China will experience further consumption and investment growth in 2013, buoyed by government's previous policy easing measures (but inflation limits room for further easing)
- China has a long-term growth trajectory ahead of it while it faces the toughest policy challenges 'ever' in the next 5-10 years
- Investment concentration and weakened exports are putting pressure on China to expedite its move away from an investment and export-oriented growth model
- 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
- Balanced view of growth needed – moderation (not always look for extremes)

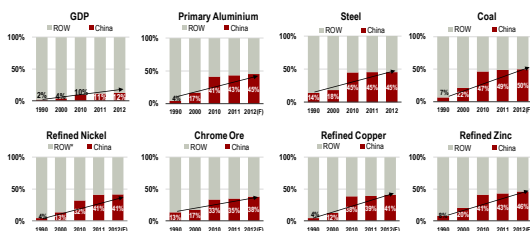
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China has dramatically increased its share of world consumption of key metals and minerals over the past two decades. Despite the economic slowdown, resource demand is expected to remain solid but variability/detail matters

China's Share of Global GDP and Consumption of Selected Commodities (% 1990, 2000, 2010, 2011, 2012)

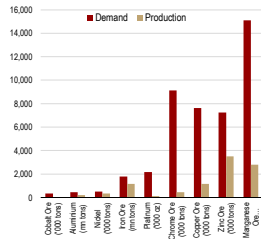


Note: ROW stands for Rest of World
Source: IMF, CHALCO World Bank, China Non-Ferrous Metals Corp, ISI, BP Statistics Yearbook 2012, ICSG, LZSG, INSG, Antiske, CNBS, CEC; The Beijing Axis Analysis

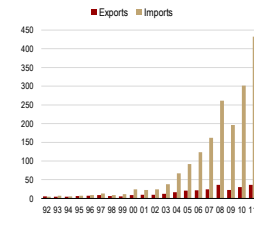
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China's demand outstrips domestic supply across a number of commodities. As a result, imports are needed to compensate for the deficit

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

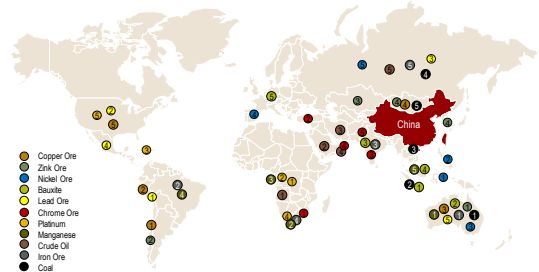


Mineral Product Imports and Exports (USD bn, 1992-2011)



Source: USGS; BP; WGC; USDA; Vaux; The Beijing Axis Analysis

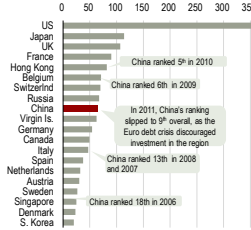
Raw material producers around the world are benefiting from this trend – Australia, Africa and Latin America are key suppliers of these raw materials to China



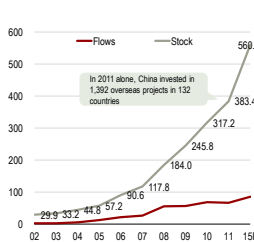
Note: The number inside the dot represents the importer's world rank. Source: UN Comtrade database; The Beijing Axis Analysis

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 ~600 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)



*Note: China OFDI flows for 2011 do not include financial investments from September-December 2011. Source: WR 2011; The Beijing Axis Analysis

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, 2002-2011)

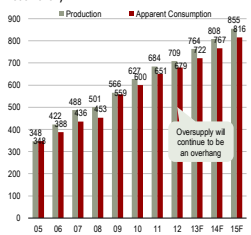


- Going forward, China Iron Steel Association announced that China would seek to derive 40% of ore imports from Chinese-invested sources by 2015 and 50% by 2020 driven by:
 - Over-reliance on high priced imports of the mineral
 - Shrinking profit margins for Chinese steel companies due to their reliance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

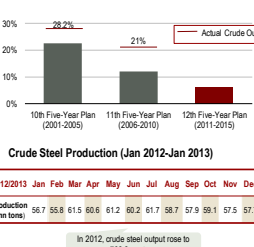
Source: Various; China Steel Association; The Beijing Axis Analysis

Steel consumption in China is moving towards a sustainable growth rate - Lower growth does not mean no growth

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



China's Crude Output Target Growth Rate



Crude Steel Production (Jan 2012-Jan 2013)



Source: CNBS; NBS; Steel Data; China Mining; The Beijing Axis Analysis

The Upshot

- China's long term demand drivers remain intact, but moderation of growth inject 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
- Trends, trends-within-trends, counter-trends, exceptions, volatility - need for superior market intelligence
- China's outbound capital will continue to hit the headlines – Australia has not yet seen the full impact of this
- Chinese investors are proceeding more cautiously and 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 – cost management and strategic marketing will be a differentiator. Getting close to end-user and CRM imperative
- CAPEX/MRO Supply
- What about access to China's resource sector?

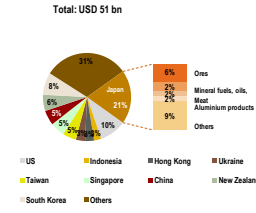
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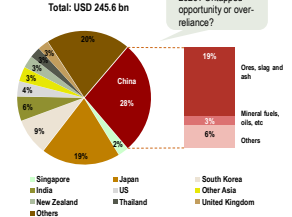
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In the last decade, China replaced Japan as Australia's largest export destination – ores make up the bulk of Australia's exports to China

Australia Export Structure (2000)



Australia Export Structure (2011)



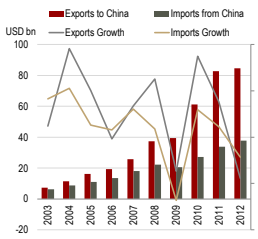
How will this look in 2020? Untapped opportunity or over-reliance?

Source: UN Comtrade; The Beijing Axis Analysis

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China's appetite for resources continues to drive trade with Australia – Expect more volatility but the long term trend is entrenched

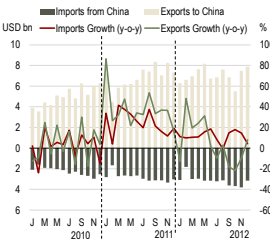
Australia's Annual Trade with China (USD bn, 2003-2012)



Source: Australian Bureau of Statistics; UN Comtrade; The Beijing Axis Analysis

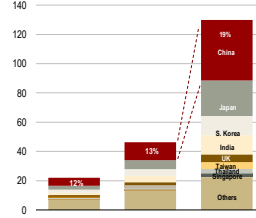
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Australia's Monthly Trade with China (USD bn, 2010-2012)



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, 2000-2011)



Sources of China's Mineral Resource Imports

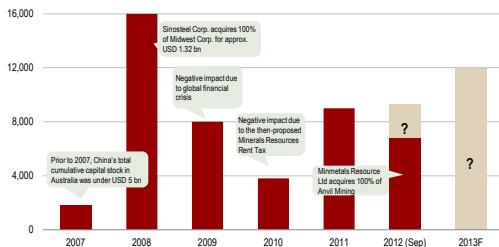
Rank	2000	2003	2011
1	Oman	Saudi Arabia	Australia
2	South Korea	Russia	Australia
3	Angola	Russia	Saudi Arabia
4	Iran	Angola	Angola
5	Saudi Arabia	Iran	Brazil
6	Australia	India	Russia
7	Indonesia	Brazil	India
8	Singapore	Oman	Indonesia
9	Russia	South Korea	Oman
10	Vietnam	Yemen	South Korea

Note: Mineral includes oil and gas. Source: UN Comtrade; The Beijing Axis Analysis

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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-Sep 2012)

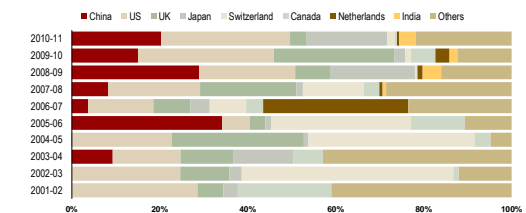


Source: Austrade; Vantage; Bloomberg; KPMG; The Beijing Axis Analysis

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China is prominent in terms of FDI in Australia's resource sector. In recent years China typically became the largest or second-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, 2001-2011)

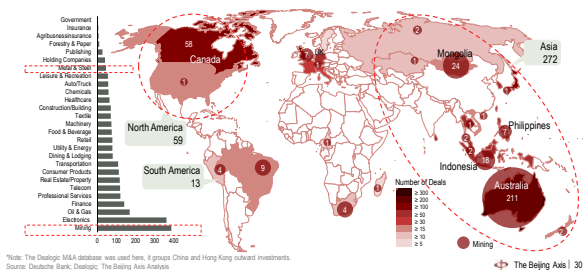


Source: FRB; The Beijing Axis Analysis

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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)



*Note: The Dealogic M&A database was used here. It groups China and Hong Kong outward investments. Source: Deutsche Bank, Dealogic, The Beijing Axis Analysis

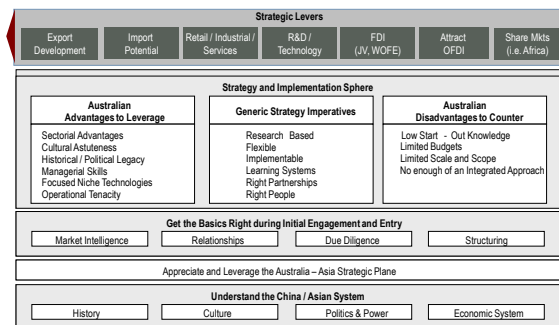
The upshot

- Australia and China are economically inter-dependent but politically divergent – geo-strategic and regional posture important for both sides; must think globally and develop an appropriate body language
- 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!

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Towards a model for thinking about strategic options in China/Asia



Source: The Beijing Axis Analysis

Final word

- China already achieved soft landing
- Growth momentum rising, but do not predict too rapid sustained acceleration in 2013/14
- Focus is on moderate, sustained growth and transformation – not rapid growth at any cost
- Australia Inc.'s overall 'China-position' is solid, and will only expand. More China investment inevitable – focus on win-win, shape and quality
- China still #1 resource driver but will play a different role. Largest growing at a solid rate; not largest + rapid growth as before. Exceptions, trends within trends, counter trends, volatility
 - Strategic intelligence is key and only listen to true experts – avoid myth, hype and orthodoxies
 - Must see Asia/China for its full potential:
 - > Sell into new, unfamiliar high-growth market segments
 - > Seek capital and partners
 - > Find new areas for project development partnering
 - > Access new technology and talent
 - > Anticipate the rise of new global competitors (e.g. Chinese car firms coming to Europe)
 - > Appreciate the 'outward-looking' stance of Asian players – new global leaders are emerging in Asia and they will act in global markets

Final word

- Australia must get the level of economic integration with rising powers right; China a key one, but not the only one (i.e. India, Indonesia, Indo-China, Africa, Latam and traditional powers)
- China's power/ambition is rising – over the long-term, Australia must balance a portfolio of international relations
- The existing China-Australia strategic plane/legacy provides a solid platform for the next stage
- Slower economic growth means that some pressure will linger in the resource sector and among service providers: service providers must strategise carefully (i.e. 'go global') – some will be acquisition targets!
- Australians 'travel well'. Now its corporations must do just that. Need to develop more executives that have a deep understanding of the Asian region and other global areas of opportunity
- Companies without global procurement strategies, marketing and investment will lose competitiveness over time - manage suppliers locally, manage supply chain globally
- Implications: develop/adapt strategic intelligence framework; transform to collaborative business models; understand the variability, volatility and exceptions; strategic marketing; supply raw materials, mfg., services to China/EM; own end-user relationships; low cost procurement; attract strategic capital
- Final analysis - winning CAPEX race was important; now winning the cost / strategic marketing race is the key



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