China's private investor

While Asian countries are generally keen to tap into growth opportunities in Australia – not least Japan – it is China's private investor that dominates the inbound deals.

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>
> **Doug Ferguson, Head of Asia and International Markets, KPMG.**

A few years back, Chinese investors into Australia were well known for the most part. They tended to be state owned enterprises (SOEs), keen to invest in the energy and resources sectors.

No longer is this the case. Over the past 24 months there has been a notable swing towards the private investor who may hail from any number of Chinese cities and has a penchant for a wide range of businesses.

"The balance between SOEs and private investors has rapidly changed over the past two years," confirms Ferguson. "The SOEs are no longer the dominant investors. While they still pull off the odd big deal in Australia, it's the private sector that is more likely to invest, whether that's in real estate, health, education or lifestyle."

KPMG research shows a 50/50 split between the two based on investment value. However, this jumps to 70:30 in favour of private investors when it comes to number of deals.

The unknown

"The interesting thing about this investor base is that you can't pick who is going to be next," says KPMG's Craig Mennie, Head of Transactions Services. "There are Chinese companies worth billions of dollars investing in Australia that yesterday we didn't know."

Mennie cites the Chinese company, Landbridge, as an example. In 2015 it acquired the 99 year lease for the Northern Territory's Port of Darwin. "Frankly, not many people would have been aware of them before doing that."

Ferguson agrees: "These companies are coming out of tier 2 or tier 3 cities in China that most people haven't heard of – let alone the company itself."

Not only are they harder to know, says Ferguson, but in general they are less experienced in global investment.

That hasn't held them back from pursuing inherently challenging deals however. "We've seen Chinese investors go from buying a block of undeveloped iron ore to developing integrated infrastructure from a gas field to a port. That cuts across a huge amount of regulatory levels at the federal, state and local level."

They have also moved into the complex domestic insurance and funds management industry, notes Ferguson, and for the first time in 2015 invested in a portfolio of Australian hospitals. "That involves the provision of health services to Australian patients so it's extremely complicated."

The middle class factor

Strong interest in a wide range of assets is evidenced by the fact Australia continues to be the second largest destination for Chinese foreign direct investment, which increased by 50 percent in Australian dollar terms in 2015 alone.

It is with good reason. Australia not only boasts ample resources in terms of energy and food, it also holds significant appeal as a destination to visit, or even migrate to. "Those people who have made their money have an aspiration to move that money offshore and to have a base not too far away from China or its time zone," explains Ferguson. "This is driving the interest in the real estate sector in particular."

Other sectors are also capturing the attention of a burgeoning middle class however. "Increasingly in the past year we've seen Chinese investment into our healthcare sector and our premium vitamins and food businesses as well," says Ferguson. "All of that ties into the middle class or upper class aspirations of the Chinese population. It's only going to be a continuing story."

Tax considerations

There are some significant tax issues that inbound investors need to be particularly mindful of when investing in Australian opportunities.

"Important to all inbound investment from overseas is the consideration of withholding tax leakage on the repatriation of profiles and income," comments Angus Wilson, Partner, Corporate Tax Deals at KPMG.

The Managed Investment Trust (MIT) regime is a means by which qualifying investors in qualifying investments are able to benefit from a reduced level of withholding or final tax on investments. "A number of qualifying investors from Asia have been able to establish or participate in MIT's when investing in Australia and as such have been able to enjoy their benefits," notes Wilson. This requires careful planning of the proposed investment structure up front.

Another key consideration is the 22 February announcement that standard tax conditions would be applied to foreign investment approvals. When the 2016 Federal Budget was handed down, the government clarified the conditions that effectively target those foreign investments that pose a risk to Australia's revenue and to make clear the requirements and expectations for investors.

The key measures include:

1. Ongoing compliance with Australia's tax laws – limited to the Foreign Investment Review Board (FIRB) 'action', and any transactions, operations or assets in connection with the assets or operations acquired as a result of the action. The clarification notes that if an applicant has a reasonably arguable position they will be seen as satisfying this condition.
2. Providing any information to the ATO required under Australia's tax laws.
3. Payment of any outstanding tax debts – it is now explicit that this condition does not apply to payment arrangements agreed with the ATO or where the ATO has exercised its discretion to defer part or all of the payment of a disputed amount.
4. Providing an annual compliance report to FIRB and within 60 days after a termination event occurring.

"These announcements highlight the increased interaction between the FIRB application process and tax affairs of the investors. It has led to the increased need for Asian investors to ensure tax structuring of investments and the tax hygiene of existing entities in Australia is managed carefully", says Wilson.

Freeing up trade

Rather than simply being an importer and distributor of goods, Chinese investors are proving keen to own the entire value chain. It is one of the notable outcomes of the free trade agreement (ChAFTA) between Australia and China.

"We've now had two rounds of tariff cuts under the agreement," says Ferguson. "That's a great opportunity for Australian companies to increase their exports to Asia but it also means Chinese corporates have a chance to invest in Australian companies – to own them and export back to China, making the most of famous Australian brands that are known for safety and quality."

It is part of a general move to invest in more sophisticated products and services in Australia. "We have seen them evolve from mining and gas to real estate and much more sophisticated services and consumer driven deal activity," says Ferguson.

He points to the Chinese sovereign wealth fund, China Investment Corp (CIC). It bought a couple of major funds from investors in 2015, including a portfolio of nine office towers from Investa Property Group worth about $2.45 billion. Mirvac Group has been chosen to manage the portfolio. "Instead of Chinese real estate developers coming into the market, they want to learn and own pools of capital."

Chinese investors have also been very interested in the Darwin and Newcastle port assets, he adds.

In search of growth

For many Chinese investors the issue is one of growth. "We've seen Chinese companies investing to overcome low growth synergies domestically. They've got surplus capital and they want to globalise their business," says Ferguson.

China's Dalian Wanda Group is a good example. KPMG advised its unit, Wanda Cinema Line Corp, in acquiring the Hoyts Group in 2015. It is part of a greater international push for China's largest private sector cinema operator. The group also bought the US cinema chain, AMC Entertainment, back in 2012. "They're the largest cinema business both in terms of cinema presentation and film production," says Ferguson. "They are globalising their business and taking advantage of value buying opportunities."

Japan buys big

Of course China is not the only Asian country intent on finding new growth opportunities. Japan with its shrinking population also has many companies expanding beyond its shores and South Korea is likely to follow suit.

Two notable deals in 2015 were Nippon Life's purchase of an 80 percent stake in NAB/MLC's life insurance business worth $2.4 billion and Japan Post's $6.5 billion takeover of Australian transport/logistics group Toll Holdings.

Both groups were driven by a desire to diversify their income resources. However, while the Nippon Life deal was two years in the making – thus allowing for extensive relationship building in the process – Japan Post happened almost overnight and was primarily an opportunistic play.

Not that a low Aussie dollar is having a noticeable impact on inbound investment yet, Mennie says: "My view would be that currency hasn't played a big part up till now. I think it will in the future and I do think we will see more opportunistic buys."

The Nippon Life/NAB deal, on the other hand, reflected a deep seated interest in financial services in Australia and worldwide – an interest evidenced in North America and among Asian investors in general.

That includes China with its seemingly limitless funds. "We've had Chinese investors ask if they can buy one of the big four banks," says Mennie. "So that shows the kind of interest they have and their ability to invest."

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