Changes in Chinese Investment in the International Minerals Industry

Matthew Greentree[1], Louis Bucci[2], Gavin Chan[3]

[1] *Principal Consultant, SRK Consulting Australasia, 10 Richardson Street, West Perth, WA Australia 6005*

[2] *Principal Consultant & Director, SRK Consulting Australasia, 365 Queen St, Melbourne, Victoria Australia 3000*

[3] *General Manager, SRK Consulting Hong Kong, Suite A1, 11/F, One Capital Place, 18 Luard Road, Hong Kong*

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China is the world's second largest economy and has become one of the largest consumers of mineral resources (World Bank, 2013 & WTO, 2013). Despite being one of the major global mineral resource producers and importers, China faces a relative shortage of resources. In order to sustain the development of China's economy, the government has set out a "Going Out Policy" to encourage Chinese companies to diversify their reliance on importing key commodities through the open market, by investing in resource companies and assets overseas (China State Council 2006).

The increase in China's demand for mineral resources in the past few decades has been the dominant contributor of the growth of the global resource industry. In 2011, the value of mineral imports into China totalled USD240.5 billion (WTO, 2013). China has become the key importer for several key commodities, and in 2012, China imported 289 million tonnes (Mt) of thermal coal, 743.55 Mt of iron ore and 4.65 Mt of copper (Wong and Lian, 2013).

In addition to imports, China tops the global foreign investment list for the energy and minerals sectors, with a cumulative total of USD99.3 billion in investment in mining and exploration projects (Figure 1, Heritage Foundation, 2013). The Australian mining industry has been a significant recipient of this investment, totalling USD36.87 billion since 2006 (Ferguson and Hendrischke, 2013). Other regions receiving significant investment include Africa (USD 22.76 billion), South America (USD17.23 billion) and broader Asia (USD18.8 billion; Heritage Foundation, 2013).

Iron ore, coal and copper exploration and mining companies are the main recipients of direct Chinese investment. Australian examples of such investment include Roy Hill (off take agreements with Shougang Group and Yaxin Steel signed in 2012), ongoing investment in the New South Wales Coal industry by the Yanzhou Coal Mining company Ltd through their stake in the ASX listed Yancoal (2005), and more recently the purchase of the North Parkes copper – gold Project by the privately owned China Molybdenum (2013). Chinese investment in the mineral resources sector is also influenced by a variety of other factors, including: vertical integration of downstream manufacturers (e.g. Baosteel, Talison Lithium); power utilities securing fuel supply (e.g. Guangdong Nuclear Power Groups acquisition of Extract Resources) or a company's strategic position on a particular commodity (e.g. Focus Minerals placement to Shandong Gold).

Foreign investment by Chinese companies has traditionally focused on advanced resources projects and / or companies with established mining operations. By direct investment in established organisations with successful operations, Chinese companies have been able to inherit effective western work practices, experienced management and compliant reporting practices that adhere to local regulatory requirements and the expectations of western investors. However, there is a growing trend towards investment in projects at earlier stages of development. Investment into early stage exploration includes such companies as the ASX listed Chinalco Yunnan Copper Resource Ltd, Sovereign Gold Ltd, Dragon Energy Ltd, Zeus Resources Ltd and Energy Metals Australia Ltd. Investment in such early stage exploration primarily represents a higher-risk strategy with respect to likely discovery and successful transition to production. However, this is countered by the relatively high returns with discovery. In these examples, it is noted that management and senior technical staff are from both Chinese and local backgrounds. This provides representation for the major stake holders and gives the company local industry project management and regulatory reporting experience.

Exploration and mining companies operating in China rely on a set of prescriptive Chinese National Standards when exploring, developing and reporting resources projects. Each commodity type and mineralization style has been allocated its own set of National Standards, and these differ relative to International Standards (e.g. those defined by CRIRSCO, 2013) in both their underlying principals and nomenclature. The primary difference is that the Chinese National Standards are a prescriptive set of work programmes for exploration and “Resource / Reserve” estimation that must be followed in order to allow definition of a particular “Resource / Reserve” category, and to assess the “economic viability” of a project (Bucci *et al*, 2006). In contrast, International Reporting Standards following the CRIRSCO template (e.g. JORC, CIM, SME, PERC and SAMREC) are non-prescriptive, and rely on the discretion of a Competent or Qualified Person (CP or QP) in regards to the implementation of appropriate exploration programmes and Resource / Reserve estimation parameters and procedures.

Due to their requirement to adhere to the Chinese National Standards, Chinese companies and State Owned Enterprises (SOE) typically approach the exploration of minerals projects outside of China in a similar manner. This is not a significant issue if the project has a history of public reporting, with an ongoing CP / QP taking responsibility for the work. However, Chinese companies bringing a Chinese project on major international stock exchanges (ASX, TSX, JSE, LSE/AIM, HKEx or SGX), will need to meet the disclosure and reporting requirements of the relevant bourse. This generally requires an assessment of whether the exploration and “Resource / Reserve” estimation work carried out under the Chinese National Standards is compliant for public reporting. This requirement for reconciliation between standards is often difficult for many Chinese companies to rationalize, and can often be time-consuming and expensive. For example, additional work is commonly needed, including drilling, Resource re-estimation, and technical studies to meet the differences between the Chinese and CRIRSCO defined feasibility studies. Despite this challenge, there is a trend for more Chinese companies to take their assets to international bourses, in particular exchanges in the Asian and Oceania regions (ASX, HKEx and to a lesser extent SGX). Although the reasons for listing may vary, this trend allows western markets to participate in the growth of the asset, and provides the Chinese investors a vehicle in which to vend earlier stage projects.

Chinese direct investment in the minerals industry compliments both the local demand for minerals and the Central Governments "Going out" Policy. Investment in mineral projects is attractive for both Chinese mineral resource companies and those wishing to expand their production, as well as downstream customers looking to secure their supply chain through vertical integration. Projects in more developed economies such as Australia, already a major supplier of key commodities, have already received a large share of this investment. However, Chinese investment has moved to capitalise on early stage exploration, and this change in strategy brings challenges seated in both opportunity and risk. Risks for the Chinese Investor include the sectors notoriously low rate of discovery success, and challenges in adaptation to different exploration philosophy, practice, and public reporting offshore. This is balanced by the opportunity to subscribe to projects at the earliest stage of the value creation pipeline. Of course, the change also provides an opportunity for the western world to continue to participate in the growth of China, not only as a supplier of key commodities and as a recipient of investment capital, but also as an investor in the often well-funded exploration vehicles that China is bringing to foreign markets.

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ASX: Australian Securities Exchange

TSX: Toronto Stock Exchange

JSE: Johannesburg Stock Exchange

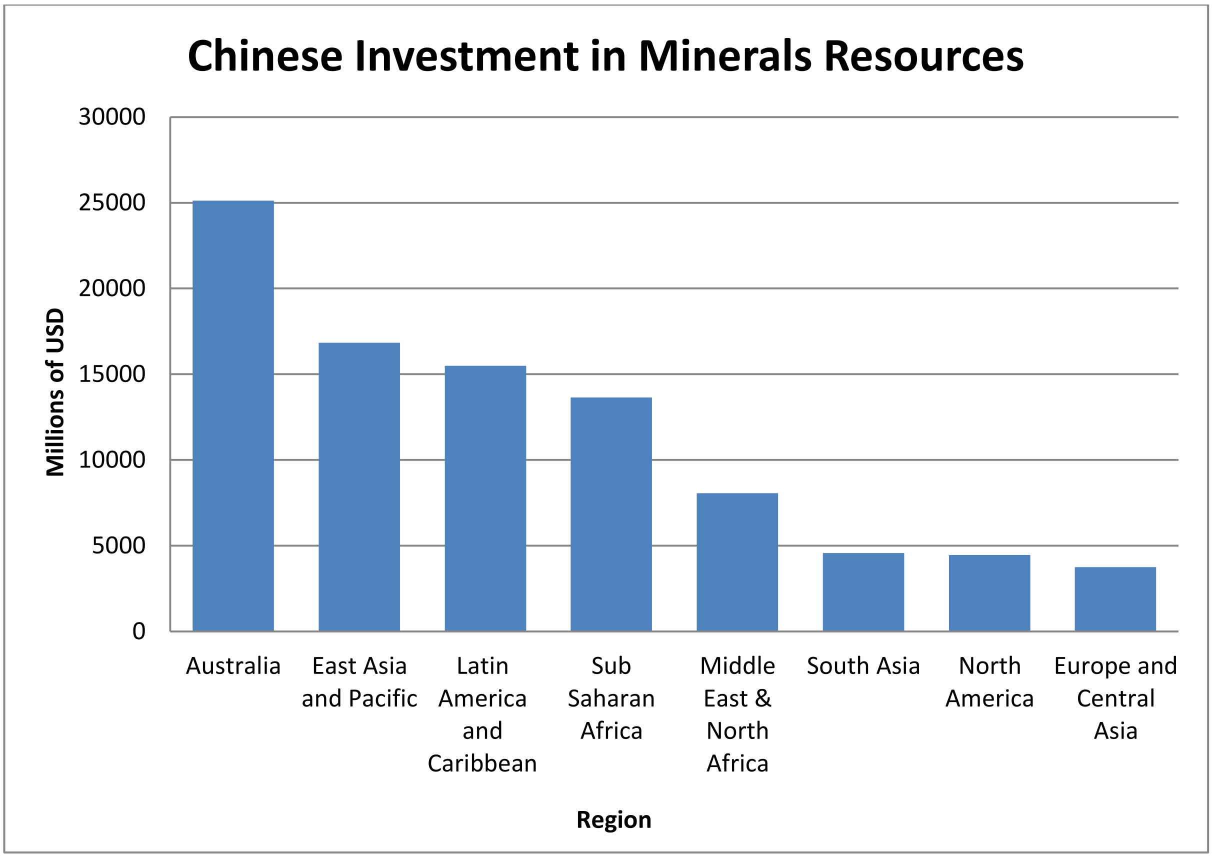
LSE: London Stock Exchange

AIM: Alternative Investment Market

HKEx: Hong Kong Stock Exchange

SGX: Singapore Stock Exchange

Figure 1. Chinese investment in the resource industry greater than USD 100 million, by region between 2005 – 2012 (Heritage Foundation, 2013)



For further information contact: info@srk.com.au