NEW ZEALAND CHINA COUNCIL

Investment Report : Fostering Growth

Contents

FOREWORD

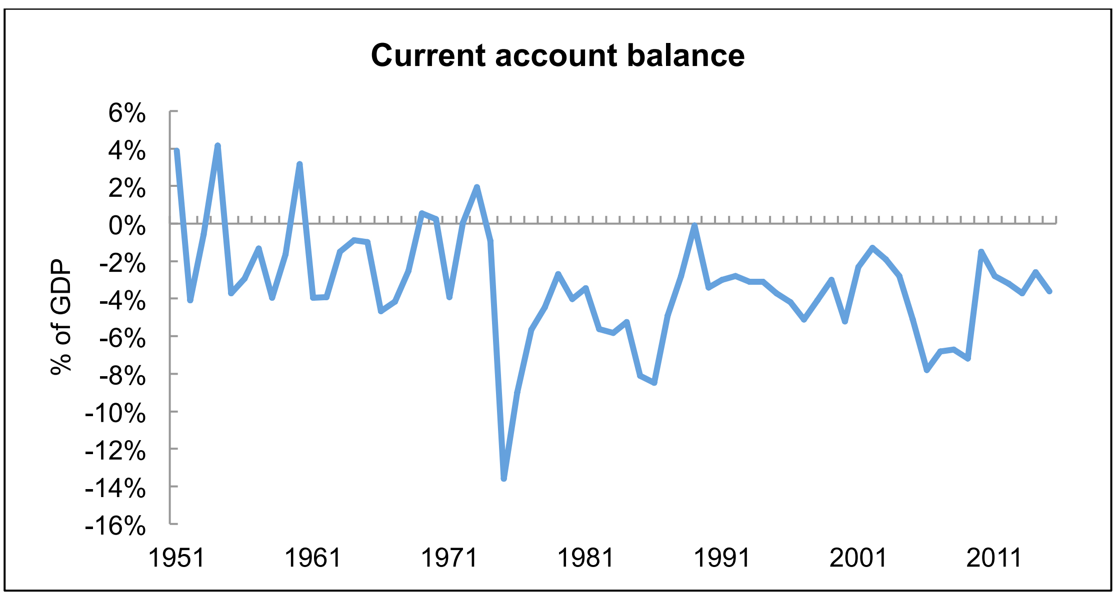
Globalisation has many characteristics. While trade in goods is the most obvious, the international flow of capital has long been an essential part of globalisation. But the flow of capital, particularly the inflow of capital, is often treated with suspicion on nationalistic grounds.

There are two main angles from which to consider capital flows: economic and political.

The economic case is heavily skewed in favour of the free flow of capital. The literature is overwhelmingly in favour, while a small minority suggest little net benefit.

The inflow of capital fills the gap between domestic savings and investment. For New Zealand this has been a longstanding issue. New Zealand's current account balance - which measures the shortfall in domestic savings that is met by foreign capital inflows - has been in deficit most years since records began in 1951.

Figure 1: New Zealand has consistently borrowed capital from overseas through decades of current account deficit



Source: Statistics NZ

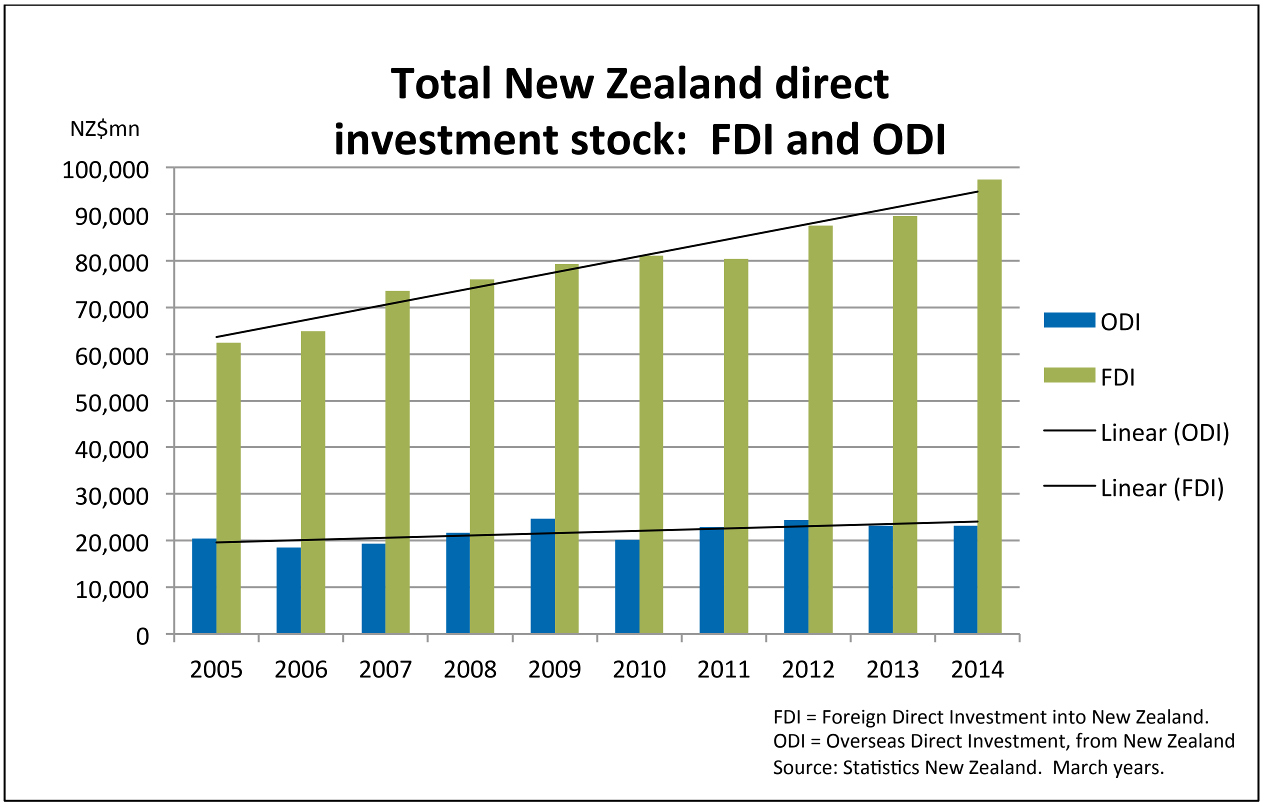
New Zealand has relied on foreign capital over a prolonged period to increase the productive capital base of the economy, which in turn has contributed to jobs and economic prosperity.

The international flow of capital - in the form of direct investment as opposed to debt -tends to be accompanied by management expertise, market access and other factors that may not be available in the recipient business or country. These tend to be the main benefits of Foreign Direct Investment (FDI).

Joint ownership of capital also strengthens the ties between the two parties in a business relationship. This effectively reduces the 'distance' between them, improving returns to both. A large body of literature shows that the more closely two markets are connected, the more mutually beneficial it is for both economies.

Similarly, the outflow of capital allows investors to own businesses and control the value chain to maximise profits. This is something that New Zealand does not yet do well. While New Zealand is a strong performer in merchandise trade (considering the size of our economy and distance from markets), we under-invest globally. This may reflect a scarcity of capital in New Zealand, but it is also a lost opportunity.

Fig 2: Comparison between New Zealand's FDI and ODI stock



Investing globally creates access to markets and supply chains that can help add more value to local production. This is because the most value is often created at the points in the supply chain that are closest to the customer. Ownership and control of the value chain also allows protection of intellectual property which is, more often than not, the source of ultimate value in the modern economy.

Criticism of foreign capital flows, in both economic and general literature, tends to focus on questions of sovereignty and political influence. The history of colonialism is characterised not only by the political and military subjugation of the colonised nation, but also an appropriation of its economic and productive assets. Fears of a modern form of economic colonialism have been sparked by successive global waves of capital investment, led by the US in the 1970s, Japan in the 1980s and most recently China. In each instance there is a fear that foreign investors will buy up businesses, land and buildings at prices that locals cannot afford, making the locals tenants in their own country. However, in most instances, these fears have proven unfounded.

Such fears are well founded in countries that lack strong institutions and an independent judiciary. Under these circumstances, potential for the extraction and abuse of ownership rights is high.

Global capital flows have increased massively over successive decades – accompanied by increased global prosperity. The positives have generally outweighed the negatives. Operating within a strong institutional framework and an independent judiciary, the advantages of FDI outweigh the disadvantages. New Zealand is fortunate to have some of the best economic settings in the world. By making better use of FDI, in terms of welcoming inflows and wisely investing offshore, New Zealand can boost prosperity at home.

Shamubeel Eaqub

Aotearoa Development Cooperative

EXECUTIVE SUMMARY

This report explores the past, present and future investment relationship between China and New Zealand. The purpose of this report is to stimulate discussion about ways to improve the strong foundation that this relationship has been built upon. The goal is to encourage and facilitate future growth in two-way investments that are mutually beneficial for both countries.

Like China, New Zealand has relied heavily on foreign direct investment (FDI) to grow its economy and develop the infrastructure needed to process and export high quality products to international markets. In comparison to other small developed economies, New Zealand's stock of FDI as a percentage of GDP remains relatively high, while overseas direct investment (ODI) is relatively low. It has been this way for many decades. In contrast, China's rapid economic development over the last 30 years sees it positioned to become a net exporter of capital in the very near future.

Although China has not traditionally been a large source of FDI into New Zealand, the rate of growth and scale of investments is rapidly increasing. Looking forward, the challenge for New Zealand is to guide FDI from China into sectors of the economy where capital is most needed and creating long term alignment of interest between the Chinese and New Zealand counterparties. These sectors include: primary industries, premium food and beverage, tourism, specialised manufacturing, infrastructure, oil, gas and mining, ICT/digital and shared services. Ideally future FDI will bring more than capital to New Zealand but will also enhance business opportunities through deeper and longer term relationships and improved access to people, skills, know-how or market access.

The growing number of large scale investments from China is a testament to the openness, and willingness of New Zealand to welcome high quality capital investment. New Zealand even offers attractive migration options for investors who meet certain capital requirements. In order to protect the quality of large scale investments, New Zealand has a thorough review and approval process before large or sensitive investments can proceed.

As an economy reliant on export income, New Zealand businesses must explore ways to increase ODI and build a stronger physical market presence in China. By doing this, there will be more opportunities for New Zealand businesses to add value to their exports by being closer to the large and increasingly affluent Chinese consumer market. Efforts to expand value adding business operations in China are currently being pioneered by a small number of New Zealand companies.

The case studies presented in this report are by no means an exhaustive list of the two-way investment activity between New Zealand and China. New and exciting investment projects are continually being announced. As future investments are made, updates to this report will be published on the NZ China Council website[1]. Recommendations on ways to improve the investment relationship discussed at this forum will also be included.

The full potential of the two-way investment relationship can only be reached if continued efforts are made to open up further opportunities for communication and information sharing. The 2015 New Zealand-China Partnership Forum presents such an opportunity. The productive dialogue and friendships established at this event will no doubt further support the future development of this important investment relationship.

Parley Reynolds

China Market Analyst

New Zealand Trade & Enterprise

[1] www.nzchinacouncil.com

NEW ZEALAND & CHINA AS GLOBAL INVESTORS - 'THE BIG PICTURE'

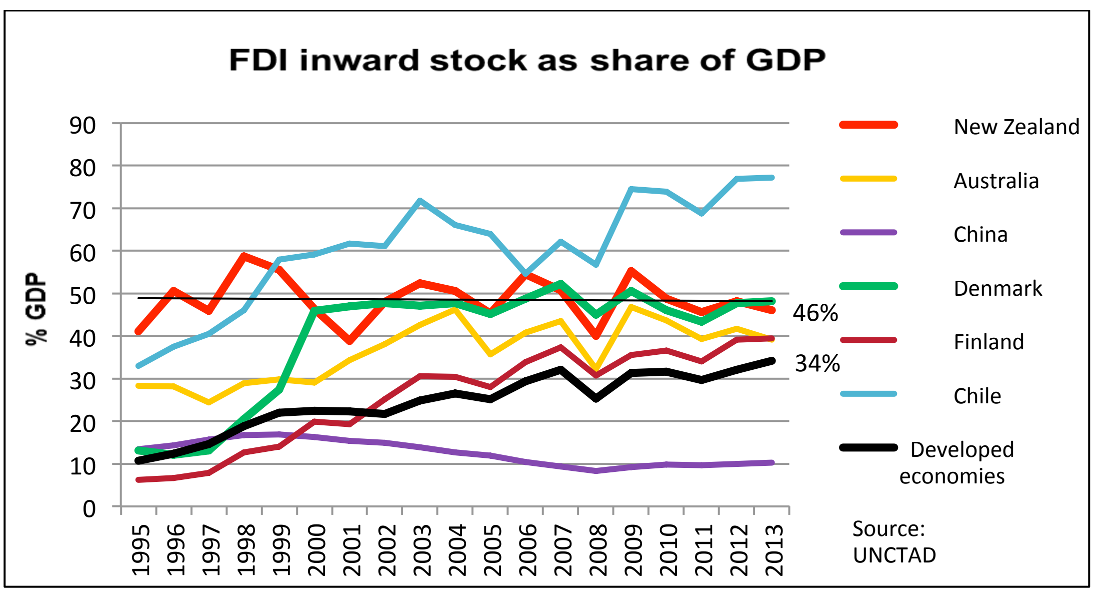
New Zealand

New Zealand has long been open to foreign investment. In the last 200 years New Zealand has been heavily reliant on foreign investment for national development projects. With a small population and a relatively large geographic area, reliance on New Zealanders' savings alone has never been realistic. But we're not just interested in the money, or even simply the additional jobs created by foreign direct investment. We want the ideas, the technologies and the new business opportunities that go with investment. These are the things that will create a stronger platform for sustained growth and prosperity over the long-run.

New Zealand faces a well-known productivity challenge, and it's likely that one of the contributing factors is our distance from other centers of innovation. Cheaper transport and communication technology have helped to close the gap, but concentrating economic activity in particular locations is still a key way of increasing productivity. This reinforces the importance of making sure that Auckland, our only global city, works well as our main physical point of connection to the world. The rise of emerging markets in the Asia Pacific region and particularly China has put us closer to the action, but Auckland is still no closer to cities in Asia than cities in Europe. We have to find other ways to bring the world closer. Foreign direct investment (FDI) is part of the answer, in that it often brings new thinking and skills from other parts of the world.

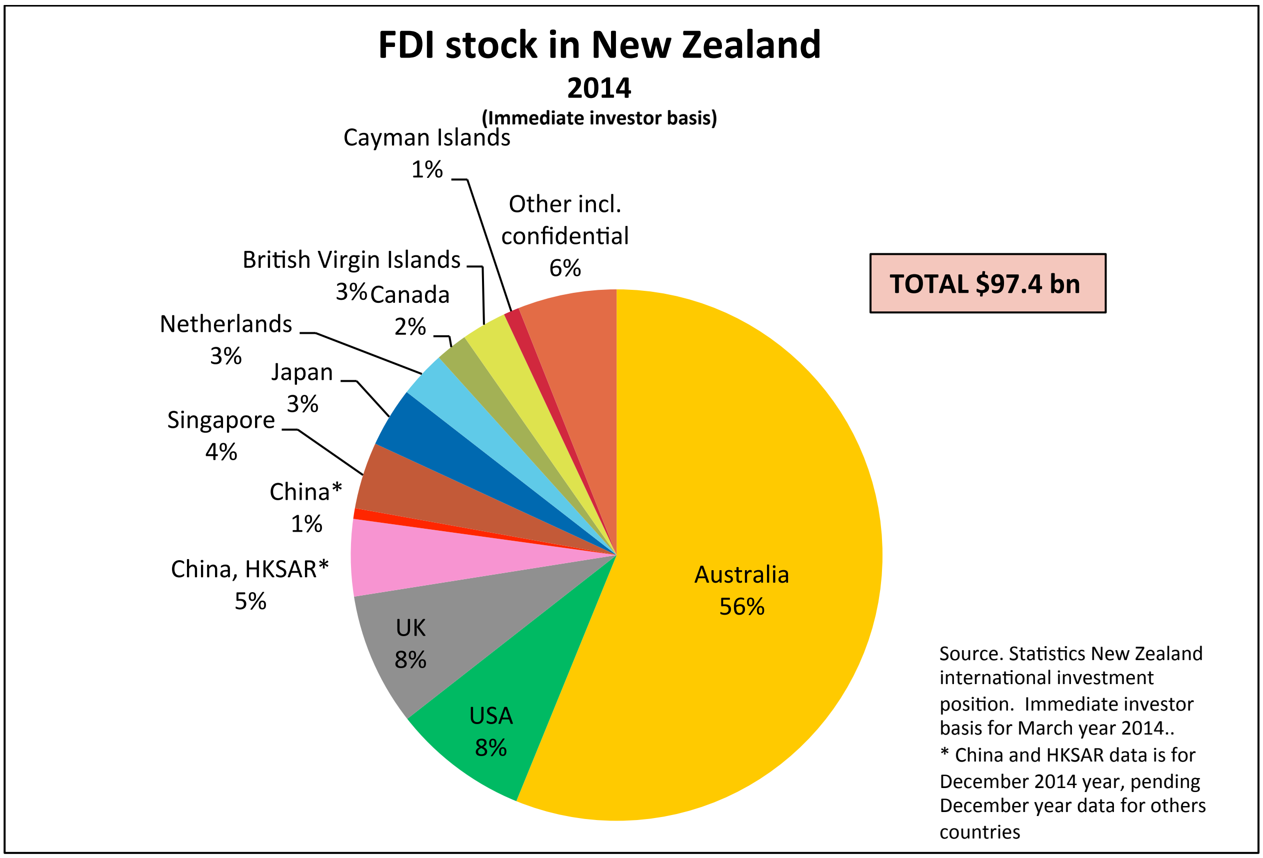
New Zealand is sometimes perceived as "not open to FDI." In fact, the opposite is true. The New Zealand economy already has a high penetration of foreign investment. Over the last twenty years, foreign direct investment has averaged around 50 percent of GDP, one of the highest levels globally among comparable small, open economies.

Fig 3: New Zealand's ratio of FDI to GDP



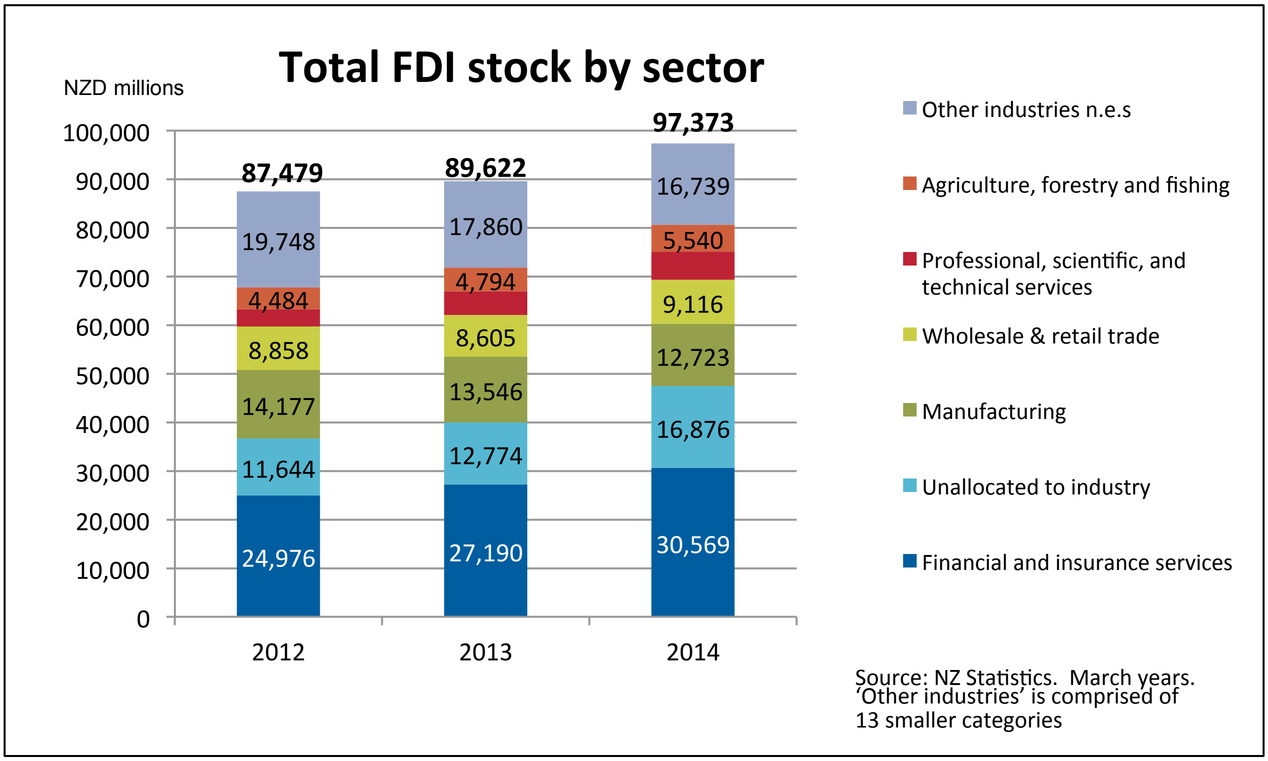
Statistics New Zealand data for the year ending March 2014 indicates that the main source of FDI into New Zealand is from Australia. This is not surprising given its close proximity and close trade ties with New Zealand. Traditional investor countries such as the USA and the UK are tied in second place at about 8% each. China, including HKSAR, is now in fourth place with $5.3 billion, nearly 6% of the total (pink for HK and red for China). It is interesting to note the importance of tax effective jurisdictions like Singapore and Holland. The British Virgin Islands and Cayman Islands together comprise 4% - $3.65 billion - of FDI in New Zealand FDI from these regions is more than the FDI from Japan 3% ($3.5 billion).

Fig 4: China is now New Zealand's fourth largest source of FDI stock



FDI in New Zealand is diversified across a number of sectors. Although the New Zealand media tends to focus on politically sensitive foreign investments that involve the sale of New Zealand land, the sector of the New Zealand economy that attracts the most FDI is the financial and insurance services sector. New Zealand's major banks are all owned by parent companies based in Australia.

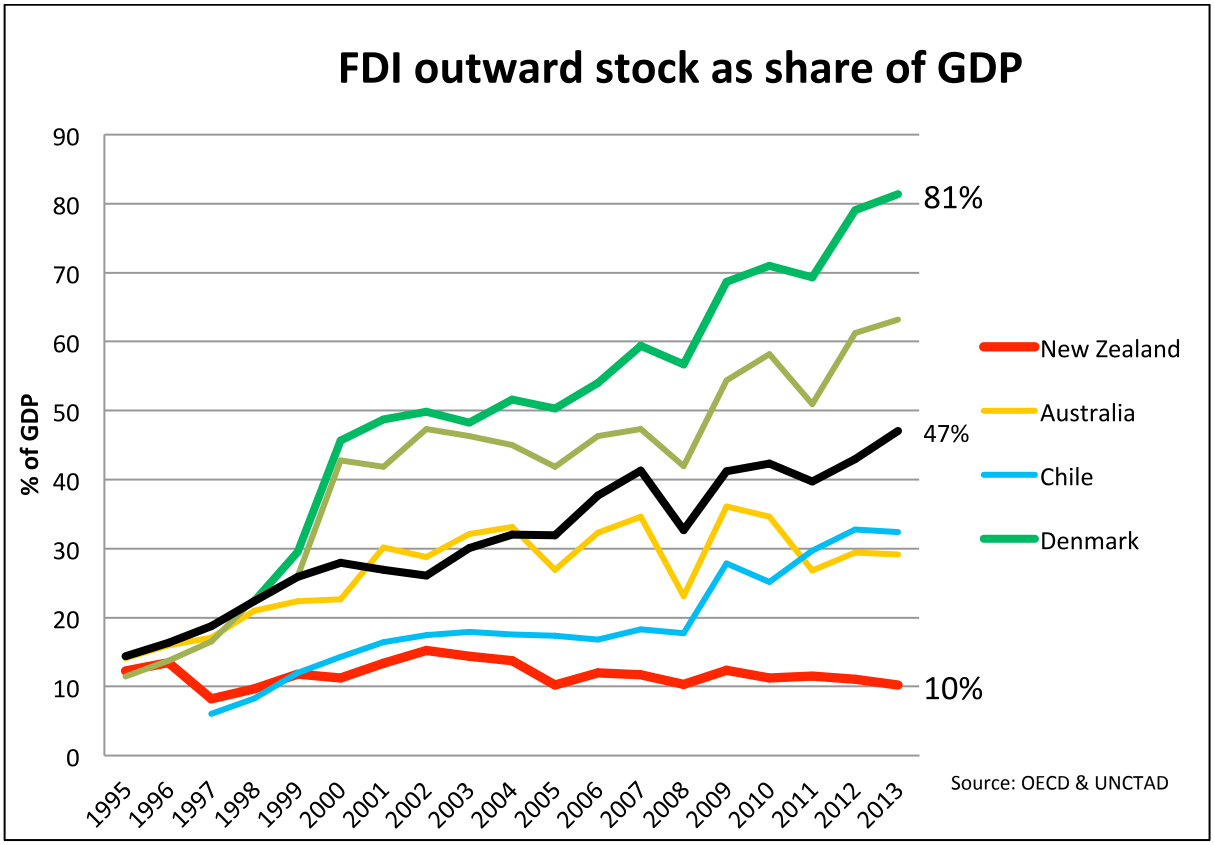
Fig 5: FDI in New Zealand by sector (year ending March 2012 – 2014)



By March 2014, the stock of New Zealand's FDI was NZD $97.3 billion. In contrast, the stock of ODI from New Zealand was only NZD $23.1 billion. To compound matters further, New Zealand's returns from ODI tends to be much lower than what foreign investors achieve in New Zealand. An assessment from ANZ Bank economists suggests that if ODI returns to New Zealand companies matched the FDI rates achieved in New Zealand by overseas firms, NZD $2-3 billion could potentially be added each year to the New Zealand economy.[2] ODI can help New Zealand businesses to shorten supply chains, get closer to customers, increase returns, and potentially open up new sources capital. However, New Zealand's ODI to GDP ratio is declining while in most other developed economies, ODI is increasing. Prior to the mid-1990s, New Zealand's ODI was similar to comparable economies. In 1995, New Zealand's ODI to GDP ratio was around 10%. In 2013, it was still 10%.

[2] Capital Markets: The new big O.E., NZ Herald, 14 May 2015. David Green - Managing Director ANZ.

Fig 6: New Zealand ODI as percentage share of GDP



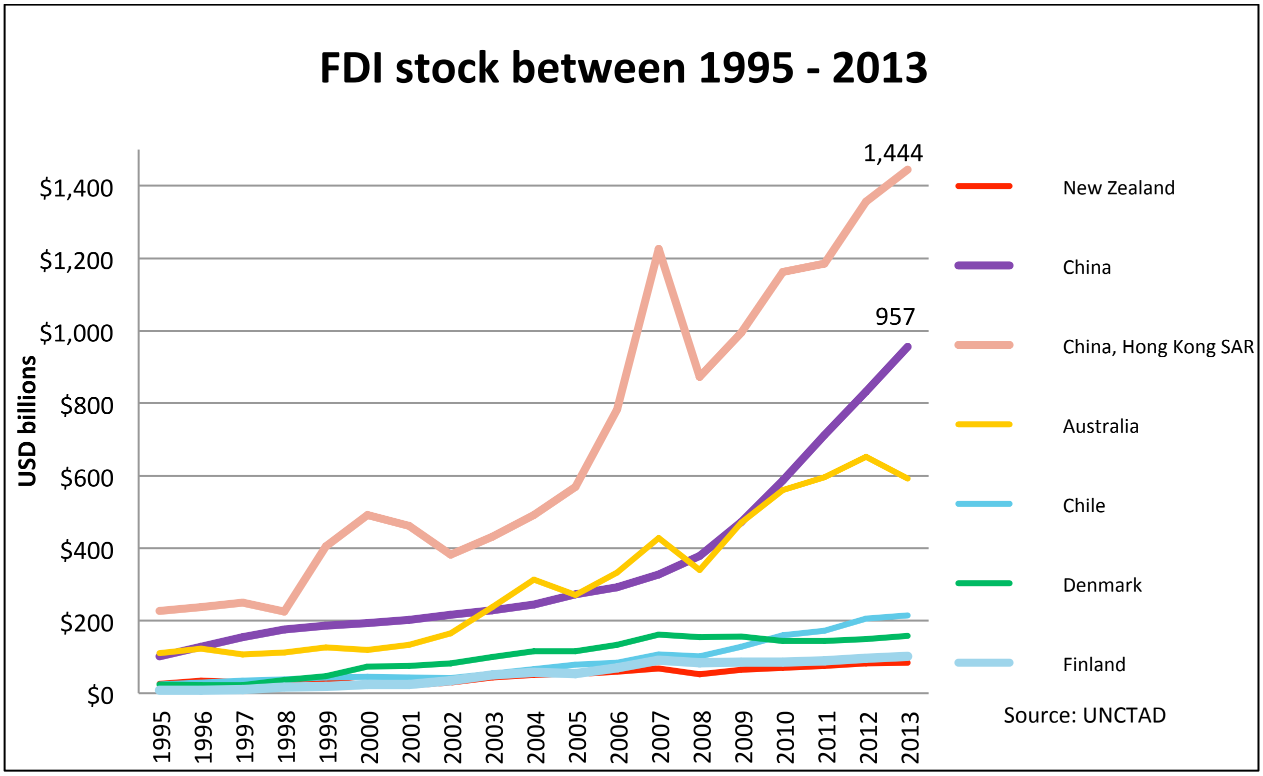
China

Over the past three decades, China has been one of the top destinations in the world for FDI, particularly in the manufacturing sector. Investors have been attracted by low labour costs and relatively developed internal infrastructure. China has welcomed FDI, seeing capital and expertise as fundamental to the economic strategy of "reform and opening" that began in the late 1970s under Deng Xiaoping. In the 1980s, the Chinese government established Special Economic Zones which were devised to target FDI. In 1995, the government issued the first catalogue of rules and regulations for FDI which identified sectors in which investment was encouraged, restricted or prohibited, depending on China's economic development plan at the time. These catalogues are still regularly updated with different types of goods highlighted in each issue.

Until the late 2000s, FDI in export processing was especially encouraged. In 2007, the Chinese government issued a revised catalogue in which the prior bias towards manufacturing for export was reversed. FDI into businesses solely devoted to export was to be limited. In 2008, tax advantages that foreign enterprises had previously received for investing in Special Economic Zones were largely eliminated (except in China's less developed western and central regions). Tax incentives were to be provided based on type of business activity, not by location. FDI was no longer primarily seen as a source of funding or job creation. Instead, it was seen as a way of bringing in advanced technology and expertise into sectors that were viewed as key to national economic development. The official guidelines on FDI issued at the end of 2011 promoted opportunities in areas such as alternative energy, biotechnology, information technology and high-end equipment manufacturing.

Rising wages in China, concerns about market access, and reduced export demand in western countries still recovering from the GFC have fuelled conjecture that FDI into China may slow in the coming years, particularly as low end manufacturing companies relocate to countries such as Bangladesh and Vietnam. However, FDI into China has become increasingly focused on the services sector, rather than on manufacturing. Rapidly growing levels of personal disposable income will encourage foreign investors to try to tap into rising domestic demand. FDI in China's financial services sector alone surged more than 400 percent in the first half of 2015 compared to the same period a year earlier. In recent years, China and Hong Kong's stock of FDI has been increasing at an annual rate of US$200 billion. This is equivalent to the size of the New Zealand economy.

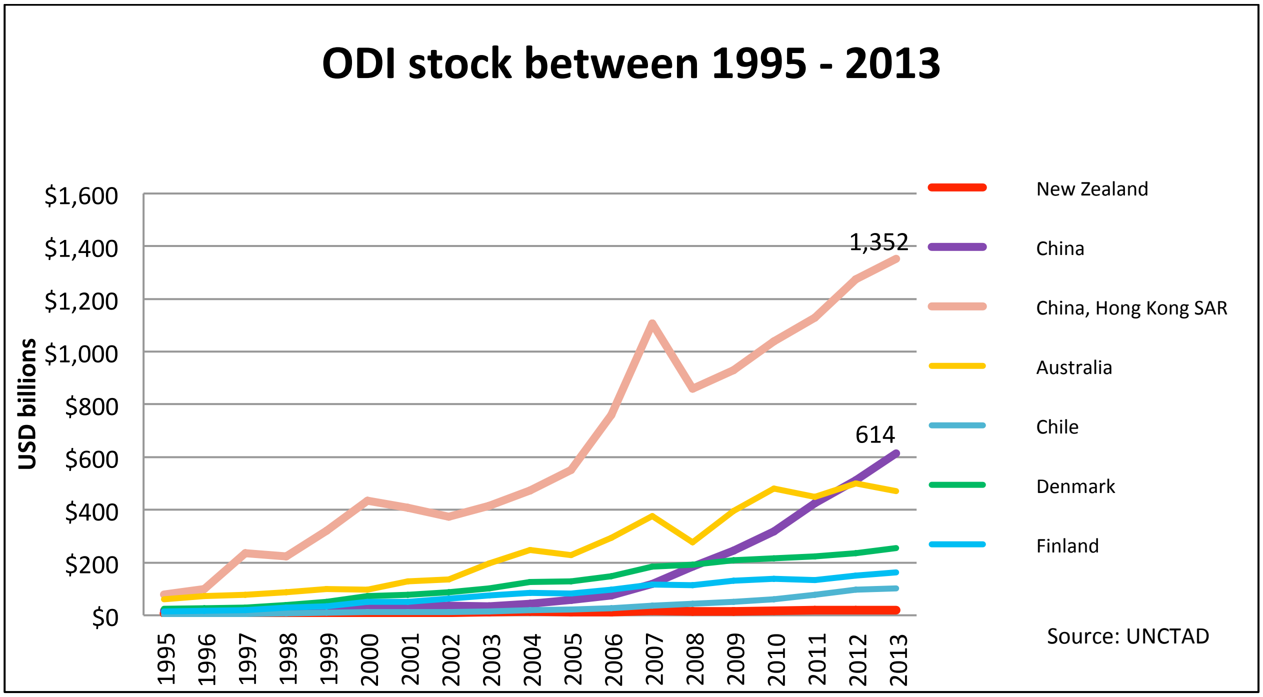
Fig 7: Value of New Zealand's stock of FDI between 1995 - 2013



In a little over a decade, Chinese ODI has increased from an insignificant level to more than $100 billion a year, making China one of the world's top three exporters of capital. China's long-term outbound investment is catching up with inbound foreign investment, bringing the country closer to becoming a net exporter of funds as it boosts its global economic clout. ODI in renminbi (RMB) terms jumped 29.2% in the first half of 2015 compared to the same period a year earlier. In comparison, FDI into China grew by 8.3% during the same period.[3] ODI was valued at 343.2 billion RMB during the period, compared with 420.5 billion RMB in FDI. It is expected that at some point in in 2015, China will become a net provider of capital to the world. Institutions like the Asian Infrastructure Investment Bank and Chinese-led regional economic integration initiatives like "One Belt One Road" will further accelerate this trend, reshaping the global economic landscape in the process.

[3] China Outbound Investment Expands as Nation Boosts Global Clout, Bloomberg, 21 July 2015,

Fig 8: Value of New Zealand's ODI stock between 1995 - 2013



Chinese companies are increasingly being encouraged to invest overseas under China's 'Going Out' policy, which provides access to lower cost loans from policy banks such as the China Development Bank. Most of the larger Chinese investors in New Zealand have been state owned enterprises, from the dairy, meat and utility sectors - the most recent example being Shanghai Maling's acquisition of 50% of Silver Fern Farms which was announced on 15 September 2015. In 2014, three Chinese state owned banks also established subsidiaries in New Zealand (Bank of China, China Construction Bank and Industrial and Commercial Bank of China).

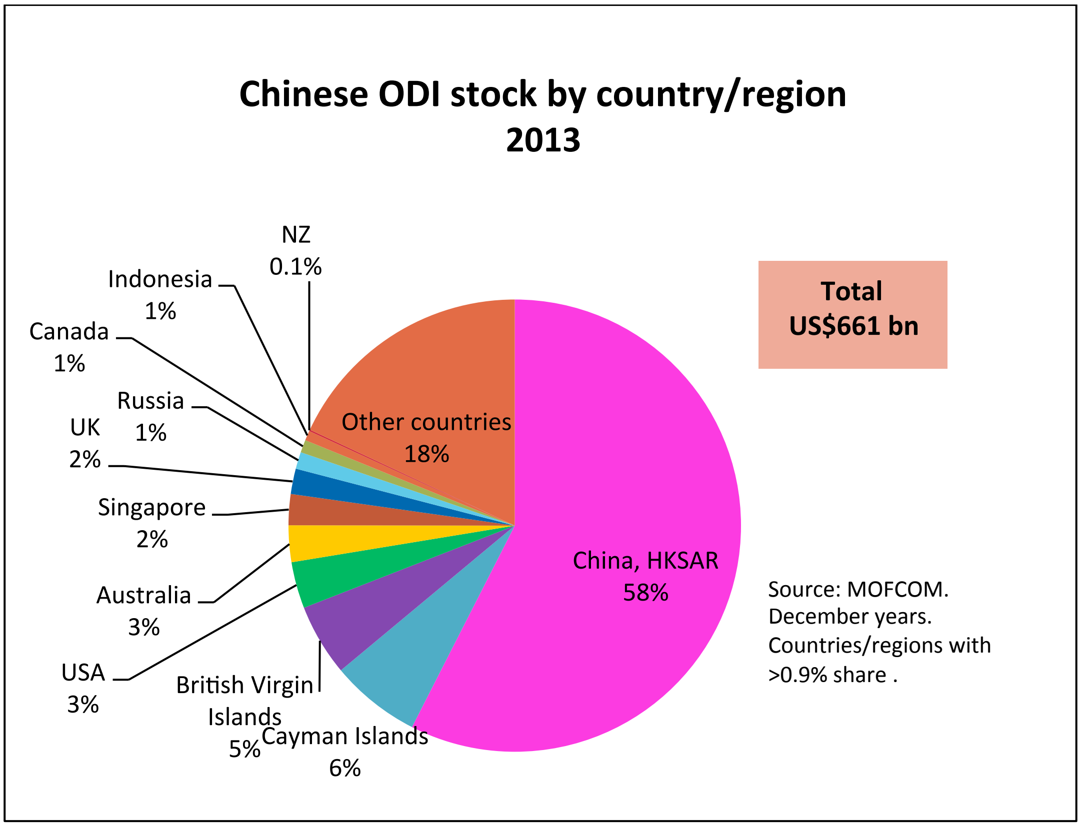
As a result, many Chinese investors are able to outbid private companies in competition for assets because of assistance from Beijing. Chinese overseas assets have posted an annual growth rate of 16.4% since 2011, rising from 2.7 trillion RMB in 2011, to 4.9 trillion RMB in 2015. China currently has 113 centrally administered SOEs. Their investments abroad account for over 70% of China's ODI. At the end of 2014, 107 Chinese SOEs had set up a total of 8,515 branches in 150 countries and regions.[4]

International investment statistics have traditionally been compiled based on the jurisdiction of registration of the immediate investor, not the jurisdiction of the investor where the funds were originally sourced. It is common practice for international investors to route funds through jurisdictions offering favourable tax treatment. Chinese investors are no exception. ODI figures are distorted by "round-tripping", whereby domestic Chinese companies funnel money to Hong Kong or other tax havens, only to bring it back into China to take advantage of favourable tax incentives. Even though a

[4] SOE overseas assets surge, China Daily, 19 June 2015

2008 law equalised tax rates for both foreign-invested and domestic enterprises, financial incentives are still available for 'foreign' investors in central and western regions of China.[5] According to MOFCOM statistics, in 2013, 70% of China's ODI was in 'tax favourable' territories. 58% of China's ODI went to Hong Kong with another 11% being invested in the Cayman Islands and the British Virgin Islands and a further 2% in Singapore. Only 3% of Chinese ODI was reported as being destined for the USA, despite the United States being the world's largest global destination for FDI.

Fig 9: Chinese ODI stock by country/ region (December 2013)



[5] Serve the people: The new landscape of foreign investment into China, Economist Intelligence Unit

NEW ZEALAND & CHINA - FDI RELATIONSHIP

FDI in New Zealand from China

As Chinese companies move offshore, they are choosing New Zealand as an investment destination, taking advantage of our stable economic and political environment, favourable regulatory environment and investor-friendly tax policies – including the lack of a capital gains tax.

New Zealand and China have seen a large increase in our two way trading relationship. In the last five years or so we have also seen a huge expansion in the bilateral investment relationship. A big factor in the growth of Chinese investment in New Zealand over the last decade has been China's 'Going out' policy, which encourages Chinese companies to invest offshore.

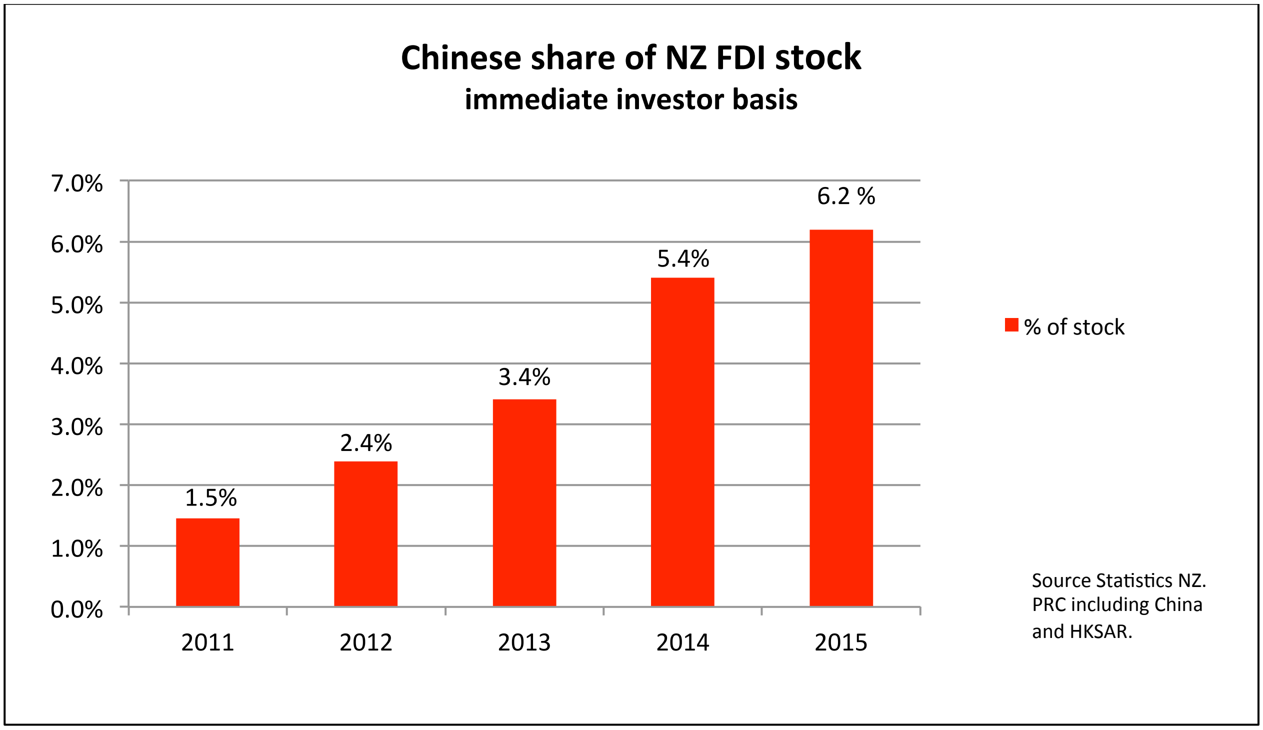
Part of the interest in investing in New Zealand has also been driven by the Free Trade Agreement which came into force in 2008 - China's first FTA with a developed economy. Almost all of the phasing out of tariffs has now come into effect, further increasing the attraction of New Zealand as an investment destination, particularly in the primary sector.

In 2010 Prime Minister John Key and Premier Wen Jiabao set a target of $20 billion in two-way goods trade by 2015. This target looked to be firmly on track until the drastic fall in global dairy prices which has led to a steep decline in the value of New Zealand merchandise exports to China. Global dairy prices are not expected to recover until mid-2016. In March 2014, Prime Minister John Key and President Xi Jinping set a new goal of achieving $30 billion in two-way trade by 2020.

Fig 10: New Zealand and China Merchandise Trade Relationship (2005 – 2015)

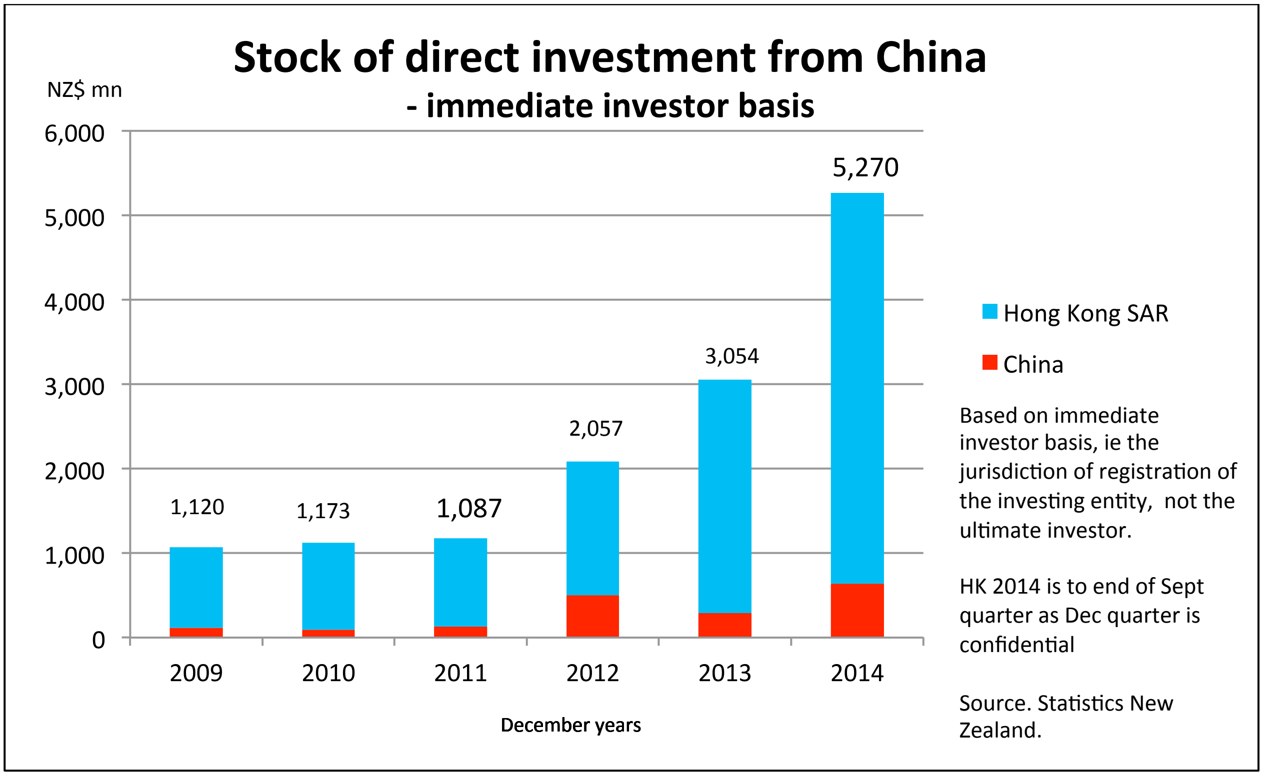
In the last few years, the increase in Chinese investment into New Zealand has been extraordinary. From a low base, China's share of New Zealand's FDI stock has grown to 6.2%. This is a 160% increase since 2011.

Fig 11: China and HKSAR investment in New Zealand as percentage of FDI stock



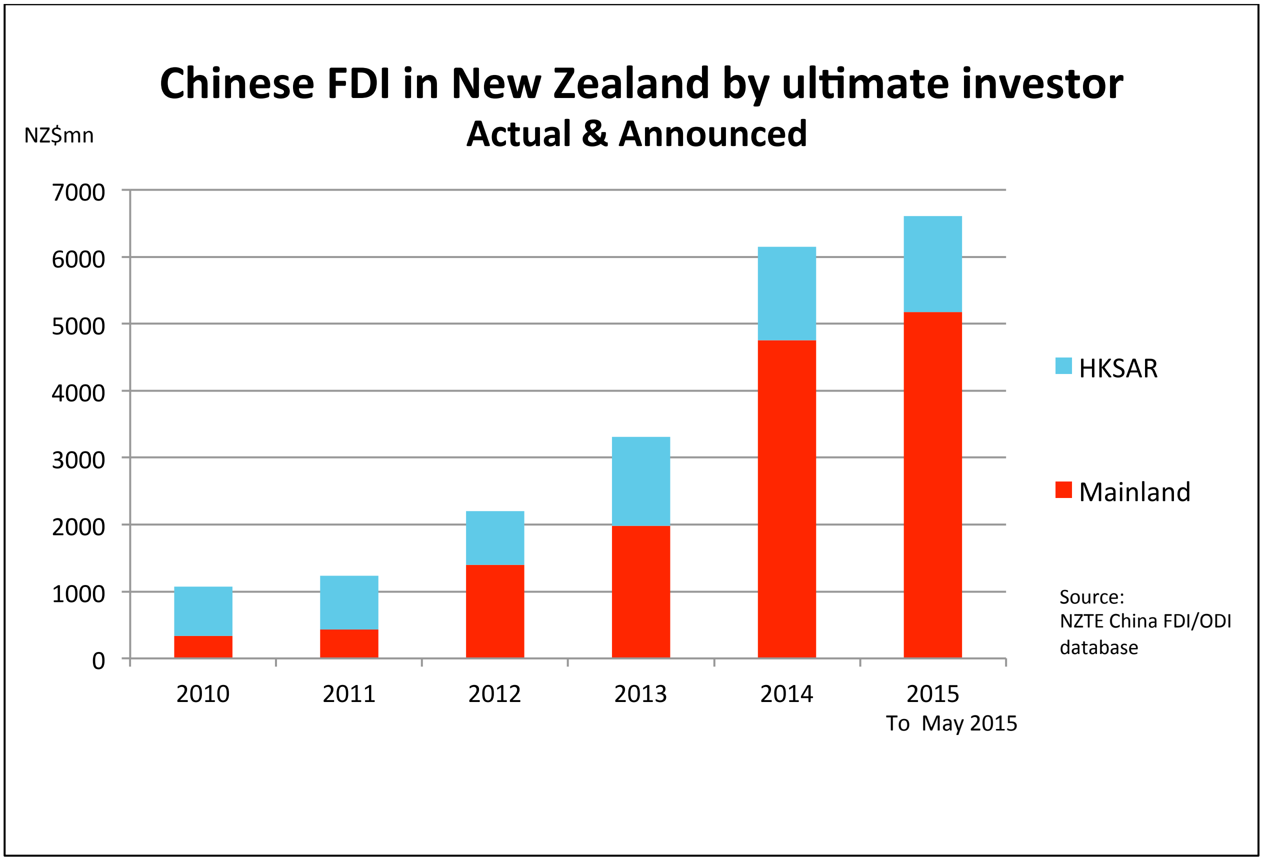
Since 2011, FDI from the PRC (including HKSAR) has gone from NZ$1.1 billion to NZ$5.3 billion, an increase of nearly 400%, or on average growth of nearly NZ $1 billion a year. When measuring FDI on an immediate investor basis, the level of investment from HKSAR is quite striking.

Fig 12: China and HKSAR investment in New Zealand – immediate investor basis



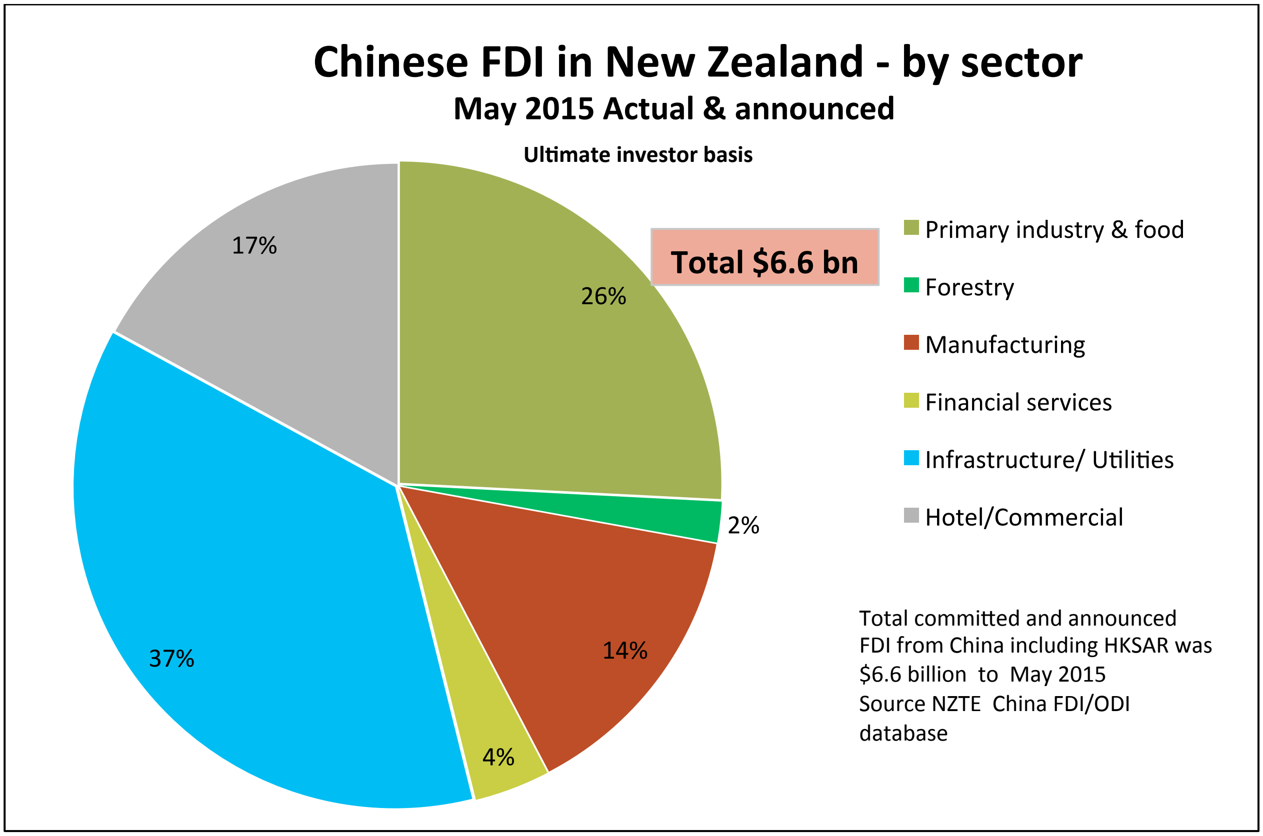
However, the actual level of direct investment from China is much higher. Data compiled by New Zealand Trade & Enterprise reveals that most Chinese investment in New Zealand is from mainland investors with companies registered in Hong Kong, Singapore, Cayman Islands, British Virgin Islands and other tax favourable territories. When also taking into account direct investments where Chinese companies are the ultimate investor, the total is much closer to NZ$7 billion. For example, in 2012 when Haier completed its purchase of New Zealand's Fisher and Paykel Appliances the New Zealand Overseas Investment Office (OIO) reported that the NZ$742 million transaction was made through Haier (Singapore) Management Holding Co Pte Ltd, a 100% owned subsidiary of the Haier Group Corporation. This investment was reflected in New Zealand's FDI statistics as being from Singapore.

Fig 13: China and HKSAR actual and announced investment - ultimate investor basis



A feature of Chinese FDI in New Zealand is the diverse range of sectors which have received investment from Chinese investors. The largest sector is infrastructure and utilities, accounting for more than one-third of announced Chinese investments. Some examples: in 2014 Beijing Capital Group acquired New Zealand's largest waste management company, for NZ$950 million. In 2008, Hong-Kong based Cheung Kong Infrastructure bought the Wellington Electricity Company for $785 million and in 2012 acquired New Zealand's second largest waste management company, Envirowaste, for NZ$490 million.

Fig 14: Chinese direct investment into New Zealand is relatively diversified



Chinese investments in New Zealand's primary industries and food processing make up the second largest sector. China is the largest foreign investor in New Zealand's dairy sector with NZ$800 million in current investments and a further NZ$700 million in announced projects. Most of China's largest dairy companies are building a stake in the New Zealand dairy sector: many of these are large greenfield projects.

In November 2014 Yili opened a NZ$214 million processing facility in the South Island and announced a $400 million expansion programme for the next five years. In November 2015 Mengniu-controlled Yashili will formally open a NZ$212 million infant formula plant in the Waikato region of the North Island. Both the Yili and Mengniu invested ventures are wholly Chinese owned. In addition, Shanghai Bright Dairy has a 39 percent stake in South Island infant formula manufacturer Synlait, which has the largest infant formula plant in New Zealand. By 2016, Beijing Sanyuan's Baxy icecream subsidiary will start producing icecream for the China market from Hauraki in the North Island. Shanghai Pengxin has invested in a number of farms in both the North Island and South Island as a base for developing new products for exporting new dairy products to the Chinese market.

As mentioned earlier, Haier owns Fisher & Paykel Appliances, one of New Zealand largest manufacturing companies, with a total investment of around NZ$1 billion. In the last couple of years

New Zealand has also seen significant new Chinese investments into the tourism sector, taking advantage of the rapid increase in Chinese visitors to our shores.

Another new sector of interest has been the finance sector. As noted above, three of China's largest banks opened New Zealand subsidiaries in 2014. A further promising area for cooperation is in the high technology sector. Earlier in 2015, Shenzhen-based KuangChi Science took a controlling stake in Martin Aircraft which is aiming to be the world's first to market a commercial jetpack as a first responder vehicle for emergency services. Another new area of interest has been the cultural services sector. In June 2015, Dalian Wanda acquired Hoyts, New Zealand'second largest cinema chain, as part of the purchase of the Australasian Hoyts Group. (Hoyts had only recently been acquired by Sun Xishuang of the Dalian Yifang group, in December 2014.)

New Zealand is a very open economy but also a relatively small economy. China's annual increase in its ODI spend globally is equivalent to half the size of New Zealand's US$200 billion economy. There is also a huge difference in the scale of our companies. New Zealand's largest company, Fonterra, a dairy cooperative, has annual sales of NZ$20 billion, while Chinese companies like Alibaba are worth more than the annual output of the New Zealand economy. New Zealand's regulatory criteria for foreign investment are intended to ensure that foreign investors in large projects and in farming are suitably qualified and of the highest integrity. The primary sector is the pillar of the New Zealand economy and particularly its export sector. All projects above NZ$100 million and all investments into rural land require the prior approval of the Overseas Investment Office. The process is transparent and more than 99% of applications to date have been approved. The large increase in Chinese investment indicates that the OIO process has not been proven to hinder investment.

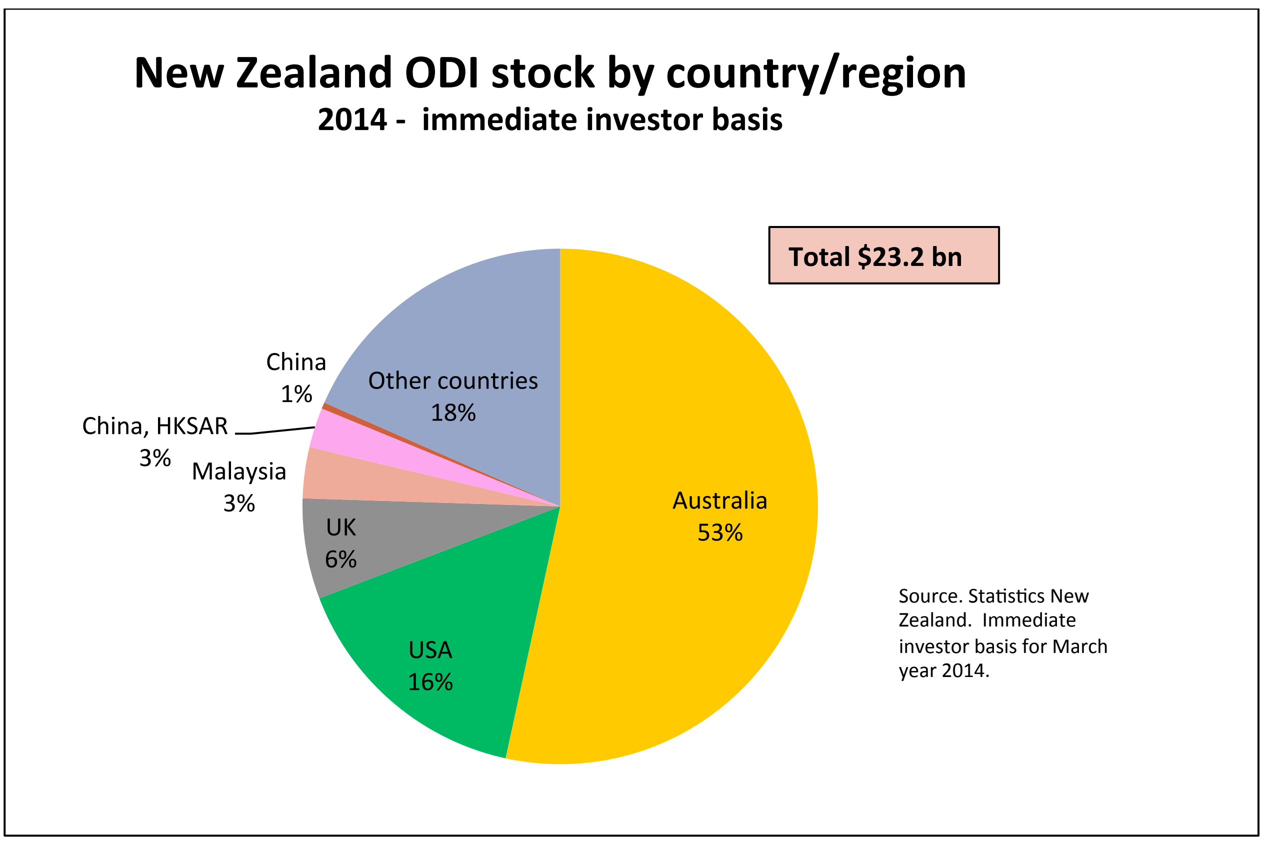
New Zealand remains, as it always has been, a net importer of capital. China now has one of the largest global pools of capital available to invest. With the FTA providing a sound framework for investment, it is not unexpected that Chinese enterprises are showing increasing interest in investing in New Zealand (as indeed they are doing elsewhere around the world).

FDI in China from New Zealand

Investment is very much a two-way affair, with New Zealand investors also active in China. Fonterra is New Zealand's largest investor in China with more than NZ$1 billion currently invested. Fonterra's farming business is building dairy hubs in North China with the aim of producing 1 billion litres of milk annually by 2018. The first hub at Tangshan is now operational and a second hub in Ying County, Shanxi Province is under construction. A third hub is expected to be built in Shandong province in conjunction with Abbott, an infant nutrition company. In March 2015 Fonterra also completed a NZ$755 million investment into infant formula manufacturer Beingmate to secure an 18.8% stake in the company. Other major New Zealand investors in China include Fletcher Building, a building materials manufacturer, and Nuplex, a specialties resin manufacturer (see case studies below).

New Zealand's ODI remains relatively small as a share of GDP and has not has not increased significantly in more than ten years. More than half of New Zealand's ODI stock is in Australia. Despite New Zealand's merchandise exports to China being comparable to those to Australia, ODI in China (including HKSAR) accounts for only 4% of New Zealand's ODI total stock. The New Zealand government encourages further investment from New Zealand into China.

Fig 15: China/HK is New Zealand's fifth largest ODI destination, with 4% of total ODI stock.



INVESTMENT REGULATION

Investing in New Zealand

OIO application and approval process

Investments by overseas persons in ‘sensitive land’, ‘significant business assets’ and fishing quota are regulated under the Overseas Investment Act 2005 (the Act), and consent is required from the Overseas Investment Office (OIO). The Act acknowledges that it is a privilege for overseas persons to own or control sensitive New Zealand assets.

'Sensitive land' includes non-urban land exceeding five hectares (i.e. farmland), any land that is part of the foreshore or seabed or on certain offshore islands, and land over 0.4 hectares that includes or adjoins certain sensitive areas such as conservation land, reserves, historic or heritage areas, lakes or foreshore or seabed. This is not an exhaustive list.

‘Significant business assets’ includes business assets in New Zealand where the value of the securities or consideration paid, or where the value of the assets of a company and its 25% or more subsidiaries exceeds $100 million.

People who are not New Zealand citizens or who do not ordinarily reside in New Zealand must apply for consent to invest in sensitive land or significant business assets. This requirement also applies to overseas owned or controlled companies, other incorporated or unincorporated bodies, such as partnerships or joint ventures, and trusts, as well as associates of overseas investors (who may be New Zealanders). The regime applies whether the acquisition is made directly, or through the acquisition of securities where the ‘overseas person’ acquires 25 percent or more of the securities.

If the applicant is investing in sensitive land and does not intend to reside in New Zealand indefinitely, the OIO and the decision-making ministers must be satisfied the overseas investment will, or is likely to, benefit New Zealand. If the land being acquired is non-urban and exceeds five hectares the applicant will also be required to demonstrate that the benefit will, or is likely to be, ‘substantial and identifiable’.

Benefits for sensitive land investments are assessed in accordance with 21 economic and non-economic factors set out in section 17 of the Act and regulation 28 of the Overseas Investment Regulations 2005 (the Regulations). These include:

- the creation of new job opportunities in New Zealand;
- the introduction into New Zealand of new technology or business skills;
- increased export receipts for New Zealand exporters;
- added market competition, greater efficiency or productivity, or enhanced domestic services in New Zealand;
- the introduction into New Zealand of additional investment for development purposes;
- increased processing in New Zealand of New Zealand's primary products;
- improved walking access across the land; and

- protection of indigenous flora and fauna.

Applications for consent should only address the benefits that are likely to flow from the investment. Would-be investors should identify and focus on the key benefits of the investment; making unnecessary or frivolous claims increases assessment times.

Overseas persons who are considering investing in New Zealand need to obtain advice from a lawyer experienced in OIO matters early on, before entering into any purchase agreement and before seeking OIO approval. Investors should also carefully read through the OIO's website: (http://www.linz.govt.nz/regulatory/overseas-investment/making-application/how-apply-for-consent). Only once the OIO has been provided with all material information relating to the proposed investment can it make a recommendation for consent.

As a consequence of the High Court decision Tiroa E and Te Hape B Trusts v Chief Executive of Land Information[6] (Tiroa E), the OIO and the decision-making ministers must also apply a "with and without" test when assessing whether an overseas investment will, or is likely to, benefit New Zealand.

Applications to the IOI must, as a result, address what is likely to happen with the investment, and what is likely to happen without the investment (the counterfactual). This means that investors will need to ask what could reasonably be expected to occur if the proposed investment does not proceed and fully explain this in any application letter.

The "with and without" test must also be applied to each of the relevant benefit factors (other than some of those in regulation 28 for which such analysis is not appropriate). The practical effect of Tiroa E is that an applicant's acquisition of the land has to deliver a benefit over and above the benefit that would be delivered by an alternative New Zealand owner.

If consent is granted the OIO will impose conditions requiring the applicant to implement its stated business plan and demonstrate that any claimed benefits have arisen. Monitoring compliance with conditions of consent is an important part of the OIO's work. Failure to comply with conditions is a serious matter and may result in enforcement action being taken.

The OIO endeavours to meet all commercial deadlines in assessing applications. However, given that the OIO is always in receipt of numerous urgent applications, its ability to expedite or fast track an application is often limited. Accordingly, applicants will need to factor in significant time to obtain consent to the relevant transaction. Applicants must ensure any agreements entered in to incorporate a sufficient OIO consent time frame.

Most major sensitive land applications are decided by two Ministers after receiving recommendations from the OIO. All other decisions are made by the OIO under delegated authority.

[6] *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information* [2012] NZHC 147.

Investing in China

Business and Investment Structures

Investment from any country or region outside the PRC Mainland (which includes Taiwan and the Special Administrative Regions of Hong Kong and Macau) constitutes foreign investment in China. Although China has encouraged foreign investment for over 25 years, the legal framework still contains significant restrictions for investors and mandates a wide range of government approvals and requirements that may be unfamiliar to New Zealand enterprises doing business in China for the first time. However, proposals to lessen these restrictions were recently announced, which are discussed in more detail below.

Limitations on foreign investment projects

The Chinese government's Provisions for Guiding the Direction of Foreign Investment categorise foreign investment projects as "encouraged", "permitted", "restricted" or "prohibited". Specific types of foreign investment that fall into the encouraged, restricted and prohibited categories are listed in the Foreign Investment Industrial Catalogue (the latest version is effective from 10 April 2015). Any person considering investing in China should consult the catalogue at an early stage. In general:

- projects that involve advanced or new technology are encouraged;
- projects in areas that are technologically backward, or belong to certain sectors that China is in the process of gradually opening up (e.g. banking, telecommunications, legal services), are restricted;
- projects that threaten public interest and national security or that may cause serious environmental pollution are prohibited; and
- projects not listed in the Catalogue are generally considered permitted and do not require special approval.

Approval Authority

Foreign investment in China is subject to a system of multi-tiered approvals.

Several factors may determine which government authority has jurisdiction over a particular company establishment. For example, if the total investment of a foreign invested enterprise (FIE) is sufficiently high, approvals from both the National Development and Reform Commission and the Ministry of Commerce (MOFCOM) would be needed, as opposed to MOFCOM alone. Moreover, the investment amount may also determine whether the provincial, municipal or district-level MOFCOM office will be the approval authority over a given project.

Additionally, if the FIE is in a specific business sector, special approvals of the FIE's business scope may be necessary. Chinese enterprises are required to have narrowly defined business scopes, and if the business described falls under the supervision of a particular government agency, an approval from that body may be required in addition to a general approval from MOFCOM.

A single project will usually involve the approval of more than one governmental agency, even if the FIE will not engage in a specially-regulated business sector. With the assortment of authorities involved, government supervision is found almost everywhere. For foreign exchange issues, the approval of the State Administration of Foreign Exchange or its local counterpart is required. For land use and real property matters, approval by the State Land Administration Bureau or its local counterpart is necessary. For Joint Ventures where a Chinese State-owned Enterprise is to contribute its tangible assets as its capital contribution into a JV, the State-owned Assets Administrative Commission will be involved in approving the asset appraisal and contribution. Specific and preferential tax treatment is approved by the State Administration of Taxation along with the State Council.

The appropriate government approvals will need to be secured. Some local governments may offer certain preferential treatment and approvals but may not have the legal authority to grant those rights. An FIE that has been improperly approved may be subject to invalidation at a later time. So it is always important to ensure that all required governmental approvals have been obtained from the proper level and proper agency of the Chinese government.

Equivalent government approvals are also generally required for the acquisition of a company by way of an M&A transaction. While the acquisition of a business through an asset purchase will not itself require any government approval, the establishment of the FIE that is to undertake the acquisition will require the equivalent government approvals.

Foreign Investment Structures

Foreign investment in China typically takes the form of either a Joint Venture (JV) or a Wholly Foreign-owned Enterprise (WFOE). JVs were the first investment structure allowed and were therefore the most common vehicle for many years. Since China began to liberalise its investment policies, and particularly after its accession to the World Trade Organisation, WFOEs became the preferred FIE structure in most unrestricted industries.

JVs and WFOEs each have their own benefits and disadvantages. Many foreign investors are attracted to the WFOE structure because it allows the foreign party to have complete control over the management of the enterprise, major financial decisions, and the use of intellectual property rights. JVs allow inexperienced China investors to work closely with a local partner who may have significant contacts with the local business community, specific geographic or industry knowledge, and experience with government relations.

Joint Ventures can be either Sino-Foreign Equity Joint Ventures (EJVs) or Sino-Foreign Cooperative Joint Ventures (CJVs).

Equity Joint Ventures

An EJV is an independent legal person with limited liability. The JV partners contribute capital to the enterprise and enjoy rights to a percentage of the profits equal to the paid-in capital. Capital contributions may be in cash or in-kind (e.g. land use rights, buildings, intangible assets or equipment). It is a legal requirement that the in-kind contributions undergo a valuation so that the parties' respective equity contributions may be determined. This is crucial in determining the equity contribution of each JV partner.

Cooperative Joint Ventures

The essential characteristic of a CJV is its flexibility and advance recoupment of investment by foreign investors. A CJV is often established as a company with limited liability and legal person status, but the law allows it to be a non-legal person enterprise without the protection of limited liability. However, in practice it is very difficult to obtain government approval to establish a CJV without legal person status, because currently there are no applicable taxes or other related laws or regulations regarding the non-legal person entity in China.

Wholly Foreign-owned Enterprise

Currently the most frequently utilised foreign investment vehicle in China is the WFOE. A WFOE typically takes the form of a limited liability company, though other forms of liability are not excluded and may be used upon approval by the relevant governmental authorities. The equity interest in a WFOE is entirely owned by its foreign investor or investors.

Alternative Foreign Investment Vehicles

The Chinese government has taken steps in recent years to facilitate Renminbi denominated investments by foreign parties - in large part to encourage successful local industries to list on Chinese stock exchanges, as opposed to the favoured offshore listings in the U.S. and Hong Kong. As a result, several new vehicles are available to foreign corporations and funds for structuring their investments in local Chinese companies, including foreign invested venture capital enterprises and foreign partnerships.

INVESTOR MIGRATION FROM CHINA

China is the world's largest source of Investor Migrants from any single country. Immigration New Zealand's Investor Migration scheme began in 2009. As at June 2015, approved applications from China account for 56% of Investor and 33% of Investor Plus applications to date. Approximately 90% of all new applications originate from China. The average value of investment made by Investor migrants from China is NZ$2.32m.

Immigration Policy requirements

The key requirements for Investor and Investor Plus are outlined below.

	INVESTOR PLUS	INVESTOR
Investment capital	$10m for 3 years	$1.5m for 4 years
Settlement funds	None	$1m on hold
Minimum English language	None	IELTS 3
Maximum age	None	65 years
Minimum business experience	None	Three years
Minimum time required in NZ	44 days per year for each of last 2 years	146 days per year for each of last 3 years

An acceptable investment under this programme is an investment that is:

- capable of a commercial return under normal circumstances
- not for the personal use of the applicant(s)
- invested in New Zealand in New Zealand currency
- invested in lawful enterprises or managed funds that comply with all relevant laws in force in New Zealand
- has the potential to contribute to New Zealand's economy.
- invested in one or more of the following assets: bonds issued by the New Zealand government, local authorities, Banks, New Zealand firms. Equity in public or private New Zealand firms, including managed funds and Venture Capital Funds. New residential and commercial property development

For more detail see www.immigration.govt.nz/invest www.newzealandnow.govt.nz/invest

CASE STUDIES - CHINESE INVESTMENT IN NEW ZEALAND

Yashili

Summary

Yashili International Holdings Limited (Yashili) through its New Zealand wholly-owned subsidiary, Yashili New Zealand Dairy Co., Limited (Yashili NZ), has successfully built a NZ$220 million infant formula processing plant at Pokeno in the Waikato.

About Yashili

Yashili was founded in 1983 and is headquartered in Chaozhou, China. It is listed on the Hong Kong Stock Exchange. Yashili, along with its subsidiaries, is engaged in the manufacturing and selling of dairy and nourishment products in China.

China Mengniu Dairy Co. Limited (Mengniu) acquired a 68% stake in Yashili in June 2013. Mengniu is a leading diversified dairy company in China, founded in 1999 by a group of former senior managers from competitor Yili. In 2009, state-owned COFCO - China's largest food processing, manufacturer and trader - became the largest shareholder of Mengniu with an 18% equity stake and total exercisable control stake of 27% through various JVs.

In February 2014, France's Danone bought a 25% stake in Yashili to become Yashili's second largest shareholder after Mengniu, which cut its holding from 68% to 51%. Danone owns 9.9% of Mengniu. It also owns infant formula businesses in China marketed under a number of different brands. In July 2015, Danone announced plans to sell its Dumex infant formula plant in China to Yashili. Danone will also increase its 9.9% stake in Mengniu. Danone and Yashili have also signalled plans to collaborate on the plant at Pokeno.

Yashili is one of the "big three" producers of infant formula in China. Its two leading brands, "Yashily" and "Scient", and the more recently introduced "Merla" brand, account for more than 80% of Yashili's business. Yashili is also one of the leading suppliers in China of soymilk powder, cereal, rice flour and milk powder for adults and teenagers. The brand is positioned via 1,900 regional distributors who own more than 105,000 retail outlets. Yashili operates milk processing plants in Guangdong, Heilongjiang, Shanxi and Henan Provinces in China.

Yashili is moving to source its ingredients internationally to position itself as a premium, trusted brand. It has been sourcing milk products from New Zealand for its premium infant formula products for over ten years – a point of difference that Yashili has used to promote its premium product. The establishment of the Pokeno plant is seen by Yashili as a first step for further growth and continued investment in New Zealand, and as a means of strengthening its brands in the Chinese market.

Competition in China's infant formula market is fierce, with Chinese consumers increasingly buying foreign-made infant formula online due to concern about the safety of local product. These safety concerns have adversely affected the profits of infant formula businesses in China including Yashili.

Infant Formula Manufacturing Plant at Pokeno

At the outset of the project, Yashili set up an office in Auckland staffed by both Chinese and local employees, who short-listed several sites, before concluding the purchase of the site at Pokeno. It is located in the newly created Gateway Business Park, adjacent to Pokeno village, with major highways and the main trunk railway nearby and a prospective work force in close proximity. Yashili's commitment to develop the plant has been the catalyst for significant further commercial development in the area.

The plant was finished in early 2015 and is expected to be fully operational in October 2015 following receipt of Chinese regulatory approvals. The 70,000 square metre plant is complete and systems testing is well under way. The plant is NZ's largest infant formula plant. At its peak, construction of the plant provided work for 350. Those workers are joined by about 35 fulltime staff whose number will grow to 130 by 2016 as the plant builds up to full production, most of whom will be sourced from the local workforce.

The plant's "state of the art" 41-metre spray dryer will be able to produce up to 8.4 tonnes an hour, helping the factory to pump out 52,000 tonnes of infant milk formula a year, destined initially for the New Zealand and Chinese markets. The plant also includes blending and canning production lines. Mengniu has made a significant contribution to the planning and establishment of the plant.

Yashili has also signed a "high level" agreement with the University of Auckland involving nutritional research and product development.

New Zealand Regulatory Environment

Yashili is committed to being a good corporate citizen in New Zealand. It intends to operate to the highest environmental standards including complying fully with all resource consents and any other applicable laws and regulatory approvals.

As the cost of establishing the plant at Pokeno will be in excess of NZ$100 million, OIO consent was required before the plant could be completed. However, the site was not sensitive land. Yashili NZ received OIO consent in March 2013. Further OIO consents were required when Mengniu acquired its 68% interest in Yashili (February 2014), and again when Danone acquired its 25% stake in Yashili (February 2015).

The required consent under the Resource Management Act 1991 for the construction of the plant was granted in September 2013 following appeals, and construction commenced in October 2013.

Fu Wah International Group

In February 2014, the Auckland Council approved Fu Wah International Group plans to build a new waterfront hotel in the Wynyard Quarter, valued at more than $200 million.

Fu Wah International Group (Hong Kong)

Fu Wah International Group is a leading industrial investment company. Since its establishment in Hong Kong in 1988, Fu Wah has been committed to integrated and high-end business development in such fields as real estate development, business operation, culture & art, health and finance. Fu Wah's chairperson, Madam Chan Laiwa , a member of the National Committee of the Chinese People's Political Consultative Conference (CPPCC) is well known in China for her business ventures as well as her establishment of the China Red Sandalwood Museum and the Chang An Club. She was listed among the "World's 100 Most Influential People" by Time magazine.

New Zealand Investment

In April 2014, Auckland Council Mayor Mr Len Brown announced Fu Wah as the successful bidder for the Auckland Waterfront Hotel in the Wynyard Quarter. Fu Wah was granted a 125-year lease on the council-owned site. The development cost is expected to exceed at least $200 million, making it the biggest foreign investment in local public infrastructure construction in Auckland to date. The hotel will be branded as a Park Hyatt and is likely to become one of the highest standard five-star hotels in New Zealand.

The project will not only facilitate tourism development, but will also provide employment opportunities to local residents, and has earned the support of the Auckland city council. The hotel is scheduled to open in 2018. OIO approval was granted in early September 2014. In 2014, Fu Wah also acquired the Park Hyatt Hotel in Melbourne.

Shanghai Pengxin

Summary

Shanghai Pengxin is a significant investor in New Zealand real estate and farmlands. Milk New Zealand is Pengxin's New Zealand operating arm. Through this and its associated entities, it holds farming assets of nearly NZD $500m. This includes 12,000ha of pastoral land and 30,000 milking cows across 29 farms. In February 2015, Andy Macleod, CEO of the Pengxin NZ Farm Group, said that the New Zealand farming arm of Pengxin planned to double its local assets to $1 billion within the next five years.

Background

Pengxin is a Shanghai-based conglomerate. Pengxin is controlled by Jiang Zhaobai and his brother Jiang Lei, who is CEO. Pengxin's international investment portfolio includes real estate development, mining, agriculture and infrastructure investments. The main business focus is in real estate development, including shopping centres under the Aqua City brand and a growing hotel portfolio. Total group assets exceed 30 billion RMB in 40 subsidiaries.

Pengxin investments in transport infrastructure include the North Section of the Shanghai A30 motorway and the Shanghai long-distance bus station. Pengxin Group's mining investments include two Canadian listed mining companies, a copper deposit in Democratic Republic of Congo and a South African gold mine.

In June 2013, Pengxin took a 55% stake in Hunan Dakang Pastoral, a Shenzhen-listed pig producer. Pengxin plans for Dakang Pastoral to evolve into an integrated distributor of imported dairy products, a pork and sheepmeat grower and processor, and an imported beef processor and distributor, with a premium protein supplier positioning. Once all of these projects enter full production, the estimated annual revenue will reach RMB 7 billion (NZ$1.4 billion). Pengxin also has a minority percent stake in Hong Kong-listed InterChina.

New Zealand Interests

- In 2011, Pengxin acquired the 16 Crafar Farms for more than $200 million, and the deal was finally approved by OIO in 2012. As a result of a legal challenge by Sir Michael Fay, the settlement was delayed until a High Court decision on the legality of the sale was overturned by the Court of Appeal. The farms are managed by Landcorp as a condition of the OIO approval.

- In 2012, Pengxin acquired a 45% interest in Top Harbour Limited, which purchased 31ha of land for $35 million on the Whangaparaoa Peninsula in Auckland as part of a $550 million land development project.

- In April 2013, during the visit of the Prime Minister to Shanghai, Pengxin signed a supply and purchase agreement with iwi-owned Miraka to process ultra-heat treated (UHT) milk for the Chinese market and launched the new product under the name TheLand (formerly NuZealand). On 21 November 2014, President Xi Jinping and the Prime Minister witnessed the signing of a three way partnership between Pengxin, Miraka, and Mengniu to expand production at the Miraka plant near Taupo.

- Pengxin-controlled listed company Hunan Dakang Pastoral is seeking OIO approval to acquire a 1,235 ha dairy farm from Fleming & Co in central North Island for $21.7 million. The hub will supply the Miraka milk processing plant near Taupo and the milk will be exported to China.

- In 2014, Pengxin acquired 74% of Synlait Farm Holdings (3,942ha) comprising 13 farms in central Canterbury, through Milk New Zealand Holdings, with OIO consent.

- Also in 2014, Pengxin purchased the Queenstown Hilton for an undisclosed sum from Hong Kong hedge fund Pacific Alliance Group, estimated to be in the order of $80 million.

- In July 2014 Pengxin made an offer for the purchase of the Lochinver Station (13,800ha) near Taupo, worth at least $70 million. Two-thirds larger than the Crafar farms, Lochinvar is one of the largest farms in New Zealand.

- On 21 November 2014, at the Agri-tech Innovation Showcase in Auckland, Pengxin signed an MOU to develop near-space helium balloons with KuangChi Science and Airways New Zealand. The signing was witnessed by Prime Minister Key and President Xi Jinping.

- Pengxin has acquired two of the four Spark Towers in Auckland.

- On 5 May 2015, Hunan Dakang Pastoral announced that it had signed an agreement to buy the 'Pinny Farms' in Northland for $42.7 million. The Pinny farms include seven dairy farms and three support farms, ranging in size from 100 to 600 hectares near Kaikohe. Fifty staff milk 3900 cows, producing about 1.2 million kg of milk solids or 15 million litres of milk a season, on a milking platform of about 1550ha of freehold land with a further 275ha of neighbouring leased land.

Beijing Capital Group

Summary

In June 2014, Beijing Capital Group (BCG) successfully completed the purchase of Australia's Transpacific Industries Groups' New Zealand waste management business (WMNZ) for NZD950 million. Under the terms of the transaction, BCG, through its Hong Kong subsidiary, acquired 100% of the shares in WMNZ via a competitive auction process - BCG's first acquisition outside China.

Background

Beijing Capital Group

BCG is one of China's core state-owned enterprises under the direct supervision of the municipal government of Beijing (Beijing SASAC). BCG is an integrated conglomerate engaged in 3 core businesses: infrastructure and environmental protection; real estate; and financial services and investment. BCG provides the municipal collections of rubbish in Beijing and Shanghai, and operates landfills in both cities. With over USD21 billion in assets, USD3.7 billion in revenues and 20,000 employees, BCG is one of China's Top 500 Enterprises.

Waste Management New Zealand

WMNZ is New Zealand's leading waste management company, with an established network of vertically integrated local waste systems. WMNZ's business activities include solid waste collection, processing, recycling and landfill disposal operations as well as the collection, treatment, recycling and disposal of liquid and hazardous waste. In 2014, WMNZ generated revenue of NZD385 million from over 200,000 customers nationally, and employs about 1,100 staff.

Rationale for Acquisition

BCG's acquisition of WMNZ is seen as a strategic long term investment and a means for BCG to acquire technology and a carbon-friendly skill set that may help it to take on China's pollution challenges. Specifically, BCG sees WMNZ's environmental practices, safety management and engineering skills as being applicable in managing BCG's landfills, operations and liquid waste in China. BCG is also keen to leverage WMNZ's well-advanced anaerobic digestion expertise – effectively the composting of various organic waste.

Current Status

Since acquiring the business in 2014, BCG has further invested in WMNZ via the acquisition of the remaining 50% in organics composting business, Living Earth.

BCG remains keen to explore further investment opportunities in New Zealand as and when opportunities arise but considers it premature to speculate on what shape such investments might take.

Shanghai Bright Dairy

Summary

During the GFC, Synlait Milk sought a strategic investor to strengthen its balance sheet and assist it to build a further dryer and a new infant formula plant. Following a competitive process Bright Dairy invested approximately $80 million in return for a 51% shareholding.

Background

Bright Dairy is a subsidiary of Bright Food, a large food industry group controlled by the Shanghai Municipal Government. Bright Dairy is a listed enterprise specialising in the complete chain of dairy products from paddock to plate. It also develops and markets health and nutrition products. The company has a product research and development centre, and dairy product processing facilities. It is the third largest dairy company in China after Yili and Mengniu.

Critical Factors

Chinese investors need to be able to move quickly and conclude a transaction in competitive bidding situations and when businesses need to find capital quickly. Bright Dairy was able to move quickly to conclude a transaction on mutually acceptable terms. Had it not been able to do so, Synlait Milk would have felt the need to choose another investor. It was important that Bright Dairy was able to agree a shareholders agreement that recognised the importance and value brought by those shareholders collectively holding 49% of Synlait Milk. Amongst other things, this left day to day operational control with Synlait Milk management.

It was possible to satisfy the Chinese party's need to consolidate a business for financial reporting purposes and for the NZ entity not to lose operational control or need to change its vision or values. However, recent changes to law in China in respect of SOE's and Government controlled organisations make this more challenging than when Bright first invested in Synlait.

Transparency around Chinese regulatory approval process is important. It gives the NZ investor confidence that the process is progressing well and addresses some of the concerns around execution risk.

Current Status

In 2013, Synlait Milk listed on the New Zealand Stock Exchange main board and Bright Dairy reduced its shareholding to approximately 40%. Bright Dairy currently holds approximately 39% of Synlait Milk. Bright Dairy continues to have the right to appoint 4 out of 8 directors to Synlait Milk for so long as it holds at least 37% of the shares. One of Bright Dairy's appointees is required to be a New Zealand resident director of high standing in New Zealand governance.

Haier – Fisher & Paykel Appliances

Summary

In 2012, Chinese electrical appliance company Haier Group (Haier) completed the purchase of New Zealand's iconic home appliances company Fisher & Paykel Appliances (F&P) valuing the company at NZ$930 million. Haier initially purchased a 20% stake in F&P in 2009 for NZ$80 million before launching a full takeover for F&P in September 2012. In November 2012 Haier obtained more than 90% of the shares in F&P, triggering the compulsory acquisition of the remaining shares under New Zealand's Takeover Code.

Background

Haier Group

Established in 1984, Haier Group has expanded its business from the single production of refrigerators to areas such as household appliances, communications, IT digital products, home furnishings, logistics, finance, real estate and bio-pharmaceutical. In 2014, Haier achieved a global turnover of 200.7 billion yuan, a total profit of 15 billion yuan. According to Euromonitor, the Haier brand accounted for 10.2% of global retail volume and is the largest household appliance brand in the world for the 6th consecutive year.

Fisher & Paykel Appliances

F&P has been designing products since 1934 and has grown into a global company operating in 50 countries and manufacturing in New Zealand, China, Thailand, Mexico and Italy.

Rationale for Acquisition

The purchase of F&P allowed Haier to expand into higher-priced products in export markets as well as give access to F&P's research and development expertise. In turn F&P has benefitted from Haier's financial strength and access to the Chinese market where demand for white goods is expanding rapidly.

Importantly, Haier has kept F&P's corporate headquarters in New Zealand and maintained its New Zealand, Australian and US brands and businesses. It has also maintained its New Zealand machinery and product development operations.

Current Status

Since the acquisition Haier and F&P have worked closely together to sell products in developed markets at higher margins than in China as well as identify opportunities for further collaboration to strengthen both brands and businesses.

Beijing Automotive Group

Summary

In February 2015, Beijing Automotive Group bought 50% equity in Pacific Aerospace Limited (PAL), a 100% owned New Zealand company. As part of the deal, PAL, Pacific Aerospace Group (PAL NZ shareholders' company (PAGL)) and Beijing General Aviation Co., Ltd (BGA) formed a Chinese JV company in Beijing that will be involved in all aspects of the aviation industry including aircraft manufacturing, sales, operations, pilot and engineering training, and maintenance.

Background

Beijing Automotive Group

Beijing Automotive Group is the fourth largest vehicle manufacturer in China and is owned by the Beijing Municipal Government. On October 25, 2011, Beijing Automotive Group and Beijing University of Aeronautics and Astronautics in Beijing signed a "framework agreement" and "investor agreement", to jointly establish the Beijing General Aviation Co., Ltd.

Pacific Aerospace Limited

Hamilton based PAL, is Australia and NZ's largest aircraft manufacturer with over 60 years' experience in designing, manufacturing and sales of general aviation aircraft. PAL's utility aircraft, the P-750 XSTOL, is an extremely short take-off and landing utility aircraft that includes a factory modular floor kit enabling any new aircraft to easily convert between 10 different roles including freight, passenger, skydive, aid, surveillance, photography, geophysical survey, medical evacuations, and agricultural operations. PAL's revenue was $18 million in 2013, of which $16 million was export revenue. In previous years, revenue exceeded $25 million but has decreased following the global credit crisis. PAL has 120 full time staff and an increasing capacity to build more aircraft for China and other markets throughout the world.

Process

BGA signed a Letter of Intent with PAL at the Beijing Air Show in 2014. The significant commercial terms were agreed with BGA to own 51 percent, PAL 10% and PAGL 39 percent of the joint venture. The P-750 XSTOL is to be sold in China through the joint venture. PAL will retain the intellectual property and will provide design support from New Zealand. BGA in China will initially build a sales pipeline and re-assemble New Zealand built aircraft in China. Once anticipated demand in China has been validated, BGA will transition to full manufacturing in China. The agreement has been approved by the various Chinese government authorities required to approve the formation of new companies.

Current Status

PAL seeks to grow and consolidate off the back of its joint venture with BGA. PAL is well placed to take advantage of the growing Chinese general aviation market and expand into other global markets. PAL, with the support of New Zealand Civil Aviation Authority, has gained the necessary approvals from the Chinese Regulator for the P-750 XSTOL aircraft to operate in China. An order for 53 aircraft (US$120M) was announced at the 2014 Zhuhai Air Show and PAL are anticipating a significant increase in production for the P-750 in the future.

CASE STUDIES - NEW ZEALAND INVESTMENT IN CHINA

Fonterra

Summary

The most significant New Zealand direct investment in China is Fonterra's dairy farm programme. Fonterra has set a goal of producing one billion litres of raw milk a year in China through building four to five dairying 'hubs' across China. Fonterra's second major investment in China was the NZ$755 million acquisition of 18.8 percent of Hangzhou-based Beingmate, one of China's largest infant formula manufacturers.

Background

Fonterra

Fonterra Co-operative Group Limited was founded in 2001 and is based in Auckland. It is New Zealand's largest business with a market capitalization of $7.8 billion and total revenue of over $20 billion. The cooperative engages in the collection, manufacture, and sale of milk and milk derived products internationally primarily from its 10,500 plus farmer members in New Zealand. It also has many production sites across the globe. Fonterra markets its products under brands such as Anlene, Anmum, Anchor, Fernleaf, Mainland, Bega, Tip Top, and Western Star.

Beingmate

Beingmate Baby & Child Food was founded in 1992 and is headquartered in Hangzhou, Zhejiang province. It is engaged in the research, development, production, and distribution of infant food products in China with over 80,000 retail outlets. Beingmate is one of the largest infant formula producer in China. Its total revenue for 2014 was $5.05 billion RMB. It is listed on the Shenzhen stock exchange. Beingmate's local milk powder is manufactured in Heilongjiang and at three other Beingmate plants in China. Beingmate also sources globally from global dairy companies such as Fonterra and Kerry Group.

Process

In January 2015, Fonterra was granted antitrust and foreign investment approval by the Chinese Ministry of Commerce to take a strategic stake in Beingmate. The transaction was completed through a partial tender offer at the Shenzhen Stock Exchange in March 2015. Fonterra are now working with Beingmate on the execution of this strategic partnership.

Current Status

The Yutian farming hub in Hebei Province is finished and a new hub at Ying County in Shanxi Province is underway. In 2014 Fonterra announced a third hub to be built in cooperation with US infant formula company Abbott.

Nuplex

Summary

Nuplex has invested in three resin manufacturing facilities ($100 million), including a new purpose-built plant at Changshu, Jiangsu Province. Nuplex has said that China is one of Nuplex's most important growth markets. Within China, Nuplex has a leading position in Performance Coating resins which includes coatings used in segments such as automotive OEM, vehicle refinish and infrastructure.

Background

Nuplex is listed on both the NZX and ASX. The company's registered office is in Auckland and the corporate office is in Sydney. Nuplex offers innovative resins for a wide variety of applications including; decorative and trim paints, automotive OEM coatings, vehicle refinish products, wood, plastic and metal coatings, marine and protective coatings, flooring and furniture coatings, inks and adhesives as well as coatings for textiles, consumer electronics and whitegoods. It also provides composite resins, including polyester and vinyl ester resins, gel coats, and flow coats.

It has seven sites across Asia employing around 450 staff. In the 2015 Financial Year, Nuplex Industries' revenue was NZ$1.4 billion and its operating EBITDA was $127.3 million. Nuplex has been investing in expanding its capacity across the Asian region for a number of years and expects at least 10% EBITDA growth from Nuplex Asia in the 2016 Financial Year.

Process

Nuplex entered the China market in 2004 via acquisition of a site in Foshan, Guangdong Province. In 2005, Nuplex acquired a production site in Suzhou, Jiangsu province as part of an acquisition of assets from Akzo Nobel. Recently, Nuplex has built a dedicated research and development centre for the company's Asia operations on this site.

Current Status

In September 2014, construction of its third China manufacturing base in Changshu, also in Jiangsu province, was completed. The cost of this plant was US$35 million (NZ$42 million). The plant was commissioned in May 2015.

Fletcher Building

Summary

Fletcher Building has two Formica® laminate plants in China ($150 million). Formica Asia's headquarters are in Shanghai. Fletcher Building's Formica Group opened a new production facility in Jiujiang, Jiangxi province in November 2013. The NZ$77 million plant is one of the largest facilities in Formica's international operations, and marks a substantial new phase of development in Asia for Fletcher Building.

Background

Fletcher Building Limited is one of the largest listed companies in New Zealand, with a market capitalisation of around $5.5 billion, revenue of $8.7 billion and net income of $400 million. It is a manufacturer and distributor of building products with operations in 40 countries around the world, and also operates a leading construction company in New Zealand and the South Pacific. Fletcher Building employs 19,500 people globally in 25 business units.

Formica® laminate is a brand of composite materials discovered in 1912. It is a heat-resistant, wipe-clean, plastic laminate of paper, metal or fabric with melamine resin. It was developed in the US where it was branded and sold as a popular laminate for tables and kitchen countertops. Fletcher Building acquired the Formica business in 2007, and now forms part of its global Laminates and Panels division.

Investment in China

Fletcher Building's investment in Asia is predominantly through its subsidiary Formica Asia which operates four High Pressure Laminate (HPL) plants across Asia (two in China plus Taiwan and Thailand). Formica has been operating in China from a production site in Qingpu, Shanghai for more than 20 years. China is seen as a key global player in decorative materials production, consumption and exportation.

Fletcher Building has made a considerable investment in best practice material sourcing, waste management, energy efficiency and emission control with many sustainable technologies adopted at Formica's Jiujiang plant.The Jiujiang plant currently houses three production presses which are capable of producing 8.5 million square metres of laminate per annum between them. The new factory's capability to produce 6x14 foot HPL is unique globally for Formica.

Fletcher Building opened a Procurement Office in Shanghai in February 2015. This office will be responsible for the sourcing, price negotiation and quality assurance processes for a broad range of products Fletcher Building currently sources from around Asia. This office is expected to grow to around 12 staff over the next 18 months.

Current Status

Currently Formica Asia is focussed on increasing China domestic sales in targeted high end market segments and expanding its geographic reach via an enhanced distributor network. HPL exports to NE Asia and ASEAN are assisting to maintain the strong market positions in these regions. Deep-sea exports volumes to Australia and Europe are further increasing plant utilisation.

Huhu Studios

Summary

Huhu Studios currently have a number of hard earned opportunities in China that embrace the digital media (including animation) and education sectors. New opportunities for studio production, distribution and funding partners have been signed with Chinese partners. Huhu Studios have two Joint Ventures with local companies strategically positioned in Beijing and Guangzhou. Further to this, they also have a JV in Taiwan as part of a 'three studio' approach that provides centres of work excellence and a competitive pricing mix to clients. Huhu Studios' 'three studio' strategy along with building friendships and alliances with like-minded parties allows the company to take opportunities in a hot industry segment. Over the next few years, revenues are estimated in the tens of millions.

Background

Huhu Studios is an animation studio based in Warkworth, New Zealand. Huhu also have a number of initiatives on the education front. These courses either support their co-located studios in China and Taiwan in a way that is similar to their NZ based offering, or provide new income streams as they diversify – including through the development of China-focused digital media curriculums in both English and Chinese languages.

China Interests

Huhu provides private Digital Media Training in a Joint Venture with a Beijing based company operational since March 2014. Courses include visual effects and gaming. Huhu has used its IP (curriculums and know-how of co-located studio to provide a unique training/classroom experience) to gain a 30% share of the new JV company (unusual in China as "hard cash" has been the key investor focus). This JV includes a co-located studio to support local initiatives for broadcasting.

The Beijing JV Company is forecasting net profits for the first 3 years of NZD $3.8m of which Huhu NZ net 30% or NZD $1.2m. The JV has secured the territory of greater China in a strategic Partner agreement to supply English and other technical courses, including Cambridge English, as well as a mix of blended learning experiences that combine web-based curriculum with classroom learning support, along with the development of Huhu branded curriculums.

Other opportunities include a number of animated and live action features with the China Film Group, where CFG is funding 50% to 60% of the projects with other local equity investors and US based distribution partners rounding out each movie deal. Once these projects are green-lit they will provide between 40%- 50% of the work on each movie to their New Zealand-based studio and an increase in jobs for local New Zealand artists. These movies, along with other work for China based studios, have provided the traction for Huhu to rapidly grow their international scope of business.

Huhu have gained significant China investor support to exploit these areas into long-term sustainable business between China and New Zealand, including scope to be the first users of the bilateral Film Co-production treaty with China. The necessary funding to ramp up the newly signed contracts has been secured and production will start prior to November 2015.

Current Status

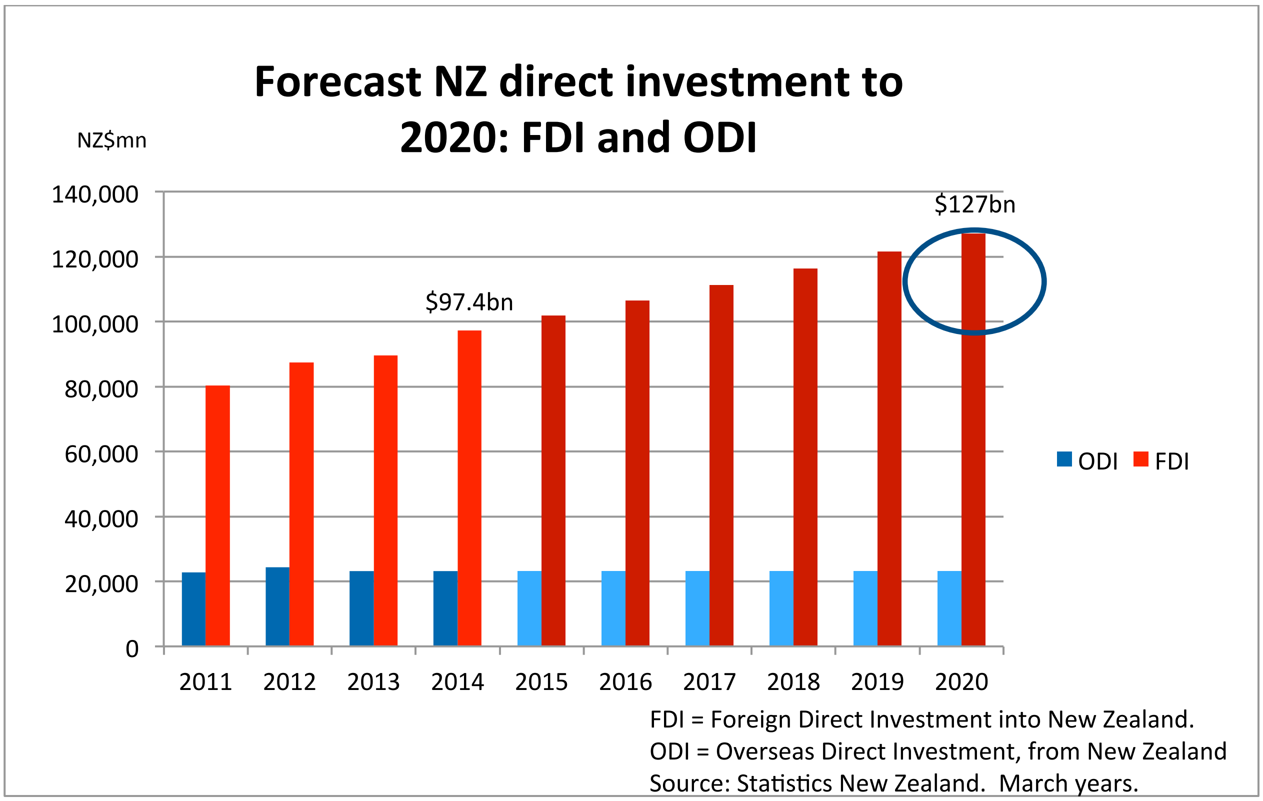
Huhu have recently signed distribution agreements for existing IP to be distributed throughout Greater China on the "Tencent" platform, and are looking for substantial passive income over the coming years from this and other ventures now in the pipeline. These results have come about from years of persistent effort, sometimes monthly trips to China, knockbacks and disappointments, but in every case learning and growing from the experience.

LOOKING FORWARD

New Zealand Investment Attraction Strategy

On 7 July 2015, the New Zealand Government unveiled a national Investment Attraction Strategy. The new strategy aims to attract $160-200 billion of overseas business investment to meet the government's goals for boosting exports to 40% of GDP by 2025, and lift R&D spending to 1% of GDP. Based on 4.5% CAGR average of FDI growth over the last ten years, total FDI stock is forecast to increase to $127 billion by 2020. That will be an increase of $30 billion in FDI invested in New Zealand. The trends shown in the graph below would indicate that a goal of reaching $160-200 billion in FDI by 2025 is certainly attainable.

Fig 16: Forecast of two way direct investment trends for New Zealand



To attract overseas investment, a better strategy to lure overseas funds and entrepreneurs is required. The investment attraction strategy sets out a common set of priorities, goals and key actions for government agencies to work with the private sector on "investment attraction activities" in what's a competitive world for investment. The strategy will be led by a cross-government team of senior officials from the Ministry of Business, Innovation and Employment, New Zealand Trade and Enterprise, Callaghan Innovation, and the Treasury.

Economic Development Minister Steven Joyce has said "While we have been seeing good growth overall in recent years, we need to sustain that and expand on it to really see a step-change in economic activity across New Zealand. This joined-up national investment attraction strategy will be tasked with building a pipeline of investable opportunities and promoting them offshore. We need to attract more international investors into opportunities that grow new industries, put more capital into existing industries, and attract investment and job growth in regions around New Zealand."[7]

The paper Minister Joyce took to the cabinet breaks the plan down into three themes.

1. Attract high-quality foreign direct investment in areas where New Zealand is competitive – in tradeable and "innovation enhancing" sectors, which are most likely to benefit the whole economy. "We propose the target for theme 1 to be to facilitate investments with a potential direct economic impact of $5 billion over three years," the paper says.
2. Attract overseas investment in R&D in New Zealand, and especially to encourage multinational companies to locate R&D facilities here. The target will be to attract 10 new offshore companies to relocate R&D activity to New Zealand over the next five years.
3. Lift New Zealand's pool of "smart capital" by convincing individual investors and entrepreneurs to live in the country. The target is to double to $7 billion within three years the amount of actual and committed capital migrant investors and entrepreneurs have brought to New Zealand. To achieve this, the paper suggests, will require "an end-to-end approach," from the design of visa categories and approval processes, through to programmes to attract the right migrants.

The paper says R&D spending should increase employment opportunities for Kiwis in science, technology, engineering and mathematics. Sectors to be targeted are primary industries, premium food and beverage, specialised manufacturing, infrastructure, oil, gas and mining, ICT/digital and shared services.

"Achieving the Government's goal of building a strong competitive economy with increasing numbers of higher-paid jobs requires ongoing significant increases in business investment," Joyce says. "Attracting more international investment will enhance our export markets and international linkages, introduce new technologies and processes to New Zealand firms, create more skilled jobs, and increase regional economic activity."[8]

Mr Joyce proposes a review of migrant visa categories "to enhance their attractiveness to high-quality applicants, tailored promotional events in key offshore markets to secure investors and entrepreneurs to New Zealand, and the capacity to provide a responsive, personalised service for high-value applicants to facilitate further investment."

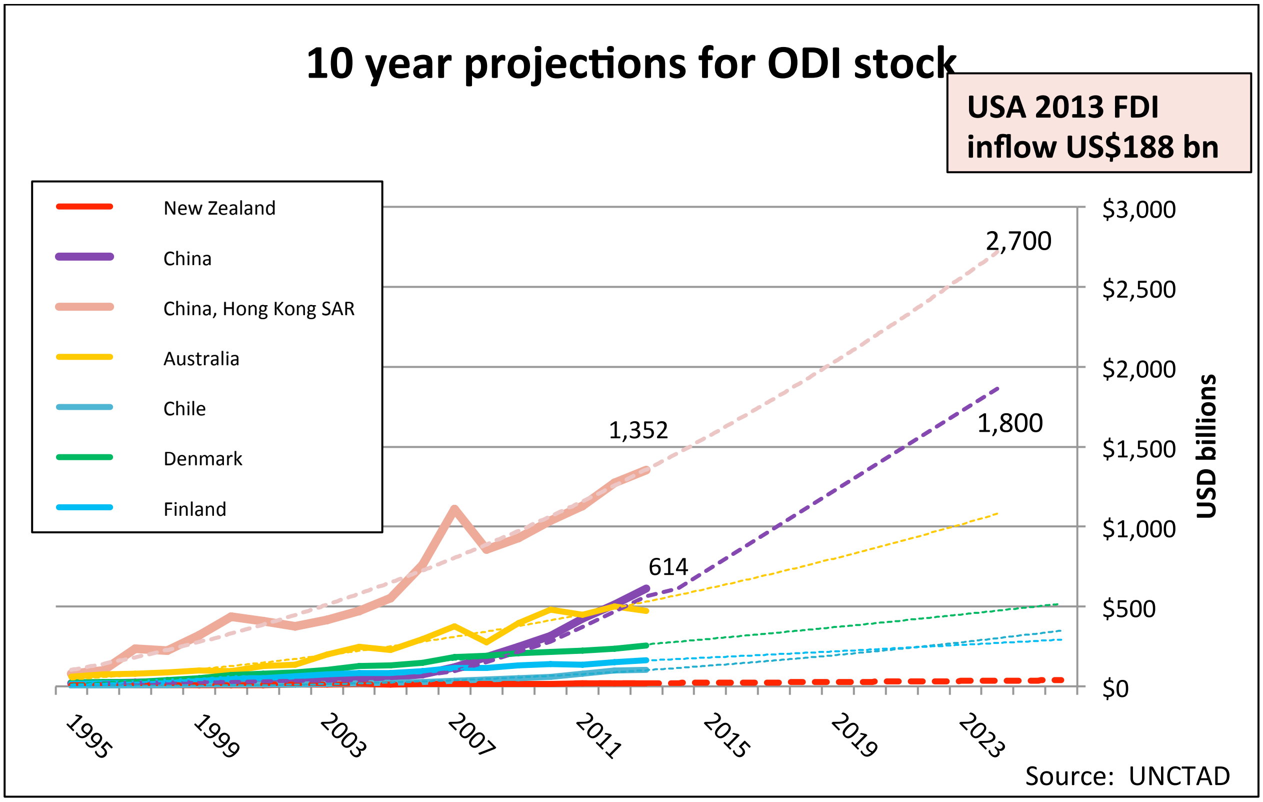
After consultation with the private sector, the final Strategy will be publicly available.

[7] 'New Zealand Investment Attraction Strategy' aims to get all government wakas paddling in the same direction to attract foreign investment, Posted in Business, 07 July 2015, by Gareth Vaughan
[8] New Zealand's export goal may require $200B of investment, Joyce's strategy paper says
Jonathan Underhill Tuesday July 7, 2015, NBR

China FDI

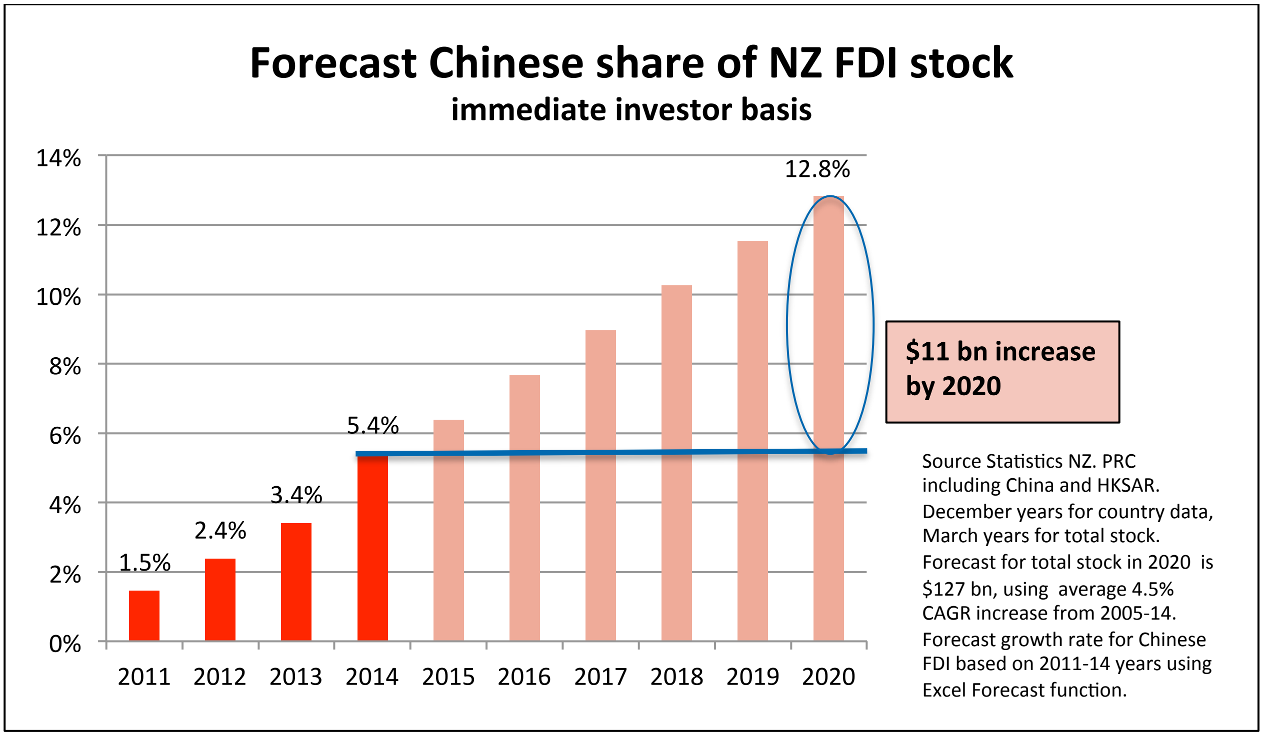
Overall growth in Chinese ODI is expected to accelerate over the next ten years. In a speech during his visit to New Zealand in 2014, President Xi Jinping forecast Chinese ODI would increase by USD$1.25 trillion in the next 10 years. This suggests that the total could reach US$2 trillion or $200 billion a year. On an annual basis, this is the size of the New Zealand economy.

Fig 17: Over the next ten years the annual increase in ODI from China/HK is likely to reach US$200 billion.



Over the next few years, Chinese investment into New Zealand is expected to continue a path of strong growth. There are at least NZ$1 billion of new Chinese investments which have already been announced and there are new projects being announced every month. Some of the larger projects in the pipeline include the $400 million by Yili for Phase 2 expansion of its South Island factory at Glenavy; $350 million by Shanghai New Development Group to build a 52 story tower in Auckland which will be New Zealand's largest commercial building; and $200 million by the Beijing-based Fu Wah International Group to build a hotel on the Auckland waterfront. In November 2014, during his visit to New Zealand President Xi Jinping said that China's overseas direct investments would increase by a further US$500 billion in the next five years. This target may be conservative – working out at an annual rate of $100 billion when China's ODI in 2013 had already increased by US$108 billion. If New Zealand were to receive just 1% of Chinese ODI over this period, Chinese companies would become the second largest foreign investor in New Zealand.

Fig 18: By 2020 Chinese FDI in NZ could reach $16 billion, 13% of total FDI stock



Proposed Changes to Chinese Investment Rules

On 19 January 2015 China's Ministry of Commerce - MOFCOM - issued a draft of the PRC Foreign Investment Law (FIL) for public comment. While the road to the actual passage of the FIL will likely take at least another eighteen months, it is clear that once adopted, the FIL's impact on foreign investment in the PRC will be far-reaching and comprehensive.

The FIL will replace three existing laws related to foreign investment – the Law of the PRC on FIEs, CJVs and EJVs. The new law will likely have a significant impact a variety of interest groups within China and abroad. It will also have an effect on China FDI as it will give foreign investors easier access to the Chinese market.

Understanding the terms

It is important to understand the FIL's key definitions in order to understand how they might impact foreign investment in China. For example, Foreign Investor refers to persons who do not hold Chinese nationality, enterprises established pursuant to the laws of other countries and regions, as well as the governments and organizations of other countries. Any PRC enterprise that is under the control of a Foreign Investor will also be viewed as a Foreign Investor. Adversely, Chinese Investor refers to persons of Chinese nationality, the PRC government and its subordinated departments or agencies and any PRC enterprise which is under the control of a Chinese Investor. The FIL also defines domestic enterprise as any company established in the PRC, and FIE as a domestic enterprise solely or partially invested in by Foreign Investors.

A key aspect of the FIL is the definition of what constitutes control. The legislative intent behind the FIL is not only to look at the place of incorporation and the nationality of direct investors, but also to establish who maintains ultimate control and whether that is held by foreign or Chinese investors. Foreign enterprises in the PRC which are controlled by overseas investors will be considered foreign, while those controlled by Chinese investors will be considered domestic. As a result, it will likely be more difficult for a foreign investor to use a Chinese company as a "cover" to operate in China and gain benefits if they own a minority stake but exercise de facto real control.

Expanding the Scope

The FIL covers traditional activities within the scope of foreign investment (e.g. green field investments and M&A), but now also covers other areas such as the provision of financing for one year to invested companies, the right to use domestic land and ownership of domestic properties, and control of a PRC enterprise through contracts and trusts. Also captured is any offshore transaction that results in a change of control of a Chinese company. No doubt, the expansion of the types of activities that are considered foreign investment, especially offshore transactions resulting in change of control, raises concerns for foreign companies, many of which have designed structures intended to provide flexibility and avoid entanglement in the PRC legal system.

Whilst the scope of activities covered by the FIL has been expanded, the PRC government also intends to do away with the requirement that MOFCOM approve all foreign investment activities in China. In its place, there will be a dual system for market entry approval and reporting. The idea is that foreign investors in the PRC should be treated the same as Chinese investors, unless otherwise stipulated in the Special Catalogue (to be issued). This means that a foreign investor should be able to go to the local Administration of Industry of Commerce and register a company just like a Chinese investor. However, unlike a Chinese investor, they would also be required to file a report to MOFCOM.

A Special Catalogue will be issued under the FIL by the State Council outlining prohibited and restricted sectors for foreign investment. For foreign investors whose investment falls within the Special Catalogue and is restricted, procedures will remain largely similar to the current approval process for foreign investment. Foreign investment authorities may also issue an approval with specific conditions, such as divestment of certain assets, limitations on shareholding percentage, operating term, geography and requirements on local employees.

Treatment of Variable Interest Entities (VIEs)

It is also clear that under the FIL, variable interest entities (VIEs) which are contractual arrangements through which a foreign company gains control over a domestic company, would be clearly regarded as a type of foreign investment which would have to comply with the FIL. As such, the current rationale for implementing a VIE structure would likely no longer exist and it is likely that they would no longer be viable in many instances, since contractual control would be treated the same as a direct investment.

Rectification of existing Foreign Invested Enterprises

When the FIL goes into effect, the Law on FIEs, EJVs and CJVs will be simultaneously repealed. This means that any existing foreign-invested enterprise has to, within three years of the FIL coming into effect, change its organisational form and organisational structure pursuant to the Company Law, the Law on Partnership Enterprises, the Law on Sole Proprietorship Enterprises and other relevant laws and regulations.

This requirement will cause substantial concern to foreign investors currently involved in joint ventures with PRC partners, as many will fear that this may provide an opportunity to re-open previously negotiated and settled contracts. What if the parties cannot agree on key provisions in new articles of association and shareholders agreements? It remains to be seen whether the drafters will provide further guidance on this area.

CONCLUSION

Foreign investment in China is currently subject to a system of multi-tiered government approvals. The FIL represents a new stage in the legal framework governing foreign investment activity in the PRC. While some elements can be viewed as a logical development and refinement of existing practices, others represent arguably a radical departure from the existing framework.

Any New Zealand enterprise considering establishing an FIE in China or undertaking an M&A transaction in China should seek advice from experienced professional advisers in China at an early stage.