BT Investment Solutions

Unleashing the dragon

China 2.0 series
August 2016

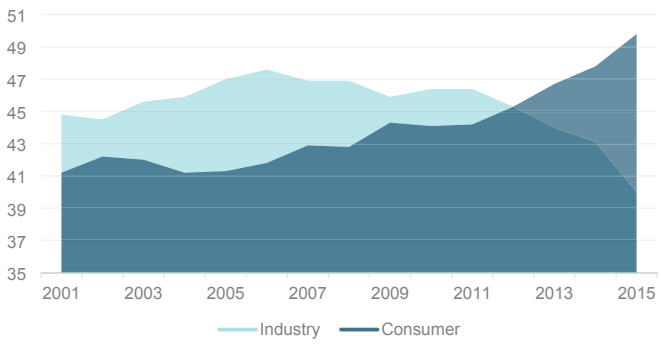
Over the next decade, China will further develop its trade network through the New Silk Road Initiative, play an increasing role in regional development, grow its political influence, and will be a major innovator in ecommerce and clean energy. China's influence is evolving and expanding, and Tim Rocks, Head of Market Research & Strategy, explores this in our China 2.0 series. In the first report, Tim focuses on how Chinese consumers are becoming a major global force and are sparking Australia's second great tourism boom.

Rebalancing to the consumer

Chinese President Xi Jinping began on a program of reform from 2012 designed to rebalance the economy away from infrastructure and apartment construction towards services and consumption. This rebalancing is now well advanced, as shown by the surge in the consumer sector in Chart 1.

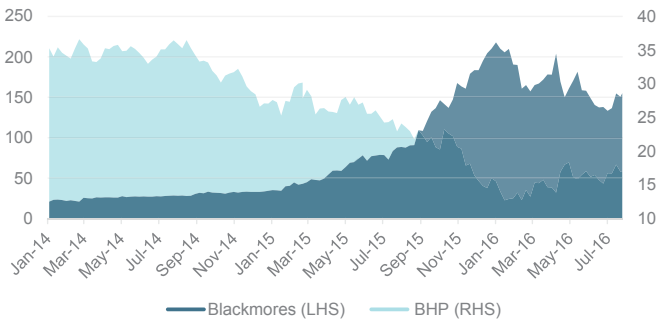
This has already had significant implications for Australian companies. Miners were affected by the decline in the industrial economy, but more surprisingly, companies like Blackmores have been able to tap into emerging Chinese consumption and are significant beneficiaries.
The performance of mining companies relative to China-exposed consumer stocks, based on Blackmores and BHP, has broadly mirrored the changes in composition of GDP (as shown in Chart 2).

Chart 1
China GDP by Sector %



Source: Datastream

Chart 2
Mining vs China exposed consumer stocks $ per share



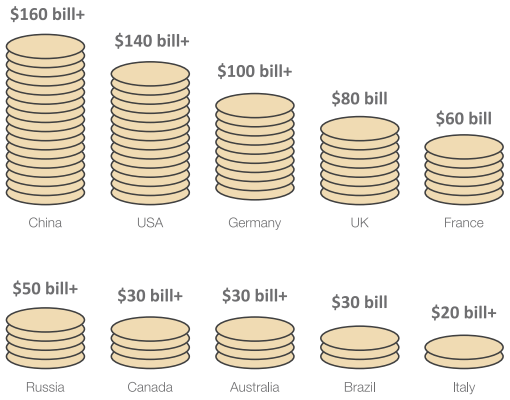
Source: Datastream

Please note Blackmores and BHP may not be representative of their broader industry sectors.

There is much more to come from the Chinese consumer. Chinese tourists already spend more in aggregate than those from any other nation in their global travels but there is far more to go, with Chinese tourists only travelling at one quarter of the rate of comparable countries (see charts 3 and 4). Given the lack of domestic tourism options (in contrast to global interest in travelling to China), further rapid growth in outbound Chinese tourism is very likely.

Chart 3

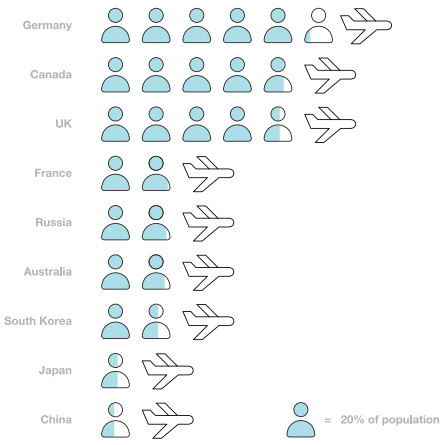
Outbound Tourism Spending by Country ($US bill)



Source: Datastream

Chart 4

Outbound departures % of population 2015



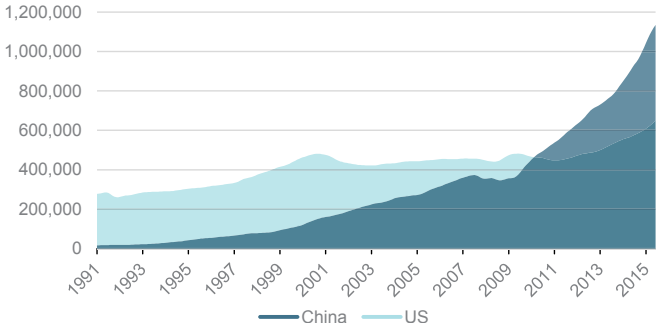
Source: Datastream

Move over Mick Dundee

Australia has already been a major beneficiary of Chinese tourism as more holidaymakers now come from China than any other country. More will follow, with the main constraint in the next few years being capacity at airports. Tourism Research Australia forecasts Chinese tourists will nearly triple to 3.2 million by 2025 and create Australia's second great tourism boom. The first lasted for 15 years from the launch of the movie Crocodile Dundee to the Sydney Olympics.

Chart 5

Tourist Arrivals by Country annual sum, number of people



Source: Datastream

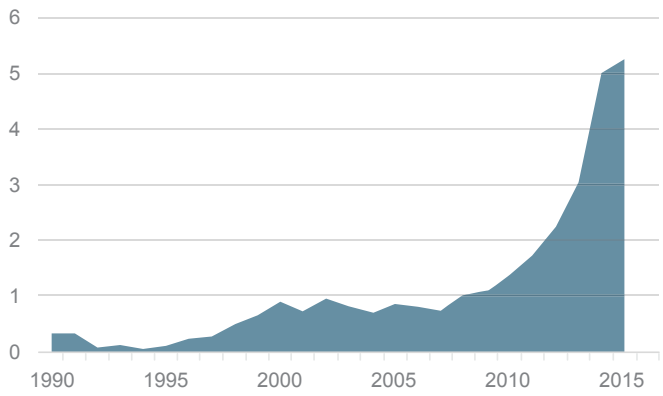
This tourism surge will have a pervasive effect on the Australian economy and the share market, with the following stocks expected to be potential winners.

+ Casinos such as Star Casino, Crown and SkyCity. There is upside for main floor revenues. For example, Chinese gamblers already represent 80% of VIP revenues at Star Casino but only around 2% of main floor revenue.
+ Theme park owners such as Ardent Leisure and Village Roadshow. The Gold Coast will be a major winner given the rapid expansion of Coolangatta Airport, and this will help the theme park operators there. Village Roadshow also has an agreement with CITIC (formerly known as the China International Trust and Investment Corporation) to build amusement parks in China.
+ Airports will experience from steady growth in volumes, particularly Sydney Airport.
+ Airlines will benefit, particularly through internal domestic flights. Virgin Australia is now part-owned by two Chinese aviation groups, Hainan Aviation and Nanshan.
+ Accommodation providers, including Mantra and Event Hospitality.
+ Flagship retailers, such as Scentre which operates the Westfield centres.

Feeding the dragon

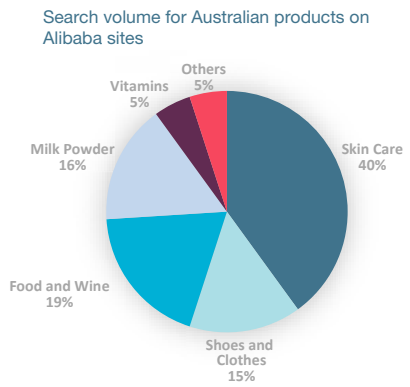
Australian food, vitamin and skin care producers are also set to be major beneficiaries, as Chinese tastes evolve. Blackmores already sources 40% of its revenue from China, mostly in online sales through local websites. Food exports from Australia to China have quadrupled since 2010 as shown in Chart 6. There is, however, some short-term uncertainty as China makes some changes to food importing rules covering taxation, labelling and safety.

Chart 6: Australian exports of food products to China



Source: Datastream

Chart 7: Search volume from Australian products on Alibaba sites



Source: Alibaba

The opportunity is large for a wide range of Australian branded food producers for a few reasons.

+ Chinese consumers' willingness to use e-commerce makes it easy to gain access to the market. They are five times more likely to use the internet than those in developed countries. In fact, Alibaba is now China's largest retailer, and this allows foreign companies to build presence relatively easily through its websites.
+ Food safety is a critical issue for Chinese consumers after some high profile scandals. Australia is seen as a trusted source which gives Australian producers a head start when entering China.

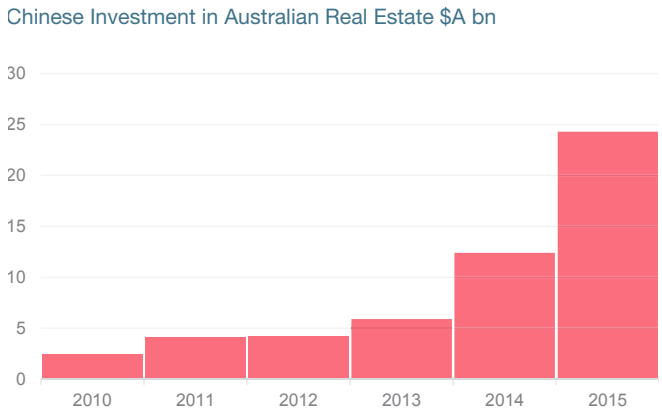
Vitamins have been the spectacular success story but data on web searches suggests skin care is an even bigger opportunity. Around 40% of web searches for Australian products are related to skin care. BWX (through its Sukin brand) is one company focusing on this. Other Australian listed companies targeting the Chinese consumer are in vitamins (Blackmores, Vitaco), milk (A2 milk, Bellamy), wine (Treasury Estates) and honey (Capillano).

Australian property in demand

Chinese flows will continue to have a strong impact on the property sector. Chinese investment into the Australian market has increased fourfold over the past two years and is the largest source of foreign buying. This is particularly the case for newly built property, given restrictions on foreigners buying existing property - for example, Mirvac estimates 21% of apartment pre-sales come from China.

There have been attempts to slow this flow over the past year but these may not be effective. Various states have introduced greater duties for foreign buyers and enforcement of FIRB (Foreign Investment Review Board) rules has been enhanced. Chinese authorities have also tightened rules on transferring money out.

Chart 8: Chinese investment in Australian Real Estate

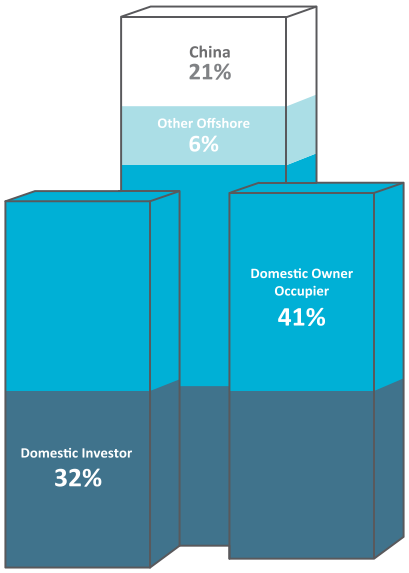


Source: FIRB

The surge in tourism is also sparking an acceleration in new hotel development for the first time in 25 years. Hotel occupancy has risen to a three-decade high of 78% in NSW and several new hotels are now under construction (see Chart 10). Hotel accommodation doubled between 1989 and 1993 at the end of the last tourism boom but there have been few developments since. New developments will ensure strong order books for developers and building materials companies over the next few years, even if apartment construction begins to slow.

Chart 9

Mirvac Presales Buyer Type %



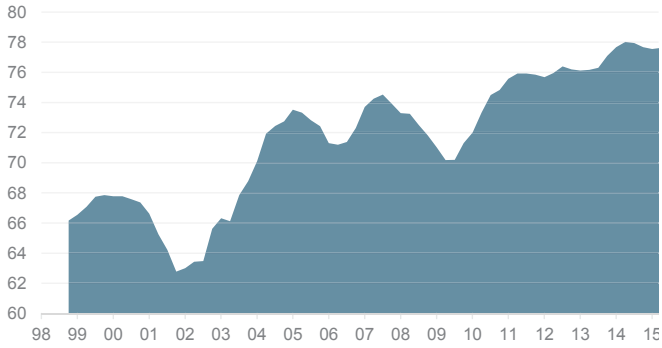
Source: Mirvac

A support for Australian shares

The rapid emergence of the Chinese consumer is a major event for the Australian economy and share market. While changes in the Chinese economy are a threat to some industries, the overall effect has been to help the Australian economy deal with lower commodity prices and collapsing mining investment. The importance of China will expand over the next decade and the benefits will pervade through industries including tourism, growing demand for Australian food and skincare products, and Australian property. There are also potential benefits for a broader range of industries including healthcare, education and financial services.

Chart 10

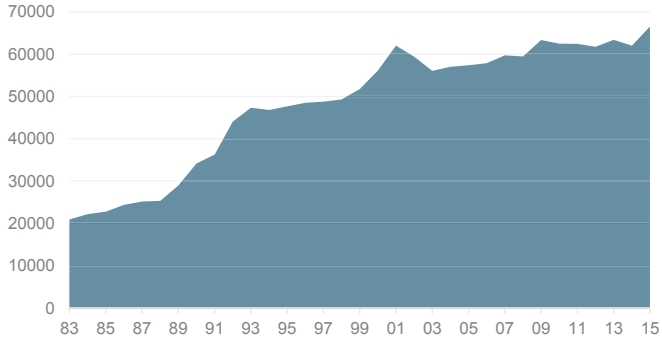
Hotel Occupancy NSW %



Source: Datastream

Chart 11

Hotel Beds in NSW



Source: Datastream

For more information on the impact of China on your clients' investments, please contact your BT relationship manager.

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