



# The Chinese revolution

The Asia-fuelled resources boom is boosting our economy but some question how long it can last, reports **Martin Roth**.

**I**t is the boom that won't go away. China's relentless drive to industrialise and modernise continues to flow through to our own economy. It has sparked a surge in the prices of some commodities and it is the key factor in the sharp appreciation in

the share prices for much of our resources sector and related stocks.

Naturally, many stockmarket investors have been wondering how long it can all last and whether they might be wise to take some profits.

Charlie Aitken, the director of

Southern Cross Equities, says: "We are in the initial stages of this economic phenomenon where global economies are being driven by China and India. Australian resource stocks are coming off 30 years of under-performance and we are only four years into strong



performance. This is a structural change. It is still in its infancy.

“The natural inclination is to say these stocks have done well, and now it is perhaps time to sell them. But they are only up in line with their profit growth. It is not as if we are paying a new price for them. We think this is a 20 year event. It is like the industrialisation of Japan, which was a 25 year event and also led to a boom in resources.”

Aitken points to Australia’s huge resource riches, our political stability and our proximity to Asia. He denies that the sharp appreciation in price for some sectors of our market puts us anywhere near bubble territory.

“Is it a bubble when stocks are still on 11 times earnings? The tech boom was a bubble – you had stocks on 100 times earnings or with no earnings at all. But this is different. It is not at all speculative. I don’t see what will interrupt this. It is the biggest investment event in 20 years. When iron ore prices go up again this year, people will realise that this is real.”

According to the Australian Bureau of Agricultural and Resource Economics, the Chinese economy is expected to grow by 11.3 per cent this year and 10.6 per cent next year. This follows figures of 10.2 per cent in 2005 and 11.1 per cent last year.

In a speech earlier this year, Phillip Mitchell, the managing director of Rio Tinto Iron Ore Development, said: “China is building from scratch a city the size of Brisbane every month. *Every month.* And our iron ore is fuelling that phenomenon.”

Nevertheless, no one is suggesting that there will not be hiccups on the way. In its September Australian commodities quarterly review, the bureau says inflationary pressures in China have been growing, “with the consumer price index rising year on year by 6.5 per cent in August, the highest in 11 years”.

“Prices of food, which account for about a third of the goods included in China’s consumer price index, increased by 18 per cent over the same period. This compares with a year-on-year rise of only 1 per cent in non-food prices in August.”

This has led to rising interest rates, with the bureau predicting a further tightening of monetary policy during the rest of the year.

In a commentary this month on the Australian resources sector, Adnan Kucukalic, an equity strategist with Credit Suisse, says: “Chinese growth is slowing in [the second half] against the backdrop of slowing US retail sales. This is a short-term negative for commodity exposure.”

Another concern is recent stockmarket volatility caused by problems in the US sub-prime mortgage market, along with the continuing weakness of the US housing market generally. It has raised the spectre of a possible global economic slowdown.

This cannot be discounted. However, as BHP Billiton officials stressed in August when announcing their June 2007 full-year financial results, for the first time ever China and India will contribute more to world economic growth this year than the US.

In other words, a pullback in the American economy would not necessarily hit Australia as badly as it would have just a few years ago.

Mark Newman, the chief investment officer of K2 Asset Management, suggests further advantages for local stocks. “Because China, and also India, have done well over the past 10 years, international investors are looking at their markets and wondering how to participate,” he says. “Some of them may think that investing directly in China is too risky, so they may invest indirectly in stocks such as BHP instead.

“Equity investors love investing in markets like Australia where the currency is strong. There is a double whammy for them.”

He says the Chinese Government customarily has bought US Treasury bonds with its vast foreign exchange reserves – an estimated \$1.3 trillion and growing by more than \$1 billion every day. However, last month it launched a \$20 billion sovereign wealth fund, a state-owned investment company which will invest globally.

“I expect them to buy minority positions in Australian resource companies such as BHP,” Newman says. “This may push our price-to-earnings ratios higher. In any case, the share prices of many resource companies have gone up less than profits. These companies haven’t been re-rated. But the sustained impact of Chinese expansion

may see a re-rating.” However, he cautions that “in any cycle there are periods of correction and consolidation. I would expect a consolidation”.

Kucukalic agrees: “I believe the market is already expensive. But can it get more expensive? Yes, for example, if global investors decide they want non-US assets like Australian shares to diversify away from a falling US dollar.

“But the higher the market goes the higher the risk and the bigger the eventual correction and the more the pain. There is not a lot we can do. The healthy thing would be a correction like the one we experienced a few months ago.”

Meanwhile, the boom continues. Simon Guzowski, a senior equities analyst with investor newsletter WiseOwl.com, says: “Japan had 2 per cent of the world’s population and when it industrialised it set off a long term commodities boom. China has 1.3 billion people and India has 1.1 billion. That is 36 per cent of the world’s population. This is unprecedented.”

#### **STOCK PICKS**

It is hard to hear a bad word said against the two diversified resources giants, BHP Billiton and Rio Tinto.

Aitken says he prefers large cap stocks such as these, believing they present greater value than smaller stocks, with less risk. He also recommends LNG and oil producer Woodside Petroleum, iron ore company Fortescue Metals Group, copper and zinc producer Oxiana and aluminium producer Alumina.

Guzowski prefers mid-cap stocks such as Pan Australian Resources, which is involved in gold and copper mining in Laos and which recently entered the S&P/ASX 200 index; nickel producer Mincor Resources, which is growing rapidly; and Kagara Zinc, which is developing a major reserve at Admiral Bay, WA.

**‘China is building from scratch a city the size of Brisbane every month. Our iron ore is fuelling that.’**

Phillip Mitchell, Rio Tinto



## Clean, green liquefied natural gas

Investors seeking the next area of the resources sector to boom should take a look at liquefied natural gas. More than half a dozen massive projects are under consideration around Australia – in Western Australia, Woodside Petroleum recently launched its \$12 billion Pluto offshore development. Annual LNG production from WA alone could triple over the next 10 to 15 years from the present 16 million tonnes, with more possible from other states

In the words of Charlie Aitken of Southern Cross Equities, "Second only to iron ore, LNG is the biggest story right now. It is the clean, green solution for the world's energy needs. Australia has huge reserves and we are close to the markets.

"Anyone who takes more than a two-minute view of the market can see that this is a sector that has to out-perform."

The key company is Woodside. It operates the \$20 billion North West Shelf Venture, Australia's largest resource project, which has been shipping LNG around the world since 1989. It is also the operator and 90 per cent owner of the Pluto

project, with a target of launching production in 2010.

Woodside also controls the Greater Sunrise gas field in the Timor Sea, although it has yet to announce any development plans.

In July this year another leading Australian energy company, Santos, announced its own LNG project, costing \$5-\$7 billion and based on coal seam gas at Gladstone, Queensland.

However, a final investment decision on whether to proceed with the project is not expected until 2009.

Preliminary work has also started on the proposed \$15-\$20 billion Gorgon gas project in WA, near the North West Shelf gas fields. The partners are three multinationals, Chevron, ExxonMobil and Shell.

Most of the engineering companies and contractors that support the resource companies (see below) have exposure to LNG projects.

Aitken also recommends Melbourne's Karoon Gas Australia, an explorer he describes as "a small stock which has the potential to be a big stock".





**Age**  
**Wednesday 24/10/2007**  
**Page: 1**  
**Section: Money**  
**Region: Melbourne Circulation: 207,000**  
**Type: Capital City Daily**  
**Size: 1,717.71 sq.cms.**  
**Published: MTWTFS-**

**Brief: WISEOWL**  
**Page 3 of 5**



## Best supporting roles – the engineers

It is not just the resources stocks that are booming. Some of the best market performances in recent years have come from the diverse engineering companies and other contractors that provide construction and maintenance services to the minerals and energy sectors. Take two of them, both S&P/ASX 200 stocks: Perth's Monadelphous Group provides project management, construction, maintenance and support services to resources companies and Sydney's WorleyParsons arranges design, management and support services for major resources projects.

According to Commonwealth Securities figures, in the three years to mid-October each company had rewarded investors with annual returns – dividends plus share-price appreciation – of more than 100 per cent. Had you bought shares in either company in October 2004, the value of your investment would effectively have more than doubled each year in the ensuing three years.

Three-year annual returns for some other resource sector support stocks include: Ausdrill 76 per cent, Austin Engineering 71, Leighton Holdings 77, Macmahon Holdings 60, RCR Tomlinson 67 and United Group 47. For investors, the question needs to be asked: can such stellar returns continue?

At Monadelphous – where the after-tax profit has soared more than 17-fold in just six years – management officials were cautious when announcing the company's June 2007 financial results.

According to an official company statement: "Capacity constraints in the form of labour shortages are now approaching a critical state and as a consequence any expectation of growth for 2007-08 should be treated with significant caution."

According to Rob Velletri, the company's managing director, "With a number of existing projects ramping down in the first half of 2007-08 and potential delays to near-term project opportunities, Monadelphous is expecting a softening of construction revenue in the first half of the new financial year."

However, some market experts believe these companies still represent excellent long-term potential. "They are in an amazing sweet spot that could continue for some years," says Charlie Aitken of Southern Cross Equities.

He points to BHP Billiton's \$22 billion development program of more than 33 major projects, either under way or in the planning stages. "Someone has to build them," he says. "These are stocks for investors

**'They are in an amazing sweet spot that could continue for some years.'**

Charlie Aitken, Southern Cross Securities

who aren't comfortable buying resource companies."

In some respects, they have less risk than resource companies. As Adnan Kucukalic of Credit Suisse says, their exposure is to production volumes rather than to commodities prices and production of Australian commodities continues to rise.

Simon Guzowski of Wise-Owl.com highlights two companies. One of these is Swick Mining Services, listed in November 2006, which provides drilling rigs. His other recommendation is Austin Engineering, which he says is working at full capacity.

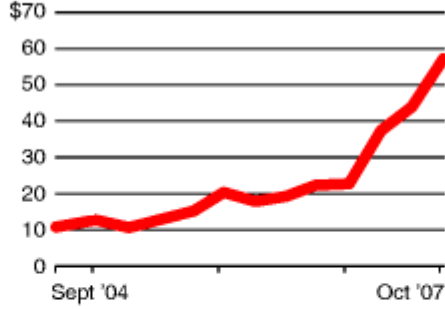


**ON THE WAY UP: RESOURCES AND ENGINEERING STOCKS**

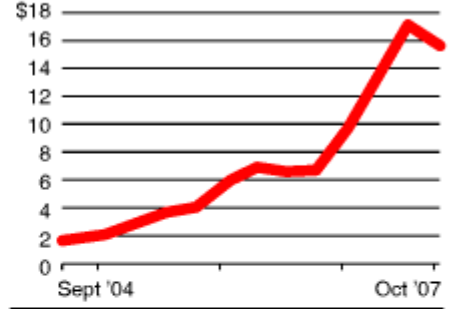
**AUSDRILL**



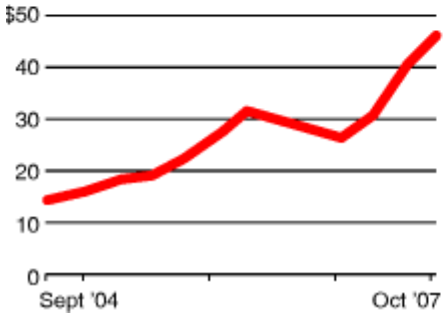
**LEIGHTON**



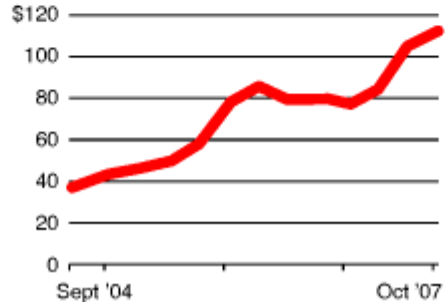
**MONADELPHOUS**



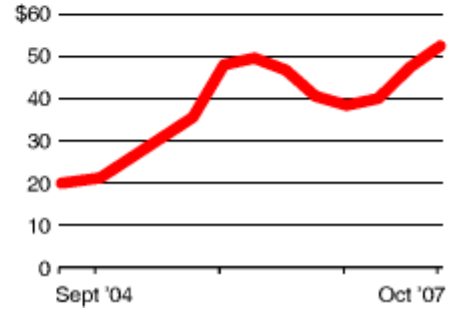
**BHP**

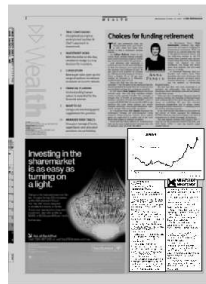


**RIO TINTO**

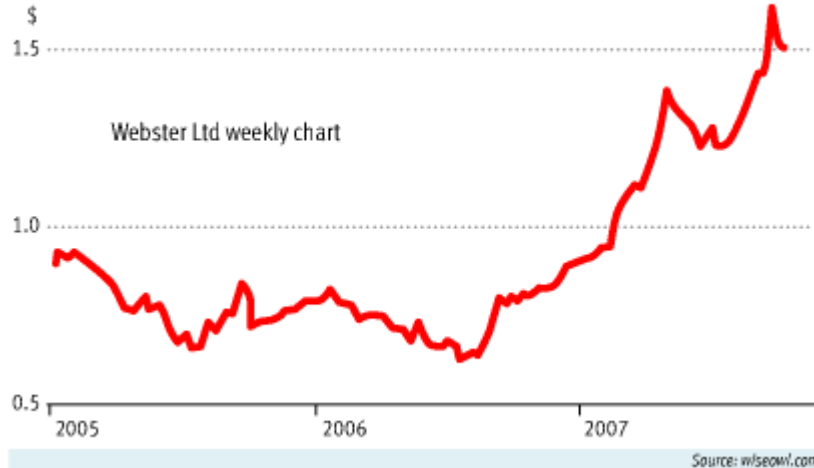


**WOODSIDE**





**UPS AND DOWNS**



**Stock: Webster Ltd**  
**Code: WBA**  
**Market cap: \$93 million**  
**Recommendation: BUY**

FOUNDED in 1831, Webster Ltd (WBA) is the fourth-oldest business in Australia.

The company has three divisions: Webster Corporate, Webster Fresh and Webster Walnuts. The company also manages 2200ha in NSW and Tasmania.

“Walnuts, carrots, onions, shallots and corporate investments are an interesting mix for any business, yet Webster is involved in all of these industries,” wise-owl.com analyst Sven Restel says.

The appeal of Webster is its focus on walnuts, which are currently driving earnings.

Walnuts are high in omega-3 fatty acids and demand is on the rise as more people learn about their health benefits.

“Most of the walnuts sold in Australia are imported, so Webster is positioning itself to supply more of the local market,” Restel says.

The European market is Webster’s biggest customer.

“In the northern European winter, demand outstrips supply; therefore the demand for Tasmanian walnuts increases considerably,” Restel says. The walnut division is the

**WHAT'S HOT**  
**WHAT'S NOT**

main earnings driver for Webster and revenue increased 133 per cent to \$4.9 million last year.

These profits were derived from nursery operations, orchard development and orchard management. Webster’s aim is to have 4000ha by 2009.

Plans have also been announced for a \$2 million processing plant in NSW, a \$10 million processing and packaging plant and a targeted \$100 million turnover.

Another interesting aspect of Webster is its 29.27 per cent holding of salmon producer Tassal Group.

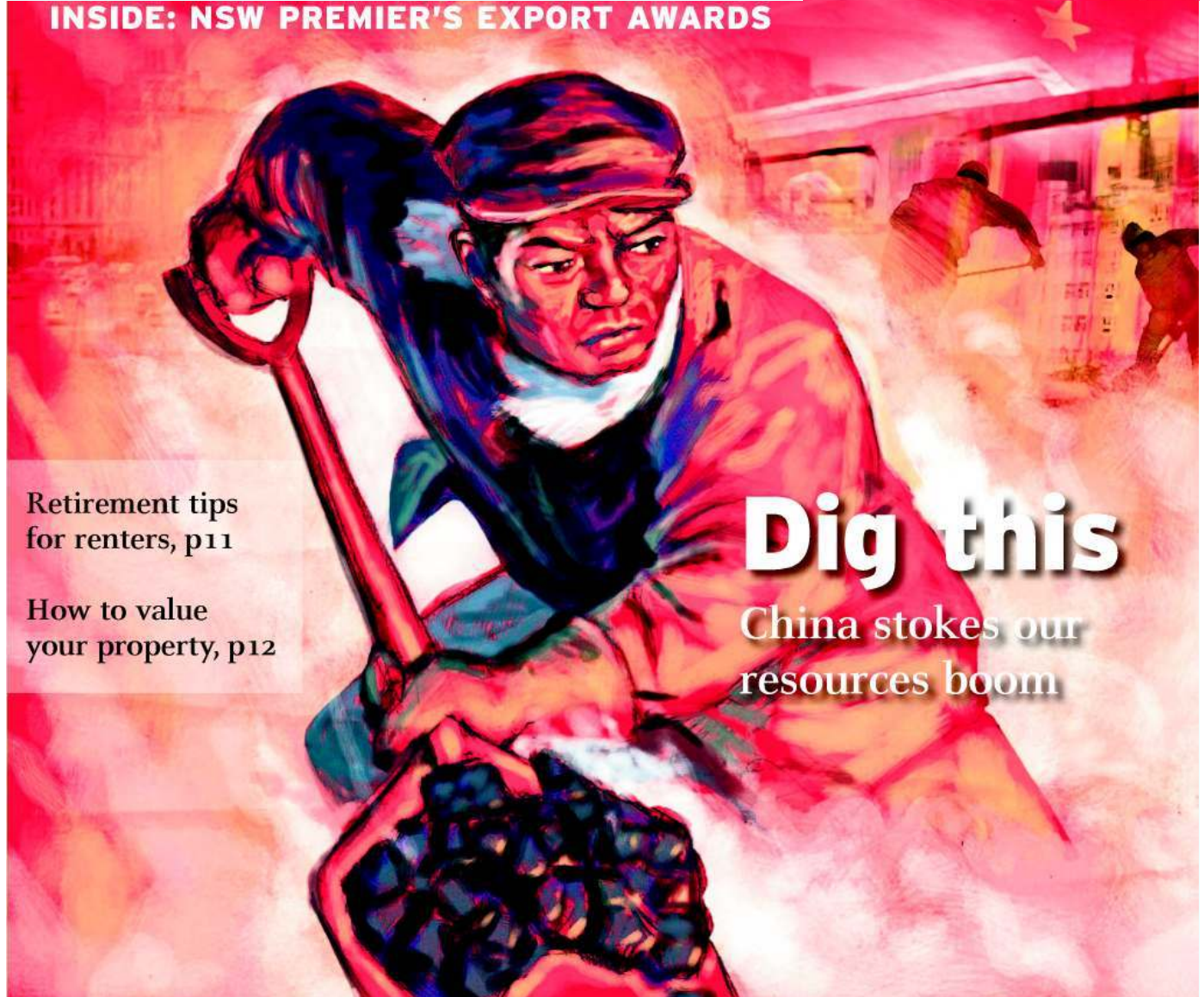
Tassal’s current market capitalisation is \$387 million, so Webster’s share is worth \$113 million (pre-CGT).

“At Webster’s current market capitalisation the company is trading at a discount to its Tassal holding alone and the market is not putting much value on their walnut and fresh food division either,” Restel says.

That alone makes Webster an appealing investment. Growth of the walnut industry is icing on the cake. wise-owl.com



**INSIDE: NSW PREMIER'S EXPORT AWARDS**



Retirement tips  
for renters, p11

How to value  
your property, p12

# Dig this

China stokes our  
resources boom



COVER STORY

# The Chinese revolution

The Asia-fuelled resources boom is boosting our economy but some question how long it can last, reports **Martin Roth**.

It is the boom that won't go away. China's relentless drive to industrialise and modernise continues to flow through to our own economy. It has sparked a surge in the prices of some commodities and it is the key factor in the sharp appreciation in the share prices for much of our resources sector and related stocks.

Naturally, many stockmarket investors have been wondering how long it can all last and whether they might be wise to take some profits.

Charlie Aitken, the director of Southern Cross Equities, says: "We are in the initial stages of this economic phenomenon where global economies are being driven by China and India. Australian resource stocks are coming off 30 years of under-performance and we are only four years into strong performance. This is a structural change. It is still in its infancy.

"The natural inclination is to say these stocks have done well, and now it is perhaps time to sell them. But they are only up in line with their profit growth. It is not as if we are paying a new price for them. We think this is a 20-year

event. It is like the industrialisation of Japan, which was a 25-year event and also led to a boom in resources."

Aitken points to Australia's huge resource riches, our political stability and our proximity to Asia. He denies that the sharp appreciation in price for some sectors of our market puts us anywhere near bubble territory.

"Is it a bubble when stocks are still on 11 times earnings? The tech boom was a bubble – you had stocks on 100 times earnings or with no earnings at all. But this is different. It is not at all speculative. I don't see what will interrupt this. It is the biggest investment event in 20 years. When iron ore prices go up again this year, people will realise that this is real."

According to the Australian Bureau of Agricultural and Resource Economics, the Chinese economy is expected to grow by 11.3 per cent this year and 10.6 per cent next year. This follows figures of 10.2 per cent in 2005 and 11.1 per cent last year.

In a speech earlier this year, Phillip Mitchell, the managing director of Rio Tinto Iron Ore Development, said: "China

is building from scratch a city the size of Brisbane every month. *Every month*. And our iron ore is fuelling that phenomenon."

Nevertheless, no one is suggesting that there will not be hiccups on the way. In its September Australian commodities quarterly review, the bureau says inflationary pressures in China have been growing, "with the consumer price index rising year-on-year by 6.5 per cent in August, the highest in 11 years".

"Prices of food, which account for about a third of the goods included in China's consumer price index, increased by 18 per cent over the same period. This compares with a year-on-year rise of only 1 per cent in non-food prices in August."

This has led to rising interest rates, with the bureau predicting a further tightening of monetary policy during the rest of the year.

In a commentary this month on the Australian resources sector, Adnan Kucukalic, an equity strategist with Credit Suisse, says: "Chinese growth is slowing in [the second half] against the



backdrop of slowing US retail sales. This is a short-term negative for commodity exposure.”

Another concern is recent stockmarket volatility caused by problems in the US sub-prime mortgage market, along with the continuing weakness of the US housing market generally. It has raised the spectre of a possible global economic slowdown.

This cannot be discounted. However, as BHP Billiton officials stressed in August when announcing their June 2007 full-year financial results, for the first time ever China and India will contribute more to world economic growth this year than the US.

In other words, a pullback in the American economy would not necessarily hit Australia as badly as it would have just a few years ago.

Mark Newman, the chief investment officer of K2 Asset Management, suggests further advantages for local stocks. “Because China, and also India, have done well over the past 10 years, international investors are looking at their markets and wondering how to participate,” he says. “Some of them may think that investing directly in China is too risky, so they may invest indirectly in stocks such as BHP instead.

“Equity investors love investing in markets like Australia where the currency is strong. There is a double whammy for them.”

He says the Chinese Government customarily has bought US Treasury bonds with its vast foreign exchange reserves – an estimated \$1.3 trillion and growing by more than \$1 billion every

day. However, last month it launched a \$220 billion sovereign-wealth fund, a state-owned investment company which will invest globally.

“I expect them to buy minority positions in Australian resource companies such as BHP,” Newman says. “This may push our price-to-earnings ratios higher. In any case, the share prices of many resource companies have gone up less than profits. These companies haven’t been re-rated. But the sustained impact of Chinese expansion may see a re-rating.” However, he cautions that “in any cycle there are periods of correction and consolidation. I would expect a consolidation”.

Kucukalic agrees: “I believe the market is already expensive. But can it get more expensive? Yes, for example, if global investors decide they want non-US assets like Australian shares to diversify away from a falling US dollar.

“But the higher the market goes the higher the risk and the bigger the eventual correction and the more the pain. There is not a lot we can do. The healthy thing would be a correction like the one we experienced a few months ago.”

Meanwhile, the boom continues. Simon Guzowski, a senior equities analyst with investor newsletter Wise-Owl.com, says: “Japan had 2 per cent of the world’s population and when it industrialised it set off a long-term commodities boom. China has 1.3 billion people and India has 1.1 billion. That is 36 per cent of the world’s population. This is unprecedented.”

#### STOCK PICKS

It is hard to hear a bad word said against the two diversified resources giants, BHP Billiton and Rio Tinto.

Aitken says he prefers large-cap stocks such as these, believing they present greater value than smaller stocks, with less risk. He also recommends LNG and oil producer Woodside Petroleum, iron ore company Fortescue Metals Group, copper and zinc producer Oxiana and aluminium producer Alumina.

Guzowski prefers mid-cap stocks such as Pan Australian Resources, which is involved in gold and copper mining in Laos and which recently entered the S&P/ASX 200 index; nickel producer Mincor Resources, which is growing rapidly; and Kagara Zinc, which is developing a major reserve at Admiral Bay, WA.

**‘China is building from scratch a city the size of Brisbane every month. Our iron ore is fuelling that.’**

Phillip Mitchell, Rio Tinto

**‘They are in an amazing sweet spot that could continue for some years.’**

Charlie Aitken, Southern Cross Securities



**ON THE WAY UP: RESOURCES AND ENGINEERING STOCKS**

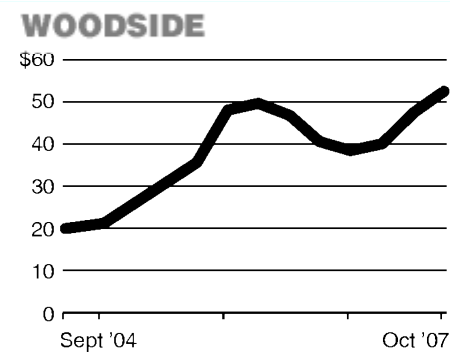
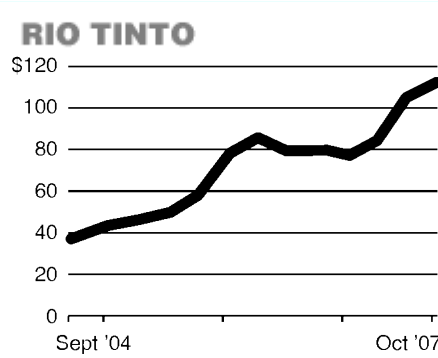
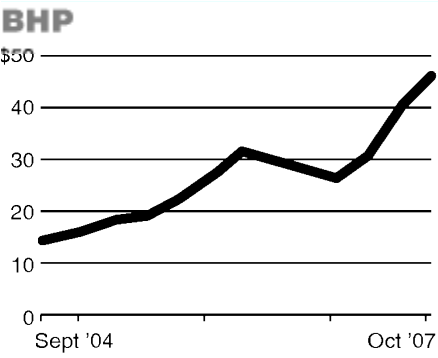
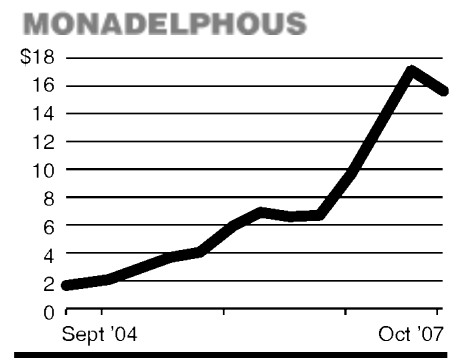
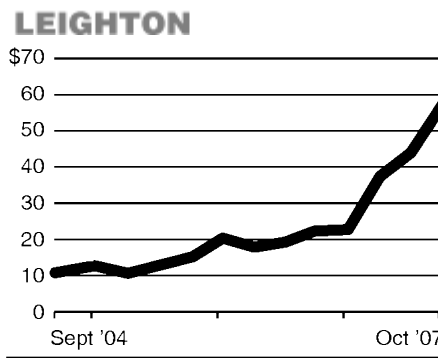
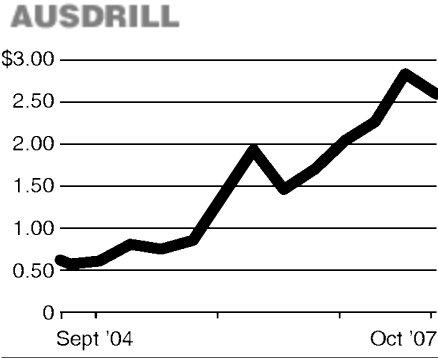


Illustration:  
Michael Mucci  
MON 004





## Clean, green liquefied natural gas

Investors seeking the next area of the resources sector to boom should take a look at liquefied natural gas. More than half a dozen massive projects are under consideration around Australia – in Western Australia, Woodside Petroleum recently launched its \$12 billion Pluto offshore development. Annual LNG production from WA alone could triple over the next 10 to 15 years from the present 16 million tonnes, with more possible from other states

In the words of Charlie Aitken of Southern Cross Equities, "Second only to iron ore, LNG is the biggest story right now. It is the clean, green solution for the world's energy needs. Australia has huge reserves and we are close to the markets.

"Anyone who takes more than a

two-minute view of the market can see that this is a sector that has to out-perform."

The key company is Woodside. It operates the \$20 billion North West Shelf Venture, Australia's largest resource project, which has been shipping LNG around the world since 1989. It is also the operator and 90 per cent owner of the Pluto project, with a target of launching production in 2010.

Woodside also controls the Greater Sunrise gas field in the Timor Sea, although it has yet to announce any development plans.

In July this year another leading Australian energy company, Santos, announced its own LNG project, costing \$5-\$7 billion and based on coal seam gas at Gladstone,

Queensland.

However, a final investment decision on whether to proceed with the project is not expected until 2009.

Preliminary work has also started on the proposed \$15-\$20 billion Gorgon gas project in WA, near the North West Shelf gas fields. The partners are three multinationals, Chevron, ExxonMobil and Shell.

Most of the engineering companies and contractors that support the resource companies (see below) have exposure to LNG projects.

Aitken also recommends Melbourne's Karoon Gas Australia, an explorer he describes as "a small stock which has the potential to be a big stock".

## Best supporting roles – the engineers

It is not just the resources stocks that are booming. Some of the best market performances in recent years have come from the diverse engineering companies and other contractors that provide construction and maintenance services to the minerals and energy sectors. Take two of them, both S&P/ASX 200 stocks: Perth's Monadelphous Group provides project management, construction, maintenance and support services to resources companies and Sydney's WorleyParsons arranges design, management and support services for major resources projects.

According to Commonwealth Securities figures, in the three years to mid-October each company had rewarded investors with annual returns – dividends plus share-price appreciation – of more than 100 per cent. Had you bought shares in either company in October 2004, the value of your investment would effectively have more than doubled each year in the ensuing three years.

Three-year annual returns for some other resource sector support

stocks include: Ausdrill 76 per cent, Austin Engineering 71, Leighton Holdings 77, Macmahon Holdings 60, RCR Tomlinson 67 and United Group 47. For investors, the question needs to be asked: can such stellar returns continue?

At Monadelphous – where the after-tax profit has soared more than 17-fold in just six years – management officials were cautious when announcing the company's June 2007 financial results.

According to an official company statement: "Capacity constraints in the form of labour shortages are now approaching a critical state and as a consequence any expectation of growth for 2007-08 should be treated with significant caution."

According to Rob Velletri, the company's managing director, "With a number of existing projects ramping down in the first half of 2007-08 and potential delays to near-term project opportunities, Monadelphous is expecting a softening of construction revenue in the first half of the new financial year."

However, some market experts

believe these companies still represent excellent long-term potential. "They are in an amazing sweet spot that could continue for some years," says Charlie Aitken of Southern Cross Equities.

He points to BHP Billiton's \$22 billion development program of more than 33 major projects, either under way or in the planning stages. "Someone has to build them," he says. "These are stocks for investors who aren't comfortable buying resource companies."

In some respects, they have less risk than resource companies. As Adnan Kucukalic of Credit Suisse says, their exposure is to production volumes rather than to commodities prices and production of Australian commodities continues to rise.

Simon Guzowski of Wise-Owl.com highlights two companies. One of these is Swick Mining Services, listed in November 2006, which provides drilling rigs. His other recommendation is Austin Engineering, which he says is working at full capacity.