

EQUITIES

Table of Contents

- | | | |
|----|---|--------|
| 1. | Coordinator's Introduction by Brian Matthews, AIA Member | Page 1 |
| 2. | The Australian Sharemarket - At a crossroad, so where to next?
by Zac Zacharia, Ord Minnett (Adelaide) | Page 2 |
| 3. | Coal Seam Gas (CSG) to Liquefied Natural Gas (LNG) – the
potential is huge but it has its risks? by Russell Lees,
Investstone Wealth Management | Page 6 |

* * * * *

COORDINATOR'S MESSAGE

By Brian Matthews

Where next the share market? If we only knew with some certainty! Fundamentals present 'green shoots' for some, whilst others suspect them to be 'yellow weeds'. Who is right? Zac Zacharia, a representative of Ord Minnett, in his article titled 'The share market – at a crossroads, so where to next?' briefly reviews current fundamentals and then looks to chart signals to throw more light on the matter. He concludes, at the time of writing, that caution should still prevail as there is no confirmation yet that a new uptrend, or bull market, has commenced.

Using charts depicting the behaviour of both shorter term investors/traders and longer term investors/superannuation funds, Zac details movements that he believes are needed to signal a market change in direction.

Coal Seam Gas (CSG) and its conversion to Liquefied Natural Gas (LNG) has been one of the hottest subjects in the market of late. And, it has been very rewarding for those invested in relevant stocks when the potential for the process came to the fore. In this edition, Russell Lees, an adviser with Investstone Wealth Management, updates readers on the sector. His article briefly details the CSG to LNG process, outlines recent Australian CSG sector activity, and reviews the status of three of the local players – namely Santos, AGL Energy and Origin Energy. Risks involved in both the process and investing in the sector are also documented.

Brian Matthews is a member of the AIA.

* * * * *

THE SHAREMARKET – AT A CROSSROADS, SO WHERE TO NEXT?

By Zac Zacharia

It would be stating the obvious to say that it has been a horrific time on the Australian sharemarket over the last 18 months. Since the 6873.2 all time high for the All Ordinaries index on the 1st of November 2007, our market fell to a low of 3090.8 on the 10th of March 2009 – a 55% (or 3782.4 point) drop in a year and four months!

This drop, amidst the unravelling financial crisis, effectively erased all of the market growth since July 2003, at a time when most of the developed world was heading into recession. Since the March lows, our market has rallied back to a high (on 11 May 2009) of 3941.7 – a 27.5% move, albeit from low levels. The question is – what happens from here?

FUNDAMENTAL SIGNALS

Fundamentally, it seems that we may have seen the bottom of the sharemarket, at least for now, as one would argue that the bad news (we know of) has been factored into the market. Investors should watch economic indicators such as business and consumer confidence data and gross domestic product (GDP) for early indications of a turnaround in the economy. This will also be confirmed once interest rates have bottomed out. Always keep in mind that the sharemarket, historically, has led the economy by between 6-12 months, so when the economy bottoms, the sharemarket has generally already reversed its direction and embarked on a sustainable uptrend. Fundamental risks to the market include further earnings downgrades and surprises around the reporting season, more dividend reductions and unforeseen provisions for bad debts.

CHART SIGNALS

From a technical (charting) viewpoint of the top 500 shares, as represented by the All Ordinaries Index, caution should still prevail as the market is at a crossroads. The key issue, at time of writing, despite the recent rally, there is no confirmation that a new uptrend, or bull market, has commenced as yet.

So what then will signal a confirmation of a new uptrend? To answer this question, we have to go back to basics - an uptrend, by definition, is a series of higher peaks AND higher troughs in price action. Therefore, unless we have both these conditions, as a minimum, we cannot strictly call any price movement, no matter how positive, as being in an uptrend. I personally add further qualifying criteria to confirm an uptrend by looking for price to remain above its 40 week moving average and also prefer to see volume flowing back into the market in sync with upward price movements.

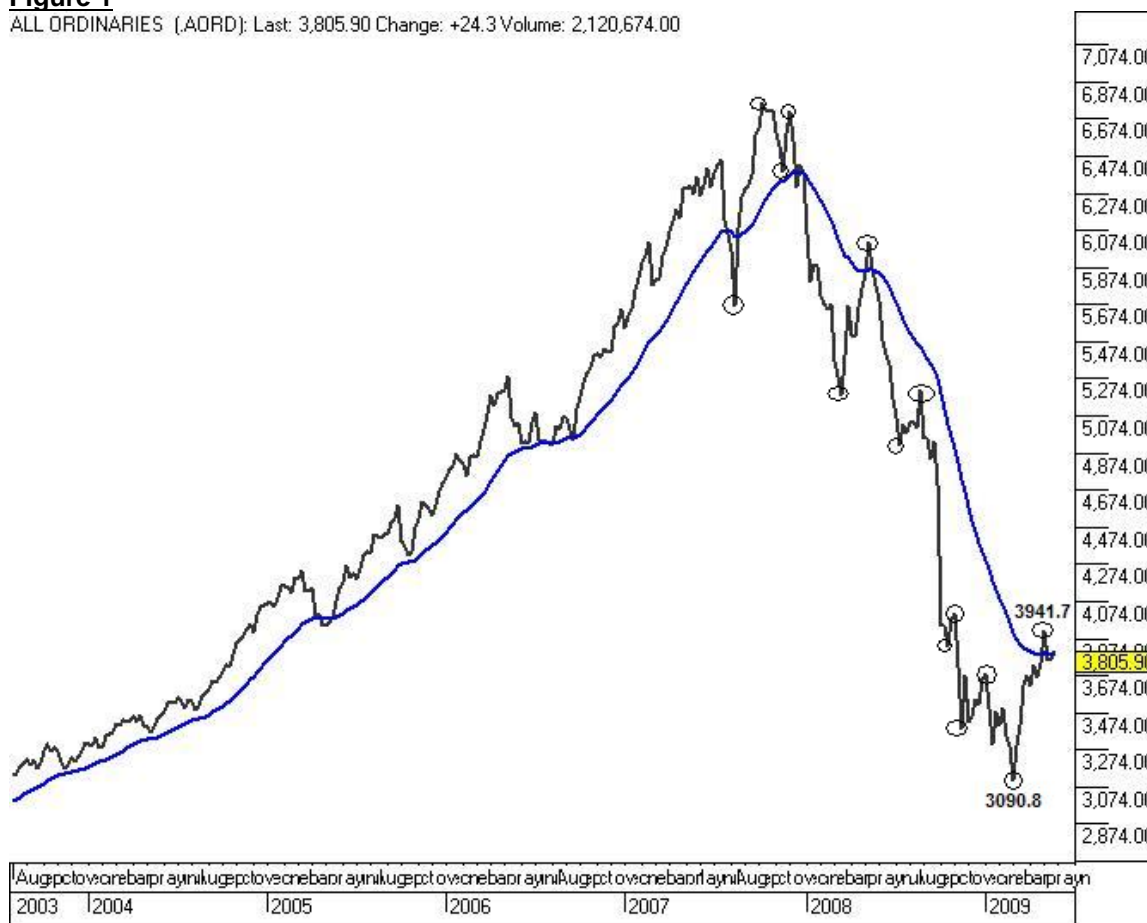
The downside to this technical definition, and waiting for confirmation of a bull market, is that you will miss out on the initial move just after the real bottom has locked in. However this is a small price to pay for safety of only getting into the market when the price has changed its trend and momentum is to the upside. Waiting for this confirmation is a much more consistently profitable strategy in the long run than trying to pick bottoms.

The weekly chart of the All Ordinaries (XAO) index shown in Figure 1 below illustrates that our market has broken its prior swing high with enthusiasm in the first quarter of this year to then make a new swing high of 3941.7. At time of writing our market has not yet made a higher swing low than the 3090.8 low of March 2009.

This situation presents a dilemma to investors...the million dollar question is: "Are we in a bull market yet or is this just another bear rally?" Based on the above definition of what constitutes an uptrend – the answer in my opinion is "NO – WE AREN'T IN A TECHNICAL BULL MARKET, YET. BUT WE CERTAINLY ARE AT A CROSSROADS".

Figure 1

ALL ORDINARIES (AORD): Last: 3,805.90 Change: +24.3 Volume: 2,120,674.00



If this is the start of what will be a change of major trend from down to up on the All Ordinaries, then we should assess how investors are “feeling” - as represented by whether investor sentiment – and whether this is changing. Ultimately this will define whether there is commitment to a price move to the upside.

MEASURING INVESTOR SENTIMENT

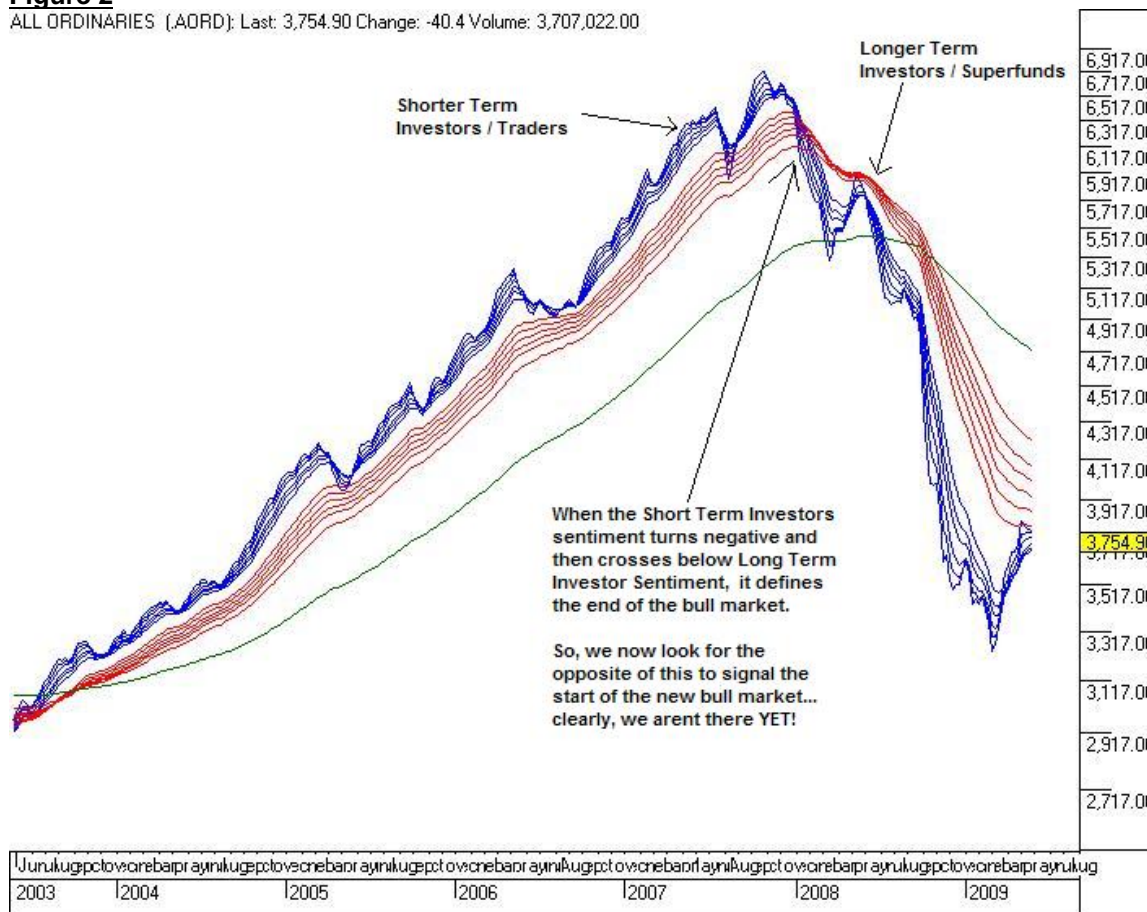
Figure 2 below is a chart of the All Ordinaries Index on a weekly timeframe once more – but overlaid with a “Guppy Multiple Moving Average” template. The group of smoother moving averages (in red) represent longer term investor (superfund-style) sentiment and the group of blue moving averages represent shorter term investor (traders) sentiment.

In a bull market, the group of shorter term investor sentiment is above the rising group of longer term investor sentiment (see the period between 2003 and 2007). This shorter group buys and sells in a rising market taking shorter term profits, but never fall below the group of longer term investor sentiment levels. Once it does breach, it is confirmation of a dynamic change in market conditions ie. that the market has now changed to a BEAR MARKET.

Referring back to Figure 2, using this technique it is quite clear that there was no reason to remain fully invested in the market after September 2007 – shorter term investor sentiment was declining and BELOW the longer term investors’ sentiment, which was also declining! Astute investors who used this simple technique would have avoided the majority of the catastrophic fall in the value of their portfolios!

Figure 2

ALL ORDINARIES (.AORD): Last: 3,754.90 Change: -40.4 Volume: 3,707,022.00



So how will we know when the sentiment of both shorter term and longer term investors in the market has changed back to become bullish once more?

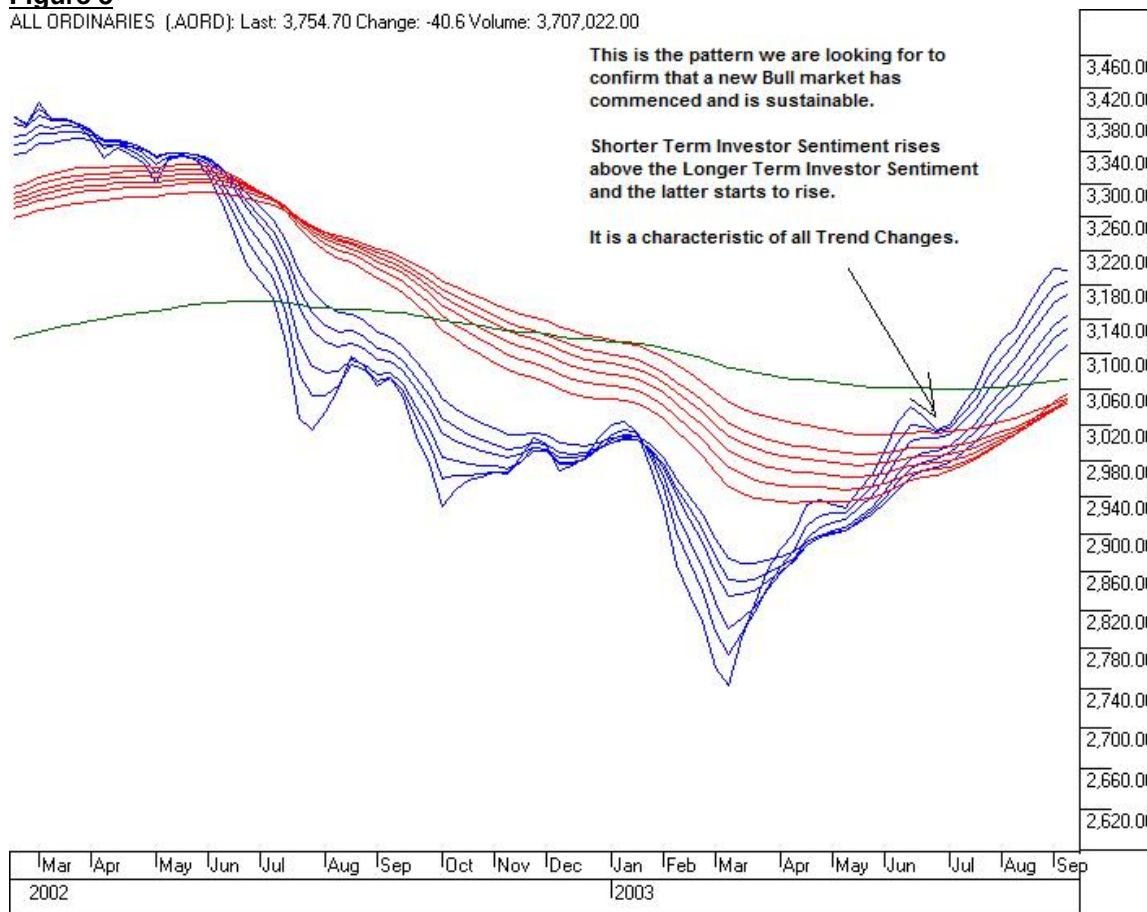
The answer is that we are seeking the exact opposite pattern than that which we saw in September 2007 when it turned negative. For a sustainable uptrend, a pattern similar to that in Figure 3 is expected - where shorter term investor sentiment strengthens and goes ABOVE longer term investor sentiment which is rising.

This pattern will only form once the shorter term investor sentiment rises through the longer term investor sentiment, and this trend change pattern always emerges when the market changes direction.

An example of this is at the start of the 2003 BULL MARKET shown in Figure 3 below.

Figure 3

ALL ORDINARIES (.AORD): Last: 3,754.70 Change: -40.6 Volume: 3,707,022.00



WHERE TO NEXT?

Based on the above analysis, I present a couple of scenarios which could unfold from here over the following months. Investors should be prepared for both and have a strategy to deal with either:

Scenario 1:

For a sustainable bull market to commence, one would ideally expect to see a pullback to 3600-3700 over several months, form a swing low, and then commence a rally from there on significant volume to then exceed the previous swing high. At least one significant higher low is needed to confirm the current market as being in a bullish trend....and ideally this would be after sufficient time has passed, and the index remains above its 40 week moving average.

Investors can therefore consider using an “averaging-in” strategy by staggering their purchases of quality shares over a period of several weeks or months, but be aware of an exit strategy should the market reverse unexpectedly.

Scenario 2:

Should a pullback in the market be accompanied by high volume and drag the market below 3500, it is highly likely that the market could retest the 3090.8 lows again. While this scenario is unlikely (given that the worst of the fundamentals of the economic crisis and company earnings revisions have been factored into current share prices) one should always be prepared for the unexpected.

Zac Zacharia is a Representative of Ord Minnett Ltd (Adelaide), AFS licence 237121. Zac can be contacted on 08-8203 2500 or zzacharia@ords.com.au. In the next issue Zac will write about when to be invested in the market and when to be invested in cash. All charts courtesy of MDS Market Analyser (www.mdsnews.com). Guppy Multiple Moving Average method applied from the learnings of Darryl Guppy (www.guppytraders.com.au).

This article contains general financial advice only and does not consider your personal circumstances; you should determine its suitability to you. Before acquiring a financial product you should consider the relevant product disclosure statement. Past performance is not a reliable indicator of future performance.

COAL SEAM GAS (CSG) TO LIQUEFIED NATURAL GAS (LNG) – THE POTENTIAL IS HUGE BUT IT HAS ITS RISKS?

By Russell Lees

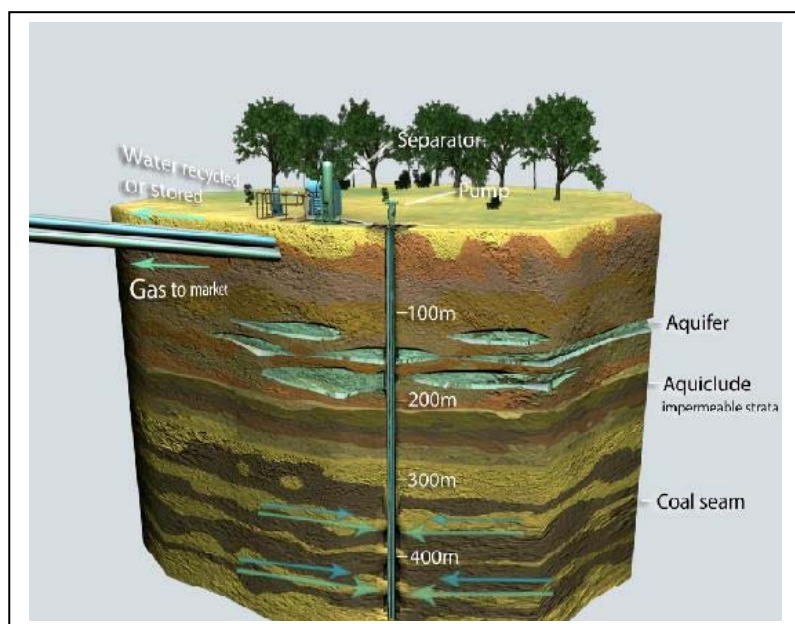
It's one of the hottest sectors of the market with all the right ingredients for making attention grabbing front page headlines as well as whetting the appetite of the most seasoned investors. So let's start by summing up the ingredients. New technology to extract gas stored in deep underground coal fields that's suitable for being turned into LNG, emerging local companies who held the access to the gas, larger Australian energy retailers hungry for access to long term gas supplies, multi-national energy giants prepared to throw billions of dollars to get a leading position in the sector, and finally, an as yet untested ability to setup large scale CSG to LNG facilities on a commercial scale that will generate profits on the billions of dollars of investment currently being made. You can start to understand why everyone's talking about it!

With so much activity going on in the CSG sector and the expectation of much more to come we update readers on what's happening in the sector, outline where it is heading and what are the opportunities as well as risks for investors.

What is Coal Seam Gas?

Deep in underground coal beds (normally these coal beds are between 300 to 1500 metres underground) natural gas is imbedded in the coal as a result of water and ground pressure. Coal seam gas refers to the gas (normally methane) lining the open fractures between the coal and the inside of pores within the coal.

To extract the gas, a well is drilled into the coal beds. This is initially used to draw out water from the coal beds which has the effect of lowering the water pressure in the coal seams. As the pressure within the coal seams decline the gas separates from the coal allowing both gas and water to escape to the surface through tubes in the well. The gas is then sent to a compressor station for processing and then is pumped into commercial gas pipelines. The water can either be reinjected back underground, sent to storing dams or recycled.



A well is used to access gas from coal seams deep underground. Source: Arrow Energy

The conversion to LNG

CSG-to-LNG conversion is not a new technology, but it is the first time efforts to commercialise the process look very likely to be successful. The process was first pioneered in the US in the 1980s, but enthusiasm waned then because of the low energy value of CSG compared with conventional natural gas. At that time, other energy sources were cheaper and more readily available. Over the last decade the focus has returned to CSG, mainly as demand for cleaner energy sources over coal has rapidly increased. With the improvement in conversion technology and the desire of traditional LNG producers (who have previously always focused on offshore natural gas) to diversify their sourcing of LNG, the CSG to LNG sector is quickly getting very hot as large global LNG players position themselves by buying up the smaller players as well as entering joint ventures with key Australian producers.

The cautionary note here is that buyers of LNG (particularly the large Asian buyers) are still to be convinced on the quality of LNG sourced from CSG compared to LNG sourced from offshore natural gas. This may explain the slowness in locking in key customers as buyers highlight the inferior quality of CSG to offshore natural gas. With large new offshore gas fields coming on line over the next decade, the current excitement with CSG could have the potential to be short lived.

The Australian CSG sector

Corporate activity over the last few years highlights exactly where we are in terms of CSG in Australia. The takeover of Queensland Gas (QGC) in 2008 and the more recent takeover of Pure Energy this year typifies the state of the sector which is highlighted by both domestic producers/retailers alongside multinational energy giants all playing musical chairs for a prime seat at the CSG table.

Let's consider Queensland Gas. Back in 2006 Santos attempted to acquire QGC via an unsolicited offer. That same year AGL entered into a strategic partnership with QGC and agreed to take up a share placement that would give AGL 27% of QGC. In 2007 Santos increased its takeover offer and QGC also received an offer by an international private equity fund by the name of TCW. AGL had no other option and was forced to increase its offer for the shares allocated in the placement to \$1.60. Just when things were looking bedded down along comes British Gas (BG) in 2008 who enter into an \$870m alliance with QGC to develop LNG from CSG and obtains a 10% stake in QGC. This is followed in the same year by QGC mopping up several of the smaller Queensland CSG players with offers for Roma Petroleum and Sunshine Gas. And finally in late 2008 BG makes a full and successful on market takeover for QGC at \$5.75 per share. Now that's what you call corporate activity!

The consolidation in the sector is continuing as other multinational energy giants enter into strategic partnerships in Australia with many of our key energy producers which will ensure the race for LNG will continue for sometime yet.

Recent corporate activity in the CSG to LNG sector

Company	Investor	Structure
Santos	Petronas	Invests US\$2.5b to acquire 40% interest in Gladstone CSG to LNG project
Origin Energy	ConocoPhillips	Invests up to A\$9.6b to acquire 50% interest in Queensland CSG to LNG project
Pure Energy	British Gas	Full takeover offer

Arrow Energy	Royal Dutch Shell	Invests A\$915m for 30% of Australian tenements and 10% of international assets
QGC	British Gas	Full takeover offer
Sydney Gas	AGL Energy	Successful takeover offer provides access to the company's NSW CSG assets

After the significant consolidation in the sector over the last few years the end game has come down to 5 key players: Santos/Petronas, Origin/ConocoPhillips, British Gas, AGL, and finally Arrow/Royal Dutch Shell.

Recent talk is all about further consolidation in the sector and is mainly focused around Gladstone in Queensland primarily as a means to lower the cost of setting up key LNG processing and export facilities. Considering the huge capital costs of setting up infrastructure as well as the large amounts of cash that has already been thrown at the sector it makes sense that some level of consolidation will continue to happen.

The players

Santos

Santos received cash of US\$2b upfront with a further US\$500m contingent payment for selling a 40% share of its CSG to LNG assets in Queensland.

The company is coming to the end of traditionally relying on its old Cooper and Carnarvon Basin gas reserves and for the last 10 years has been frantically looking for new growth options. It has found growth in LNG and has setup LNG facilities in Darwin and is also relying on the joint venture with Petronas in Queensland with CSG to LNG. Santos is also a 17.7% partner in the PNG LNG project.

The company has recently announced a 2 for 5 rights issue to raise up to A\$3b to fund its share of the PNG LNG project as well as the redemption of the FUELS hybrids. With the removal of the 15% shareholding cap Santos has been rerated on both its takeover appeal and its LNG growth profile. Our view is the stock is fully valued at the current price – HOLD (take up the rights entitlement).

AGL Energy

AGL is potentially the smart one of the group having cashed up several of its LNG interests over the last year by selling its interest in the PNG oil and gas fields for \$1.1b in 2008 and selling its stake in QGC to British Gas for \$1.18b whilst locking in long term gas supply contracts with BG.

It has been slowly reinvesting the cash via a takeover of Sydney Gas, which holds CSG interests in NSW and has also been heavily focussed on buying renewable energy assets, which positions them well for being a key beneficiary of the government's renewable energy policies.

With plenty of cash still on hand and its competitors focused on LNG, AGL is well positioned to be a key beneficiary of the expected NSW government's energy assets privatisation.

With the stock trading on attractive fundamentals and providing exposure to defensive earnings streams along with an excellent portfolio of renewable and CSG energy assets we rate the stock as a BUY.

Origin Energy

Origin is probably Australia's most vertically integrated energy company, having interests in energy retailing, power generation projects (QLD, WA, SA), upstream oil and gas production and exploration (the Cooper, Eromanga and Bass Basins), coal seam gas (QLD & Otway Basin) and infrastructure management via its interest in and contracts with Envestra.

Diversification into NZ came through the acquisition of Contact Energy.

Origin is now actively building its CSG reserve base ahead of its LNG venture with ConocoPhillips which is scheduled for start up production in 2014. Trading on high fundamentals (PE of 27 yield of 4.3%) we rate the stock as a HOLD.

Summary

The often overlooked issue for Australia from the significant investment into CSG to LNG is the massive potential in export earnings should all projects get to completion.

With question marks over the longer term prospects of the sector and buyer preference for LNG sourced from higher quality conventional gas, the sector certainly has its risks.

If it works, the potential rewards are significant for all players including investors but especially for our terms of trade and value of our exports, which for a country reliant on imports, is just what we need.

Russell Lees is an Adviser with Investstone Wealth Management. This article first appeared in the May 2009 edition of the "Investing Times" newsletter, published by Investstone Wealth Management.

* * * * *

This bulletin is produced by the:

Australian Investors' Association
PO Box 2477
Fortitude Valley BC Qld 4006
Tel: 1300 555 061 Fax: 07 3257 3932
Email: aia@investors.asn.au
Web: www.investors.asn.au

Disclaimer

This Disclaimer is made for the purposes of the Corporations Act 2001 as amended by the Financial Services Reform Act 2001 ("the Acts").

The Australian Investors' Association

The Australian Investors Association ABN 75 052 411 999 ("AIA") is a non-profit association that aims to assist investors become more knowledgeable and independent. In furthering its aims the AIA offers general information through its **publications**. The AIA has no Australian Financial Services Licence ("AFSL") under Part 7 of the Corporations Act 2001 as amended.

Does not contravene the Acts

The AIA, its officers, agents, representatives, and employees do not hold an AFSL and does not purport to give advice or operate in any way in contravention of the Acts. The AIA, its officers, agents, representatives, and employees exclude all liability whatsoever, in negligence or otherwise, for any loss or damage relating to this publication to the full extent permitted by law. The AIA has a policy that does not permit the endorsement or recommendation of any product or service regulated by the Acts.

Provides Information only

This **publication** has been prepared as an information **publication** without consideration of any *reader's* specific investment objectives, personal financial situations or needs. Because of this, no reader should rely upon the information and/or recommendations contained in this **publication**. Readers should, before acting on any information contained herein, consider the appropriateness of the information, having regard to their objectives, financial situation and needs.

The AIA believes that the material contained in this **publication** is based on the information from sources that are considered reliable and is accurate when issued. However, the AIA does not warrant its accuracy or reliability. All views and information expressed by the AIA, its officers, agents, representatives, and employees are for the purposes of discussion only.

If this **publication**, or any information, relates to the acquisition, or possible acquisition, of a particular financial product, the reader should obtain a product disclosure statement relating to the product and consider that statement, and should consult a licenced person before making any decision about whether to acquire the product.

The opinions expressed in this **publication** are those of the authors and do not necessarily reflect the views of the AIA.

Copyright: All rights reserved. No re-publication or copying in any way, including electronic means, may be made without the prior written consent of the AIA.