China attracts private companies to provide clean water
Sophie Taylor and Alison Leung

China has opened the door to foreign investment in providing clean water, like at a Macao water plant, which is operated by a joint French and Chinese company. (Garrige Ho/Reuters)

When Chen Xiangwen first moved to Beijing eight years ago, she expected to be able to drink the tap water. After all, she was living in a city about to host the 2008 Olympic Games.

But like millions of Beijingers, Chen soon discovered the tap water was unfit to drink and was a possible health hazard.

"The tap water had a funny smell, and it seemed like there were all sorts of particles in it," said the 30-year-old consultant. "Once I found a convenient place to buy bottled water, I never looked back."

More than half of the water in China - the world's fourth-largest economy after the United States, Japan and Germany - is unfit to drink. Last year, around 48 million people living there lacked sufficient drinking water.

Well aware of its shoddy environmental image, China has declared cleaner water to be one of its major policy goals, and it has thrown open the doors to foreign firms eager to grab a piece of the fast-growing $14.2 billion market.

It is now one of Asia's most promising investment destinations for water treatment, drawing in the likes of Veolia Environnement and Suez. Local rivals, such as China Water Industry Group and Guangdong Investment, have also sprung up.

The government's stance on water has given China an edge over India in drawing in foreign investment.

"India has decided to invest in the water sector mostly through public money, but China has decided to allow private companies, including foreign investors, to participate in water supply and sewage products," Christopher Wong, an analyst with UBS, wrote in a recent research note. "As a result, most of the listed companies in Asia that have water exposure are focused on the China market."

But problems abound. Fierce competition for water projects mean margins may be squeezed in the near term. Opaque regulations and a recent government price freeze on public utilities, including water, are also red flags.

"One challenge is frequent regulatory changes in the acquisition of land, in the usage of land, the end-right use of a particular piece of land," said Sam Ong, the chief financial officer of Singapore-listed water treatment company Hyflux .

China boasts a fifth of the world's population, yet it has only 7 percent of global water resources, according to Fusion Consulting.

The country's per-capita water resources stand at a mere fifth of the world average. More than 70 percent of China's rivers and lakes are polluted, according to Macquarie Research.

"China is experiencing one of its most severe water shortages," Leah Jiang, an analyst with Macquarie, wrote in a recent note. "We believe this is one of the key issues that will determine China's future in next twenty years."

Beijing has been slowly prying China's water industry from the grips of lumbering state-owned enterprises since the 1990s and plans to invest $130 billion in water and waste water treatment from 2006 to 2010.

Foreign firms are upbeat that this will translate into healthy growth prospects and are keen to get a foothold.

Suez Environnement, for example, will invest €100 million, or $158 million, annually in sewage treatment and water projects in China over the next five years.

"This is a country with limited water resources to start with," Suez Environnement's chief executive, Jean-Louis Chaussade, said. "On top of this, industrialization comes with a transfer of population toward the eastern part of the country," which "will lead to considerable water needs and environmental issues."

Sino French Water Development, a venture between Hong Kong's NWS Holdings and Suez, aims to increase daily output from its Changshu plant near Shanghai by over 40 percent by 2010 and also plans a sludge treatment center to match the capacity.

"The return of our company is long-term," said Steve Clark, executive director of Suez's China subsidiary and Sino French Water Development. "We have a profitable business with revenues that experience double-digit growth every year."

Hyflux expects its China revenues to jump 30 percent this year, said Ong.

Investors are also optimistic, cheering on shares in China Water Affairs Group, which were up 61 percent and China Water Industry Group up 43 percent last year.

But with so many players piling into China's water market, industry watchers say competition may cut away at margins.

"We believe intense competition for water projects and opaque regulations has dampened the attractiveness of water projects in the near term," said Wong, of UBS.

Rising water prices in China - in many cities they have doubled in the past four years - are one main reason that foreign companies are counting on significant future returns.

The country has traditionally supported its agricultural industry, which makes up over 60 percent of total water consumption, by keeping prices low.

Standard sewage treatment fees do not even meet the cost of treatment, analysts say, adding that it will take years before prices reach a level high enough to encourage efficiency and reduce wastage.

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But with Beijing wary of stoking inflation, which is already high, China may not be able to increase rates any time soon.

In January, the State Council set an immediate price freeze effective on all public utilities, including water.

And local authorities, leery of stirring up political friction with central government, are unlikely to ask for the public hearing needed before they can hike prices.

"We think this is a key risk to private investment in the water industry as the water tariff remains a politically sensitive area for most local governments," said Macquarie.

Macquarie expects a 5 percent annual increase in water resources and supply fees for Guangdong Investment and China Water Affairs Group from 2009 to 2018.

Price increases are not everything.

"I expect that the current tariff rate will be adjusted, but that doesn't necessarily solve the water shortage problem," Clark said. "Instead, the market should look to improve efficiency and infrastructure that cause problems like leakage."

Alison Leung reported from Hong Kong.

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