

## An Unexploited Way to Play the China Boom? ....Water.

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It is very clear that the most important economic and investment developments of this new century are resulting from the emergence of China as a world-class economy, competing very aggressively in world trade with their low prices stemming from low labor costs.

The primary thought of investors thus becomes: "How do I best participate in the China boom?" Pundits have had many answers, including buying the stocks of companies that supply the raw materials to China (copper, steel, oil, etc.), investing in the spread of basic telephone and Internet services across China, and/or directly buying some of the Chinese industrial giants that have become public companies.

While world markets have avidly bid most "China plays" to premium price levels, little attention has been paid to the most basic and compelling requirement for the sustained growth of the Chinese economy: Adequate water and sanitation facilities. We have found some very attractively-priced companies involved in these markets, and their rapid growth in future years seems assured.

Most don't realize that China is presently undergoing the largest population migration in human history. Indeed, some 120 million people, 40% the size of the U.S., have already been forced to leave their rural villages and move to the industrial zones in search of employment, which is virtually non-existent in the rural countryside. As the Chinese economy grows, the huge wave of humanity towards the factories continues, and the problem of providing adequate basic facilities for these masses of workers has become critical: Only 20% of the cities currently have any sewage treatment whatsoever, and the first drinking water treatment facility in the country was only installed in 1985. The infrastructure supporting the worker force is critically lagging and this has become a substantial impediment to continued economic growth.

China has about as much water as Canada, but has 100 times more people. China's per capita water reserves are only about 1/4 the global average, and are only slightly above the water assets of India. Of the 669 cities in the country, 440 suffer water shortages, and 110 of these cities are considered to have reached the critical level.

North China houses about 43% of the population, but has only 14% of the water. Yet in 2002, some 99% of the region's water was consumed by water-guzzling industries and only 65% of this water was recycled, versus an average of some 85% in other nations at a similar status of industrial development. The situation has become so bad in three industrial zones in the north that factories have been forced to close due to insufficient water supplies, and such closures definitely are getting the attention of the central government in Beijing.

While the Chinese government may not be very responsive to humanistic and/or environmental concerns, they are very sensitive to economic problems, and water has become the most important limitation on the growth of the economy in China. Recently, the Government has started to reveal their severe water problems in public: Just a few days ago, on December 27, 2004, the Minister of Water Resources stated publicly that, "**The price of China's economic boom is being paid in water**", and you can be sure he didn't make those remarks without the approval of the central government.

Obviously, those investor-owned companies that can help to solve these massive water problems are looking at assured demand for their services for years to come, and such demand is virtually independent of other global economic factors. After a great deal of research work, we have found a number of companies that are focused on the water problems of China and which recognize a big, and rapidly growing, part of their revenues from this source. We have found these companies trading in Singapore, Japan, and in Europe, with few American companies presently involved to any substantial degree.

To indicate how unexploited this group is to date, consider this: A company with a 39.7% return on equity for the last 12 months, yet trading at only 11 times earnings. Another company in our group had a 42% return on equity in the last 12 months, and still another had a 38.3% average annual return on equity for the last 5 years, indicating that recent growth in this space is not just a one-time event.

We are steadily accumulating positions in this new "China Water Infrastructure" segment of our portfolio, and we are very optimistic about the long term attractiveness of this segment of our portfolio.

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