

**A**S expected, the rally on the Kuala Lumpur Stock Exchange (KLSE) continues to spur trading interest among market participants and investors.

Historically, long market rallies are always led by some kind of theme play, be it sector, personality, or events/developments such as an election or budget.

Readers who have followed our previous articles on theme plays will have noted the various plays associated with the last major bull run in 1993. The theme plays that have accompanied the current market rise since July are bank mergers, the oil & gas sector and Mesdaq stocks.

While the play on bank mergers was short-lived, the latter two performances have been nothing short of astounding. Oil & gas stocks like Scomi, Petra Perdana and Crest Petroleum and Mesdaq stocks like GHL System, Nova and MKN Technology have easily gained more than 100% over the past two months.

While some analysts believe the rally on these stocks still has room to move with the impending announcement of new contracts in the oil & gas sector and the absence of share overhang in Mesdaq stocks, the risk for retail players in continuing to chase up these stocks has undoubtedly risen very much.

Some market observers believe that for latecomers and investors who missed the boat, they may well be better off putting their bets on the next potential theme play and wait for the bets to pay off as the pay-off ratio could be high, rather than investing in stocks that have gone up considerably.

As one analyst comments, 'Every theme play has its own cycle and the trick is not to get caught holding the abandoned baby.' Crudely put but certainly good advice to ponder.

Having said that, what could be next? A number of market participants are increasingly bullish about the water sector as prospects for the sector are indeed promising. We talk to some analysts and industry players on why they are touting water as the next sector to watch out for in future market rallies.

### The Water Sector

The rationale behind the rising bullish view on water stocks actually comes from

# Water Stocks Set to Gush?

**With the federal government taking over management of water resources from the states, water may be the next theme play on the KLSE.**

*By James S*

the estimates of the National Water Resources Council (NWRC). The industry's umbrella body has estimated that Malaysia may need to invest at least RM52 billion until 2050 to build at least 47 dams and large water treatment plants, as well as infrastructure to meet demand and ease the transfer of water between states.

In other words, there will be plenty of projects and business opportunities, especially over the next three Malaysia five-year development plans, for the water industry players. However, while many have always known of the huge opportunities in the sector, they have been restrained by the various different state legislations, as water is a state right rather than a federal one.

The spark for the industry is that the federal government had, in July, announced that it plans to centralise water resource management. Currently, while federal bodies like the NWRC are the ones that formulate water policy, their legislation and enforcement are left to the state governments.

The obvious disadvantage here is that it could lead to duplication of resources and planning and actions by over-protective state government officials. Hence, industry players view the federal move positively as it would streamline most of the water projects that would be implemented in the future.

It was reported by the *Water Industry Guide 2003*, published by the Malaysian Water Association, that the government

had allocated almost RM4 billion under the Eighth Malaysia Plan (2001/05) for 129 water supply projects in all states.

Of the amount, RM532.9 million was for 2001, RM860.4 million for 2002 and RM1.28 billion for this year. The figure is expected to continue to rise as the country heads towards its target of becoming a developed country by 2020.

### Who Could Be The Winners?

While most of the news flow appears to be positive for the sector, the question now is, which industry player will benefit the most from the projects to be awarded?

Some analysts believe that not all are expected to benefit equally from future privatisation of water supply. This is due mainly to a mismatch between the cost of supply and existing water tariffs.

The *Water Industry Guide* shows that the industry had not been profitable since water privatisation took off in 1997. It says in 2001, operating expenditure of operators totalled RM2.76 billion compared with revenue of RM2.23 billion.

This is probably due to the fact that treated water supply is lost by as much as 40% through leaking pipes and water thefts. The tariffs are not set to cover such inefficiencies. For example, PUAS Bhd, the Selangor Government's privatised body and water distribution agency, has yet to resolve its unpaid bills to its water treatment company, Puncak Niaga Holdings Bhd, which is burdened by the sum owed amounting

to RM800 million.

Currently, most large water projects are federal-funded, except for some projects such as the Pahang-Selangor water transfer project that receives financial assistance in the form of a soft loan from the Japan Bank of International Cooperation (JBIC).

Fortunately, some recent privatisation of both treatment and distribution entities have shown encouraging signs. PBA Holdings Bhd and Ranhill Utilities Bhd, both listed companies on the KLSE main board, are two examples. Unlike Puncak Niaga, which only supplies treated water to the state water authority, PBA and Ranhill are involved in the whole water supply process from treatment to distribution.

The state governments, disregarding the possible adverse effects on the electorate, have allowed these companies to raise their water tariffs to cover the cost of refurbishing and replacing old pipes in order to ensure a more efficient water supply in the long term.

For industry players, those in the higher value chain are likely to benefit the most. These are companies involved in the con-

struction of dams, water treatment plants and water pipes. Among major listed companies in this segment are the main water contractors like Ranhill Bhd, Road Builder Holdings Bhd and Gamuda Bhd, according to a research note from Mayban Securities Research.

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It says that other smaller dam-builders and contractors like Loh & Loh Construction Bhd, ACP Industries Bhd and newly listed Salcon Bhd could also be significant beneficiaries.

Following the top end, companies that operate in the middle of the value chain like pipe-makers such as YLI Holdings Bhd may also stand to benefit. Companies in pipe replacements such as TSR Capital

Bhd, Puncak Niaga, Ranhill and UAC Bhd will also be reaping the good fortune. It is expected that mass pipe replacement projects will begin once the federal government takes over management of water from the state governments.

At the bottom half of the value chain are water supply concessionaires, and managers and operators of water treatment systems. They include Puncak Niaga, Ranhill Utilities, PBA Holdings, Taliworks Bhd and Intan Utilities Bhd, which will benefit from more water privatisation projects to be handed out by the federal government.

## Conclusion

Most of the water-related stocks above could benefit from the potential mega water projects to be dished out especially after the federal government takes over management of water from state governments.

Speculation over the shape and size of future water-privatisation projects could well spur trading on such stocks and the sector, especially if more positive news flow appears on the horizon. 