

Dear Shareholders,

I shall present the annual report of China Water Affairs Group Limited and together with its subsidiaries (the "Group") for the year ended 31 March 2005.

RESULTS OF THE YEAR

During the year under review, the Group has continuously focused on expanding in water supply and sewage treatment business in PRC and consolidation of the electronic business.

The turnover of the Group increase from HK\$33.2 million to HK\$48.5 million, an increase of 46.1%. The gross profit amounted to HK\$3.7 million (2004: gross loss of HK\$20.2 million).

The loss from operations improved from HK\$34.5 million last year to HK\$11.7 million. The loss attributable to shareholders was HK\$29.3 million (2004: HK\$97.6 million), representing a net loss per share of 7 Hong Kong cents (2004: 47 Hong Kong cents). During the year, 39.7% of loss attributable to shareholders contributed from investment in Electronic Tomorrow Manufactory Inc. ("ETMI") of which amounted to approximately HK\$11.6 million in aggregate together with full impairment of long term investment in Shanghai Jianhua Satellite Communication Co., Ltd of which amounted to HK\$3.5 million.

DIVIDEND

The Directors do not recommend the payment of a dividend.

BUSINESS REVIEW

Urban water supply business segment

During the year, the Directors continue deploying their expertise in pursuing business of urban water supply. The turnover of urban water supply business has grown from HK\$0.6 million to HK\$6.7 million, an increase of 10.2 times over the last year. The segment loss amounted to HK\$3.2 million for the year ended 31 March 2005 (2004: 1.6 million). The LBITDA of urban water supply business segment amounted to HK\$1.2 million (2004: LBITDA of HK\$0.9 million). The LBITDA of the year ended 31 March 2005 was mainly attributable to an impairment loss on fixed assets of HK\$ 2.7 million of a water supply plant in Renhua County, Guangdong Province, the PRC. The impairment of the fixed assets is due to the application of increase of the water tariffs is submitted to local government authorities and is under review and certain installation income of the water supply plant has not been considered under the review of impairment of the fixed assets of that water supply plant. Upon approval of



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increase of water tariffs and expanding water supply serving areas of water supply plant in Renhua County, Guangdong Province, the PRC and the Group is actively look for acquisition of water supply business with high growth potential, the Directors expected that the performance of urban water supply business segment will have significant improvement for the coming year.

Sewage treatment business segment

The turnover of sewage treatment business amounted to HK\$6.0 million (2004: Nil). The segment profit amounted to HK\$3.5 million for the year ended 31 March 2005 (2004: Nil). The EBITDA of sewage treatment business segment amounted to HK\$4.8 million (2004: Nil). The segment profit was mainly attributable to a sewage treatment plant which locate in Xinle City, Hebei Province with daily capacity of 40,000 tons. As the sewage treatment plant in Xinle City, Hebei Province which become a 55% owned subsidiary of the Group since August 2004, the Directors expected that the contribution from that sewage treatment plant to the segment results will be more in the coming year.



Electronics business segment

During the year, turnover of the electronics business operations amounted to HK\$35.8 million (2004: HK\$32.6 million), an increase of approximately 9.8% over the last year. By added experienced personnel to oversee the electronic business operations, the performance of the electronics business has improved over last year. The segment loss has reduced from HK\$23.8 million to HK\$5.6 million for the year ended 31 March 2005. The LBITDA of electronic business segment amounted to approximately HK\$48,000 (2004: LBITDA of HK\$21.2 million) with large improvement over the last year. As at 31 March 2005, the segment assets of electronic business amounted to HK\$15.3 million represented only 13.7% of total assets of the Group (2004:32.1%).

Interest in Electronic Tomorrow Manufactory Inc. ("ETMI")

As at 31 March 2005, the Group holds 25.7% equity interest in Electronic Tomorrow Manufactory Inc. ("ETMI"). During the year, the performance of ETMI was disappointing to the Directors again. The share of loss of ETMI for the year ended 31 March 2005 amounted to approximately HK\$3,292,000. In view of this successive losses making records of ETMI and continuous equity injection requirement, the Directors have decided to dispose of the Group's investment in ETMI at a cash consideration of HK\$1.2 million which the transaction was completed on 7 April 2005.



CAPITAL RAISING AND OPEN OFFER

On 22 March 2004, an underwriting agreement was entered into between Asset Full Resources Limited ("Asset Full"), the substantial shareholder of the Company, Kingston Securities Limited and the Company pursuant to which the Company offer one offer share at HK\$0.2 per offer for every two existing shares. The proposed open offer was duly approved by the EGM on 21 June 2004. The net proceed of approximately HK\$27.6 million has been used as to about HK\$10.1 million for its general working capital, as to about HK\$2.3 million for repayment of other payables of the Company,

as to about HK\$3.2 million for payment of the remaining cash consideration for acquisition of two water sewage plants and as to about HK\$6.5 million for development of water supply business. The unused proceed of HK\$5.5 million is held as bank balances of the Group.

Pursuant to the placing and subscription agreement dated 14 March 2005, Asset Full, the substantial shareholder of the Company, placed 30,000,000 ordinary shares of HK\$0.01 each in the capital of the Company at HK\$0.50 per share to over six independent placees and on 23 March 2005 subscribed for 30,000,000 new ordinary shares of the Company at HK\$0.50 per share. The net proceed received by the Company under the subscription were approximately HK\$14.4 million of which HK\$9.4 million used for investment in city water supply business in the PRC and as to the remaining HK\$5.0 million utilised as the general working capital.



Pursuant to the placing and subscription agreement dated 4 April 2005, Asset Full, the substantial shareholder of the Company, placed 57,600,000 ordinary shares of HK\$0.01 each in the capital of the Company at HK\$0.50 per share to over six independent placees and on 18 April 2005 subscribed for 57,600,000 new ordinary shares of the Company at HK\$0.50 per share. The net proceed received by the Company under the subscription were approximately HK\$28.1 million of which HK\$25.1 million used for investment in city water supply business in the PRC and as to the remaining HK\$3.0 million utilised as the general working capital.

FUTURE PLANS AND PROSPECTS

China is the most populous country in the world, and also the country with meagrest of water resources. Water supply business, as a public utility business, enjoys long term, steady returns and also has regional monopoly characteristic.



At present, the water tariffs in the PRC are on rising trend over these few years as a measure to increase public awareness of water conservation in PRC. By applying the Group's senior management's expertise and their extensive networks in these fields, the Directors expect that the pace of the expansion in water business will be significantly accelerated in the coming year.

Subsequent to the balance sheet date, the Group has announced several joint venture investments with several strategic partners in the PRC.

On 11 April 2005, the Group entered a joint venture agreement with Nanchang Municipal Public Investment Holding Group Company Limited, Beijing Lan Tian Bi Shui Investment Company Limited and Shenzhen Lan Tian Bi Shui Enterprise Development Company Limited pursuant to which the Group agreed to contribute RMB20,700,000 to the joint venture and holds 52.8% of its equity interest. The joint venture will engage in the business of water supply, water sewage and waste management related business with bases in Nanchang, Jiangxi Province, the PRC.

On 21 April 2005, the Group entered into a joint venture agreement with Jiangxi Water Resources and Hydropower Development Company. The Group agreed to contribute RMB29,250,000 to the joint venture and holds 65% of its equity interest. The joint venture will undertake water supply, water sewage treatment and development of hydroelectric power in the Jiangxi Province, the PRC.



On 28 June 2005, the Group entered into a preliminary cooperation agreement with Xinyu Shi Construction Bureau. Pursuant to the preliminary cooperation agreement, subject to the entering into of the joint venture agreement, the Company and Xinyu Shi Construction Bureau will form a joint venture to undertake water supply and water sewage treatment in Xinyu City, the Jiangxi Province, the PRC. It is currently expected that the total capital to be contributed by the Company and its subsidiaries will not exceed RMB60 million.

On 15 July 2005, the Group entered into investment agreement with China National Administration Center for Sea Buckthorn Development, Beijing You Bang Tian Cheng Technology Limited and Beijing Jiang Huo Sea Buckthorn Company pursuant to which the Group agreed to inject RMB20 million into Conseco Seabuckthorn Co., Ltd, the leading company for soil land and water conservation with planting seabuckthorn in China. The Group will own 50% of its registered capital. Conseco Seabuckthorn Co., Ltd is principally engaged in the production and sale of sea buckthorn and related products. The purpose for this investment is to improve the water environment to prevent soil erosion and develop seabuckthorn products in the west and north part of China.

By combining the local expertise of these strategic partners who have solid background and establishment in water business with the extensive industry experience of the Group's senior management, the Directors believe that the Group's competitiveness will be strengthened and will derive benefits from synergies. The Group also only invests in joint ventures in which it controls equity interest and has major representation in the board of the directors of the joint ventures. Moreover, the fund contribution will be paid as capital injection and for the development of these joint ventures. This allows more effective use of the Group's financial resources.

The management of the Group will continue devote their sincere efforts in actively identifying and acquiring high potential water business in PRC. The Directors of the Group are optimistic about the future prospects of the Group. While the Group continuously expanding into water business, the Group will consider to invite some international and the PRC strategic partners to join the Group to strengthen the competitiveness of the Group.

On 21 July 2005, the People's Bank of China, the central bank of the PRC, announced a reform of the Renminbi exchange rate mechanism. The acts include adjustment to the exchange rate of the Renminbi to 8.11 to the US dollar, up from 8.28, represented of appreciation of 2%. Moreover, Renminbi will no longer be pegged to the US dollar and exchange rate will be adjusted according to a basket of currencies. As the Group has focused on water supply and sewage treatment business in PRC, it is expected that the major revenue of the Group will principally generate in the PRC and denominated in Renminbi in the coming year. As the Group's reporting currency is denominated in Hong Kong dollar, the management considers that the appreciation of Renminbi will have positive effect to the Group's results in the coming years and the Group will also benefit from the appreciation of assets which are located in PRC and denominated in Renminbi.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 March 2005, the Group has total cash and bank balances of approximately HK\$20.2 million (2004: HK\$3.2 million). The gearing ratio, calculated as a percentage of total liabilities to total assets, is 61.9% (2004: 69.4%) as at 31 March 2005. The current ratio has been improved from approximately 0.27 times as at 31 March 2004 to approximately 0.80 times as at 31 March 2005.

In the opinion of the Directors, the Group will have sufficient working capital to meet its financial obligations in full as they fall due in the foreseeable future.

EMPLOYEES

As at 31 March 2005, the Group has employed approximately 200 staff, principally in Hong Kong and the PRC. The remuneration package of the employees is determined by various factors including their experience and performance, the market condition, industry practice and applicable employment law.

FOREIGN EXCHANGE RISK MANAGEMENT

During the year, the Group's trading activities were principally denominated in Hong Kong dollars, United State dollars and China Renminbi. As the exchange rate of Renminbi against Hong Kong dollar was relatively stable during the year while the United States dollars are pegged against Hong Kong dollar, the management considers the fluctuations among these currencies as minimal and the Group do not exposed to excessive currency fluctuation risk.

The recent announcement of the reform of Renminbi exchange rate system, will not expose the Group to currency fluctuation risk but will benefit the Group's results in the coming years as the main revenue of the Group will be generating in PRC and denominated in Renminbi but the Group's financial results are reporting in Hong Kong dollar.

PLEDGE OF ASSETS

As at 31 March 2005, none of the owned assets of the Group were utilised as security for the Group's borrowings.

CHANGE OF COMPANY'S NAME

Pursuant to a special resolution passed by the shareholders in the special general meeting held on 6 December 2004, the Company changed its name from "China Silver Dragon Group Limited" to "China Water Affairs Group Limited" to reflect the change in the business focus of the Group. A new Chinese name of "中國水務集團有限公司" was adopted by the Company to replace the old Chinese name of "中國銀龍集團有限公司" for identification purpose. The certificate of incorporation on change of name issued by the Registrar of Companies in Bermuda has certified that the Company's name was changed and registered with effect from 10 December 2004.

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CONTINGENT LIABILITIES

As at 31 March 2005, the Group did not have any significant contingent liabilities (2004: Nil).

ACKNOWLEDGEMENTS

On behalf of the Directors, I wish to express my gratitude to all staff and business associates of the Group for their continued support.

Duan Chuan Liang

Chairman

Hong Kong, 27 July 2005