



Management Discussion and Analysis

FINANCIAL PERFORMANCE

For the year ended 31 December 2006, the Group made a loss for the year of HK\$95.7 million as compared with a loss of HK\$44.3 million recorded in 2005. Loss for the year increased by HK\$51.4 million was mainly due to inventories written off of HK\$35.3 million and further bad and doubtful debts provision of HK\$14.9 million being provided in computer peripherals business and HK\$14.0 million of advertising expenses spent in promotion of the TechnoMarine watch business. Whereas, the slightly increment in Gross Profit of HK\$3.6 million and increased in other operating income of HK\$2.4 million as well as the decrease in the selling and distribution costs by HK\$5.9 million were set off the negative impact of substantial provision for and write-off the loss of segment business.

Total turnover of the group amounted to HK\$70.1 million, an increase of 14.5% as compared with the turnover of HK\$61.2 million reported in last year. The increase in turnover was mainly attributable to the growth from trading of TechnoMarine watches and accessories business amounted to approximately HK\$35.1 million, however, the significant decrease of HK\$26.1 million in trading of computer peripherals was affected by rapidly down-sizing market of desktop DIY product.

Other operating income increased by HK\$2.4 million to HK\$3.0 million as compared to last year. The major contributions were generated from the disposal of assets held for sales amounted to HK\$1.0 million, unrealized exchange gain of HK\$0.5 million and gain from disposal of subsidiary amounted to HK\$0.1 million.

The selling and distribution costs reduced by 54.4% sharply to HK\$4.9 million as compared to last year. The decrease in the selling and distribution costs was in line with the decrease in turnover of computer peripherals business.

The administrative expenses substantially increased by 100% to HK\$54.9 million as compared to last year. It was mainly due to mainly HK\$14.0 million of advertising expenses utilized in promotion of the TechnoMarine watches business and additional operating costs of HK\$7.0 million incurred which were affected by the escalating rental for shops and growing staff costs.

BUSINESS SEGMENTS REVIEW

Computer Peripherals Business

The computer peripherals business recorded a 46.1% decrease in revenue from HK\$56.7 million in 2005 to HK\$30.6 million in 2006. It was operated under tough conditions during the price erosion as in the intense competition in the personal computer peripherals market for the year. Raw material costs, in particular, the imported aluminum and plastic escalated to a record high, and the increase of oil price as well as commodities price were adding pressure to the costs of production. The labour costs continued to increase due to labour shortage in the Pearl River Delta region in China which the computer peripherals business faced to the difficult environment. In addition, the development of OEM/ODM was failure to attract new clients in North America and continued to face intense competition in the personal computer peripherals market. All these critical factors have severely affected the operating profit which in turn made the segment result recorded loss of HK\$67.8 million in this year, mainly due to written off of inventories of HK\$35.3 million and provision of bad and doubtful debts HK\$14.9 million.

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Trading of TechnoMarine Watches and Accessories Business

In previous year, the Group has diversified into the trading of watches and accessories business to broaden its revenue and earning base. The Group has been working hard to promote “TechnoMarine” watches in Hong Kong and the Asia Pacific Market. The Group has put in substantial resources in expanding retail spots and conducting promotion campaigns to capture the growth in luxury and branded watches market. The segment was the biggest revenue contributor, which accounted for 56.4% of the total turnover for the year. The turnover of the segment amounted to HK\$39.6 million which represented an increase by 779.7%, as compared with the turnover of HK\$4.5 million in last year. However, the growth in turnover was not sufficient to offset the significant surge in operating expenses. During the year, the segment suffered from a loss of HK\$26.0 million. The result was disappointing especially when comparing with a marginal break-even in last year. The segment loss was attributable to HK\$14.0 million advertising expenses spent in promoting the TechnoMarine brand, and an increase in operating costs by approximately HK\$7.0 million owing to the escalating shop rentals and growing staff costs.

Water Supply and Sewage Treatment Business in the PRC

In view of China’s huge population and is one of the 13 countries with the most severe shortage of water resources. The Chinese Government has stated in the National 11th Five Year Development plan that water prices should be raised to a reasonable level to achieve a more conserving and efficient use of water. In addition, the Chinese Government allowed the investors in either local or foreign to participate the operation in water sector. All the investment projects of water supply will grant to the operating entity a monopolistic right by the local authorities, the length period of license is ranging from 25 to 30 years. The water supply industry in mainland China is characterized by its natural monopoly nature, the profit margin of water on average is fixed at 8%-12%. Accordingly, China’s water sector created huge business opportunities and provided a steady with fair return on investment.

Under the new business direction of the Group, the Company, had, through its wholly-owned subsidiaries, to acquire equity interest in the three domestic companies in the PRC, which are principally engaged in water supply and sewage treatment businesses in the PRC. The following three acquisitions provide good opportunities for the Company to participate in the water service industry in the PRC which will further broaden the Group’s revenue base and have a positive impact on the Company’s profitability. At the year ended, the consolidated operating results were increased by sharing of profits from newly acquired associated company of Onfar International approximately HK\$0.34 million but Dang Shan and Haiyuan, newly acquired subsidiaries, did not contribute to the Group’s turnover or loss for the year as they were acquired at the balance sheet date.

During the year, the Group acquired the equity interests in the following companies:

In October 2006, the Group acquired acquire 40% equity interest of Onfar International Limited (the “Onfar International”) which indirectly hold 51% equity interest in Yi Chun Water Industry Co. Limited (“Yichun”). Yichun has been engaging in the water industry by supplying drinkable water and sewage treatment to the residents in Yichun City. Yichun has been granted a 30 years’ licence starting from 30 November 2004 till 20 November 2034 to supply drinkable water in Yichun City, Jiangxi Province. Onfar International is an associate of the Group after the completion. The acquisition was completed on 14 November 2006.

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In December 2006, the Group acquired 100% equity interest in Anhui Dang Shan Water Industry Company Limited (“Dang Shan”), which has been engaging in the water supply industry by supplying drinkable water to the residents and enterprises in downtown area of Dang Shan County. Dang Shan has been granted a water supply licence from 30 years starting from November 2004 till November 2034 to supply drinkable water in Dang Shan County, Anhui Province. Dang Shan is a wholly-owned subsidiary of the Group after the completion. The acquisition was completed on 31 December 2006.

In December 2006, the Group acquired 70% equity interest in Jining City Haiyuan Water treatment Company Limited (“Haiyuan”), which has been engaging in sewage water and liquid waste treatment and water treatment related engineering and construction work in Jixiang County, Shandong Province. A license is granted to build and operate the sewage water plant for an operating period of 29 years commencing from the completion of the construction in May 2007. Haiyuan is a subsidiary of the Group after the completion. The acquisition was completed on 31 December 2006.

FUTURE PROSPECTS

Computer Peripherals Business

The business environment for the year will remain challenging in view of price compression in the down-sizing DIY desktop market, larger manufacturers launched cheaper-price desktop for increasing market share, and customers continued to shift from desktops to mobility products. In addition the surging price of materials and the appreciation of RMB will continue to be critical factors affecting the results of this segment. During the year, the Group has adopted various measures to improve cost control and production as well as operation efficiency. Nevertheless, the Group’s computer peripheral business still could not generate a positive profit figure. In light of continued loss-making track record, the Directors decided not to inject further resources and would maintain the existing scale of operation but continue to seek for effective cost saving methods.

Trading of TechnoMarine Watches and Accessories Business

Pursuant to a distribution agreement with the TechnoMarine brand owner, the Group has granted the exclusive right to market, sell and distribute watches and watch related accessories in the territories covering in PRC, Malaysia, Vietnam, Singapore, Australia, Hong Kong, Taiwan and Korea for a term of 7 years commencing from 1 January 2006. However, expansion in retail spots in the Asia Pacific region was behind the management’s expectation in its brand management and development strategic plan. In addition, customers could easily purchase same products via internet or in small watch shops. This has seriously affected sales growth and selling price. Moreover, escalating rental for shops, growing staff costs and increasing advertising and promotion expenses were adding pressure on operating costs. The management was considering focusing on wholesale of watch and watch related products in order to reduce the influence from increasing shop rentals and staff costs.

Water Supply and Sewage Treatment Business in China

In the past five years, the average GDP growth rate in China has been around 10%. Rapid economic growth, trend of urbanization, increasing per capita income and upward trend in the growth of the water supply industry, all boost the water demand in China. At present, the water tariffs in the China are on rising trend over these few years as a measure to increase public awareness of water conservation in China. This was reflected in the announcement of the Company dated 28 March 2007 regarding the People’s Government of Yichun City approved the increase in water tariffs with effect from 1 April 2007. The directors expect that the pace of expansion in water business will be significant accelerated in the coming years.

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LIQUIDITY, GEARING & FINANCIAL RESOURCES

As at 31 December 2006, the cash and bank balances of the Group increased by HK\$0.6 million to HK\$5.1 million (31 December 2005: HK\$4.5 million).

As at 31 December 2006, the Group had outstanding borrowings and finance lease payables denominated in Hong Kong dollars with an aggregate amount of HK\$7.7 million (31 December 2005: HK\$4.7 million).

The short-term borrowings and the obligations under finance leases within 1 year of the Group accounted for 85.7% (31 December 2005: 88.6%) of the total borrowings at 31 December 2006.

The interest expenses of the Group for 2006 were HK\$0.5 million (31 December 2005: HK\$0.3 million).

As at 31 December 2006, the gearing ratio (expressed as total liabilities to total assets of the Group) was 64.4% (31 December 2005: 35.7%) and the current ratio of the Group was approximately 0.6 times (31 December 2005: 2.3 times).

CAPITAL RAISING AND USE OF PROCEEDS

On 2 February 2006, the Company made the placement of 250,000,000 new shares to raise approximately HK\$27.5 million, of which HK\$8 million for the payment of the remaining balance of the consideration pursuant to the terms of the distribution agreement of TechnoMarine and the remaining balance of HK\$19.5 million for implementation of the distribution and for general working capital of the Group.

On 7 November 2006, the Company issued and allotted 180,000,000 new shares at HK\$0.20 per share (equivalent to HK\$36 million) for the consideration to Boost Skill Investments Limited of the acquisition of 40% equity interest in Onfar International Limited.

SIGNIFICANT INVESTMENTS

Save as disclosed in the announcements, there was no significant investment held by the Company for the year ended 31 December 2006.

MATERIAL ACQUISITION AND DISPOSALS OF SUBSIDIARIES

- (a) On 14 November 2006, the Group acquired 40% equity interest of Onfar International Limited (the "Onfar International") which indirectly hold 51% equity interest in Yi Chun Water Industry Co. Limited ("Yichun"), which has been engaging in the water industry by supplying drinkable water and sewage treatment to the residents in Yichun City. Yichun has been granted a 30 years' licence starting from 21 November 2004 till 20 November 2034 to supply drinkable water in Yichun City, Jiangxi Province. Onfar International is an associate of the Group after the completion. The acquisition was completed on 14 November 2006. Details of the transaction have been contained in the Company's circular to its shareholders dated 27 October 2006.

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- (b) On 31 December 2006, the Group acquired 100% equity interest in Anhui Dang Shan Water Industry Company Limited (“Dang Shan”), which has been engaging in the water supply industry by supplying drinkable water to the residents and enterprises in downtown area of Dang Shan County. Dang Shan has been granted a water supply license from 30 years starting from November 2004 till November 2034 to supply drinkable water in Dan Shan County, Anhui Province. Dang Shan is a wholly-owned subsidiary of the Group after the completion. The acquisition was completed on 31 December 2006. Details of the transaction have been contained in the Company’s circular to its shareholders dated 10 November 2006.
- (c) On 31 December 2006, the Group acquired 70% equity interest in Jining City Haiyuan Water Treatment Company Limited (“Haiyuan”), which has been engaging in sewage treatment and liquid waste treatment and sewage treatment related engineering and construction work in Jixiang County, Shandong Province. A license is granted to build and operate the sewage treatment plant for an operating period of 29 years commencing from the completion of the construction in May 2007. Haiyuan is a subsidiary of the Group after the completion. The acquisition was completed on 31 December 2006. Details of the transaction have been contained in the Company’s circular to its shareholders dated 22 December 2006.
- (d) On 28 December 2006, the Group disposed a wholly-owned subsidiary of the Company, Mascot Distribution Limited to Time Capture International Limited, third party independent of the Group, at a total consideration of HK\$11,700 and agreed to finance or procure the finance to repay the debt to the Mascot Industries Limited.

EMPLOYEE & REMUNERATION POLICY

As at 31 December 2006, the Group had a total of 435 employees, 400 of whom were employed in mainland China and 35 in Hong Kong, Taiwan and overseas. The Group implements remuneration policy, bonus and share options schemes with reference to the performance of the Group and individual employees. The Group also provides benefits such as insurance, medical and retirement funds to employees.

PLEDGE OF ASSETS

The Group has pledged freehold land and buildings with a net book value of approximately HK\$4.5 million (2005: HK\$4.6 million) and bank deposits of approximately HK\$2.1 million (2005: Nil) to secure general banking facilities granted to the Group. In addition, the Group’s obligations under finance leases are secured by the lessors’ title to the leased assets, which have a carrying amount of approximately HK\$440,000 (2005: HK\$772,000).

CAPITAL COMMITMENT

As at 31 December 2006, the Group has the capital commitments contracted but not provided for acquisition of property, plant and equipment approximately HK\$1.3 million (2005: Nil).

FOREIGN CURRENCY EXPOSURE

The Group mainly earns revenue and incurs cost in US dollars, HK dollars and RMB foreign exchange exposure of the Group is minimal as long as the policy of the Government of HKSAR to link the Hong Kong dollars to the US dollars remains in effect.

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FUTURE PLANS AND SOURCES OF FUNDINGS

As an integral part of the Company business strategies, the Company continues to expand through acquisition and merger activities.

In March 2007, the Company, through its wholly-owned subsidiary, entered into a non-legally binding heads of agreement with (the Management Committee of Shu Yang District Economic Development Zone in Jiangsu Province*) 江蘇省沭陽縣經濟開發區管理委員會 of the People's Republic of China (the "PRC") in relation to the establishment of a wholly-owned subsidiary in Shu Yang District Economic Development Zone in Jiangsu Province of the PRC to principally engage in the construction and operation of a water supply plant with a water supply capacity of 30,000 tons per day and a sewage treatment plant with a sewage treatment capacity of 15,000 tons per day.

In March 2007, the Company, through its wholly-owned subsidiary, entered into the agreement with Boost Skill Investments Limited, a substantial shareholder of the Company, in relation to the acquisition of 60% of the entire issued share capital in Onfar International Limited (安發國際有限公司) for a total consideration of RMB30,000,000 in cash.

In April 2007, China Water Industry (Hong Kong) Limited (the "China Water"), an indirect wholly-owned subsidiary of the Company had entered into the joint venture agreement with (Linyi City Hedong District Water Supply Company Limited*) (臨沂市河東區自來水有限公司) in relation to the establishment of a joint venture company (the "JV Company") principally engaged in water supply business in Linyi City, Hedong District, Shangdong Province, PRC. China Water will be contributed in the aggregate sum of RMB18,000,000 in cash for 60% of the register capital in JV Company.

In April 2007, China Water Industry (Hong Kong) Limited (the "China Water"), an indirect wholly-owned subsidiary of the Company, entered into the Letter of Intent with 河南省商丘市公用事業管理局 (Public Utility Management Bureau of Shang Qiu City in Henan Province*) of the People's Republic of China (the "JV Partner"), pursuant to which China Water has agreed to establish the JV Company named 商丘正源水務有限公司 (Shan Qiu Zheng Yuan Water Company Limited*) (the "JV Company") with the JV Partner to principally engage in the construction and operation of water supply plants with aggregate water supply capacity of 1 million tonnes per day for 商丘市城區 (the urban area of Shang Qiu City*), 永城市 (Yong Cheng City*), 夏邑縣 (Xia Yi District*), 虞城縣 (Yu Cheng District*), 柘城縣 (Zhe Cheng District*), 寧陵縣 (Ning Ling District*), 睢縣 (Ju District*) and 民權縣 (Min Quan District*) of the PRC. Upon the establishment of the JV Company, it will be held as to 51% by China Water and 49% by the JV Partner.

Providing that the joint venture agreements together with further acquisition 60% equity interest in Onfar International can be timely executed in 2007, the Company will increase its population coverage from the existing 0.6 million to 2.42 million people. The total daily water supply capacity will increase to about 1.29 million tons from the existing 0.19 million tons.

In January and March, 2007, the Company successfully raised an aggregate net funds of HK\$417.4 million by the Top-up placing to third parties independent of the Group which has further strengthened the Company's financial position to fund its future expansion. The Company has set aside approximately 84% of net proceed for finance further expansion of the Group's business in water supply and water-related industries in Mainland China by way of new acquisitions and the balance 16% of net proceeds for general working capital of the Group.

* for identification purpose only