



China Water Industry Group Limited
中國水業集團有限公司*

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 1129

2007
Interim Report



* for identification purpose only

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CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Mr. Wang Chia Chin (*Chairman*)
 Mr. Liu Peng Cheng (*Deputy Chairman*)
 (appointed on 25 June 2007)
 Mr. Wong Xiao Bo (*Deputy Chairman*)
 (resigned on 25 June 2007)
 Mr. Zhong Wen Sheng (*Managing Director*)
 Mr. Sze Chun Ning, Vincent (*Deputy Managing Director*)
 Mr. Liu Bai Yue (*Chief Operating Officer*)
 (appointed on 8 January 2007)
 Mr. Shi De Mao
 Ms. Chu Yin Yin, Georgiana
 Mr. Wu Chi Lok (resigned on 16 January 2007)

Non-Executive Directors

Mr. Huang Yuan Wen
 Mr. Pan Shi Ying

Independent Non-Executive Directors

Mr. Chang Kin Man
 Mr. Wu Tak Lung
 Mr. Gu Wen Xuan

AUDIT COMMITTEE

Mr. Chang Kin Man (*Chairman*)
 Mr. Wu Tak Lung
 Mr. Gu Wen Xuan

REMUNERATION COMMITTEE

Mr. Chang Kin Man (*Chairman*)
 Mr. Wu Tak Lung
 Mr. Zhong Wen Sheng
 (appointed on 25 April 2007)
 Mr. Wu Chi Lok
 (resigned on 16 January 2007)

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Ms. Chu Yin Yin, Georgiana

LEGAL ADVISERS

To Hong Kong Laws

Robertsons Solicitors & Notaries
 William W. L. Fan & Co.

As To Cayman Islands Laws

Conyers Dill & Pearman

AUDITORS

SHINEWING (Hong Kong) CPA Limited

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
 Butterfield House
 68 Fort Street
 P.O. Box 705
 George Town
 Grand Cayman KY1-1107
 Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR TRANSFER OFFICE

Union Registrars Limited
 Room 1803, Fook Lee Commercial Centre
 Town Place, 33 Lockhart Road
 Wanchai, Hong Kong

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

Room 1207, 12th Floor
 West Tower, Shun Tak Centre
 168-200 Connaught Road Central
 Sheung Wan, Hong Kong

WEBSITE

www.chinawaterind.com

STOCK CODE

1129

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended 30 June 2007

The Board of Directors (the "Board") of China Water Industry Group Limited (the "Company") is pleased to announce the unaudited condensed consolidated financial results of the Company and its subsidiary (collectively referred to as the "Group") for the six months ended 30 June 2007 (the "Interim Period"), together with comparative figures for the corresponding period in 2006. These interim financial statements have not been audited but have been reviewed by the Company's Audit Committee.

CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 June 2007

		Six months ended 30 June	
		2007	2006
	<i>Notes</i>	HK\$'000	<i>HK\$'000</i>
		(Unaudited)	(Unaudited)
Turnover	3	36,285	33,477
Cost of sales		(33,591)	(21,219)
Gross profit		2,694	12,258
Other operating income		3,705	1,365
Selling and distribution costs		(2,084)	(6,119)
Administrative expenses		(67,840)	(28,628)
Allowance for bad and doubtful debts		(2,041)	–
Share of result of an associate		749	–
Finance costs		(165)	(306)
Loss before tax	4	(64,982)	(21,430)
Income tax expense	5	(70)	–
Loss for the period		(65,052)	(21,430)
Attributable to:			
Equity holders of the parent		(65,349)	(21,185)
Minority interests		297	(245)
		(65,052)	(21,430)
Loss per share	6		
Basic		HK(4.02) cents	HK(2.35) cents
Diluted		N/A	N/A

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2007

	Notes	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Non-current assets			
Property, plant and equipment	8	208,705	64,628
Prepaid lease payment		11,544	–
Goodwill	9	44,390	1,361
Interest in an associate	10	1,496	36,477
		266,135	102,466
Current assets			
Inventories		14,194	18,783
Trade and other receivables	11	29,149	33,781
Amount due from an associate		13,293	–
Amount due from a related party		247	–
Amount due from a director		1,530	–
Pledged bank deposits		–	2,061
Bank balances and cash		389,670	5,045
		448,083	59,670
Current liabilities			
Trade and other payables	12	50,839	78,340
Tax payables		10,283	10,213
Obligations under finance leases		140	140
Short-term borrowings	13	11,427	6,442
Amounts due to related parties		8,028	5,274
Amounts due to directors		–	2,834
Amount due to a minority shareholder of a subsidiary		15,953	–
		96,670	103,243
Net current assets (liabilities)		351,413	(43,573)
Total assets less current liabilities		617,548	58,893

CONDENSED CONSOLIDATED BALANCE SHEET *(Continued)*

As at 30 June 2007

	<i>Notes</i>	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Capital and reserves			
Share capital	14	188,070	116,450
Reserves		286,785	(64,722)
Equity attributable to equity holders of the parent		474,855	51,728
Minority interests		56,883	6,063
Total equity		531,738	57,791
Non-current liabilities			
Obligations under finance leases		198	245
Long-term borrowings and other liabilities	15	85,612	857
		85,810	1,102
		617,548	58,893

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2007

	Attributable to equity holders of the parent								
	Share capital	Share premium	Share options reserve	Translation reserve	Reserve funds	Accumulated profits (losses)	Total	Minority interests	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2006	73,450	8,182	–	1,054	228	(6,315)	76,599	1,960	78,559
Issue of shares	25,000	1,790	–	–	–	–	26,790	–	26,790
Loss for the period	–	–	–	–	–	(21,185)	(21,185)	(245)	(21,430)
Exchange differences arising on translation of foreign operations	–	–	–	452	–	–	452	–	452
At 30 June 2006 (Unaudited)	98,450	9,972	–	1,506	228	(27,500)	82,656	1,715	84,371
At 1 January 2007	116,450	27,905	7,635	1,277	228	(101,767)	51,728	6,063	57,791
Issue of shares	53,000	377,700	–	–	–	–	430,700	–	430,700
Share issue expenses	–	(28,482)	–	–	–	–	(28,482)	–	(28,482)
Recognition of equity-settled share based payment	–	–	40,432	–	–	–	40,432	–	40,432
Exercise of share options	18,620	38,248	(10,432)	–	–	–	46,436	–	46,436
Capital contribution from a minority shareholder of a subsidiary	–	–	–	–	–	–	–	12,310	12,310
Acquisition of subsidiaries	–	–	–	–	–	–	–	38,213	38,213
(Loss) profit for the period	–	–	–	–	–	(65,349)	(65,349)	297	(65,052)
Exchange differences arising on translation of foreign operations	–	–	–	(610)	–	–	(610)	–	(610)
At 30 June 2007 (Unaudited)	188,070	415,371	37,635	667	228	(167,116)	474,855	56,883	531,738

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2007

	Six months ended 30 June	
	2007 HK\$'000 (Unaudited)	2006 HK\$'000 (Unaudited)
NET CASH USED IN OPERATING ACTIVITIES	(30,619)	(23,199)
NET CASH USED IN INVESTING ACTIVITIES	(56,338)	(8,916)
NET CASH GENERATED FROM FINANCING ACTIVITIES	472,192	32,596
INCREASE IN CASH AND CASH EQUIVALENTS	385,235	481
CASH AND CASH EQUIVALENTS AT 1 JANUARY	5,045	4,491
EFFECT OF FOREIGN EXCHANGE RATE CHANGES	(610)	–
CASH AND CASH EQUIVALENTS AT 30 JUNE, represented by bank balances and cash	389,670	4,972

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the six months ended 30 June 2007

1. COMPANY INFORMATION

China Water Industry Group Limited (the “Company”) was incorporated in the Cayman Islands as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”). The Company’s head office and principal place of business is located at Room 1207, 12th Floor, West Tower, Shun Tak Centre, 168-200 Connaught Road Central, Sheung Wan, Hong Kong.

The unaudited condensed consolidated interim financial information (“Interim Financial Information”) are presented in Hong Kong dollars, which is the same as the functional currency of the Company and its subsidiaries (the “Group”).

2. BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES

The Interim Financial Information have been prepared in accordance with Hong Kong Accounting Standard 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on the Stock Exchange. The Interim Financial Information do not include all the information and disclosures required in the annual financial statements and should be read in conjunction with the Group’s annual financial statements for the year ended 31 December 2006.

The accounting policies used in the preparation of the Interim Financial Information are consistent with those used in the Group’s annual financial statements for the year ended 31 December 2006 except for the following new/revised standards, amendments and interpretations (“INTs”) which are effective and mandatory for accounting periods commencing on or after 1 January 2007:

HKAS 1 (Amendment)	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HK (IFRIC)-INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK (IFRIC)-INT 8	Scope of HKFRS 2
HK (IFRIC)-INT 9	Reassessment of embedded derivatives
HK (IFRIC)-INT 10	Interim Financial Reporting and Impairment

The adoption of the above new/revised standards, amendments and INTs has no material effect on the Group’s Interim Financial Information, but will have certain presentational implications on the coming annual financial statements.

At the date of this Interim Financial Information, the HKICPA has issued the following standards, amendments and INTs that are not yet effective or mandatory for the Group’s accounting periods beginning on or after 1 January 2007, for which the Group has not early adopted:

HKAS 23 (Revised)	Borrowing Costs ¹
HKFRS 8	Operating Segments ¹
HK(IFRIC)-INT 11	HKFRS 2 – Group and Treasury Share Transactions ²
HK(IFRIC)-INT 12	Service Concession Arrangements ³

¹ Effective for annual periods beginning on or after 1 January 2009.

² Effective for annual periods beginning on or after 1 March 2007.

³ Effective for annual periods beginning on or after 1 January 2008.

The directors of the Company anticipate that the application of these standards, amendments or INTs will have no material impact on the results and the financial position of the Group.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

3. SEGMENT INFORMATION

Business segments:

For management purposes, during the six months ended 30 June 2007, the Group is organised into three operating divisions – production and sales of computer peripherals, trading of watches and accessories and provision of water supply and sewage treatment. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

- (a) Production and sales of computer peripherals;
- (b) Trading of watches and accessories; and
- (c) Provision of water supply and sewage treatment in the People's Republic of China (the "PRC").

The unaudited segment information about these businesses is presented below:

For the six months ended 30 June (Unaudited)

	Production and sales of computer peripherals		Trading of watches and accessories		Provision of water supply and sewage treatment		Total	
	2007	2006	2007	2006	2007	2006	2007	2006
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Sales to external customers	9,759	16,210	14,601	17,267	11,925	–	36,285	33,477
Segment results	(5,950)	(16,642)	(14,069)	714	724	–	(19,295)	(15,928)
Unallocated corporate income							2,285	1,365
Share-based payment expense							(40,432)	–
Unallocated corporate expenses							(8,124)	(6,561)
Finance costs							(165)	(306)
Share of result of an associate							749	–
Loss before tax							(64,982)	(21,430)
Income tax expense							(70)	–
Loss for the period							(65,052)	(21,430)

The Group's operations are located in the PRC and Hong Kong. The Group's trading of watches and accessories division is located in Hong Kong. Production and sales of computer peripherals, provision of water supply and sewage treatment are carried out in the PRC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

3. SEGMENT INFORMATION (Continued)

The following table provides an analysis of the Group's sales by geographical market, irrespective of the origin of the goods/services:

	Six months ended 30 June	
	2007	2006
	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)
Europe	2,465	1,649
Asia Pacific	33,464	20,198
North America	356	11,630
	36,285	33,477

4. LOSS BEFORE TAX

	Six months ended 30 June	
	2007	2006
	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)
Loss before tax has been arrived at after charging (crediting):		
Staff costs including directors' emoluments:		
– wages, salaries and other benefits	7,922	3,580
– share-based payment expense	1,052	–
– defined benefit scheme contributions	143	94
Total staff costs	9,117	3,674
Amortisation of prepaid lease payment for land use rights	25	–
Allowance for inventories included in cost of sales	4,715	15,382
Allowance for bad and doubtful debts	2,041	–
Share-based payment expense	39,380	–
Cost of inventories recognised and included in cost of sales	11,074	17,782
Depreciation of property, plant and equipment	3,208	2,357
Loss on disposal of investments held for trading	–	1,200
Minimum lease payments under operating leases:		
– Factory premises, plant and staff quarters	1,751	2,192
Loss (gain) on disposal of property, plant and equipment	288	(1,013)
Interest income	(3,028)	(42)
Net foreign exchange gain	(17)	(486)

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

5. INCOME TAX EXPENSE

	Six months ended 30 June	
	2007	2006
	<i>HK\$'000</i>	<i>HK\$'000</i>
	(Unaudited)	(Unaudited)
Current tax in the PRC	70	–

No Hong Kong profits tax has been provided as the Group did not have estimated assessable profits arising in Hong Kong for the six months ended 30 June 2007 (six months ended 30 June 2006: Nil). Taxes arising in other jurisdictions are calculated at the rates of tax prevailing in the respective jurisdictions in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

6. LOSS PER SHARE

The calculation of basic and diluted loss per share attributable to the ordinary equity holders of the parent is based on the following data:

	Six months ended 30 June	
	2007	2006
	<i>HK\$'000</i>	<i>HK\$'000</i>
	(Unaudited)	(Unaudited)
Loss attributable to equity holders of the parent	(65,349)	(21,185)
Number of shares	'000 shares	'000 shares
Weighted average number of ordinary shares for the purpose of basic loss per share	1,623,809	902,556
Effect of dilutive potential ordinary shares: Share options issued by the Company	58,968	–
Weighted average number of ordinary shares for the purpose of diluted loss per share	1,682,777	902,556

No diluted loss per share for the six months ended 30 June 2007 has been presented as the effect of the conversion of the Company's outstanding share options since their exercise was anti-dilutive.

No diluted loss per share for the six months ended 30 June 2006 has been presented as there was no dilutive potential ordinary shares in issue during that period.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

7. DIVIDENDS

No dividend was paid or proposed during the six months ended 30 June 2007, nor has any dividend been proposed since the balance sheet date (six months ended 30 June 2006: Nil).

8. PROPERTY, PLANT AND EQUIPMENT

During the six months ended 30 June 2007, the Group's purchased property, plant and equipment amounted to approximately HK\$58,745,000 (six months ended 30 June 2006: approximately HK\$1,476,000).

During the six months ended 30 June 2007, property, plant and equipment with an aggregate amount of approximately HK\$12,310,000 was injected by a minority shareholder of a subsidiary as contribution to the registered capital of that subsidiary (six months ended 30 June 2006: Nil).

During the six months ended 30 June 2007, property, plant and equipment with an aggregate amount of approximately HK\$76,563,000 was acquired by the Group through acquisition of subsidiaries (six months ended 30 June 2006: Nil).

9. GOODWILL

	<i>HK\$'000</i>
At 31 December 2006 and 1 January 2007	1,361
Adjustments to measurement of consideration for acquisition of subsidiaries in the year of 2006	1,578
	<hr/> 2,939
Transfer from interest in an associate on acquisition of additional equity interests (<i>Note 10</i>)	25,238
Goodwill arising from acquisition of subsidiaries (<i>Note 19(a)</i>)	16,213
	<hr/> 44,390
At 30 June 2007	44,390

10. INTEREST IN AN ASSOCIATE

	<i>HK\$'000</i>
At 31 December 2006 and 1 January 2007	36,477
Share of results for the period	749
Adjustments to measurement of consideration for acquisition of an associate in the year 2006	1,592
Transfer of goodwill on acquisition of additional equity interests (<i>Note 9</i>)	(25,238)
	<hr/> 13,580
Interest in an associate before acquisition of additional 60% equity interests in the associate	13,580
Elimination as a result of acquisition of additional 60% equity interests in the associate (<i>Note 19(a)</i>)	(13,580)
	<hr/> –
Acquisition of an associate through acquisition of a subsidiary	1,496
	<hr/> 1,496
At 30 June 2007	1,496

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

11. TRADE AND OTHER RECEIVABLES

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Trade receivables	38,964	49,916
Less: Accumulated impairment	(23,176)	(21,135)
	15,788	28,781
Other receivables	11,500	2,752
Deposit paid	1,861	2,248
	29,149	33,781

The Group allows an average credit period of 30 days to 180 days given to the customers.

An aged analysis of trade receivables at the balance sheet dates, based on invoice date, and net of impairment losses is as follows:

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Current 90 days	10,238	14,729
91 – 180 days	1,086	8,742
Over 180 days	4,464	5,310
	15,788	28,781

The fair values of the Group's trade and other receivables at 30 June 2007 and 31 December 2006 approximate to their corresponding carrying amounts due to their short-term maturities.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

12. TRADE AND OTHER PAYABLES

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Trade payables, aged analysis based on payment due date		
Current 30 days	1,788	6,615
31 – 90 days	6,619	5,283
91 – 180 days	716	1,849
181 – 365 days	1,877	1,024
Over 1 year	2,383	2,474
	13,383	17,245
Other payables	37,456	61,095
	50,839	78,340

The fair values of the Group's trade and other payables at 30 June 2007 and 31 December 2006 approximate to their corresponding carrying amounts due to their short-term maturities.

13. SHORT-TERM BORROWINGS

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Secured bank borrowings repayable within one year	11,427	6,442

Included in short-term borrowings as at 31 December 2006 and 30 June 2007 was an amount of approximately HK\$6,442,000 (equivalent to New Taiwan dollar 27,000,000) which bears interest at 4% per annum and was secured by a charge over land and buildings of the Group and personal guarantee of a director of the Company.

The remaining balance of the short-term borrowings as at 30 June 2007 represented a bank loan of approximately HK\$4,985,000 (equivalent to approximately RMB5,000,000) bearing interest at 7.344% per annum and was secured by a charge over the Group's certain prepaid lease payment for land use rights and buildings.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

14. SHARE CAPITAL

	At 30 June 2007 (Unaudited)		At 31 December 2006 (Audited)	
	Number of shares	Amount HK\$'000	Number of shares	Amount HK\$'000
Ordinary shares of HK\$0.1 each				
Authorised capital:				
At beginning and end of period/year	4,000,000,000	400,000	4,000,000,000	400,000
Issued and fully paid capital:				
At 1 January	1,164,500,000	116,450	734,500,000	73,450
Issue of shares by way of private placement	530,000,000	53,000	430,000,000	43,000
Exercise of share options	186,200,000	18,620	–	–
At end of period/year	1,880,700,000	188,070	1,164,500,000	116,450

Notes:

- (a) On 31 January 2007, the Company, Boost Skill Investments Limited ("Boost Skill"), a substantial shareholder of the Company, Favor Jumbo Investments Limited ("Favor Jumbo"), a company beneficially wholly owned by Mr Wang Xiao Bo, an executive director of the Company at that time, and Sure Ability Limited ("Sure Ability"), a company beneficially wholly owned by Mr Sze Chun Ning, Vincent, an executive director of the Company, entered into a placing and subscription agreement pursuant to which the First Shanghai Securities Group agreed to place up to 230,000,000 existing shares of the Company at the price of HK\$0.49 per share. Under the placing and subscription agreement, Boost Skill, Favor Jumbo and Sure Ability have agreed to subscribe for up to 230,000,000 subscription shares which are equal to the number of placing shares under the placing and subscription agreement. On 2 February 2007, a total of 230,000,000 existing shares have been placed.
- (b) On 23 March 2007, the Company, Boost Skill and Favor Jumbo entered into a placing agreement to place up to 300,000,000 existing shares of the Company at the price of HK\$1.06 per share. On 29 March 2007, 300,000,000 shares of the Company have been placed.
- (c) During the six months ended 30 June 2007, 186,200,000 options were exercised. Details of which has been set out in note 18 below.

All new shares issued rank pari passu in all respects with other shares in issue.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

15. LONG-TERM BORROWINGS AND OTHER LIABILITIES

	Notes	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Unsecured borrowing at amortised cost	(i)	865	857
Interest-free government loans	(ii)	7,722	–
Secured bank loan	(iii)	29,911	–
Other liabilities	(iv)	47,114	–
		85,612	857

Notes:

- (i) Pursuant to an agreement entered into between Anhui Dang Shan Water Industry Company Limited*安徽省碭山水業有限公司 (“DS Water”), a wholly-owned subsidiary of the Company, and Anhui Dang Shan County Finance Bureau (“DS Finance Bureau”) on 1 March 2006, a loan of RMB1,200,000 (equivalent to approximately HK\$1,196,000) (31 December 2006: RMB1,200,000, equivalent to approximately HK\$1,196,000) was granted by DS Finance Bureau to DS Water, and guaranteed by Dang Shan County Water Supply Bureau. The loan is unsecured, interest-bearing at the fixed deposit rate as stipulated by the People’s Bank of China plus 0.3% per annum and repayable on 28 February 2021.
- (ii) Interest-free government loans of approximately HK\$7,722,000 (31 December 2006: Nil) are unsecured, interest-free and have no fixed terms of repayment.
- (iii) Amount represents a bank loan of RMB30,000,000 (equivalent to approximately HK\$29,911,000 (31 December 2006: Nil) granted by a bank to a subsidiary of the Company, Yichun Fangke Waste Water Investment Limited. Such bank loan is interest-bearing at fixed interest rate of 7.821% per annum, repayable by 10 equal annual installments of RMB3,000,000 each and secured by a pledge over the subsidiary’s revenue from the provision of sewage treatment. As at 30 June 2007, such subsidiary has not yet commenced business.
- (iv) Yichun Water Industry Co. Limited (“Yichun”), a subsidiary of the Company, has been granted by the local government of the PRC an aggregate amount of approximately HK\$47,114,000 (31 December 2006: Nil) for the expansion and construction of water plants and pipelines of Yichun. As at 30 June 2007, the construction of water plants and pipelines was in progress.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

16. CAPITAL COMMITMENT

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Capital commitments contracted but not provided for:		
– acquisition of property, plant and equipment	6,939	1,265

17. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had future minimum lease payments under non-cancellable operating leases which fall due as follows:

	At 30 June 2007 HK\$'000 (Unaudited)	At 31 December 2006 HK\$'000 (Audited)
Within one year	3,808	4,872
In the second to fifth years, inclusive	11,895	12,544
More than five years	4,275	3,174
	19,978	20,590

18. SHARE-BASED PAYMENT TRANSACTIONS

Equity-settled share option scheme:

The Company's share option scheme (the "Scheme"), became effective on 17 January 2002 for the primary purpose of providing incentives to directors and eligible employees or persons and, unless otherwise cancelled or amended, will remain in force for 10 years from that date. Under the Scheme, the board of directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company. Additionally, the Company may, from time to time, grant share options to outside third parties for settlement in respect of goods or services provided to the Company.

At 30 June 2007, the number of shares in respect of which options had been granted and remained outstanding under the Scheme was 368,200,000 (30 June 2006: Nil), representing 19.6% (30 June 2006: Nil) of the shares of the Company in issue at that date.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 30% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders. The number of shares issued and to be issued in respect of which options granted and may be granted to any individual in any one year is not permitted to exceed 1% of the shares of the Company in issue at any point in time, without prior approval from the Company's shareholders. Options granted to substantial shareholders or independent non-executive directors in excess of 0.1% of the Company's share capital or with a value in excess of HK\$5 million, within one year, must be approved in advance by the Company's shareholders.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

18. SHARE-BASED PAYMENT TRANSACTIONS (Continued)

Options granted must be taken up within twelve months of the date of grant, upon payment of HK\$1 per option. Options may be exercised at any time from the date of grant of the share option to the tenth anniversary of the date of grant. The exercise price is determined by the directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant; (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

The following table discloses movements of the Company's share options held by directors and others eligible persons during the six months ended 30 June 2007:

	Outstanding at 1 January 2007	Granted during the period	Exercised during the period	Outstanding at 30 June 2007
Directors	–	28,200,000	–	28,200,000
Eligible persons	98,400,000	427,800,000	(186,200,000)	340,000,000
	98,400,000	456,000,000	(186,200,000)	368,200,000

During the six months ended 30 June 2007, options were granted on 11 January 2007, 17 January 2007, 4 April 2007 and 28 June 2007 respectively. The estimated fair value of the options granted is approximately HK\$40,432,000. No option has been granted or outstanding during the six months ended 30 June 2006.

The fair value was calculated using the Black-Scholes pricing model. The inputs into the model were as follows:

	Share options granted on			
	11 January 2007	17 January 2007	4 April 2007	28 June 2007
Grant date share price	HK\$0.31	HK\$0.42	HK\$1.03	HK\$1.14
Exercise price	HK\$0.34	HK\$0.42	HK\$1.078	HK\$1.14
Expected volatility	50.27%	50.42%	44.41%	40.29%
Option life	0.5 year	0.5 year	0.5 year	0.5 year
Risk-free rate	3.63%	3.69%	3.40% to 3.52%	3.84% to 3.96%
Expected dividend yield	0%	0%	0%	0%

Expected volatility was determined by using the historical volatility of the share price of comparable listed companies in Hong Kong which engaged in the same business of the Group in the PRC over the previous one year. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioral considerations.

The Group recognised the total expense of approximately HK\$40,432,000 for the six months ended 30 June 2007 in relation to share options granted by the Company (six months ended 30 June 2006: Nil).

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

19. ACQUISITIONS OF SUBSIDIARIES

(a) Acquisition of additional interests in Onfar International Limited for the six months ended 30 June 2007

On 12 March 2007, Billion City Investments Limited ("Billion"), a wholly-owned subsidiary of the Company, and Boost Skill entered into an agreement pursuant to which Billion agreed to acquire from Boost Skill a 60% of the entire issued share capital and shareholder's loan of Onfar International Limited at a consideration of approximately HK\$32,605,000. Such transaction constituted a major and connected transaction. The acquisition was completed on 14 May 2007.

On completion, the Group's shareholding in Onfar International Limited increased from 40% to 100% and Onfar International Limited became a wholly-owned subsidiary of the Group thereafter. Onfar International Limited and its subsidiaries ("Onfar Group") contributed revenue of approximately HK\$10,252,000 and profit of approximately HK\$946,000 to the Group from the completion date of acquisition to 30 June 2007.

The fair values of identifiable assets and liabilities acquired from Onfar Group are based on the best estimation of the Board of directors. Professional valuation of the acquired subsidiaries is in progress. The directors consider that the fair values of the identifiable assets and liabilities acquired during the period ended 30 June 2007 have no significant differences from their respective carrying amounts.

The net assets acquired in the transaction and the goodwill arising are as follows:

	Onfar Group HK\$'000
Net assets acquired:	
Property, plant and equipment, net	76,563
Prepaid lease payment for land use rights	9,810
Interest in an associate	1,496
Inventories	6,248
Trade and other receivables	33,496
Bank balances and cash	49,694
Trade and other payables	(20,453)
Short-term borrowings	(4,985)
Loan from the former shareholder of Onfar International Limited	(22,670)
Long-term borrowings and other liabilities	(61,014)
Minority interests of a subsidiary	(38,213)
Net assets	29,972
Less: 40% equity interests acquired previously recognised as interest in an associate (Note 10)	(13,580)
Net assets acquired	16,392
Goodwill (Note 9)	16,213
	32,605

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

19. ACQUISITIONS OF SUBSIDIARIES (Continued)

(a) Acquisition of additional interests in Onfar International Limited for the six months ended 30 June 2007
(Continued)

	Onfar Group HK\$'000
Satisfied by:	
Direct costs relating to the acquisition	2,605
Cash consideration paid	30,000
	<hr/> 32,605

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition of Onfar Group is as follows:

	HK\$'000
Cash consideration for acquisition of additional 60% equity interests	(30,000)
Direct costs relating to the acquisition	(2,605)
Cash and bank balances acquired	49,694
	<hr/> 17,089

The goodwill is attributable to the high profitability of the acquired business and the significant synergies expected to arise after the Group's acquisition of Onfar Group.

If the acquisition had been completed on 1 January 2007, total Group's turnover for the six months ended 30 June 2007 would have been increased by approximately HK\$13,902,000 and profit for the six months ended 30 June 2007 would have been increased by approximately HK\$3,746,000. The proforma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2007, nor is it intended to be a projection of future results.

- (b) Linyi Fenghuang Water Industry Co. Ltd ("Linyi Fenghuang") was established in the PRC with limited liability on 1 June 2007 with an operating period of 30 years and is principally engaged in water supply business in Linyi City, Shandong Province, the PRC. The registered capital of Linyi Fenghuang was approximately HK\$30,520,000 (equivalent to approximately RMB30,000,000) which is owned as to 60% by the Group and 40% by Linyi City Hedong District Water Supply Company* (臨沂市河東區自來水公司) ("Linyi Water"). Up to the balance sheet date, Linyi Water had paid up its share of capital by way of injecting plant and machinery of approximately HK\$12,310,000 (equivalent to approximately RMB12,000,000) while the Group had paid HK\$9,400,000 (equivalent to approximately RMB9,163,308). The Group is required to make capital contribution to the remaining unpaid registered capital of approximately HK\$8,810,000 (equivalent to approximately RMB8,836,692) on or before 28 February 2008.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

20. POST BALANCE SHEET EVENTS

- (a) On 3 July 2007, a Company's subsidiary, China Water Industry (HK) Limited ("China Water (HK)") entered into an agreement with Huge Summit Management Limited ("Huge Summit"), pursuant to which Huge Summit has conditionally agreed to sell and China Water (HK) has conditionally agreed to purchase the entire issued share capital of Longwide Investment Limited ("Longwide"), being one ordinary share of Longwide at a consideration of RMB67,500,000 (equivalent to approximately HK\$69,400,000) which will be paid in cash. Longwide is an investment holding company holding 51% equity interests each in Shangqiu Zhengyuan Water Industry Co. Ltd* (商丘市正源水務有限公司) and Linyi Ganghua Water Industry Co., Ltd* (臨沂港華水務有限公司). Further details of the transaction had been set out in the Company's circular dated 20 July 2007.
- (b) On 9 July 2007, China Water (HK) entered into a letter of intent with the Construction Bureau of Yingtan City* (鷹潭市建設局) to form a joint venture company named Yingtan Water Industry Group Company Limited* (鷹潭水業集團有限公司) ("Yingtan Water") which will be principally engage in the water supply to urban areas in Yingtan City in Jiangxi Province of the PRC. Yingtan Water is also planning to acquire two domestic water supply companies in Gui Xi City* (貴溪市) and Xu Jiang County* (余江縣) in Jiangxi Province of the PRC. The proposed establishment of Yingtan Water is subject to the entering into of a joint venture agreement by both parties. Upon the establishment of Yingtan Water, it will be held as to 51% by China Water (HK) and 49% by the Construction Bureau of Yingtan City.
- (c) On 19 July 2007, a Company's subsidiary, China Ace Investment Limited ("China Ace") entered into an agreement with Jinan Hong Quan Water Company Limited* (濟南泓泉制水有限公司) ("JHQ Water"), pursuant to which China Ace and JHQ Water have agreed to provide additional capital contributions to an existing subsidiary, Jining City Haiyuan Water Treatment Company Limited* (濟寧市海源水務有限公司). Accordingly to the terms as set out in the agreement, China Ace and JHQ Water shall make additional capital contribution of RMB21,000,000 and RMB9,000,000 in form of cash respectively.
- (d) On 3 August 2007, the Company issued convertible bonds in aggregate principal amounts of HK\$385 million.

The convertible bonds bear interest from 3 August 2007 at the rate of 0.25%, per annum, payable semi-annually in arrear on 3 February and 3 August in each year. Unless previously redeemed, converted or purchased and cancelled, the Company may redeem each outstanding convertible bond at 159.3976% of its principal amount on 3 August 2012. The redemption premium is derived based on yield to maturity at 9.75% per annum. The directors (including the independent non-executive directors) are of the view that the yield to maturity at 9.75% per annum is fair and reasonable so far as the Company and its shareholders are concerned.

The net proceeds from the issue of the convertible bonds will be used wholly by way of capital expenditure and working capital in Hong Kong and for investment in water supply and/or water related projects in the PRC which have not yet been identified.

On the basis of the Company's 1,880,700,000 shares in issue as at 30 June 2007, upon full conversion of the entire principal amount of the convertible bonds into the shares at the initial conversion price of HK\$1.42, a total of 271,126,760 conversion shares will be issued, which represents approximately 14.42% of the issued share capital of the Company as at 30 June 2007 and approximately 12.06% of the issued share capital of the Company as enlarged by such conversion, assuming no other issue of the Company's shares is made before full conversion of the convertible bonds.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended 30 June 2007

20. POST BALANCE SHEET EVENTS (Continued)

- (e) On 13 August 2007, China Water (HK) entered into a letter of intent with the People's Government of Du Yun City in Guizhou Province, the PRC to form a joint venture company named Du Yun City Water Industry Company Limited* (都匀市水業有限責任公司) which will be principally engaged in water supply to urban areas in Du Yun City* (都匀市) in Guizhou Province of the PRC. The proposed establishment of the joint venture company is subject to the entering into of the joint venture agreement by both parties. Upon the establishment of the joint venture company, it will be held as to 51% by China Water (HK) and 49% by the People's Government of Du Yun City.
- (f) On 27 August 2007, China Water (HK) entered into a letter of intent with the Management Committee of Suzhou Economic Development Zone* (宿州經濟開發區管委會) in Anhui Province of the PRC to form either a joint venture company or a wholly-owned subsidiary to engage in investing, constructing and operating a water supply plant and sewage treatment plant in Suzhou City Economic Development Zone* (宿州市經濟開發區) in Anhui Province of the PRC. The proposed investments are subject to the entering into of an agreement by both parties.

21. PENDING LITIGATION

On 31 May 2007, a winding-up petition against a Company's subsidiary, Technostore Limited ("Technostore"), was filed by the minority shareholder of Technostore. The directors of the Company are seeking legal opinion on the said legal proceeding. In the opinion of directors, the legal proceeding is considered as not probable and no material future outflow of resources from the Group is expected.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE

The Group's turnover amounted to approximately HK\$36.29 million for the Interim Period, represented a moderate increase by 8.4% as compared to that of approximately HK\$33.48 million in the corresponding period last year. The increase in turnover signified the achievement of the Group's to diversify its business in the water supply and sewage treatment sector. During the Interim Period, this new business segment has contributed HK\$11.93 million in turnover. On the other hands, the operating environments of the Group's computer peripherals and watch retail businesses were getting tougher and rigorous. Revenue contribution by the computer peripherals and watch retail segments have dropped significantly by 39.8% and 15.4% respectively.

Net loss attributable to shareholders for the Interim Period amounted to HK\$65.35 million, which represented an increase of HK\$44.16 million as compared with the net loss of HK\$21.19 million in the corresponding period in 2006. The increase was mainly due to the share-based payment expenses recognized in accordance with the Hong Kong Financial Reporting Standard 2 in relation to share options granted to eligible participants pursuant to the Company's share option scheme. During the Interim Period, fair value of share options granted amounted to HK\$40.43 million and included in administrative expenses with a corresponding credit to the share option reserve. The management is in the belief that the grant of share option is an effective way to expedite business development of the Group, especially in the PRC water supply and sewage treatment sector, without incurring any outflow of cash or financial resources. If excluding this share-based payment expenses, the net loss for the Interim Period would have been increased by HK\$3.19 million as comparing with last year. In addition, for prudent sake, the Group has made a provision for bad and doubtful debts of HK\$2.04 million against the account receivables of the computer peripherals business.

Share of profit from an associate, Onfar Group amounted to HK\$0.75 million. Onfar Group is a milestone of the Group's business development as it is the Group's first acquisition in the PRC water supply industry. During the Interim Period, the Group has acquired the remaining equity interest of Onfar Group, thus it is now a wholly owned subsidiary of the Group. The financial results of Onfar Group have been consolidated in the Group's financial statement since 14 May 2007, being the date of completion of the further acquisition.

Other operating income increased by HK\$2.34 million to HK\$3.7 million. This was mainly due to the reversal of allowance for bad and doubtful debts in the water supply segment.

Selling and distribution costs reduced sharply by 65.9% to HK\$2.08 million. This was consistent to the decline in the businesses of computer peripherals and watch retail. Subsequent to the Interim Period, the Group has closed image shop of TechnoMarine in Hong Kong.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

BUSINESS SEGMENTS REVIEW

Computer Peripherals business

The turnover of computer peripherals business decreased by HK\$6.45 million to HK\$9.76 million (30 June 2006: HK\$16.21 million) and recorded at loss of HK\$5.95 million (30 June 2006: HK\$16.66 million). Owing to the low entry barriers, the competition, especially in price, in the Computer Peripherals business is very keen. Customers are very cautious and conservative in placing orders. The Group has lost some customers in North America region. This has adversely affected the operating scale in the segment. Moreover growing staff costs, rising commodities and raw materials price, as well as the gradual appreciation of Renminbi, all of these were adding cost pressure to us. With intense competition in the industry, customers were quite resistant and sensitive to price increase. We were hard to adjust our selling price upwards to offload a portion of the cost increment to our customers. As a result, gross profit margin in the Interim Period dropped to 12.5% (30 June 2006: 33%). In the Interim Period, the Group had not fully utilized the production facilities due to the decrease of sales orders. To minimize future business risk in the segment, the management is in the process of evaluating the merits of sub-contracting part or the entire production plant to an independent third party. Yet at the date of this report, neither any concrete plan nor preliminary negotiation has been formed or commenced.

Trading of watches and accessories business

During the Interim Period, turnover of the segment has dropped by HK\$2.67 million to HK\$14.60 million and a gross loss of HK\$2.52 million was recorded. When we first introduced "TechnoMarine" brand to the market, it did attract stylish and trendy person to buy our product. However, in recent years, many watches of similar style as "TechnoMarine" have been pushed to the market. In the absence of a very solid customers' loyalty, the market development of "TechnoMarine" was hindered. Expansion in retail spots in the Asia Pacific region was slowed down, and the management was very cautious in introducing new models and product lines. To stimulate sales, the Group was forced to adopt an aggressive pricing strategy to offer a relative big discount even on new products. All of these have seriously affected the revenue contribution of the segment to the Group. Moreover, escalating rental for shops, rising staff costs and declining sales coerced the management to close the image shop located in the Festival Walk in August 2007. During the Interim Period, the segment suffered from a loss of HK\$14.07 million (30 June 2006: profit of HK\$0.71 million).

The management thought that the future development of the TechnoMarine watches business was relatively limited and has decided not to inject further resources to the segment.

Water Supply and Sewage Treatment business in China

In last year, the Group has decided to diversify its business to the PRC water supply and related industries. At present, the Group has already acquired 3 water supply plants and 2 sewage treatment facilities in the PRC. The planned aggregate water supply capacity of these water supply plants reach 260,000 tonnes per day, and the planned aggregate sewage treatment capacity of these sewage treatment plants are 70,000 tonnes per day.

During the period under review, the turnover of Onfar Group and Anhui Dang Shan Water Industry Company Limited (the "DS Water") amounted to HK\$11.93 million. They contributed HK\$0.72 million in operating profit to the Group. During the Interim Period, Jining City Haiyuan Water Treatment Company Limited and Linyi Fenghuang Water Industry Company Limited have not yet commenced commercial operation, and no turnover and operating profit were recorded in the interim financial statements. It was expected that their business operation will be started soon.

MANAGEMENT DISCUSSION AND ANALYSIS *(Continued)*

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2007, the Group has a strong liquidity position with cash and cash equivalents amounted to HK\$389.67 million (31 December 2006: HK\$5.05 million). During the Interim Period, the Group has carried out 2 fund raising exercises through top-up placing and subscription of shares. These fund raising activities were successful, which evidenced market appreciation towards the Group's business diversification into the PRC water supply industry. Net proceeds from these fund raising activities amounted to HK\$417.70 million. With steady cash flows generated from the water supply segment and existing available financial resources, the Group is in a very strong position to expand further in the PRC water supply industry.

Total borrowings of the Group as at 30 June 2007 were HK\$97.38 million (31 December 2006: HK\$7.68 million) comprising secured bank loan of HK\$41.34 million and unsecured bank loan of HK\$0.87 million as well as interest free government loans of HK\$54.84 million (31 December 2006: HK\$7.30 million) and obligations under finance leases of HK\$0.34 million (31 December 2006: HK\$0.39 million). Bank loans were mainly denominated in New Taiwan dollar and Renminbi, the interest rates of which were fixed interest rate.

The Group's gearing ratio as at 30 June 2007 was 25.5% (31 December 2006: 64.4%), which was calculated by dividing total liabilities of HK\$182.48 million over total assets of the Group of HK\$714.22 million. The gearing ratio dropped sharply as the Group has a very strong cash position as noted above.

As at 30 June 2007, the net current assets of the Group was HK\$351.41 million (31 December 2006: net current liabilities HK\$43.57 million) and the current ratio of the Group was approximately 4.6 times (31 December 2006: (0.6) times).

CAPITAL RAISING AND USE OF PROCEEDS

On 2 February 2007, 230,000,000 new Shares were allotted and issued under a Top-up placing (the "First Top-up Placing") at a placing price of HK\$0.49 per placing Share to third parties independent of the Group. The placing Shares represent approximately 19.76% of the then existing issued share capital of the Company. The net proceeds of the First Top-up Placing were estimated to be approximately HK\$109.3 million and were intended to be applied as to approximately HK\$95 million for further expansion of its business in water supply and water-related industries in Mainland China and the balance for general working capital of the Group.

On 29 March 2007, 300,000,000 new Shares were allotted and issued under a Top-up placing (the "Second Top-up Placing") at a placing price of HK\$1.06 per placing Share to third parties independent of the Group. The placing Shares represent approximately 19.35% of the then existing issued share capital of the Company. The net proceeds of the Second Top-up Placing were estimated to be approximately HK\$308.4 million and were intended to be applied as to approximately HK\$262 million for further expansion of its business in water supply and water-related industries in Mainland China and the balance for general working capital of the Group.

As of the balance sheet date, approximately HK\$104 million was used for investing in water supply and water related business projects in the PRC and the remaining balance of HK\$313.70 million being placed in bank. The unutilized amounts will continue to be invested in the projects committed.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

FOREIGN EXCHANGE RISK

Most of the Group's business transactions, assets and liabilities are denominated in Hong Kong dollars, United States dollars and Renminbi. The Group's exposure to United States dollars currency risk is minimal as Hong Kong dollars is pegged to United States dollars. Nevertheless, as Renminbi is becoming more volatile, the Group's operations and performances might thus be affected. Presently, the Group does not have any currency hedging policy but will closely monitor the fluctuation of Renminbi exchange rate and take appropriate measures to minimize any adverse impact that may be caused by such fluctuation.

CAPITAL COMMITMENTS

As at 30 June 2007, the Group has the capital commitments contracted but not provided for acquisition of property, plant and equipment approximately HK\$6.94 million (2006: HK\$1.27 million).

EMPLOYEES AND REMUNERATION POLICES

As at 30 June 2007, the Group had approximately 703 full-time employees (2006: 435 full-time employees). Most of them station in the PRC while the remaining in Hong Kong. The remuneration package of the employees is determined by various factors including the employees' experience and performance, the market condition, industry practice and applicable employment law.

MAJOR EVENTS

Acquisition of subsidiaries

On 12 March 2007, the Company entered into the Sales and Purchase Agreement with Boost Skill Investments Limited to acquire the remaining 60% equity interest of Onfar International Limited which directly holds 51% of equity interest in Yichun Water Industry Company Limited (the "Yichun") at a total cash consideration of RMB30 million in cash in 2007. Yichun has been engaging in the supply of water and provision of sewage treatment service to the residents in Yichun City.

On 11 April 2007, the Company entered into Joint Venture Agreement with People's Government of Hedong District in Linyi City* (臨沂市河東區人民政府) (the "JV Partner") and Linyi City Hedong District Water Supply Company* (臨沂市河東區自來水公司) ("Linyi Water"). The Company and the JV Partner have established a joint venture company named Linyi Fenghuang Water Industry Company Limited in Linyi City, Shandong Province, the People's Republic of China ("PRC") (the "JV Company") which is principally engaged in water supply business in Linyi City, Hedong District, Shandong Province, PRC. The Company holds 60% equity shares in this JV Company at a total consideration of RMB18 million.

Letter of Intent

On 15 March 2007, the China Water Industry (HK) Limited (the "China Water HK"), a wholly owned indirect subsidiary of the Company, entered into a non-legally binding heads of agreement with the Management Committee of Shu Yang District Economic Development Zone in Jiangsu Province of the PRC* (江蘇省沭陽縣經濟開發區管理委員會). Pursuant to which China Water HK agreed to establish a wholly-owned subsidiary in Shu Yang District Economic Development Zone in Jiangsu Province of the PRC.

MANAGEMENT DISCUSSION AND ANALYSIS *(Continued)*

MAJOR EVENTS *(Continued)*

Letter of Intent *(Continued)*

On 23 April 2007, the China Water Industry (HK) Limited (the "China Water HK"), a wholly owned indirect subsidiary of the Company, entered into a non-legally binding Letter of Intent with Public Utility Management Bureau of Shang Qiu City in Henan Province* (河南省商丘市公用事業管理局) of the People's Republic of China (the "JV Partner"), pursuant to which China Water HK has agreed to form a joint venture company named Shan Qiu Zheng Yuan Water Company Limited* (商丘正源水務有限公司) (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 (Sui District*) and 民權縣 (Min Quan District*) of China, which the China Water will hold 51% of equity shares of the JV company.

Pending litigation involving Technostore Limited, a subsidiary of the Company

A winding-up petition dated 30 May 2007 was filed by Mr. Mao Chi Fai ("Mr. Mao"), a minority shareholder and a sole director of Technostore Limited (the "Technostore"), against the Technostore in respect of the affairs of the Technostore were being conducted in a manner which is unfairly prejudicial to the interest of Mr. Mao. On 8 August 2007, the Court ordered the relevant parties to exchange evidence and to fix a date for hearing the petition. The legal case is still pending for hearing of the petition at the High Court. As advised by the Company's solicitor, the directors of the Company believed that Mr. Mao does not have a valid claim in obtaining a winding-up order against the Technostore and therefore it is unlikely to have material adverse financial impact on the Group. Save and except for this, the Company is not aware of any other significant proceedings instituted against the Company.

PROSPECT

Since the core business of the Group has been completely redirected to water related investment, substantial provisions were made for assets related to production of computer peripheral equipment and sales of "TechnoMarine" watches in December 2006. During the first half of 2007, scale of operations of such businesses have been significantly downsized. It is expected that the accounting treatment for disinvestment of the relevant businesses and assets will be completed in the near future. The Group will become a dedicated water industry investor.

The People's Republic of China (the "PRC") is one of the largest countries in the world suffering severe water shortage and water pollution. To cope with the enormous demand for water as a result of urbanization and industrialization and curb the spread of water pollution, the PRC government has been actively introducing extensive measures, including raising water prices and encouraging foreign and private enterprises to invest in the water industry. The board of directors of the Group is convinced that the rapid social and economic development in the PRC and the measures adopted by the PRC government have brought a prosperous future for the water industry in the PRC. The Group will focus on expanding its investment business in this industry.

As for investment in water industry, the Group has shifted its investment focus from small cities to medium-sized cities since the first half of 2007. It is expected that the Group will continue to focus on acquiring water related projects in large and medium-sized cities in the second half of 2007, with a view to establishing a regional water supply group enterprise that serves large and medium-sized cities covering small cities. Meanwhile, the Group will also increase its investment in sewage treatment on an appropriate scale.

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

PROSPECT (Continued)

In respect of operation of water related business, the Group has set up an internal special task force to change its former State-owned enterprise operating mechanism to a private equity enterprise operating mechanism, and to implement stringent measures of cost control and business performance evaluation. It is expected that the level of water supply will be increased substantially with reduced operation costs, and revenue streams, such as installation of water meters and construction of pipe systems, will be expanded.

The board of directors of the Group believes that the water related business of the Group will attain larger scale of operation and better profitability by way of expanded investment in water industry and our efforts on optimising water related business operation in 2007, which will bring significant contribution to our profits and shareholders' return in the future.

SUPPLEMENTARY INFORMATION

INTERIM DIVIDENDS

The Board does not recommend payment of interim dividend for the six months ended 30 June 2007 (six months ended 30 June 2006: Nil).

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES

As at 30 June 2007, the interests and short positions of the Directors and Chief Executive of the Company, or their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), the "SFO") which had been notified to the Company and the stock exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions in which they were deemed or taken to have under such provisions of the SFO) or which were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), to be notified to Company and the Stock Exchange were as follows:

Name of director	Nature of interest	Number of issued ordinary shares held	Total interest	Percentage of the issued share capital of the Company
Mr. Wang Chia Chin	Beneficial owner Interest of spouse (Note 1)	16,840,000	16,840,000(L)	0.89%
Mr. Liu Peng Cheng	Interest in controlled corporation (Note 2)	310,150,000	310,150,000(L)	16.49%
Mr. Sze Chun Ning, Vincent	Interest in controlled corporation (Note 3)	55,000,000	55,000,000(L)	2.92%

For the purpose of this section, the shareholding percentage in the Company is calculated on the basis of 1,880,700,000 Shares in issue as at 30 June 2007.

SUPPLEMENTARY INFORMATION *(Continued)*

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES *(Continued)*

The letter "L" denotes a long position in shares of the Company

Notes:

1. These Shares are held and beneficially owned by Ms. Ko Su Mei, the spouse of Mr. Wang Chia Chin. Under the SFO, Mr. Wang Chia Chin is deemed to be interested in these 16,840,000 Shares.
2. These Shares are held by Boost Skill Investments Limited (as to 180,000,000 Shares) and Favor Jumbo Investments Limited (as to 130,150,000 Shares), each of which is beneficially wholly-owned with sole directorship by Mr. Liu Peng Cheng.
3. These Shares are held by Sure Ability Limited, a company beneficially wholly-owned with sole directorship by Mr. Sze Chun Ning, Vincent.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2007, so far as was known to the Directors or chief executives of the Company, there is no person known to the Directors (other than the Directors or chief executives of the Company as disclosed in the above), who had interests or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under provisions of Divisions 2 and 3 of Part XV of the SFO, or recorded in the register kept by the Company pursuant to Section 336 of the SFO, or who were, directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying the right to vote in all circumstances at general meetings of the Company or any member of the Group.

SUPPLEMENTARY INFORMATION *(Continued)*

SHARE OPTION SCHEME

The Company had adopted a share option scheme on 17 January 2002 (the "Scheme"), the details of which have been set out in note 18 to the consolidated financial statements. During the Interim Period, 456,000,000 options have been granted to certain directors of the Company and other eligible participants pursuant to the terms of the Scheme. As at 30 June 2007, 368,200,000 options granted and exercisable at the discretion of the relevant option holders were outstanding. The outstanding options represented approximately 19.58% of the issued share capital of the Company as at 30 June 2007.

Details of the movements in the share options during the period ended 30 June 2007 under the Scheme are as follows:

Name or category of participant	Date of grant	Outstanding as at 1 January 2007	Granted during the year	Exercised during the year	Lapsed during the year	Outstanding as at 30 June 2007	Exercisable period	Exercise Price per share of the Company HK\$
<i>Directors</i>								
Sze Chun Ning, Vincent	11 January 2007	-	11,600,000	-	-	11,600,000	11 January 2007 to 10 January 2017	0.335
Chu Yin Yin, Georgiana	11 January 2007	-	11,600,000	-	-	11,600,000	11 January 2007 to 10 January 2017	0.335
Liu Bai Yue	17 January 2007	-	5,000,000	-	-	5,000,000	17 January 2007 to 16 January 2017	0.420
Sub-total		-	28,200,000	-	-	28,200,000		
<i>Other eligible participants</i>								
	11 January 2007	-	87,800,000	87,800,000	-	-	11 January 2007 to 10 January 2017	0.335
	4 April 2007	-	155,000,000	-	-	155,000,000	4 April 2007 to 3 April 2017	1.078
	28 June 2007	-	185,000,000	-	-	185,000,000	28 June 2007 to 27 June 2017	1.144
Sub-total		-	427,800,000	87,800,000	-	340,000,000		
Total as at 30 June 2007		-	456,000,000	87,800,000	-	368,200,000		

Save as disclosed in the directors and chief executives' interests in securities and Share Option Scheme above, none of the Directors or chief executives of the Company and their associates had any interests or short positions in any shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required pursuant to Section 352 of the SFO to be entered in the register maintained by the Company referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

SUPPLEMENTARY INFORMATION *(Continued)*

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SECURITIES

During the six months ended 30 June 2007, neither the Company nor its subsidiaries had not redeemed, and neither the Company nor any of its subsidiaries had purchased or sold any of the Company's listed securities.

CORPORATE GOVERNANCE PRACTICES

The Group recognizes the importance of transparency and accountability to shareholders. The Board will continually review and enhance its corporate governance practices to ensure that they meet shareholders' expectation and comply with relevant standards.

During the six months ended 30 June 2007, the corporate governance practices adopted by the Company has complied with the code provisions set out in the Code of Corporate Governance Practices contained in Appendix 14 of the Listing Rules (the "CGP Code") except for the deviations from the following provisions of the CGP Code:

1. Code provision A4.1 stipulates that non-executive Directors should be appointed for a specific term. However, none of the existing non-executive Directors of the Company (including independent non-executive) is appointed for a specific term since all non-executive Directors of the Company (including independent non-executive) are subject to retirement by rotation and re-election at annual general meetings of the Company in line with the Company's Articles of Association. The Company considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those in the CGP Code.
2. Code provision E1.2 stipulates that the chairman of the board (the "Chairman") should attend the annual general meeting (the "AGM"). The Chairman was unable to attend the AGM on 31 May 2007 due to his personal reasons but he has designated the Managing Director of the Company to answer questions raised at the AGM.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 to the Listing Rules as its own Code of Conduct regarding securities transactions by the Directors of the Company. All Directors have confirmed that they have complied with the required standard set out in the Model Code throughout the six months ended 30 June 2007.

AUDIT COMMITTEE

The Audit Committee comprises three independent non-executive directors of the Company, has reviewed with the management of the Company the accounting principles and practices adopted by the Group and discussed auditing internal controls and financial reporting matters including the review of the unaudited interim financial statements for the six months ended 30 June 2007.

REMUNERATION COMMITTEE

The Remuneration Committee comprises two independent non-executive directors of the Company and one executive director of the Company is responsible for reviewing and evaluating the remuneration policies of executive directors and senior management and making recommendations to the Board from time to time.

SUPPLEMENTARY INFORMATION *(Continued)*

PUBLICATION OF THE INTERIM RESULTS AND REPORT

This interim results announcement is published on the websites of the Company (www.chinawaterind.com) and Hong Kong Exchanges and Clearing Limited (<http://www.hkex.com.hk>). The interim report of the Company for 2007 containing all information required by the Listing Rules will be dispatch to Shareholders and made available on the above websites in due course.

APPRECIATION

Finally, I would like to take this opportunity to express my gratitude to my fellow directors, management and employees for their contributions and dedication to the development of the Group and deep thanks to our shareholders, customers, suppliers and business partners for their continued supports.

By order of the Board
China Water Industry Group Limited
Zhong Wen Sheng
Managing Director

Hong Kong, 24 September 2007

* *for identification purpose only*