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

China Water Industry Group Limited

(Incorporated in the Cayman Islands with limited liability)

Annual Report 2007

Stock Code: 1129

*for identification purpose only

China Water Industry Group Limited
Annual Report 2007

Contents

CORPORATION INFORMATION

BOARD OF DIRECTORS

EXECUTIVE DIRECTORS

Mr. Li Yu Gui *(Chairman)*
Mr. Liu Peng Cheng *(Deputy Chairman)*
Mr. Zhong Wen Sheng *(Managing Director)*
Mr. Sze Chun Ning, Vincent *(Deputy Managing Director)*
Mr. Liu Bai Yue *(Chief Operating Officer)*
Mr. Shi De Mao
Ms. Chu Yin Yin, Georgiana
Mr. Wang Chia Chin

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

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Ms. Chu Yin Yin, Georgiana

PRINCIPAL BANKERS

PRC

Agricultural Bank of China
Bank of China
Industrial and Commercial Bank of China

Hong Kong

DBS Bank (Hong Kong) Limited
The Hongkong and Shanghai Banking Corporation Limited
Hang Seng Bank Limited
Bank of China (Hong Kong) Limited
Chiyu Banking Corporation Limited

LEGAL ADVISERS

CHINA

Guangdong Huaxida Lawyers

HONG KONG

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

AS TO CAYMAN ISLANDS LAWS

Conyers Dill & Pearman

AUDITORS

SHINEWING (HK) CPA Limited

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
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HONG KONG BRANCH SHARE REGISTRAR TRANSFER OFFICE

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HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

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STOCK CODE

1129

CHAIRMAN'S STATEMENT

On behalf of the board of directors (the "Board"), I am pleased to present to the shareholders the annual results of China Water Industry Group Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2007.

RESULTS

In the year of 2007, the Group's turnover was HK$74.29 million, an increase of 87.82% against the HK$39.55 million in 2006. Gross profit for the year was HK$20.65 million, representing an increase of 47.78% over the HK$13.97 million in 2006. The losses of the Group for the year ended 31 December 2007 substantially decreased of HK$80.07 million to HK$15.67 million from its results of previous corresponding year of losses of approximately HK$95.7 million, principally due to a combination of the following: (i) decrease in loss from discontinued operation and recognition of a gain as a result of the disposal of computer peripherals business; (ii) net positive effect arising from fair value adjustment in derivative component and recognition of interest expense on the liability component of the convertible notes; (iii) increase in other operating income; and (iv) increase in share-based payment expenses for the granting of share options by the Company during the year.

BUSINESS REVIEW

Computer Peripherals Business

After due consideration, the Group decided to terminate and dispose the computer peripherals business in 2007. In the opinion of the directors, the business did not achieve satisfactory performance in profitability and continued to record losses due to rising costs of raw materials, significant appreciation of Renminbi and intensified market competition in recent years. In spite of a number of measures adopted for cost control and promoting sales, the directors were not optimistic about the current and future profitability of the business. As a result, investment in the business was discontinued in the first half of the year. Inventories and provision for doubtful debts were written off. The business was sold to an independent third party in the second half of the year.

TechnoMarine Watches Business

During 2007 the Group decided to discontinue its investment in this business after careful consideration. Sales of the "TechnoMarine" brand had been on a decline. Expansion to the retail market in the Asia Pacific region was slowed down due to the rapid influx of watches having similar style resulting in intensified competition. Moreover, in spite of a series of aggressive pricing and sales promotion strategies for the new products, the rise in sales was insufficient to offset the increase in shop rental and staff costs. Investment in the business was discontinued. The image shop operating under the business was liquidated and closed.

Urban Water Supply and Sewage Treatment Business

The Group had been successful in focusing into its core business development on urban water supply and sewage treatment in the PRC. At present, the Group consolidated its capital to acquire 7 urban water supply enterprises and 4 sewage treatment enterprises in the PRC, with aggregate water supply capacity of 2.3 million tonnes per day and aggregate sewage treatment capacity of 100,000 tonnes per day, providing water supply and sewage treatment services to a population of 4.81 million in Shandong, Jiangxi, Henan, Anhui and Hainan provinces. The acquired water supply enterprises are well-operated water supply entities and the sewage treatment enterprises were newly built projects, which commenced operation during the year.

CHAIRMAN'S STATEMENT

PROSPECTS

During the year under review, the Group completed initial realignment of its business. After offloading the computer peripherals and the TechnoMarine watch businesses and making the associated financial provisions, the core business of the Group can be more effectively redirected to the water-related industries in the PRC that includes water supply and sewage treatment.

There is an enormous demand for urban water supply and sewage treatment services due to shortage of water resources in the PRC and rapid urbanization in recent years. The PRC government has adopted a number of measures, including raising water fares, imposing sewage treatment fees, tax concessions, etc., to encourage and attract foreign and private enterprises to increase their investments in the water industry. It is expected that water fares in urban areas will continue to rise in the PRC and preferential policies adopted for related industries will continue to be sustained or strengthened.

The directors of the Group believe that water-related industries, including urban water supply and sewage treatment industries, being regional monopoly public utilities with sufficient cash flow and less economic cycle fluctuation, will bring substantial and steady investment returns for the Group in the future.

During the year under review, the Group successfully acquired or established 4 water supply enterprises and 4 sewage treatment enterprises. These enterprises are operating in a mature market with reasonable water fares. They have strengthened their cost control and performance evaluation by reforming their operating mechanisms, and have closed self-supply wells to reduce loss rate. Performance on their various water projects have achieved remarkable progress after expansion of auxiliary water business, such as installation of water meters and construction of pipe systems, bringing higher revenue to the Group. It is expected that these enterprises will bring more profits to the Group in the new financial year.

Looking ahead, with the strong support of the relevant authorities and local governments, the Group will continue to follow the investment strategy of acquiring well-developed water supply enterprises in large and medium-sized cities, as well as developing sewage treatment business in urban areas in the coming year. Moreover, reserved projects of the Company with cooperation intention will become concrete investment operation projects. It is expected that the scale of the Group's water business will achieve multiple growth on the existing foundation and bring substantial streams of revenue for the Company in the next one to two years.

The Group is a foreign enterprise in the PRC, which has entered into the water industry at an early stage. After active expansion, our water business has achieved sizeable scale, and we have accumulated broad experience in water enterprise investments and operations. Together with our strong management team, we enjoy a privileged position to achieve sustainable development in the industry. The Board believes that it is a right strategy to focus on a single business. Concentrated investment will enable the Company to expand its scale of business in the water industry, and sound operation will empower the Company to obtain long term and stable return. The Group will certainly become a star enterprise in the water industry of the PRC.

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.

LI Yu Gui
Chairman

Hong Kong, 23 April 2008

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE

Turnover and Gross Profit

The Group's turnover and gross profit for the year 2007 was HK$74.29 million and HK$20.65 million respectively, which represented a robust growth of 87.82% in turnover and 47.78% in gross profit as compared with those in last year. This was contributed by the numerous acquisitions of water supply plants and sewage treatment facilities completed in the period. During the year under review, the new business segment of water supply and sewage treatment services has contributed HK$59.69 million in turnover and HK$25.59 million in gross profit. This proved the achievement and insight of the Group's strategic change to diversify its business in the water industry sector in the PRC. The Group's computer peripherals and watch retail businesses had been facing with an adverse operating environments as previous years. Revenue contribution by these two business units have dropped significantly by 32.72% and 63.08% respectively. During the year, to stop bleeding and avoid further erosion on the Company's financial position, the Company has disposed of its entire interest in the computer peripherals segment in November and has closed the image shop of TechnoMarine in Hong Kong. Following the closure of the image shop, the business operation of the trading of watch and accessories segment has been substantially scaled-down. Sufficient provision has been made on assets including inventory and receivables for the watch business segment. It is believed that both the computer peripherals and watch business segments will not have any material financial impact on the Group's financial statements in the forthcoming financial periods.

Financial Results

Net loss attributable to shareholders for the year amounts to HK$15.67 million, which represents a significant decrease of HK$80.07 million compare to the net loss of HK$95.74 million in 2006. The significant drop in loss was due to the fact that water and sewage treatment operations acquired have been contributing positively to the Group's overall financial results. During the year 2007, the Company has issued convertible bonds for fund raising purpose. The Company has accounted for the change in fair value of the convertible bonds in accordance with the Hong Kong Financial Reporting Standard 7. At the balance sheet date, as a result of the decrease in the share price of the Company comparing with that at the date of issuing the convertible bonds, the fair value of the derivative component of the convertible bonds has decreased accordingly. A fair value gain of approximately HK$58.13 million has been recognized in the income statement. In addition, the Group ceased the operation of computer peripherals business in October 2007 in order to cut loss, it made the loss recorded in this segment substantially decreased by HK$60.81 million to HK$9.35 million comparing with last year. On the other hand, the net loss for the year was mainly attributable to the recognition of the share-based payment expenses accounted for in accordance with the Hong Kong Financial Reporting Standard 2 in relation to the fair value of share options granted to eligible participants pursuant to the Company's share option scheme. The fair value of share options granted during the year amounted to HK$40.43 million and has been charged to administrative expenses with a corresponding credit to the share option reserve. The management believes that granting 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 the loss from discontinued operations, as well as those fair value adjustments and charges made in accordance with respective accounting standards like share-based payment expenses for share options, and net positive effect arising from gain from derivative component of convertible bonds, the consolidated losses of the Group for the year ended 31 December 2007 would have been HK$10.50 million, that was a decreased by HK$7.73 million as comparing with last year.

MANAGEMENT DISCUSSION AND ANALYSIS

Other Operating Income

Other operating income has increased by HK$23.54 million to HK$24.09 million. This comprised mainly of bank interest income of HK$10.34 million and profit on disposal of a subsidiary of HK$7.02 million. The guaranteed profit of HK$5.40 million represented warranty and undertaking provided by the respective vendors of the respective water plants and sewage treatment plants acquired by the Group during the year. These profits are contributed by Anhui Dang Shan Water Industry Company* (安徽省碭山水業有限公司), Jining City Haiyuan Water Treatment Company Limited* (濟寧市海源水務有限公司) and Linyi Fenghuang Water Industry Company Limited which amounts to HK$1.86 million, HK$0.57 million and HK$2.97 million respectively. The actual accounting profit for these newly acquired subsidiaries fell below the guaranteed level. The vendor is obliged to replenish and to pay the shortfall to the Group in accordance with the sales and purchase contracts.

Operating Expenses

The Group's administrative expenses amounted to HK$46.20 million (31 December 2006: HK$29.86 million). This mainly consisted of preliminary operating costs of newly established plants, legal and professional fees, staff costs and impairment loss of fixed assets. Selling and distribution costs increased by 23.40% to HK$3.49 million. The increase in both administrative expenses and selling and distribution costs were due to several water plants and sewage treatment plants being acquired and commenced operation in 2007. In addition, for prudent sake, the Group has made prudent to made an impairment loss for trade receivable of HK$1.1 million.

BUSINESS SEGMENTS REVIEW

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 7 water supply plants and 4 sewage treatment facilities in the PRC. The aggregate water supply capacity is expected to reach 2.3 million tonnes per day, and the aggregate sewage treatment capacity is expected to be 100,000 tonnes per day. Meanwhile, the Group also signed MOU with total daily water supply capacity and sewage treatment capacity reached 2.4 million and 0.74 million respectively. The Group's footprints in water supply and sewage treatment industries is extended to cover Yichun County of Jiangxi Province, Yingtan City of Jiangxi Province, Dangshan County of Anhui Province, Jinan City of Shandong Province, Jinxiang County and Liangshan Country in Jining city of Shandong Province, Linyi City of Shandong Province, Shangqiu City of Henan Province and Danzhou City of Hainan Province.

During the year, total revenue contributed from water related business reached HK$59.69 million, already taken up 80.35% of the Group's turnover in 2007.

Computer Peripherals business – Discontinued Operation

The Group has faced cut throat competition from competitors who are persistent in their strategy of price-cutting measures to maintain market shares. In addition, the soaring prices of raw materials and labor costs imposed significant additional burden on the Group but only part of the rising operation costs can be built into the price of the goods to remain competitive. In response to such competition and in light of the customary narrow profit margin in the manufacturing industries, the Group had determined to discontinue the operation of production plant in October 2007 so as to mitigate the effect of further operating losses. Seeking to relieve the effect of the drop in business and to secure an immediate financial return for the purpose of obtaining additional resources, the Company has disposed 100% of its interest in the non-performing Pablo Enterprises Limited (the "Pablo Group") in order to focus the Group's resources in the development of its core business in the water industry.

MANAGEMENT DISCUSSION AND ANALYSIS

Turnover of the computer peripherals business in 2007 has decreased by HK$10.00 million to HK$20.58 million (compare with HK$30.58 million on 31 December 2006) and the record segment loss is HK$6.78 million (compare with HK$57.34 million on 31 December 2006). Following the completion of disposal, the Company will not suffer from further losses.

Trading of watches and accessories business

Turnover of the watch segment has dropped by HK$24.95 million to HK$14.60 million and a gross loss of HK$4.90 million is recorded. In recent years, many watches of similar style as "TechnoMarine" have flooded into the market. In the absence of a solid customer loyalty base, the effort in the market development of "TechnoMarine" is futile. Expansion in the retail markets in the Asia Pacific region is slowed down, and the management is very cautious in introducing new models and product lines. To stimulate sales, the Group is 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, in view of the escalating shop rental and staff costs, and declining sales, the management is coerced to close the image shop located in the Festival Walk in August 2007. During the year under review, the segment has suffered from a loss of HK$18.95 million (compare with a loss of HK$14.79 million on 31 December 2006).

The management thought that the scale of the TechnoMarine watch business is downsizing and has decided not to inject further resources to the segment.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2007, the Group continues to be in a healthy financial position with cash and cash equivalents amount to HK$108.84 million (compare with HK$5.05 million on 31 December 2006). During the year, the Group has carried out three fund raising exercises through two times of top-up placing and subscription of shares and the issuance of convertible bonds ("CB") respectively, which are well received by the market towards the Group's business diversification into the PRC water supply industry. Net proceeds from these fund raising activities amount to HK$788.12 million. These capital resources provide a substantial support for the Group to explore investment opportunities in the China Mainland's waterworks market. With the steady cash flows that are generated from the water supply segment and the 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 31 December 2007 are HK$431.84 million (compare with HK$7.68 million on 31 December 2006) comprising of the issuance of CB of HK$326.87 million, long-term borrowings HK$44.69, interest free government loans of HK$50.79 million (compare with nil on 31 December 2006). The CB is denominated in HK dollars and loans are mainly denominated in Renminbi and the interest rates of which were fixed.

The Group's gearing ratio as at 31 December 2007 is 42.95% (compare with 64.36% on 31 December 2006), which is calculated by dividing total liabilities of HK$462.32 million over total assets of the Group of HK$1,076.48 million.

At the year end, the net current assets of the Group is HK$132.88 million (compare with the net current liabilities of HK$43.57 million on 31 December 2006) and the current ratio of the Group was approximately 4.49 times (compare with 0.58 times on 31 December 2006).

MANAGEMENT DISCUSSION AND ANALYSIS

CAPITAL RAISING AND USE OF PROCEEDS

There are 230,000,000 new shares placed on 2 February 2007. This first placement of new shares in 2007 were allotted and issued under a top-up placing (the "First Top-up Placing") at a placing price of HK$0.49 per share to third parties independent of the Group. These new shares represent approximately 19.75% of the then existing issued share capital of the Company. The net proceeds of the First Top-up Placing are estimated to be HK$109.3 million and approximately HK$95 million of the net proceeds are intended for further expansion of its business in water supply and water-related industries in Mainland China. The balance is for general working capital of the Group.

Another 300,000,000 new shares are placed on 29 March 2007. These 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 share to third parties independent of the Group. These new shares represent approximately 21.51% of the then existing issued share capital of the Company. The net proceeds of the Second Top-up Placing are estimated to be HK$308.4 million and approximately HK$262 million of the net proceeds are intended for further expansion of its business in water supply and water-related industries in Mainland China. The balance is for general working capital of the Group.

There is a Bond Purchase Agreement (the "Agreement") entered amongst the Company as the issuer, Abax Lotus Limited and UBS AG as the Subscribers, and UBS AG as the placing agent on 3 August 2007. The Agreement is for a 5-year term due in 2012 at an interest rate of 0.25% per annum in relation to the subscription by the subscribers for the convertible bonds issued by the Company in an aggregate principal amount of up to HK$385 million. The initial conversion price is HK$1.42 per Share, for a total of 271,126,760 conversion shares, representing 14.42% of the issued shares capital of the Company as at 30 June 2007. The net proceed of HK$370.42 million from the issue of the Convertible Bonds will be wholly used by way of capital expenditure and working capital. The share price of the Company on 3 February 2008 has triggered the provisions set out in the Agreement on adjustment to the conversion price. The Board has decided to make a downward adjustment to the conversion price from HK$1.420 to HK$1.136 per share. Up to date, none of the bond is converted into shares by the bondholders.

As of the balance sheet date, the Group's capital expenditure amounted to HK$677.70 million (compare with HK$27.5 million on 31 December 2006). The expenditure is mainly on the strategic acquisitions, including HK$116.50 million for investing in water supply and water related business projects in the PRC and HK$541.20 million as a deposit paid for purchasing 67.32% equity interest in iMerchants Limited from controlling shareholder and for acquiring the Blue Mountain Hong Kong Group Limited ("Blue Mountain") respectively, the remaining balance of HK$108.84 million being placed in bank and at financial institution. The unutilized amounts will continue to be invested in the committed projects.

MAJOR EVENTS DURING THE YEAR UNDER REVIEW

Acquisition of subsidiaries

On 12 March 2007, the Billion City Investments Limited, a wholly-owned subsidiary of 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 Water") at a total cash consideration of RMB30 million. Yichun has been engaging in the supply of water and provision of sewage treatment service in Yichun city.

On 11 April 2007, the China Water Industry (HK) Limited ("China Water (HK)"), an indirectly wholly-owned subsidiary of the Company entered into a Joint Venture Agreement with the People's Government of Hedong District in Linyi

MANAGEMENT DISCUSSION AND ANALYSIS

City* (臨沂市河東區人民政府) (the "JV Partner") and Linyi City Hedong District Water Supply Company Limited* (臨沂市河東區自來水有限公司) ("Linyi Water Supply Limited"). China Water (HK) and the JV Partner have established a joint venture company named Linyi Fenghuang Water Industry Company Limited in Linyi City, Shandong Province, the PRC (the "JV Company") which is principally engaged in water supply business in Linyi City, Hedong District, Shandong Province, the PRC. The Company holds 60% equity shares in this JV Company at a total consideration of RMB18 million.

On 3 July 2007, the China Water (HK) entered into an agreement with Huge Summit Management Limited, pursuant to which China Water (HK) and Huge Summit have agreed to sell and purchase the entire issued share capital of Longwide Investment Limited ("Longwide") at a consideration of RMB67.5 million which will be paid in cash. Longwide is an investment holding company holding 51% equity interests in each of Shangqiu Zhengyuan Water Industry Co. Limited* (商丘市正源水務有限公司) and Linyi Ganghua Water Industry Company Limited* (臨沂港華水務有限公司).

On 19 July 2007, the China Ace Investment Limited ("China Ace"), an indirectly wholly-owned subsidiary of the Company 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, representing their respective equity interest in Jining City Haiyuan Water Treatment Company Limited*.

Letter of Intent

On 15 March 2007, the China Water (HK) 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.

On 23 April 2007, the China Water (HK) entered into a non-legally binding Letter of Intend 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 (HK) has agreed to form a joint venture 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 China, which the China Water (HK) will holds 51% of equity shares of the JV company.

On 13 August 2007, the China Water (HK) entered into the Letter of Intent with the People's Government of Du Yun City* (都勻市人民政府) in Du Yun City in Guizhou Province* (貴州省都勻市) of the PRC (the "JV Partner"), pursuant to which China Water (HK) has agreed to establish the JV Company with the JV Partner to principally engage in water supply and sewage treatment for urban areas in Du Yun City in Guizhou Province* (貴州省都勻市) of the PRC. The estimated aggregate water supply capacity of the JV Company is 100,000 tones per day. The proposed establishment of the JV Company is subject to the entering into of the JV Agreement by China Water (HK)and the JV Partner. Upon the establishment of the JV Company, it will be held as to 51% by China Water (HK) and 49% by the JV Partner.

MANAGEMENT DISCUSSION AND ANALYSIS

On 27 August 2007, the China Water (HK) entered into the 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* (安徽省) of the PRC (the "Chinese Partner"), pursuant to which China Water (HK) has agreed 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 Economic Development Zone* (宿州經濟開發區管委會) in Anhui Province* (安徽省) of the PRC. The estimated aggregate water supply capacity of the water supply plant is 100,000 tonnes per day and the estimated aggregate sewage treatment capacity of the sewage treatment plant is 120,000 tonnes per day.

On 9 October 2007, China Water (HK) entered into the Letter of Intent with the Construction Bureau of Linyi City (臨沂市建設局) in Shandong Province of the PRC (the "JV Partner"), pursuant to which China Water (HK) has agreed to establish the JV Company with the JV Partner to principally engage in constructions and acquisitions of water supply and sewage treatment plants in Lan Shan District* (蘭山區), Luo Zhuang District* (羅莊區) and the subordinated regions including Tan Cheng County* (郯城縣), Cang Shan County* (蒼山縣), Ju Nan County* (莒南縣), Yi Shui County* (沂水縣), Meng Yin County* (蒙陰縣), Ping Yi County* (平邑縣), Fei County* (費縣), Yi Nan County* (沂南縣) and Lin Shu County* (臨沭縣) in Linyi City in Shandong Province of the PRC. Following completion of the above constructions and acquisitions of water supply and sewage treatment plants by the JV Company, the aggregate water supply and sewage treatment capacity of the JV Company will be 1,500,000 tones and 600,000 tones per day, respectively. The proposed establishment of the JV Company is subject to the entering into of the JV Agreement by China Water (HK) and the JV Partner. Upon the establishment of the JV Company, it will be held as to 51% by China Water (HK) and 49% by the JV Partner.

Disposal of subsidiary

On 13 November 2007, the Company and Mega Glory International Company Limited, an independent (the "Acquirer") entered into the Disposal Agreement to dispose of its entire interest in Pablo Enterprises Limited and its subsidiaries (the "Pablo Group") to the Acquirer at a cash consideration of HK$1. Approval from independent shareholders of the Company regarding the disposal transaction was obtained on 24 December 2007 and the disposal transaction was completed on 28 December 2007. Pablo Group are principally engaged in the production and sales of computer peripherals. The Group no longer holds any interest in Pablo Group thereafter.

Litigation involving Technostore Limited, a subsidiary of the Company

On 30 May 2007, a Petition was filed under sections 168A and 177 of the Companies Ordinance (Cap. 32) to wind-up Technostore Limited, a company in which the Company holds 50.01% of issued shares. The Petition was commenced by Mao Chi Fai ("Petitioner"), the minority shareholder of Technostore Limited holding 49.99% of issued shares.

On 3 August 2007, the Petitioner applied to join the Company as a respondent to the Petition and to amend the Petition accordingly. After changing solicitors, and upon taking legal advice, it was decided by the Board that an opposition to that application would not be in the Company's best interests as the application will likely be granted and in such situation, if opposed, the Company will be responsible to pay costs of the application. Accordingly, the Company consented to the application and the costs of that application was borne by the Petitioner.

Following this, and in light of the cessation of Technostore Limited's business, under the sole Directorship of the Petitioner, it was decided by the Board that it would not be practical to oppose the winding-up of Technostore Limited. With a view to avoid wasting costs and time, the Board came to an agreement with the Petitioner that the Company would not oppose the Petition provided that each party to the Petition bears its own costs.

MANAGEMENT DISCUSSION AND ANALYSIS

On 7 November 2007, an Order was made by the High Court to wind-up Technostore Limited with no order as to costs. On 7 March 2008, the adjourned creditors' meeting approved to appoint a provisional liquidator and formed a Committee of Inspection. The matter is still in the liquidation process and is handled by Official Receiver's Office. The directors of the Company believed that no material future outflow of resources from the Group is expected and sufficient provisions have been provided on assets related to Technostore, 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 any member of the Group.

MAJOR EVENTS SUBSEQUENT TO THE YEAR

Acquisition of subsidiaries

On 6 November 2007, the Super Sino Investment Limited ("Super Sino"), an indirectly wholly-owned subsidiary of the Company entered into a share transfer agreement with Hainan Nanshenghe Company Limited* (海南南聖河實業有限公司) to purchase 51% equity interest in the shareholder's loan due by Danzhou Lian Shun Tong Water Pipe Company Limited* ("Danzhou Water Pipe") (儋州聯順通自來水管網有限公司) for a consideration of RMB8.68 million which will be satisfied in cash. The transaction has been completed on 22 April 2008.

On 6 November 2007, the Super Sino entered into a net asset transfer agreement with the People's Government of Danzhou City, Hainan Province to purchase 49% equity interest in Danzhou Water Pipe and other assets and liabilities of Danzhou City Water Company* (儋州市自來水公司) for a consideration of RMB25.3 million which will be satisfied in cash. The transaction has been completed on 21 February 2008.

On 26 November 2007, the Smart Giant Group Limited, a direct wholly-owned subsidiary of the Company entered into an agreement to acquire the entire share capital and a shareholder's loan of Blue Mountain for an aggregate consideration of HK$230 million. Blue Mountain is an investment holding company of which its major associates are engaged in the water supply business and engineering construction work in Jinan City, Shandong Province, the PRC. The transaction has not been completed as of 31 December 2007. An amount of approximately HK$246,361,000 has been paid as a deposit for the acquisition as of 31 December 2007. The transaction has been completed on 18 January 2008.

On 1 December 2007, the Bonus Raider Investments Limited ("Bonus Raider"), a direct wholly-owned subsidiary of the Company entered into an agreement to acquire approximately 67.32% equity interest of iMerchants Limited ("iMerchant") at an aggregate consideration of approximately HK$198 million. iMerchants is a company incorporated in Hong Kong with limited liability whose issued shares are listed on the Growth Enterprise Market of the Stock Exchange. The transaction has not been completed as of 31 December 2007. An amount of approximately HK$294,842,000 has been paid as a deposit for the acquisition as of 31 December 2007. The transaction has been completed on 14 February 2008.

On 4 February 2008, the China Water (HK) entered into a joint venture agreement with the Construction Bureau of Yingtan City (the "JV Partner") to establish a joint venture company in Yingtan City in Jiangxi Province of the PRC. The joint venture company will be principally engaged in the provision of water supply and related services in Yingtan City, Jiangxi Province, the PRC. The registered capital of the joint venture company will be approximately RMB82.4 million which will be contributed as to 51% by China Water (HK) in cash and 49% by the JV Partner by way of injection of net assets. The transaction has not been completed as of the report date. Details of which are set out in the Company's announcement dated 22 February 2008.

MANAGEMENT DISCUSSION AND ANALYSIS

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 becomes 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 31 December 2007, the Group has the capital commitments contracted but not provided for acquisition of property, plant and equipment of approximately HK$25.56 million (compared with HK$1.27 million in 2006).

EMPLOYEES AND REMUNERATION POLICES

As at 31 December 2007, the Group has 2,200 full-time employees (compare with 435 full-time employees in 2006) between Hong Kong and PRC, with the majority stationed in the PRC. The remuneration package of the employees is determined by various factors including the employees' experience and performance, market condition, industry practice and applicable employment law.

* *for identification purpose only*

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

DIRECTORS

Executive Directors

Mr. Li Yu Gui *(Chairman)*, aged 62, is currently the Secretary General of the Guangdong Water Supply Association* (廣東省城鎮供水協會). Mr. Li has accumulated more than 30 years of experience in the organization and management of middle-to-large scale city water treatment plants as well as the construction of water supply facilities. Prior to joining the Company, Mr. Li had been the Chief Officer of the Infrastructure Department of the Guangzhou Utilities Authority* (廣州市公用事業局基本建設處), the General Manager of Guangzhou Water Supply Company* (廣州市自來水公司), the Vice Chairman of the National Water Supply Association* (全國城鎮供水協會) and the Chairman of the board of directors of the Guangdong Water Supply Association* (廣東省城鎮供水協會). During his tenure in the Guangzhou Water Supply Company, he had successively organized several large scale water supply construction projects, in which Mr. Li had taken a leading and directive role, collectively supply 4 million tones drinkable water to Guangzhou city per day.

Mr. Liu Peng Cheng *(Deputy Chairman)*, aged 35, holds a Bachelor of Science degree in Physics from the Shenzhen University. Before joining the Company, Mr. Liu was the Chief Marketing Executive in Southern China Region of Anhui Guo Zhen Environmental Energy Savings Technology Company Limited* (安徽國禎環保節能科技有限公司), which is a sizeable enterprise in the People's Republic of China (the "PRC") engaging in environmental protection industry. Mr. Liu has extensive expertise and more than 10 years experience in water and water related industries. He had been responsible for the design and constructing of various water supply and sewage treatment factories in the PRC.

Mr. Zhong Wen Sheng *(Managing Director)*, aged 40, holds a Master's degree in National Economic Management from the Sichuan University. Mr. Zhong has over 15 years of experience in the corporate finance, management, and treasury control, especially in the China water and related industries. Prior to joining the Company, he was the General Manager in-charging the Corporate Finance Department and the Financial Controller of the Shenzhen Head Office of China Water Affairs Group Limited (Stock Code: 855), a company listed on the main board of the Stock Exchange of Hong Kong.

Mr. Sze Chun Ning, Vincent *(Deputy Managing Director)*, aged 42, specialises in project investment and development, international trading business, sales and marketing. Mr. Sze had worked for a well-known toys manufacturing and trading company, which is based in Hong Kong for over 13 years, he has extensive experience in product research and development, factory operations and management, launch of new products.

Mr. Liu Bai Yue *(Chief Operating Officer)*, aged 57, graduated from the School of Adult Education, China University of Political Science and Law. Mr. Liu is a registered practicing certified enterprise legal advisor as well as an arbitrator of the Guangzhou Arbitration Commission in the PRC. Prior to joining the Company, Mr. Liu as an official representative of People's Government of Guangdong Province worked in GDH Limited including its predecessor Guangdong Enterprises (Holdings) Limited from 1986 to 2006. Mr. Liu has over 20 years of experience in handling and management of international trade, investment, corporate restructure and merger and acquisition.

Mr. Shi De Mao, aged 46, completed his studies in accountancy in the Shandong TV University, Shandong Province, the People's Republic of China (the "PRC"). Before joining the Company, Mr. Shi has accumulated over 20 years of experience in the fields of financial management, innovation of technologies and water supply industry.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Ms. Chu Yin Yin, Georgiana, aged 37, is also the Company Secretary of the Company, holds a Bachelor's Degree of Business Administration in Accountancy and a Master's Degree of Corporate Governance. She is a fellow member of both the Hong Kong Institute of Certified Public Accountants and the Association of the Chartered Certified Accountants and a member of the Institute of Chartered Accountants in England and Wales. Ms. Chu is also an associate of the Institute of Chartered Secretaries and Administrators and a member of the Hong Kong Institute of Company Secretaries. Prior to joining the Company, she has over 10 years' extensive experience by working in an international audit firm and other listed companies.

Mr. Wang Chia Chin, aged 57, has over 20 years of experience in the computer peripherals manufacturing and distributing industry and is responsible for the strategic planning, overall business development and distribution business of the Group.

Non-executive Directors

Mr. Huang Yuan Wen, aged 72, had been the general manager of Jinan Water Supply Industry Group Company Limited. Mr. Huang had been playing a prominent role in the design and construction for a number of large-scale water supply-related projects in the Shandong Province, the PRC by acting as the chief engineer in these projects. Mr. Huang has extensive expertise and accumulated over 40 years of extensive experience in management and operation of water supply-related projects in PRC. Mr. Huang completed his studies and obtained his Bachelor degree specializing in water supply and drainage system from The Shanghai Tongji University.

Mr. Pan Shi Ying, aged 35, is currently a director and a deputy general manager of Jinan Water Supply Industry Group Company Limited. Mr. Pan had also been the plants manager of a number water-related factories in Shandong Province, PRC and has over 10 years of extensive working and management experience in water supply-related industry. Mr. Pan obtained his Bachelor degree in Automation Engineering from The Shandong University of Technology.

Independent Non-executive Directors

Mr. Chang Kin Man, aged 44, is a certified public accountant in Hong Kong and a fellow member of the Association of Chartered Certified Accountants and an associate member of the Hong Kong Institute of Certified Public Accountants. Mr. Chang holds a bachelor's degree in economics and a master's degree in applied finance. Mr. Chang has extensive experience in corporate finance and in accounting field. He worked for an international accounting firm and a number of public listed companies for more than 15 years.

Mr. Wu Tak Lung, aged 42, is a fellow member of the Association of Chartered Certified Accountants, The Hong Kong Institute of Chartered Secretaries and The Taxation Institute of Hong Kong. Mr. Wu is also a Full Member of the Hong Kong Securities Institute and an associate member of The Hong Kong Institute of Certified Public Accountants. Mr. Wu received a bachelor's degree in Business Administration from the Hong Kong Baptist University and a Master Degree in Business Administration from University of Manchester and University of Wale. Mr. Wu is a Committee Member of The Association of Chartered Certified Accountant and Vice-President of The Taxation Institute of Hong Kong. He is also a Council Member of Hong Kong-Guangdong Youth Exchange Promotion Association, Kiangsu and Chekiang Resident (HK) Association and an Honorary Associate of the School of Business of the Hong Kong Baptist University.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Mr. Gu Wen Xuan, aged 65, had been the Deputy Director General of The Department of Urban Planning of The Ministry of Construction of the PRC and taking a leading role in other related bureau. During his working for the government bureau, Mr. Gu was responsible for urban planning and in charge of the designs of various infra-structures (which includes the planning and designs of water supply-related projects) for the urban cities in the PRC. Mr. Gu had accumulated over 15 years of experience in urban planning. Mr. Gu obtained his Bachelor degree in Geography and Master degree of Science in Regional Planning from The Beijing Normal University. Mr. Gu has been qualified as a Research Fellow of the Seal of the Evaluation Committee of Professional Titles and also a State Certified Planner of The Ministry of Construction of the PRC.

SENIOR MANAGEMENT OF THE GROUP

Mr. Gu Ling Bo, aged 39, holds a bachelor degree in Radiation Chemistry from Sichuan University, the People's Republic of China (the "PRC") and a master degree in Business Administration from the New York Institute of Technology, USA. Currently, Mr. Gu is a General Manager of the Company, the Vice Executive President of Jiangxi Yichun Water Supply Company Limited* ("Yichun Water") (江西宜春市供水有限公司) since 2004 and also being the Managing Director of Jiangxi Yichun Fangke Sewage Treatment Company Limited* ("Yichun Fangke") (江西宜春方科污水處理有限公司) since 2005. Mr. Gu has successfully reorganized the management team of Yichun Water and brought a remarkable profit growth to Yichun Water under his governance. Mr. Gu has more than 10 years extensive expertise and experiences in corporate development and project management.

Mr. Yang Bin, aged 34, holds a bachelor degree in Financial Accounting from Jiujiang University, Jiangxi Province, the PRC. Mr. Yang joined the Company in 2007 as a Deputy General Manager of the Company. He has over 10 years working experience in water industry. Before joining Company, Mr. Yang was a Supervisor of Jiangxi Shangrao Water Supply Company* (江西省上饒市自來水公司) where he was mainly responsible for the business promotion towards the urban residents of Shangrao City, and the design and construction of piping network.

Mr. Wang Xiao Bo, aged 39, is a Deputy General Manager of the Company, has substantial experience in the management of the water supply and related industries in China. Mr. Wang holds a Bachelor Degree in Enterprise Management from the Shandong University of Technology.

Mr. Zhang Yan Qing, aged 39, is a Deputy General Manager of the Company. Mr. Zhang holds a Master's Degree in Business Administration from Hefei University of Technology. Before joining Company in 2006, Mr. Zhang was a financial controller of Yichun Water since 2004. He has over 10 years' extensive experience in the financial accounting and management accounting.

Ms. Lam Man Yee, **Maria**, aged 36, is the Financial Controller of the Company, holds a Bachelor's Degree in Accountancy. Ms. Lam is responsible for Financial Management and Corporate Administration. Ms. Lam is an associate member of Hong Kong Institute of Certified Public Accountants and an associate member of Association of International Accountants. Before joining the Group in December 2006, she had over ten years of working experience in auditing, internal auditing, financial accounting and management accounting, including working experience in other listed companies.

* *for identification purpose only*

CORPORTAE GOVERNANCE REPORT

OVERVIEW

The directors of the Company are committed to achieving and maintaining high standards of corporate governance to ensure that all decisions are made in good faith, in the best interest of shareholders and in long-term shareholders value.

The corporate governance standards of the Company are built on the principles of independence, accountability, transparency and fairness. The Company has complied with the code provision set out in the Code of Corporate Governance Practices (the "Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules") which was in force prior to 1 January 2005.

1. Corporate Governance Practice

(a) With respect to the compliance with paragraph A of the Code, the Company has carried out the following corporate governance practices:

The Company has held 58 Board meetings in the year of 2007. Directors have been consulted to advice the agenda of the Board meeting. Sufficient notice of the Board meeting has been given to the Directors. Directors may attend meetings in person or through other means of telephone, electronic or other communication facilities in accordance with the Company's Articles of Association. The Minutes of the Board and the Board Committees are recorded in sufficient details and kept by the company secretary for inspection at any reasonable time on reasonable notice by any Director. Directors were supplied with adequate and relevant information in a timely manner to enable them forming decision in the relevant meetings. The composition of the Board is shown on page 18 of this report. At every annual general meeting, one-third of the Directors for the time being or, if their number is not a multiple of three or a multiple of three, then the number nearest to but not exceeding one-third shall retire from office by rotation provided that every Directors, including those appointed for a specific term shall be subject to retirement by rotation at least once every three years. A retiring Director shall be eligible for re-election to fill a casual vacancy until the next general meeting or the next annual general meeting. Every Director is aware that he/she should give sufficient time and attention to the affairs of the Company. Details of the Directors attendance in different meetings are set out on page 19 of this report. Agreed procedures are in place providing to the member of the Board and/or committee to seek independent professional advice at the Company's expenses to assist them to discharge their duties.

For other details of the responsibilities of Directors, please refer to the section "Board of Directors".

(b) With respect to the compliance with paragraph B of the Code, the Company has established a remuneration committee with specific written terms of reference, details of which are set out in pages 20 to 21 of this report.

CORPORTAE GOVERNANCE REPORT

(c) With respect to the compliance with paragraph C of the Code, the Company has carried out the following corporate governance practices:

Management has provided sufficient explanation and information to the Board as will enable the Board to make an informed assessment of financial and other information put before the Board for approval. The Company has announced the annual report of 2007 on 23 April 2008. A statement by the auditors about their reporting responsibilities is included in the Independent Auditor's Report on pages 32 to 33 of this annual report. The details of the internal controls of the Company and the audit committee are set out under the section "Internal Control" and "Audit Committee".

Internal Control

The Board acknowledges its responsibility in maintaining sound and effective internal control system for the Group to safeguard investments of the shareholders and assets of the Company at all times. The system of internal controls aims to help achieving the Group's business objectives, safeguarding assets and maintaining proper accounting records for provision of reliable financial information. However, the design of the system is to provide reasonable, but not absolute, assurance against material misstatement in the financial statements or loss of assets and to manage rather than eliminate risks of failure when business objectives are being sought. During the year under review, the Board reviewed the overall effectiveness of the Group's system of internal control over financial, operational and compliance controls and risk management functions. The Board concluded that in general, the Group's internal control system is effective and adequate, no material deficiencies have been identified.

(d) With respect to the compliance with paragraph D of the Code, the Company has carried out the following corporate governance practices:

When the Board delegates aspects of its management and administration functions to management, it has given clear directions as to the powers of management, in particular, with respect to the circumstance where management shall report back and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Company. The Company has set up two committees, for details please refer to the relevant sections below.

(e) With respect to the compliance with paragraph E of the Code, the Chairman of the Company and the Chairman of the audit committee, remuneration committees were attend in the annual general meeting to answer questions at the general meetings. The procedures for demanding a poll by the shareholders were incorporated in every circular issued during the financial year ended 31 December 2007.

CORPORTAE GOVERNANCE REPORT

Save as deviations from the code provisions A4.1, the Company has complied with the Code throughout the financial year ended 31 December 2007.

(f) Pursuant to A4.1 of the CG Code, Non-executive directors should be appointed for a specific term, subject to re-election while all directors should be subject to retirement by rotation at least once every three years.

Under the period of review, all Non-executive directors of the Company were not appointed for a specific term but they 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. As such, 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 CG Code.

2. Directors' Securities Transaction

The Company has adopted the full set of Model Code set out in Appendix 10 of the Listing Rules as the code of the conduct for securities transactions by directors (the "Model Code"). The prohibitions on securities dealing and disclosure requirements in the Model Code apply to specified individuals including the Group's senior management and also persons who are privy to price sensitive information of the Group. Having made specific enquiry of all directors, the Board confirms that the director of the Company have complied with the Model Code regarding directors' securities transactions during the year and up to the date of publication of the Annual Report.

3. Board of Directors

(a) The Board comprises a total of 13 members including 8 executive directors, 2 non-executive directors and 3 independent non-executive directors. Members of the Board have different professional and relevant industry experiences and background so as to bring in valuable contributions and advices for the development of the Group's business. 3 out of 13 Directors are independent non-executive directors and two of them are qualified accountants.

(b) The Company has received written confirmation from each independent non-executive director of their independence to the Group. The Group considered all of Independent Non-Executive Directors meets the independence guidelines set out in Rule 3.13 of the Listing Rules and are independent in accordance with the terms of the guidelines. The names of the directors and their respective biographies are set out on pages 13 to 15 of this annual report.

CORPORTAE GOVERNANCE REPORT

(c) The Board holds meetings on a regular basis and will meet on other occasions when a board-level decision on a particular matter is required. The Board also monitors and controls financial performance in pursuit of the Group's strategic objectives. The names of the directors during the financial year and their individual attendance of is set out below:

Name	**Board**	**Audit Committee**	**Remuneration Committee**
Total numbers of meetings held during the year of 2007	58	2	1
Executives:			
Mr. Li Yu Gui *(Chairman)* (Appointed on 25 October 2007)	6/58	N/A	N/A
Mr. Liu Peng Cheng *(Deputy Chairman)* (Appointed on 25 June 2007)	13/58	N/A	N/A
Mr. Wang Xiao Bo *(Deputy Chairman)* (Resigned on 25 June 2007)	4/58	N/A	N/A
Mr. Zhong Wen Sheng *(Managing Director)*	51/58	N/A	1
Mr. Sze Chun Ning, Vincent *(Deputy Managing Director)*	54/58	N/A	N/A
Mr. Liu Bai Yue *(Chief Operating Officer)* (Appointed on 8 January 2007)	33/58	N/A	N/A
Mr. Shi De Mao	35/58	N/A	N/A
Ms. Chu Yin Yin, Georgiana	50/58	N/A	N/A
Mr. Wang Chia Chin	31/58	N/A	N/A
Mr. Wu Chi Lok (Resigned on 16 January 2007)	N/A	N/A	N/A
Non-Executives:			
Mr. Huang Yuan Wen	29/58	N/A	N/A
Mr. Pan Shi Ying	33/58	N/A	N/A
Independent Non-Executives:			
Mr. Chang Kin Man	50/58	2	1
Mr. Wu Tak Lung	12/58	2	1
Mr. Gu Wen Xuan	47/58	2	N/A

(d) The Board is responsible for the leadership and control of the Company, oversee the Group's businesses and evaluate the performance of the Group. The Board also focuses on overall strategies and policies with particular attention paid to the growth and financial performance of the Group.

(e) The Board delegates day-to-day operations of the Group to Executive Directors and senior management, while reserving certain key matters for its approval. When the Board delegates aspects of its management and administration functions to Management, it has given clear directions as to the powers of the Management, in particular, with respect to the circumstances where Management shall report back and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Company.

CORPORTAE GOVERNANCE REPORT

4. Chairman and Chief Executive Officer

(a) The position of the Chairman and Chief Executive Officer is held by Mr. Li Yu Gui ("Mr. Li") and Mr. Zhong Wen Sheung ("Mr. Zhong") respectively. Mr. Zhong was appointed as a Managing Director but his role and function are same as the Chief Executive Officer of which are mainly in charge of the Company's day-to-day management and operations and set up long- term business objectives. They pay different and distinctive roles, their responsibilities are clearly defined and as set out in the Guidance notes of the separation of roles of the Chairman and Chief Executive Officer under the CG Code of the Company adopted in 2006.

(b) The Chairman provides leadership and is responsible for the effective functioning of the Board in accordance with good corporate governance practice. With the support of the senior management, the Chairman is also responsible for ensuring that the Directors receive adequate, complete and reliable information in a timely manner and appropriate briefing on issues arising at board meeting.

(c) The Chief Executive Officer focuses on implementing objectives, policies and strategies approved and delegated by the Board. He is in charge of the Company's day-to-day management and operations. He is also responsible for developing strategic plans and formulating the company practices and procedures, business objectives and risk assessment for the Board's approval.

5. Non-executive Directors

The Board appointed two directors namely Mr. Huang Yuan Wen and Pan Shi Ying, as Non-executive Directors on 9 November 2006. They are subject to retirement by rotation and eligible for re-election in annual general meeting in accordance with the articles of association of the Company.

6. Remuneration of Directors

(a) The Company has established a remuneration committee since 29 June 2005 with written terms of reference in consistence with the Corporate Governance Code. The primary duties of the remuneration committee include the following:

i. To make recommendation to the board on the Company's policy and structure for all remuneration of directors and senior management.

ii. To determine the remuneration packages of executive directors and senior management, according to the major scope, responsibilities and duties, importance of position of the directors and the senior management as well as the remuneration level of the related position in the market, including benefit in kind, pension rights and compensation payments which include compensation payable for loss or termination of their office or appointment.

iii. To review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the board from time or time.

iv. To review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not exercise for the Company.

v. To ensuring that no director or any of his associates shall be involved in any decisions as to their own remuneration.

vi. To advising shareholders on how to vote with respect to any service contracts of directors that requires shareholders' approval under the Listing Rules.

(b) During the year under review, the members of remuneration committee comprised Mr. Chang Kin Man (Independent Non-executive Director) who acts as Chairman of the remuneration committee, Mr. Wu Tak Lung (Independent Non-executive Director) and Mr. Zhong Wen Sheung (Managing Director).

(c) The number of remuneration committee meeting held during the year and record of individual attendance of members, on a named basis, at meetings held during was set out in section headed "Board of Directors" above.

(d) The emolument policy of the employees of the Group was set up by the Remuneration Committee on the basis of their merit, qualification and competence.

(e) The emolument of the directors of the Company are determined by the Remuneration Committee, having regard to the Group's operating results, individual performance and comparable market statistics.

(f) Further details on the emolument policy and the basis of determining the emolument payable to the Directors are set out in the pages 62 to 64 of this annual report.

(g) The Group's share option scheme as described on pages 93 to 94 of this annual report is adopted as the Group's long-term incentive scheme.

7. Nomination of Directors

The Company does not have a nomination committee, and the power to nominate or appoint additional directors is vested in the Board according to the articles of association of the Company, in addition to the power of the shareholders to nominate any person to become a director of the Company in accordance with the articles of association of the Company.

The Board from time to time considers replenishing the composition of the Board whenever the Company requires to meet the business demand, opportunities and challenges and to comply with the laws and regulations. The nomination procedures basically follow the articles of association which empowers the Board from time to time and at any time to appoint any person as a director either to fill a casual vacancy or as an additional to the Board. The Directors will select and evaluate the balance of skills, qualification, knowledge and experience of the candidate to the directorship as may be required by the Company from time to time by such means as the Company may deems fit. The Directors shall consider the candidate from a wide range of backgrounds, on his/her merits and against objective criteria set out by the Board and taking into consideration his/her time devoted to the position.

CORPORTAE GOVERNANCE REPORT

8. Auditors' remuneration

For the financial year, SHINEWING (HK) CPA Limited, the auditors of the Company, received approximately HK$2.18 million in total in respect of HK$0.60 million of audit service and HK$1.58 million of non-audit services provided to the Group. The non-audit services normally were performing financial due diligence review on acquisitions and disposal of subsidiary. The auditors' remuneration has been duly approved by the audit committee and there was no disagreement between the Board and the audit committee on the selection and appointment of auditor.

9. Audit Committee

The audit committee of the Company was established since 29 June 2005 comprises three independent non-executive directors, namely Mr. Chang Kin Man (Chairman of the Audit Committee), Mr. Wu Tak Lung and Mr. Gu Wen Xuan. Mr. Chang and Mr. Wu both are certified public accountant for many years. They are responsible for review of the Group's financial information and oversight of the Group's financial reporting system and internal control procedure. The Committee is also responsible for reviewing the interim and final results of the Group prior to recommending them to the Board for approval. In performing its duties, it has unrestricted access to personnel, records, external auditors and senior management.

The Audit Committee has specific written terms of reference which are of no less exacting terms than those stipulated in Code provision. For the year under review, the Audit Committee held two meetings included the review of the final results for the year ended 31 December 2007 and interim accounts for 30 June 2007. The Group's annual report for the year ended 31 December 2007 has been reviewed by the Audit Committee.

10. Shareholder Rights and Investor Relations

The rights of shareholders and the procedures for demanding a poll on resolutions at shareholders' meetings are contained in the Company's articles of association. Details of such rights to demand a poll and the poll procedures are included in all circulars to shareholders and will be explained during the proceedings of meetings.

Poll results will be published in newspapers on the business day following the shareholders' meeting and posted on the Company's website and the Stock Exchange's website.

The general meetings of the Company provide a forum for communication between the shareholders and the Board. The Chairman of the Board as well as chairman of the Audit Committee and Remuneration Committee, or in their absence, other members of the respective committees, are available to answer questions at the shareholders' meetings.

Separate resolutions are proposed at shareholders' meetings on each substantial issue, including the election of individual directors.

The Company continues to enhance communications and relationships with its investors. Designated senior management maintains regular dialogue with investors and analysis to keep them abreast of the Company's developments. Enquiries from investors are dealt with in an informative and timely manner.

REPORT OF THE DIRECTORS

The Broad of Directors of the Company, present their report together with the audited consolidated financial statements of the company and its subsidiaries (collectively, the "Group") for the year ended 31 December 2007.

PRINCIPAL ACTIVITIES AND ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities and other particulars of the subsidiaries of the Company are set out in note 48 to the consolidated financial statements. Most of the Group's core businesses are remain unchanged except the non-core business of computer peripherals being disposed in the year.

An analysis of the group's turnover for the year by business category is set out in note 7 to the consolidated financial statements.

SEGMENTAL INFORMATION

The analysis of the Group's principal activities and geographical locations of customers of the group during the financial year are set out in note 9 to the consolidated financial statements.

RESULTS

The results of the Group for the year ended 31 December 2007 are set out in the consolidated income statement on page 34.

DIVIDENDS

The Board did not recommend any payment of final dividend for the year ended 31 December 2007 (2006: Nil).

LOSS PER SHARE

The calculation of basic loss per share for the year is based on the loss for the year attributable to equity holders of the parent of approximately HK$24,344,000 (2006: HK$95,452,000), and the weighted average number of 1,754,342,000 (2006: 989,705,000) ordinary shares in issue and share options issued by the Company of 47,794,000 shares (2006: 98,400,000 shares) in issue during the year.

No diluted loss per share is presented for the year ended 31 December 2007 as the effect of the conversion of the Company's outstanding share options since their exercise was anti-dilutive.

No diluted loss per share has been presented for the year ended 31 December 2006 as there was no dilutive event existed in 2006.

REPORT OF THE DIRECTORS

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2007, the aggregate amount of turnover attribute to the Group's five largest customers was less than 30% of the total value of the Group's turnover. The Group's purchase to the five largest suppliers accounted for less than 30% of the total value of the Group's purchase.

At no time during the year the Directors, their associates or any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interest in the major customers or suppliers.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the group during the year are set out in note 17 to the consolidated financial statements.

SHARE CAPITAL, SHARE OPTIONS AND CONVERTIBLE BONDS

Details of the movements in the Company's share capital, share options and convertible bonds during the year are set out in notes 34, 46 and 37 to the consolidated financial statements, respectively.

RESERVES

Details of movements in the reserves of the Group during the year are set out in the consolidated statement of changes in equity on page 36.

BANK BORROWINGS AND BANKING FACILITIES

Particulars of bank loans of the Group as at 31 December 2007 are set out in notes 30 and 35 to the consolidated financial statements.

FIVE-YEARS FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the group for the last five financial years is set out on page 100.

REPORT OF THE DIRECTORS

DIRECTORS

The Directors of the Company during the year and up to the date of this report were:

Executives:

Mr. Li Yu Gui *(Chairman)*	(Appointed on 25 October 2007)
Mr. Liu Peng Cheng *(Deputy Chairman)*	(Appointed on 25 June 2007)
Mr. Wang 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. Wang Chia Chin	
Mr. Wu Chi Lok	(Resigned on 16 Jan 2007)

Non-Executives:

Mr. Huang Yuan Wen
Mr. Pan Shi Ying

Independent Non-Executives:

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

In accordance with article 108(A) of the Company's articles of association, one-third of the Directors for the time being or, if their number is not a multiple of three or a multiple of three, then the number nearest to but not exceeding one-third shall retire from office by rotation provided that every Directors, including those appointed for a specific term shall be subject to retirement by rotation at least once every three years, the directors included Mr. Wang Chia Chin, Mr. Chang Kin Man and Mr. Sze Chun Ning, Vincent respectively. In addition, in accordance with article 112 of the Company's articles of association, at any time to appoint directors either to fill a casual vacancy or as an addition to the Board, they shall retire from office at the forthcoming annual general meeting and shall be eligible for re-election the directors included Mr. Li Yu Gui and Mr. Liu Peng Cheng.

DIRECTORS' BIOGRAPHICAL DETAILS

Biographical details of the directors of the Company are set out on pages 13 to 15 of the annual report.

EMOLUMENT POLICY

A remuneration committee is set up for reviewing the Group's emolument policy and structure for all remuneration of the directors and senior management of the Group, having regard to the group's operating results, individual performance and comparable market practices.

The Company has adopted a share option scheme as incentive to Directors and eligible employees, details of the scheme are set out as "Share Option Scheme" below.

REPORT OF THE DIRECTORS

DIRECTORS' SERVICE CONTRACTS

Mr. Wang Chia Chin is an Executive Director of the Company, has entered into a service contract with the Company for an initial fixed term of three years commencing from 1 January 2002 for Mr. Wang and will continue thereafter until terminated by in writing served by either party giving to the other not less than three months' notice after the expiration of the said initial fixed term.

As at 31 December 2007, saved for Mr. Wang's service contract, none of the Directors has entered into any service contracts with the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations and does not have specific terms of appointment but is subject for retirement and for re-elections at the forthcoming AGM as required by the articles of association of the Company.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES

As at 31 December 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 (the "SFO")), which had been notified of 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:

(i) Interest in the Shares

Name of director	Nature of interest	Number of issued ordinary shares held	Total interest	Percentage of the issued share capital of the Company
Wang Chia Chin	Beneficial owner	–	–	–
	Interest of spouse *(Note 1)*	17,348,000	17,348,000 (L)	0.92%
Liu Peng Cheng	Interest in controlled corporations *(Note 2)*	310,150,000	310,150,000 (L)	16.40%
Sze Chun Ning, Vincent	Interest in controlled corporation *(Note 3)*	55,000,000	55,000,000 (L)	2.91%
	Beneficial owner	1,008,000	1,008,000 (L)	0.05%
Chu Yin Yin, Georgiana	Beneficial owner	7,432,000	7,432,000 (L)	0.39%

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

Notes:

1. These Shares are wholly 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 17,348,000 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 wholly and beneficially owned by Mr. Liu Peng Cheng.

3. These Shares are held by Sure Ability Limited, a company wholly and beneficially owned by Mr. Sze Chun Ning, Vincent.

(ii) Interest in underlying Shares

Name of director	**Exercise Price** *(HK$)*	**Exercise Period**	**Number of underlying Shares (under share options of the Company)**	**Approximate shareholding** % *(Note)*
Sze Chun Ning, Vincent	0.335	11 January 2007 to 10 January 2017	10,000,000	0.53
Chu Yin Yin, Georgiana	0.335	11 January 2007 to 10 January 2017	3,000,000	0.16
Liu Bai Yue	0.420	17 January 2007 to 16 January 2017	5,000,000	0.26

Note: For the purpose of this section, the shareholding percentage in the Company is calculated on the basis of 1,890,900,000 Shares in issue as at 31 December 2007.

Save as disclosed above, as at 31 December 2007, none of the Directors or chief executive of the Company had any interest or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations (as defined in Part XV of the SFO) which are 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 recorded in the register required to be kept by the Company under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

REPORT OF THE DIRECTORS

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2007, as far as known to the Directors or chief executive of the Company, the following persons (other than a Director or chief executive of the Company disclosed under the section "Directors' and chief executive's interests in Securities" above) had an interest in the shares or short position in the shares, or underlying shares of the Company which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who were directly or indirectly interested in 10% or more of the nominal value of any class of Shares carrying rights to vote in all circumstances at general meetings of the Company or any other member of the Group:

Name of shareholder	Capacity	Number of issued Shares held	Approximate Percentage of the issued share capital of the Company
Abax Arhat Fund	Interest of controlled corporation	183,098,591 *(Note 1)*	9.68%
Abax Claremont Limited	Interest of controlled corporation	183,098,591 *(Note 1)*	9.68%
Abax Global Capital	Interest of controlled corporation	183,098,591 *(Note 1)*	9.68%
Abax Global Opportunities Fund	Interest of controlled corporation	183,098,591 *(Note 1)*	9.68%
Abax Upland Fund, LLC	Interest of controlled corporation	183,098,591 *(Note 1)*	9.68%
Abax Lotus Limited	Beneficial owner	183,098,591 *(Note 1)*	9.68%
Ward Ferry Management (BVI) Limited	Investment Manager	132,092,000	6.99%

Note 1: These 183,098,591 underlying Shares are those Shares which would be issued upon exercise of the convertible rights attaching to the convertible bonds issued by the Company as disclosed in the announcement of the Company dated 31 July 2007. As the issued share capital of Abax Lotus Limited is held indirectly or directly by Abax Arhat Fund, Abax Claremont Limited, Abax Global Capital, Abax Global Opportunities Fund and Abax Upland Fund, LLC, they are deemed to be interested in the underlying Shares under SFO.

Note 2: For the purpose of this section, the shareholding percentage in the Company is calculated on the basis of 1,890,900,000 Shares in issue as at 31 December 2007.

Save as disclosed herein, there is no person known to the Directors or chief executive of the Company, no other person (other than a Director or chief executive of the Company), who, as at 31 December 2007, had an interest or short position in the Shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was directly or indirectly interested in 10% or more of the normal value of any class of shares carrying the rights to vote in all circumstances at general meetings of the Company or any other members of the group and none of the Directors held any directorship or employment in a company which has an interest or short position in the Shares and underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

REPORT OF THE DIRECTORS

DIRECTORS' AND CHIEF EXECUTIVES' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed under the heading "Share option scheme" below, at no time during the year were the rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any Director or chief executive of the Company or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company and its subsidiaries a party to any arrangement to enable the Directors to acquire such rights in any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contract of significance to which the Company or its subsidiaries was a party, in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or in the year under review.

CONNECTED TRANSACTIONS

On 12 March 2007, the Billion City Investments Limited, a wholly-owned subsidiary of 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 ("Onfar group") which directly holds 51% of equity interest in Yichun Water Industry Company Limited (the "Yichun Water") at a total cash consideration of RMB30 million. Following the completion of this transaction during the year, Onfar group became an indirectly wholly-owned subsidiary of the Group. For details, please refer to the circular dated 5 April 2007.

DIRECTORS' INTERESTS IN COMPELTING BUSINESS

During the year and up to the date of this report, none of the Directors are considered to have an interest in a business which competes or is likely to compete, either directly or indirectly, with the business of the Group, pursuant to the Listing Rules, other than those business of which directors were appointed as directors to represent the interest of the Company and/or the Group.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEME

The Company had adopted share option scheme on 17 January 2002 (the "Scheme") for which the details are set out in note 46 to the consolidated financial statements.

Details of the movements in the share options during the year ended 31 December 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	Cancelled during the year	Outstanding as at 31 December 2007	Exercisable period	Exercise Price per share of the Company	Closing price immediately before the dates of grant	Weighted average closing price immediately before the dates of exercise
								HK$		
Directors										
Sze Chun Ning, Vinent	11 January 2007	–	11,600,000	1,600,000	–	10,000,000	11 January 2007 to 10 January 2017	0.335	0.330	0.740
Chu Yin Yin, Georgiana	11 January 2007	–	11,600,000	8,600,000	–	3,000,000	11 January 2007 to 10 January 2017	0.335	0.330	0.642
Liu Bai Yue	17 January 2007	–	5,000,000	–	–	5,000,000	17 January 2007 to 16 January 2017	0.420	0.400	–
Sub-total		–	28,200,000	10,200,000	–	18,000,000				
Other eligible participates	11 January 2007	–	87,800,000	87,800,000	–	–	11 January 2007 to 10 January 2017	0.335	0.330	1.153
	4 April 2007	–	155,000,000	–	155,000,000	–	4 April 2007 to 3 April 2017	1.078	1.060	–
	28 June 2007	–	185,000,000	–	185,000,000	–	28 June 2007 to 27 June 2017	1.144	1.130	–
Sub-total		–	427,800,000	87,800,000	340,000,000	–				
Total		–	456,000,000	98,000,000	340,000,000	18,000,000				

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to its existing shareholders.

PURCHASES, REDEMPTIONS OR SALES OF COMPANY'S LISTED SECURITIES

There were no purchases, redemptions or sales of the Company's listed securities by the Company or any of its subsidiaries during the year.

REPORT OF THE DIRECTORS

RETIREMENT SCHEMES

The Group's subsidiary in the People's Republic of China (the "PRC") participates in a defined contribution retirement scheme organized by the PRC municipal government and is required to make contribution as 8% of the relevant PRC employees' salaries to the scheme. The Group's subsidiary in Hong Kong has also participated in a mandatory provident fund scheme for its staff baled in Hong Kong pursuant to the Mandatory Provident Fund Schemes Ordinance. Save as disclosed the Group was not required to operate any other of retirement benefits of its employees during the year.

POST BALANCE SHEET EVENTS

Details of the post balance sheet events for the year are set out in note 50 to the consolidated financial statements.

SUFFICIENT OF PUBLIC FLOAT

As far as the information publicly available to the company is concerned and to the best knowledge of the Directors of the Company, at least 25% of the Company's issued share capital were held by members of the public as at 23 April 2008 (being the latest practicable date prior to the printing of this annual report for the purpose of ascertaining the relevant information contained in this report).

AUDIT COMMITTEE

In accordance with the requirements of the Listing Rules, the Group established an audit committee comprising three independent non-executive directors of the Company. The Audit Committee of the Company has reviewed the unaudited consolidated financial statements for the year ended 31 December 2007. Information on the work of Audit Committee and its composition are set out in the Corporate Governance Report on page 22 of this Annual Report.

CORPORATE GOVERNANCE

The Company's corporate governance principles and practices are set out in the Corporate Governance Report on pages 16 to 22 of this Annual Report.

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 following specific enquiry by the Company that they have complied with the required standard set out in the Model Code during the year.

AUDITORS

SHINEWING (HK) CPA LIMITED retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

By order of the Board

Li Yu Gui
Chairman

Hong Kong, 23 April 2008

INDEPENDENT AUDITOR'S REPORT

信永中和 ShineWing

SHINEWING (HK) CPA Limited
16/F., United Centre
95 Queensway, Hong Kong

TO THE SHAREHOLDERS OF CHINA WATER INDUSTRY GROUP LIMITED
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of China Water Industry Group Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 34 to 99, which comprise the consolidated balance sheet as at 31 December 2007, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITOR'S REPORT

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2007 and of the Group's loss and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

SHINEWING (HK) CPA Limited
Certified Public Accountants
Pang Wai Hang
Practising Certificate Number: P05044

Hong Kong
23 April 2008

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2007

	Notes	2007 HK$'000	2006 HK$'000
Continuing operations			
Turnover	7	**74,287**	39,552
Cost of sales		**(53,640)**	(25,580)
Gross profit		**20,647**	13,972
Other operating income	8	**24,085**	541
Change in fair value of convertible bonds		**58,128**	–
Selling and distribution costs		**(3,491)**	(2,829)
Administrative expenses		**(46,195)**	(29,591)
Convertible bonds issue expense		**(13,520)**	–
Share-based payment expense		**(40,433)**	(7,635)
Impairment loss on trade receivables		**(1,098)**	–
Share of results of associates		**(1,834)**	338
Finance costs	10	**(2,612)**	(48)
Loss before tax	11	**(6,323)**	(25,252)
Income tax expense	13	**–**	(336)
Loss for the year from continuing operations		**(6,323)**	(25,588)
Discontinued operations			
Loss for the year from discontinued operations	15	**(9,349)**	(70,154)
Loss for the year		**(15,672)**	(95,742)
Attributable to:			
Equity holders of the Company		**(24,344)**	(95,452)
Minority interests		**8,672**	(290)
		(15,672)	(95,742)
Dividend	14	**–**	–
Loss per share	16		
For the continuing and discontinued operations			
Basic		**(1.4) cents**	(9.6) cents
Diluted		**N/A**	N/A
From continuing operations			
Basic		**(0.9) cents**	(2.5) cents
Diluted		**N/A**	N/A
From discontinued operations			
Basic		**(0.5) cents**	(7.1) cents
Diluted		**N/A**	N/A

CONSOLIDATED BALANCE SHEET

At 31 December 2007

	Notes	2007 HK$'000	2006 HK$'000
Non-current assets			
Property, plant and equipment	17	**240,551**	64,628
Intangible assets	18	**–**	–
Prepaid lease payments	19	**10,143**	–
Goodwill	20	**77,333**	1,361
Interests in associates	21	**7,617**	36,477
Deposits paid for acquisition of subsidiaries	24	**567,990**	–
		903,634	102,466
Current assets			
Inventories	22	**4,116**	18,783
Trade and other receivables	23	**58,514**	33,781
Amount due from a related party	25	**213**	–
Amount due from a minority shareholder of subsidiaries	26	**946**	–
Prepaid lease payments	19	**221**	–
Pledged bank deposits	27	**–**	2,061
Cash held at a financial institution	27	**30,000**	–
Bank balances and cash	27	**78,839**	5,045
		172,849	59,670
Current liabilities			
Trade and other payables	28	**29,770**	78,340
Obligations under finance leases	29	**–**	140
Bank borrowings – repayable within one year	30	**–**	6,442
Amounts due to related parties	31	**204**	5,274
Amounts due to directors	32	**223**	2,834
Tax payables		**281**	10,213
Other loans	33	**9,487**	–
		39,965	103,243
Net current assets (liabilities)		**132,884**	(43,573)
		1,036,518	58,893
Capital and reserves			
Share capital	34	**189,090**	116,450
Reserves		**340,601**	(64,722)
Equity attributable to equity holders of the Company		**529,691**	51,728
Minority interests		**84,475**	6,063
Total equity		**614,166**	57,791
Non-current liabilities			
Obligations under finance leases	29	**–**	245
Long-term bank and other borrowings	35	**32,955**	857
Loans from a minority shareholder	36	**11,738**	–
Convertible bonds	37	**326,872**	–
Government grants	38	**50,787**	–
		422,352	1,102
		1,036,518	58,893

The consolidated financial statements on pages 34 to 99 were approved and authorised for issue by the Board of Directors on 23 April 2008 and are signed on its behalf by :

Li Yu Gui	**Zhong Wen Sheng**
Chairman	*Managing Director*

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2007

	Attributable to equity holders of the Company								
	Share capital HK$'000	Share premium HK$'000	Share options reserve HK$'000	Translation reserve HK$'000	Reserve funds HK$'000 (Note)	Accumulated profits (losses) HK$'000	Total HK$'000	Minority interests HK$'000	Total HK$'000
At 1 January 2006	73,450	8,182	–	1,054	228	(6,315)	76,599	1,960	78,559
Issue of shares	43,000	20,500	–	–	–	–	63,500	–	63,500
Share issue expenses	–	(777)	–	–	–	–	(777)	–	(777)
Recognition of equity-settled share based payments	–	–	7,635	–	–	–	7,635	–	7,635
Loss for the year	–	–	–	–	–	(95,452)	(95,452)	(290)	(95,742)
Acquisition of subsidiaries	–	–	–	–	–	–	–	4,393	4,393
Exchange differences arising on translation of foreign operations	–	–	–	223	–	–	223	–	223
At 31 December 2006 and 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 payments	–	–	40,433	–	–	–	40,433	–	40,433
Exercise of share options	19,640	40,970	(10,757)	–	–	–	49,853	–	49,853
Cancellation of share options	–	–	(36,584)	–	–	36,584	–	–	–
Capital contribution from a minority shareholder of a subsidiary	–	–	–	–	–	–	–	21,587	21,587
Acquisition of subsidiaries	–	–	–	–	–	–	–	48,153	48,153
Disposal of subsidiaries	–	–	–	677	(228)	228	677	–	677
Loss for the year	–	–	–	–	–	(24,344)	(24,344)	8,672	(15,672)
Exchange differences arising on translation of foreign operations	–	–	–	9,126	–	–	9,126	–	9,126
At 31 December 2007	189,090	418,093	727	11,080	–	(89,299)	529,691	84,475	614,166

Note: As stipulated in the relevant laws and regulations, certain subsidiaries operating in the People's Republic of China (the "PRC") are required to maintain certain statutory reserves which include the general reserve fund and staff welfare and bonus fund (together as the "Reserve Funds"). Appropriations to the Reserve Funds are made out of net profit as reported in the PRC statutory financial statements. The amounts of appropriations are determined by the respective board of directors. All statutory reserves are for specific purposes and are not distributable in the form of dividends. Starting from 1 January 2006, the Group is not required to transfer any net profit to statutory welfare fund in accordance with the amendment in the PRC Companies Ordinance.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007

	2007	2006
	HK$'000	*HK$'000*
OPERATING ACTIVITIES		
Loss before tax – continuing	**(6,323)**	(25,252)
Loss before tax – discontinued	**(9,305)**	(70,154)
Loss before tax	**(15,628)**	(95,406)
Adjustments for:		
Depreciation of property, plant and equipment	**9,099**	4,758
Impairment loss on trade receivables	**4,324**	14,870
Change in fair value of convertible bonds	**(58,128)**	–
Loss on disposal of property, plant and equipment	**1,065**	74
Convertible bonds issue expense	**13,520**	–
Allowance for inventories	**8,352**	11,601
Written off of inventories	**–**	35,277
Impairment loss on intangible assets	**–**	2,160
Share-based payment expense	**40,433**	7,635
Amortisation of prepaid lease payments	**132**	–
Finance costs	**2,827**	494
Loss on disposal of investments held for trading	**–**	1,200
Loss on deconsolidation of a subsidiary	**98**	–
Share of results of associates	**1,834**	(338)
Gain on disposal of assets held for sale	**–**	(1,013)
Compensation income	**(5,366)**	–
Gain on disposal of subsidiaries	**(7,020)**	(148)
Written back of long outstanding payables	**(617)**	(36)
Bank interest income	**(10,337)**	(115)
Operating cash flows before movements in working capital	**(15,412)**	(18,987)
Decrease (increase) in inventories	**590**	(23,382)
(Increase) decrease in trade and other receivables	**(8,826)**	1,363
Increase in amount due from a related party	**(213)**	–
Decrease in amounts due from a minority shareholder of subsidiaries	**1,923**	–
(Decrease) increase in trade and other payables	**(59,879)**	7,161
Increase in amounts due to related parties	**3,395**	5,274
(Decrease) increase in amounts due to directors	**(2,611)**	2,834
Cash used in operations	**(81,033)**	(25,737)
Income taxes paid	**(124)**	(455)
NET CASH USED IN OPERATING ACTIVITIES	**(81,157)**	(26,192)

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2007

	Notes	2007 HK$'000	2006 HK$'000
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(96,418)**	(2,853)
Acquisition of investments held for trading		**–**	(7,414)
Net cash (outflow) inflow in respect of the acquisition of subsidiaries	*39*	**(32,473)**	2,583
Direct expenses paid for acquisition of subsidiaries		**(1,582)**	–
Net cash (outflow) inflow from disposal of subsidiaries	*40*	**(762)**	12
Net cash outflow from deconsolidation of a subsidiary	*41*	**(515)**	–
Increase in deposits paid for acquisition of subsidiaries		**(567,990)**	–
Proceeds from disposal of investments held for trading		**–**	6,214
Proceeds from disposals of property, plant and equipment		**–**	182
Interest received		**10,337**	115
Proceeds from disposal of assets held for sale		**–**	2,094
Decrease (increase) in pledged bank deposits		**2,061**	(2,061)
Increase in cash held at a financial institution		**(30,000)**	–
Cost paid directly attributable to the acquisition of equity interest in an associate		**(1,592)**	(139)
NET CASH USED IN INVESTING ACTIVITIES		**(718,934)**	(1,267)
FINANCING ACTIVITIES			
Proceeds from issue of ordinary shares		**430,700**	27,500
Proceeds from exercise of share options		**49,853**	–
Proceeds from issue of convertible bonds		**385,000**	–
Payment for convertible bonds issue expense		**(13,520)**	–
Proceeds from capital contribution from minority shareholders of subsidiaries		**21,587**	–
New borrowings raised		**43,755**	6,442
Repayment of borrowings		**(10,855)**	(3,898)
Payment for share issue expenses		**(28,482)**	(777)
Interest paid		**(2,060)**	(494)
Repayment of obligations under finance leases		**(385)**	(388)
NET CASH FROM FINANCING ACTIVITIES		**875,593**	28,385
NET INCREASE IN CASH AND CASH EQUIVALENTS		**75,502**	926
CASH AND CASH EQUIVALENTS AT 1 JANUARY		**5,045**	4,491
EFFECT OF FOREIGN EXCHANGE RATE CHANGES		**(1,708)**	(372)
CASH AND CASH EQUIVALENTS AT 31 DECEMBER, represented by bank balances and cash		**78,839**	5,045

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

1. GENERAL

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 addresses of the registered office and principal place of business of the Company are disclosed in the "Corporate Information" section of the annual report.

The Company is an investment holding company. The principal activities of its subsidiaries (together with the Company collectively referred to as the "Group") are set out in Note 48.

Other than those operating subsidiaries established in the People's Republic of China (the "PRC") and engaged in the provision of water supply and sewage treatment services, which functional currency is Renminbi ("RMB"), the functional currency of the Company and its subsidiaries is Hong Kong dollars. The consolidated financial statements are presented in Hong Kong dollars. The reason for selecting Hong Kong dollars as its presentation currency is because the Company is a public company with the shares listed on the Stock Exchange.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

In the current year, the Group has applied, for the first time, a number of new standards, amendments and interpretations ("New HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") which are either effective for accounting periods beginning on 1 January 2007. The adoption of the New HKFRSs had no material effect on how the results and financial position for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

The Group has not early applied the following new and revised Hong Kong Accounting Standards ("HKASs"), HKFRSs and interpretations ("HK(IFRIC)-INTs") that have been issued but are not yet effective for accounting period beginning on 1 January 2007. The directors of the Company anticipate that the application of these HKASs, HKFRSs and HK(IFRIC)-INTs will have no material impact on the results and the financial position of the Group are prepared and presented.

HKAS 1 (Revised)	Presentation of Financial Statements[1]
HKAS 23 (Revised)	Borrowing Costs[1]
HKAS 27 (Revised)	Consolidated and Separate Financial Statements[2]
HKFRS 2 (Amendment)	Share-based Payment – Vesting Conditions and Cancellation[1]
HKFRS 3 (Revised)	Business Combination[2]
HKFRS 8	Operating Segments[1]
HK(IFRIC)-INT 11	HKFRS 2 – Group and Treasury Share Transactions[3]
HK(IFRIC)-INT 12	Service Concession Arrangements[4]
HK(IFRIC)-INT 13	Customer Loyalty Programmes[5]
HK(IFRIC)-INT 14	HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction[4]

[1] Effective for annual periods beginning on or after 1 January 2009.
[2] Effective for annual periods beginning on or after 1 July 2009.
[3] Effective for annual periods beginning on or after 1 March 2007.
[4] Effective for annual periods beginning on or after 1 January 2008.
[5] Effective for annual periods beginning on or after 1 July 2008.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

3. BASIS OF PREPARATION

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial instruments, which are measured at fair values as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities of the Stock Exchange and by the Hong Kong Companies Ordinance.

4. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", which are recognised and measured at fair value less costs to sell.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Business combinations *(Continued)*

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

Goodwill

Goodwill arising on an acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the consolidated balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of subsidiaries, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Investments in associates

An associate is an entity over which the investor has significant influence and that is not a subsidiary nor an interest in a joint venture.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognised at the date of acquisition is recognised as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment.

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Property, plant and equipment

Property, plant and equipment including buildings held for use in the production or supply of goods or services, or for administrative purposes (other than construction in progress) are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets, or where shorter, the term of the relevant lease.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year in which the item is derecognised.

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Construction-in-progress

Construction-in-progress represents property, plant and equipment in the course of construction for production or for its own use purposes. Construction-in-progress is carried at cost less any recognised impairment loss. Construction-in-progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Intangible assets

Expenditure on research activities is recognised as an expense in the year in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment losses.

The amount initially recognised for internally-generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria. Where no internally-generated intangible asset can be recognised, development expenditure is recognised as expense in the year in which it is incurred. Subsequent to initial recognition, internally-generated intangible asset is reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

Intangible assets with finite useful lives are tested for impairment when there is an indication that an asset may be impaired (see the accounting policy in respect of impairment below).

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the consolidated income statement when the asset is derecognised.

Land use rights

Payment for obtaining land use right is considered as operating lease payment. Land use rights are stated at cost less accumulated amortisation and accumulated impairment losses, amortisation is charged to consolidated income statement over the period of the rights or the term of the respective enterprise to which the land use rights are granted, whichever is the shorter, using the straight-line method.

Financial instruments

Financial assets and financial liabilities are recognised on the consolidated balance sheet when a group entity becomes a party to the contractual provisions of the instruments. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Financial assets

The Group's financial assets are classified as loans and receivables. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of the financial assets are set out below.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and other receivables, deposits, amount due from a related party and a minority shareholder, cash held at a financial institution and bank balance) are carried at amortised cost using the effective interest method, less any identified impairment losses (see accounting policy on impairment loss on financial assets below).

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on effective interest basis for the debt instruments.

Impairment loss on financial assets

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For all of the Group's financial assets, objective evidence of impairment could include:

– significant financial difficulty of the issuer or counterparty; or

– default or delinquency in interest or principal payments; or

– it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Impairment loss on financial assets (Continued)

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments as well as observable changes in national or local economic conditions that correlate with default on trade receivables.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivable, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

For financial assets measured at amortised cost, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment losses was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The Group's financial liabilities are generally classified into other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Other financial liabilities

Other financial liabilities including trade and other payables, amounts due to related parties and directors, loans from a minority shareholder, obligations under finance leases, bank and other borrowings are subsequently measured at amortised cost, using the effective interest rate method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Other financial liabilities (Continued)

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. Interest expense is recognised on an effective interest basis other than those financial liabilities designated as at fair value through profit or loss upon initial recognition if:

– such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or

– the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

– it forms part of a contract containing one or more embedded derivatives, and HKAS 39 "Financial Instruments: Recognition and Measurement" permits the entire combined contract (asset or liability) to be designated as at fair value through profit or loss.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Convertible bonds

Convertible bonds issued by the Group (including related embedded derviates) are designated as financial liabilities at fair value through profit or loss on initial recognition. At each balance sheet date subsequent to initial recognition, the entire convertible bonds are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

Equity-settled share-based payment transactions

Share options granted to employees of the Company

The fair value of services received determined by reference to the fair value of share options granted at the grant date is recognised as an expense in full at the grant date when the share options granted vest immediately, with a corresponding increase in equity (share options reserve).

At each balance sheet date, the Group revises its estimates of the number of options that are expected to ultimately vest. The impact of the revision of the estimates, if any, is recognised in profit or loss, with a corresponding adjustment to share options reserve.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Equity-settled share-based payment transactions (Continued)

Share options granted to employees of the Company (Continued)

At the time when the share options are exercised, the amount previously recognised in share options reserve will be transferred to share premium. When the share options are forfeited, cancelled or are still not exercised at the expiry date, the amount previously recognised in share options reserve will be transferred to accumulated profits (losses).

Share options granted to consultants

Share options issued in exchange for services are measured at fair values and are recognised as expenses immediately, unless the services qualify for recognition as assets. Corresponding adjustments has been made to equity (share options reserve).

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss. If the Group retains substantially all the risks and rewards of ownership of a transferred asset, the Group continues to recognise the financial asset and recognise a collateralised borrowing for proceeds received.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Government grants

Government grants relating to costs are deferred and recognised in the consolidated income statement over the period necessary to match them with the costs that they are intended to compensate and are presented separately from the costs. Government grants relating to the purchase of assets are included in non-current liabilities as deferred government grants and are recognised in the consolidated income statement on a straight line basis over the expected lives of the related assets.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Assets held for sale

Non-current assets are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition.

Non-current assets classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

Impairment loss on tangible assets and intangible assets with finite useful lives other than goodwill (see the accounting policy in respect of goodwill above)

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets with finite useful lives to determine whether there is any indication that those assets have suffered impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as expense immediately.

Where impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided in the normal course of business, net of discounts and sales related taxes.

Revenue from sales of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed.

Revenue arising from water supply is recognised based on water supplied as recorded by meters read during the year.

Revenue from sewage treatment is recognised according to price and capacity as agreed with the regulatory authority in the PRC.

Water supply related installation and construction revenue is recognised when services are rendered and income can be measured reliably.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes income statement items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amount of assets and liabilities in the consolidated financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the year in which they arise, except for exchange differences arising on monetary item that forms part of the Group's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the year except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

4. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Foreign currencies *(Continued)*

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the year, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the year in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the translation reserve.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the terms of the relevant leases. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Borrowing costs

Borrowing costs are charged to the consolidated income statement in the year in which they are incurred.

Retirement benefits costs

Payments to the Mandatory Provident Fund Scheme are charged as an expense when employees have rendered services entitling them to the contributions.

The subsidiaries in the PRC participate in the central pension scheme (the "CPS") operated by the PRC government for all of their staff. The subsidiaries are required to contribute a certain percentage of their covered payroll to the CPS to fund the benefits. The only obligation of the Group will respect to the CPS is to pay the ongoing required contributions under the CPS. Payments to the CPS are charged as expenses as they fall due in accordance with the rules of the CPS.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

5. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group's accounting policies which are described in Note 4, management has made the following judgements that have significant effect on the amounts recognised in the consolidated financial statements. The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

Useful lives and impairment assessment of property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and identified impairment losses. The estimation of useful lives impacts the level of annual depreciation expenses recorded. Property, plant and equipment are evaluated for possible impairment on a specific asset basis or in groups of similar assets, as applicable. This process requires management's estimate of future cash flows generated by each asset or group of assets. For any instance where this evaluation process indicates impairment, the relevant asset's carrying amount is written down to the recoverable amount and the amount of the write-down is charged against the consolidated income statement.

Allowances for bad and doubtful debts

The policy for allowance for bad and doubtful debts of the Group is based on the evaluation of collectability and aging analysis of accounts and on management's judgement. A considerable amount of judgement is required in assessing the ultimate realisation of these receivables, including the current creditworthiness and the past collection history of each customer. If the financial conditions of customers of the Group were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Allowances for inventories

The management of the Group reviews an aging analysis at each balance sheet date, and makes allowance for obsolete and slow-moving inventory items identified that are no longer suitable for use in production. The management estimates the net realisable value for such items based primarily on the latest invoice prices and current market conditions. The Group carries out an inventory review on a product-by-product basis at each balance sheet date and makes allowance for obsolete items.

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

Fair values of the convertible bonds

The fair values of the convertible bonds involve assumptions on the Company's credit spread, discount rate, expected credit rating and future cash flows. Should these assumptions change, there would be material changes to the valuation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Categories of financial instruments

	2007	2006
	HK$'000	*HK$'000*
Financial assets		
– Loans and receivables (including cash equivalents)	**736,433**	40,887
Financial liabilities		
– Other financial liabilities, at amortised cost	**84,377**	94,132
– Convertible bonds, at fair value through profit or loss	**326,872**	–
	411,249	94,132

The Group's major financial instruments include deposits paid for acquisition of subsidiaries, trade and other receivables, amounts due from a related party and a minority shareholder, cash held at a financial institution, bank balances, trade and other payables, amounts due to related parties and directors, loans from a minority shareholder, bank borrowings, long-term bank and other borrowings, obligations under finance leases and convertible bonds. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Currency risk

Currency risk refers to the risk that movement in foreign currency rate which will affect the Group's financial results and its cashflow. The management considers the Group does not expose to significant foreign currency risk as majority of its operations and transactions are denominated in the functional currencies of the group entity. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

Credit risk

The Group's principal financial assets are trade and other receivables and bank balances, which represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31 December 2007 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. In order to minimise the credit risk, the management of the Group has regularly reviews the recoverable amount of each individual receivable at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

Credit risk *(Continued)*

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

The bank balance, pledged bank deposits and cash held at a financial institution were deposited in banks and financial institution with high crediting, thus the credit risk on these balances is limited.

Liquidity risk

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuations in cash flows. The management will closely monitor the cash flow generated from operations and the Group's needs for different types of external financing and will negotiate for proper facilities and consider proper means of equity financing as appropriate.

The following table details the contractual maturities at the balance sheet date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates) and the earliest date the Group can be required to pay:

	On demand or within one year *HK$'000*	More than one year less than two years *HK$'000*	More than two years less than five years *HK$'000*	More than five years *HK$'000*	Total undiscounted cash flows *HK$'000*	Carrying amounts *HK$'000*
2007						
Financial liabilities						
Trade and other payables	29,770	–	–	–	29,770	29,770
Amounts due to related parties	204	–	–	–	204	204
Amounts due to directors	223	–	–	–	223	223
Other loans	9,961	–	–	–	9,961	9,487
Loans from a minority shareholder	–	5,662	7,187	–	12,849	11,738
Long-term bank and other borrowings	5,706	5,456	14,865	20,966	46,993	32,955
	45,864	11,118	22,052	20,966	100,000	84,377

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

Liquidity risk *(Continued)*

	On demand or within one year	More than one year less than two years	More than two years less than five years	More than five years	Total undiscounted cash flows	Carrying amounts
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
2006						
Financial liabilities						
Trade and other payables	78,340	–	–	–	78,340	78,340
Obligations under finance leases	164	164	122	–	450	385
Bank borrowings	6,442	–	–	–	6,442	6,442
Amounts due to related parties	5,274	–	–	–	5,274	5,274
Amounts due to directors	2,834	–	–	–	2,834	2,834
Long-term bank and other borrowings	–	–	–	1,196	1,196	857
	93,054	164	122	1,196	94,536	94,132

Fair values of financial assets and liabilities

The directors consider the fair values of equity, trade and other receivables, deposits paid for acquisition of subsidiaries, amounts due from a related party and a minority shareholder of subsidiaries, bank deposits and balances, trade and other payables, amounts due to related parties and directors reported in the consolidated balance sheet approximate their carrying amounts due to their immediate or short-term maturities.

The fair values of the Group's finance lease obligations, determined based on the present value of the estimated future cash flows discounted using the prevailing market rate at the balance sheet date approximate to their carrying amounts.

The directors consider that the carrying amounts of bank and other borrowings approximate their fair values because of the borrowing rate currently available for bank and other borrowings with similar terms and maturities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

6. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

Interest rate risk

The Group's fair value interest rate risk relates primarily to the Group's bank deposits, cash held at a financial institution, convertible bonds, bank borrowings, long-term bank and other borrowings and obligations under finance leases.

The Group's exposures to interest rates on financial liabilities are detailed in the liquidity risk section of this Note. Bank and other borrowings were issued at fixed rates expose the Group to fair value interest-rate risk. The Group historically has not used any financial instruments to hedge potential fluctuations in interest rates.

Sensitivity analysis

At 31 December 2007, it is estimated that a general 50 basis point increase or decrease in interest rates, with all other variables held constant, would increase or decrease the Group's loss for the year and accumulated losses by approximately HK$195,000 (2006: HK$220,000).

The above sensitivity analysis has been determined assuming that a change in interest rates had occurred at the balance sheet date and had been applied to the exposure to interest rate risk for financial instruments in existence at that date. The 50 basis point increase or decrease represents management's assessment of a reasonably possible change in interest rates over the period until the next annual balance sheet date. The analysis was performed on the same basis for 2006.

Capital risk management

The primary objective of the Group's capital risk management is to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and to provide adequate return to shareholders by pricing products and services commensurately with the level of risk.

The Group monitors capital by maintaining an adequate capital structure. Capital of the Group comprises all components of equity, including share capital and reserves, cash and bank balances and various types of borrowings. The Group's approach to capital risk management remains unchanged throughout the years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

7. TURNOVER

Turnover represents the net amounts received and receivable for goods sold and services provided by the Group to outside customers, less returns and discounts.

An analysis of the Group's turnover is as follows:

	2007	2006
	HK$'000	*HK$'000*
Continuing operations		
Trading of watches and accessories	**14,601**	39,552
Provision of water supply	**24,430**	–
Water supply related installation and construction revenue	**28,424**	–
Sewage treatment	**6,832**	–
	74,287	39,552
Discontinued operations		
Sales of computer peripherals	**20,576**	30,582
	94,863	70,134

8. OTHER OPERATING INCOME

	2007	2006
	HK$'000	*HK$'000*
Continuing operations		
Bank interest income	**10,331**	108
Net foreign exchange gain	**163**	22
Compensation income *(Note)*	**5,366**	–
Gain on disposal of subsidiaries	**7,020**	148
Written back of long outstanding payables	**617**	36
Others	**588**	227
	24,085	541
Discontinued operations		
Bank interest income	**6**	7
Net foreign exchange gain	**322**	464
Gain on disposal of assets held for sale	**–**	1,013
Others	**583**	1,021
	911	2,505
	24,996	3,046

Note: Pursuant to several agreements between the Group and the former shareholders of certain subsidiaries, the former shareholders had guaranteed a minimum profit to the Group (the "Guaranteed Profits"). The Group will be compensated by the respective former shareholders for the shortfall on the Guaranteed Profits. During the year ended 31 December 2007, the Group recognised an income at an aggregate sum of approximately HK$5,366,000 as a compensation for the shortfall of the Guaranteed Profits for the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

9. SEGMENT INFORMATION

Business segments

For management purposes, the Group organised into three operating divisions – production and sale of computer peripherals, trading of watches and accessories and provision of water supply and sewage treatment during the year. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

(a) Production and sale of computer peripherals;

(b) Trading of watches and accessories to customers in Hong Kong; and

(c) Provision of water supply and sewage treatment business in the PRC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

9. SEGMENT INFORMATION *(Continued)*

Segment information about these businesses is presented below:

For the year ended 31 December

	Continuing operations				Discontinued operations			
	Trading of watches and accessories		Provision of water supply and sewage treatment		Production and sale of computer peripherals		Consolidated	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
TURNOVER								
External sales	**14,601**	39,552	**59,686**	–	**20,576**	30,582	**94,863**	70,134
RESULTS								
Segment results	**(18,949)**	(14,793)	**7,900**	(268)	**(6,775)**	(57,342)	**(17,824)**	(72,403)
Unallocated corporate income							**17,976**	2,898
Unallocated corporate expenses							**(17,990)**	(3,388)
Gain on disposal of subsidiaries							**7,020**	148
Change in fair value of convertible bonds							**58,128**	–
Convertible bonds issue expense							**(13,520)**	–
Impairment loss on trade receivables	**(755)**	–	**(343)**	–	**(3,226)**	(14,870)	**(4,324)**	(14,870)
Share-based payment expense							**(40,433)**	(7,635)
Share of results of associates							**(1,834)**	338
Finance costs	**–**	(48)	**(2,612)**	–	**(215)**	(446)	**(2,827)**	(494)
Loss before tax							**(15,628)**	(95,406)
Income tax expense	**–**	(336)	**–**	–	**(44)**	–	**(44)**	(336)
Loss for the year							**(15,672)**	(95,742)
OTHER INFORMATION:								
Depreciation of property, plant and equipment	**62**	188	**5,817**	–	**3,220**	4,570	**9,099**	4,758
Amortisation of prepaid lease payments	**–**	–	**132**	–	**–**	–	**132**	–
Impairment loss on trade receivables	**755**	–	**343**	–	**3,226**	14,870	**4,324**	14,870
Impairment loss on intangible assets	**–**	–	**–**	–	**–**	2,160	**–**	2,160
Allowance for inventories (Included in costs of sales)	**3,144**	–	**–**	–	**5,208**	11,601	**8,352**	11,601
Written off of inventories (Included in administrative expenses)	**–**	143	**–**	–	**–**	35,134	**–**	35,277
Loss on disposal of property, plant and equipment	**544**	–	**49**	–	**472**	74	**1,065**	74
Loss on disposal of investment held for trading	**–**	–	**–**	–	**–**	1,200	**–**	1,200
Loss on deconsolidation of a subsidiary	**98**	–	**–**	–	**–**	–	**98**	–
Capital expenditure:								
Property, plant and equipment, through acquisition of subsidiaries	**–**	–	**95,046**	45,468	**–**	–	**95,046**	45,468
Property, plant and equipment by the Group itself	**–**	–	**96,418**	–	**–**	2,853	**96,418**	2,853

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

9. SEGMENT INFORMATION *(Continued)*

Segment information about these businesses is presented below *(Continued)*:

At 31 December

	Continuing operations				Discontinued operations			
	Trading of watches and accessories		Provision of water supply and sewage treatment		Production and sale of computer peripherals		Consolidated	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
ASSETS								
Segment assets	**1,335**	22,462	**347,392**	71,716	**–**	29,492	**348,727**	123,670
Interests in associates							**7,617**	36,477
Goodwill							**77,333**	1,361
Deposits paid for acquisition of subsidiaries							**567,990**	–
Unallocated segment assets							**74,816**	628
Consolidated total assets							**1,076,483**	162,136
LIABILITIES								
Segment liabilities	**1,433**	3,125	**26,343**	47,753	**–**	36,672	**27,776**	87,550
Other loans	**–**	–	**9,487**	–	**–**	–	**9,487**	–
Long-term bank and other borrowings	**–**	–	**32,955**	–	**–**	–	**32,955**	–
Loans from a minority shareholder	**–**	–	**11,738**	–	**–**	–	**11,738**	–
Convertible bonds							**326,872**	–
Government grants	**–**	–	**50,787**	–	**–**	–	**50,787**	–
Unallocated segment liabilities							**2,702**	16,795
Consolidated total liabilities							**462,317**	104,345

Geographical segments

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

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

	2007	2006
	HK$'000	*HK$'000*
Europe	**2,465**	4,621
The PRC, Hong Kong and Taiwan	**92,042**	40,572
North America	**356**	24,941
	94,863	70,134

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

9. SEGMENT INFORMATION *(Continued)*

Geographical segments *(Continued)*

Revenue from the Group's discontinued operations, production and sale of computer peripherals, was derived principally from the PRC, Hong Kong and Taiwan.

The following is an analysis of the carrying amounts of segment assets, and additions to property, plant and equipment, analysed by the geographical areas in which the assets are located:

	Carrying amounts of segment assets		**Additions to property, plant and equipment by the Group itself**	
	2007	2006	**2007**	2006
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
The PRC	**348,726**	121,787	**94,266**	1,756
Hong Kong	**727,757**	31,660	**2,152**	1,097
Taiwan	**–**	8,689	**–**	–
	1,076,483	162,136	**96,418**	2,853

10. FINANCE COSTS

	2007	2006
	HK$'000	*HK$'000*
Interest on:		
– Bank borrowings wholly repayable within five years	**207**	442
– Finance leases	**8**	52
– Interest on convertible bonds	**393**	–
– Other loans and borrowings	**2,198**	–
– Imputed interest expenses on unsecured borrowing repayable over five years	**21**	–
	2,827	494
Attributable to:		
Continuing operations	**2,612**	48
Discontinued operations	**215**	446
	2,827	494

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

11. LOSS BEFORE TAX

	Continuing operations		Discontinued operations		Consolidated	
	2007	2006	**2007**	2006	**2007**	2006
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Loss before tax has been arrived at after charging:						
Amortisation of prepaid lease payments	**132**	–	**–**	–	**132**	–
Auditors' remuneration	**600**	566	**–**	14	**600**	580
Impairment loss on trade receivables	**1,098**	–	**3,226**	14,870	**4,324**	14,870
Allowance for inventories (included in cost of sales)	**3,144**	–	**5,208**	11,601	**8,352**	11,601
Written off of inventories (included in administrative expense)	**–**	143	**–**	35,134	**–**	35,277
Impairment loss on intangible assets	**–**	–	**–**	2,160	**–**	2,160
Share-based payment *(Note)*	**39,381**	7,635	**–**	–	**39,381**	7,635
Convertible bonds issue expense	**13,520**	–	**–**	–	**13,520**	–
Cost of inventories recognised as expenses	**27,909**	25,365	**7,901**	9,618	**35,810**	34,983
Depreciation of property, plant and equipment	**5,879**	188	**3,220**	4,570	**9,099**	4,758
Loss on disposal of property, plant and equipment	**593**	–	**472**	74	**1,065**	74
Loss on disposal of investments held for trading	**–**	–	**–**	1,200	**–**	1,200
Loss on deconsolidation of a subsidiary	**98**	–	**–**	–	**98**	–
Minimum lease payment under operating leases	**1,427**	3,408	**1,459**	1,695	**2,886**	5,103
Staff costs excluding directors' emoluments						
– Salaries, wages and other benefits	**13,144**	4,241	**4,466**	4,979	**17,610**	9,220
– Retirement benefits scheme benefits	**940**	123	**291**	474	**1,231**	597
Total staff costs	**14,084**	4,364	**4,757**	5,453	**18,841**	9,817

Note: The amounts represent the fair value of consultancy services provided to the Group in the current year in relation to identifying potential water projects in the PRC. The consultancy service fees are settled through the issue of 427,800,000 share options in the current year as set out in Note 46.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

12. EMOLUMENTS FOR DIRECTORS AND EMPLOYEES

(a) Directors' emoluments

Directors' remuneration for the year ended 31 December 2007 is as follows:

The emolument paid or payable to each of the 15 (2006: 21) directors were as follows:

		Other emoluments			
Name	Fees	Salaries, allowance and benefits in kind	Retirement benefits scheme contributions	Share-based payments	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Executive directors:					
Wu Chi Lok[1]	–	–	–	–	–
Chu Yin Yin, Georgiana	–	555	12	370	937
Li Yu Gui[2]	–	45	–	–	45
Liu Bai Yue[2]	–	360	12	312	684
Liu Peng Cheng[2]	–	–	–	–	–
Shi De Mao	–	120	–	–	120
Sze Chun Ning, Vincent	–	424	12	370	806
Wang Chia Chin	–	–	–	–	–
Wang Xiao Bo[1]	–	90	–	–	90
Zhong Wen Sheng	–	405	–	–	405
	–	1,999	36	1,052	3,087
Non-executive directors:					
Huang Yuan Wen	–	73	–	–	73
Pan Shi Ying	–	73	–	–	73
	–	146	–	–	146
Independent non-executive directors:					
Chang Kin Man	–	150	–	–	150
Wu Tak Lung	–	120	–	–	120
Gu Wen Xuan	–	100	–	–	100
	–	370	–	–	370
Total	–	2,515	36	1,052	3,603

1 resigned during the year

2 appointed during the year

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

12. EMOLUMENTS FOR DIRECTORS AND EMPLOYEES *(Continued)*

(a) Directors' emoluments *(Continued)*

Directors' remuneration for the year ended 31 December 2006 is as follows:

		Other emoluments			
Name	Fees	Salaries, allowance and benefits in kind	Retirement benefits scheme contributions	Share-based payments	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Executive directors:					
Wang Chia Chin	–	806	7	–	813
Chen Ho Fa[2]	–	349	–	–	349
Wu Chi Lok[4]	–	690	12	–	702
Wong Chong Fai, William[2]	–	1,010	11	–	1,021
Yeung Tsz Keung, Jackey[2]	–	100	6	–	106
Luk Chi Shing[3]	–	120	–	–	120
Sze Chun Ning, Vincent[1]	–	140	–	–	140
Chu Yin Yin, Georgiana[1]	–	90	–	–	90
Shi De Mao[1]	–	50	–	–	50
Zhong Wen Sheng[1]	–	20	–	–	20
Wang Xiao Bo[1]	–	–	–	–	–
	–	3,375	36	–	3,411
Non-executive directors:					
Huang Yuan Wen[1]	–	13	–	–	13
Pan Shi Ying[1]	–	13	–	–	13
	–	26	–	–	26
Independent non-executive directors:					
Chan But Leung[2]	–	36	2	–	38
Shum Po Cheung[2]	–	32	2	–	34
Lui Nam Kit[2]	–	33	2	–	35
Lien Wai Hung[3]	–	37	2	–	39
Lee Hung Sang[3]	–	50	2	–	52
Chang Kin Man[1]	–	68	2	–	70
Wu Tak Lung[1]	–	63	2	–	65
Gu Wen Xuan[1]	–	20	–	–	20
	–	339	14	–	353
Total	–	3,740	50	–	3,790

[1] appointed during the year

[2] resigned during the year

[3] appointed and resigned during the year

[4] resigned after the year ended 31 December 2006

There was no arrangement under which directors waived or agreed to waive any emoluments in each of the years ended 31 December 2006 and 2007.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

12. EMOLUMENTS FOR DIRECTORS AND EMPLOYEES *(Continued)*

(b) Employees' emoluments

Details of the five highest paid individuals included four directors (2006: two directors), whose emoluments are set out in (a) above. The emoluments of the remaining one (2006: three) highest paid individuals were as follows:

	2007	2006
	HK$'000	*HK$'000*
Salaries, allowance and benefits in kind	**326**	2,134
Retirement benefits scheme contributions	**12**	30
	338	2,164

Their emoluments were within the following bands:

	No. of employees	
	2007	2006
Nil to HK$1,000,000	**1**	2
HK$1,000,001 to HK$1,500,000	**–**	1

During each of the years ended 31 December 2006 and 2007, no emolument was paid to the five highest paid individuals (included both directors and employees) and other directors as an inducement to join or upon joining the Group or as compensation for loss of office.

No other remuneration paid to other members of key management during each of the years ended 31 December 2006 and 2007.

13. INCOME TAX EXPENSE

	2007	2006
	HK$'000	*HK$'000*
Current tax:		
– Hong Kong	**44**	336
Attributable to:		
Continuing operations	**–**	336
Discontinued operations	**44**	–
	44	336

Hong Kong Profits Tax is calculated at 17.5% (2006: 17.5%) of the estimated assessable profit for the year. Taxation arising in other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

13. INCOME TAX EXPENSE *(Continued)*

Pursuant to the relevant law and regulations in the PRC, certain of the Company's PRC subsidiaries are entitled to exemption from PRC Enterprise Income Tax.

The tax charge for the year can be reconciled to the loss before tax per the consolidated income statement as follows:

	2007	2006
	HK$'000	*HK$'000*
Loss before tax – continuing	**(6,323)**	(25,252)
Loss before tax – discontinued	**(9,305)**	(70,154)
Loss before tax	**(15,628)**	(95,406)
Tax at the domestic income tax rate of 17.5% (2006: 17.5%)	**(2,735)**	(16,696)
Tax effect of share of results of associates	**321**	59
Tax effect of expenses not deductible in determining taxable profit	**15,389**	12,566
Tax effect of income not taxable for tax purpose	**(12,312)**	(224)
Effect of different tax rates of subsidiaries operating in other jurisdictions	**957**	–
Effect of tax exemption and reduction granted to the Group	**(4,234)**	–
Tax effect of deferred tax assets not recognised	**2,658**	4,631
Tax charge for the year	**44**	336

Deferred taxation

There was no significant deferred taxation for the year or at the balance sheet date.

14. DIVIDENDS

No dividend was paid or proposed during the years ended 31 December 2006 and 2007, nor has any dividend been proposed since the balance sheet date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

15. DISCONTINUED OPERATIONS

On 13 November 2007, the Group entered into an agreement to dispose of a subsidiary, Pablo Enterprise Limited ("Pablo"), which carried out all of the Group's production and sale of computer peripherals operations. The disposal was effected in order to focus the Group's resources in its remaining businesses. The disposal was completed on 28 December 2007 on which date control of Pablo Enterprise Limited passed to the acquirer.

The loss for the year from the discontinued operations is analysed as follows:

	2007	2006
	HK$'000	*HK$'000*
Loss on production and sale of computer peripherals operations for the year	**(9,349)**	(70,154)
Gain on disposal of production and sale of computer peripherals operations	**6,241**	–
	(3,108)	(70,154)

The results of the production and sale of computer peripherals operations for the period from 1 January 2007 to 28 December 2007, which have been included in the consolidated income statement, were as follows:

	Period ended 28/12/2007	Year ended 31/12/2006
	HK$'000	*HK$'000*
Turnover	**20,576**	30,582
Cost of sales	**(19,922)**	(32,934)
Gross profit (loss)	**654**	(2,352)
Other operating income	**911**	2,505
Selling and distribution costs	**(748)**	(2,090)
Administrative expenses	**(6,681)**	(17,767)
Written off of inventories	**–**	(35,134)
Impairment loss on trade receivables	**(3,226)**	(14,870)
Finance costs	**(215)**	(446)
Loss before tax	**(9,305)**	(70,154)
Income tax expense	**(44)**	–
Loss for the period/year	**(9,349)**	(70,154)
Attributable to:		
Equity holders of the Company	**(9,349)**	(70,154)
Minority interests	**–**	–
	(9,349)	(70,154)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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16. LOSS PER SHARE

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

Loss

	2007	2006
	HK$'000	*HK$'000*
Loss for the purpose of basic loss per share (Loss for the year attributable to equity holders of the Company)	**24,344**	95,452

	2007	2006
	HK$'000	*HK$'000*
Loss for the year attributable to equity holders of the Company	**24,344**	95,452
Less: Loss for the year from discontinued operations attributable to equity holders of the Company used in the calculation of basic loss per share from discontinued operations	**(9,349)**	(70,154)
Loss used in the calculation of basic loss per share from continuing operations	**14,995**	25,298

Number of shares

	2007	2006
	'000	*'000*
Weighted average number of ordinary shares for the purpose of basic loss per share	**1,754,342**	989,705
Effect of dilutive potential ordinary shares:		
– share options issued by the Company	**47,794**	98,400
– conversion of convertible bonds	**112,165**	–
Weighted average number of ordinary shares for the purpose of diluted loss per share	**1,914,301**	1,088,105

The computation of diluted loss per share does not assume the conversion of the Company's outstanding convertible bonds since their conversion would result in a decrease in loss per share from continuing operations for the year ended 31 December 2007.

No diluted loss per share is presented for the years ended 31 December 2006 and 2007 as the effect of the exercise of the Company's outstanding share options and conversion of convertible bonds was anti-dilutive from both continuing operations and discontinued operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

17. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Plant and machinery	Leasehold improvements	Motor vehicles	Construction in progress	Water pipeline	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
COST							
At 1 January 2006	5,009	41,922	2,891	2,720	–	–	52,542
Acquired on acquisition of subsidiaries	7,241	378	36	70	17,439	20,304	45,468
Additions	–	717	1,880	256	–	–	2,853
Disposals of subsidiaries	–	–	(331)	–	–	–	(331)
Disposals	–	(833)	(200)	(298)	–	–	(1,331)
Exchange realignment	50	1,546	55	31	–	–	1,682
At 31 December 2006 and 1 January 2007	12,300	43,730	4,331	2,779	17,439	20,304	100,883
Acquired on acquisition of subsidiaries	15,061	5,445	58	1,931	66,681	5,870	95,046
Additions	9,634	21,215	698	2,888	45,082	16,901	96,418
Transfers	5,257	57,876	–	–	(66,405)	3,272	–
Disposals of subsidiaries	(5,059)	(48,398)	(245)	(2,344)	–	–	(56,046)
Deconsolidation of a subsidiary	–	–	(31)	–	–	–	(31)
Disposals	–	(708)	(347)	(722)	–	–	(1,777)
Exchange realignment	1,661	5,279	22	156	2,966	2,430	12,514
At 31 December 2007	**38,854**	**84,439**	**4,486**	**4,688**	**65,763**	**48,777**	**247,007**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

17. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

	Land and buildings	Plant and machinery	Leasehold improvements	Motor vehicles	Construction in progress	Water pipeline	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ACCUMULATED DEPRECIATION AND IMPAIRMENT							
At 1 January 2006	416	28,840	502	1,793	–	–	31,551
Provided for the year	99	3,649	850	160	–	–	4,758
Disposal of subsidiaries	–	–	(66)	–	–	–	(66)
Eliminated on disposals	–	(681)	(364)	(30)	–	–	(1,075)
Exchange realignment	4	1,049	4	30	–	–	1,087
At 31 December 2006 and 1 January 2007	519	32,857	926	1,953	–	–	36,255
Provided for the year	1,195	5,546	238	556	–	1,564	9,099
Disposal of subsidiaries	(595)	(37,659)	(244)	(1,910)	–	–	(40,408)
Deconsolidation of a subsidiary	–	(13)	–	–	–	–	(13)
Eliminated on disposals	–	(234)	(201)	(277)	–	–	(712)
Exchange realignment	43	1,573	2	45	–	572	2,235
At 31 December 2007	**1,162**	**2,070**	**721**	**367**	**–**	**2,136**	**6,456**
CARRYING AMOUNTS							
At 31 December 2007	**37,692**	**82,369**	**3,765**	**4,321**	**65,763**	**46,641**	**240,551**
At 31 December 2006	11,781	10,873	3,405	826	17,439	20,304	64,628

The above items of property, plant and equipment are depreciated on a straight-line basis at the following rates per annum:

Freehold land	Nil
Land and buildings	Over the shorter of the term of the lease, or 30 years
Plant and machinery	5 to 10 years
Leasehold improvements	Over the shorter of the term of the lease, or 5 years
Motor vehicles	5 years
Water Pipeline	15 years

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

17. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

The carrying amounts of the properties shown above comprises:

	2007	2006
	HK$'000	*HK$'000*
Freehold land and buildings outside Hong Kong	**–**	4,540

As at 31 December 2006, net carrying amount of motor vehicles of approximately HK$440,000 (2007: Nil) was held under finance leases.

The Group has pledged land and buildings having a net carrying amount of approximately HK$4,540,000 (2007: Nil) to secure general banking facilities granted to the Group.

18. INTANGIBLE ASSETS

	Development costs
	HK$'000
COST	
At 1 January 2006 and 31 December 2006	3,600
Disposal of subsidiaries	(3,600)
At 31 December 2007	**–**
ACCUMULATED AMORTISATION AND IMPAIRMENT	
At 1 January 2006	1,440
Impairment losses recognized	2,160
At 31 December 2006	3,600
Disposal of subsidiaries	(3,600)
At 31 December 2007	**–**
CARRYING AMOUNTS	
At 31 December 2007	**–**
At 31 December 2006	–

Development costs have definite useful lives and were originally amortised on a straight-line basis over 5 years.

The directors reviewed the carrying values of intangible assets as at 31 December 2006 based on a value-in-use calculation. As a result of huge loss for the year ended 31 December 2006, the directors consider that the above intangible assets did not bring economic benefits to the Group and as such impairment losses are provided in the year ended 31 December 2006 on the full carrying amount of the intangible assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

19. PREPAID LEASE PAYMENTS

	2007	2006
	HK$'000	*HK$'000*
COST		
Acquisition of subsidiaries	**9,810**	–
Exchange realignment	**691**	–
At 31 December	**10,501**	–
ACCUMULATED AMORTISATION		
Provided for the year	**132**	–
Exchange realignment	**5**	–
At 31 December	**137**	–
NET CARRYING VALUES		
At 31 December	**10,364**	–

The Group's prepaid lease payments in relation to land use rights are under medium-term leases in the PRC, and analysed for reporting purposes as:

	2007	2006
	HK$'000	*HK$'000*
Current assets	**221**	–
Non-current assets	**10,143**	–
	10,364	–

20. GOODWILL

	HK$'000
COST	
Goodwill arising on acquisition of subsidiaries during the year and as at 31 December 2006	1,361
Adjustments to cost of investment due to contingent transaction costs crystalised for the acquisition of subsidiaries in the year of 2006	1,582
	2,943
Transfer from interest in an associate on acquisition of additional equity interest *(Note 21)*	26,830
Goodwill arising on acquisition of subsidiaries during the year *(Note 39)*	47,560
At 31 December 2007	**77,333**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

20. GOODWILL *(Continued)*

The goodwill was recognised on acquisitions of subsidiaries, which are engaged in the water supply and sewage treatment business. For the purposes of impairment testing, goodwill has been allocated to the cash generating units of provision for water supply and sewage treatment ("CGU") approximately HK$77,333,000.

Management of the Group considers cashflow projections which was prepared based on financial budgets covering respective period of goodwill and determined that there was no impairment of any of its CGUs containing goodwill as at 31 December 2007.

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired. The recoverable amount of the CGU, which covers the above goodwill is determined from a value-in-use calculation. The key assumptions for the value-in-use calculation are those regarding the discount rate, growth rate, and expected changes to selling prices and direct costs during the period. The Group estimates discount rate using the prevailing market rate of return of similar companies in the market adjusted with the specific risks relating to relevant subsidiaries. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on the management's past experience and expectations of future changes in the relevant markets.

The Group prepares five-year cash flow forecasts (the "Forecasts") derived from the CGU's financial budgets for 2008 to 2012, of which are approved by the management of the CGU. The rate used to discount the Forecasts is 8% per annum.

As the water supply and sewage treatment business is regulated by government in the PRC, the Group considers that the Forecasts covering a period of 5 years and an average growth rate of 5% per annum are appropriate for the impairment test review.

The results for the reviews undertaken as at 31 December 2007 indicated that no impairment loss was necessary for the year ended 31 December 2007.

21. INTERESTS IN ASSOCIATES

	2007	2006
	HK$'000	*HK$'000*
Investments in unlisted equity interests, at cost	**10,200**	36,139
Share of post-acquisition results	**(2,583)**	338
	7,617	36,477

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

21. INTERESTS IN ASSOCIATES *(Continued)*

Movements in the Group's interests in associates during the year are summarised below:

	2007	2006
	HK$'000	*HK$'000*
At 1 January	**36,477**	–
Acquisition of an associate *(Note)*	**–**	36,139
Adjustments to cost of investment due to contingent transaction costs crystalised for the acquisition of an associate in the year 2006	**1,592**	–
	38,069	36,139
Share of profit for the year before acquisition of additional interest in an associate	**749**	338
	38,818	36,477
Transfer to subsidiaries on acquisition of additional interest in associate		
– share of net assets	**(11,988)**	–
– goodwill	**(26,830)**	–
	(38,818)	–
Acquisition of an associate through acquisition of subsidiaries *(Note 39)*	**10,200**	–
Share of post-acquisition loss for the year	**(2,583)**	–
At 31 December	**7,617**	36,477

Note: Included in amount was goodwill arising from acquisition of an associate amounted to Nil (2006: HK$25,238,000).

The goodwill was recognised on acquisition of an associate, 40% interest in Onfar International Limited acquired during the year ended 31 December 2006. The associate is investment holding company of which its major subsidiaries are engaged in the provision of water supply and sewage treatment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

21. INTERESTS IN ASSOCIATES *(Continued)*

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired. The recoverable amount of the associate, which covers the above goodwill is determined from a value-in-use calculation and based on the dividend income received from the associate. The key assumptions for the value-in-use calculation are those regarding the discount rate, growth rate, dividend yield rate and expected changes to selling prices and direct costs during the year. The Group estimates discount rate using the prevailing market rate of return of similar companies in the market adjusted with the specific risks relating to the associate. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on the past industry practices and expectations of future changes in the relevant markets. The dividend yield rate is estimated with reference to the historical profit trends of the associate.

The Group prepares five-year cash flow forecasts ("Forecasts") derived from the associate's financial budgets, of which are approved by the management of the associate. The rate used to discount the Forecasts is 8% per annum.

As the water supply and sewage treatment business is regulated by government in the PRC, the Group considers that the Forecasts covering a period of 5 years and an average growth rate of 5% per annum are appropriate for the impairment test review.

The results for the reviews undertaken as at 31 December 2007 indicated that no impairment loss was necessary for the year ended 31 December 2007.

As at 31 December 2007, the Group had interests in the following associate:

Name of entity	Form of business structure	Place of establishment	Proportion of equity interests held by the Group	Principal activity
Shangqiu Zhengyuan Water Industry Co., Ltd. ("Shangqiu")	Incorporated	PRC	29.15%	Provision for water supply

Shangqiu was acquired by the Group on 3 July 2007. The results of which have been accounted for into the Group's consolidated financial statement by equity accounting method, and are derived from the unaudited financial statements of Shangqiu from 3 July 2007 to 31 December 2007.

During the year, the Group's share of loss of this associate recognised in consolidated income statement amounted to approximately HK$2,583,000 (2006: Nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

21. INTERESTS IN ASSOCIATES *(Continued)*

As at 31 December 2006, the Group had interests in the following associate:

Name of entity	Form of business structure	Place of incorporation	Proportion of equity interests held by the Group	Principal activity
Onfar International Limited	Incorporated	British Virgin Islands	40%	Investment holding

Onfar International Limited was acquired by the Group as an associate on 14 November 2006 and subsequently became a subsidiary on 14 May 2007. The results of which have been accounted for into the Group's consolidated financial statements by equity accounting method, and are derived from the unaudited financial statements of Onfar International Limited from 14 November 2006 to 31 December 2006 and from 1 January 2007 to 14 May 2007 (the date on which Onfar International Limited became a subsidiary of the Group).

During the year, the Group's share of profit of this associate recognised in consolidated income statement amounted to approximately HK$749,000 (2006: HK$338,000).

The summarised financial information in respect of the Group's associates as at the balance sheet date is set out below:

	2007	2006
	HK$'000	*HK$'000*
Total assets	**266,630**	188,022
Total liabilities	**(240,500)**	(96,829)
Net assets	**26,130**	91,193
Group's share of net assets of associates	**7,617**	36,477
Revenue	**10,161**	2,152
(Loss) profit for the year	**(8,860)**	845
Group's share of (losses) profits of associates for the year *(Note)*	**(1,834)**	338

Note: The Group's share of results of associates for the year ended 31 December 2007 include the share of results of Onfar International Limited and its subsidiaries ("Onfar Group") for the period from 1 January 2007 to 14 May 2007 and the share of results of Shangqiu for the period from 3 July 2007 to 31 December 2007.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

22. INVENTORIES

	2007	2006
	HK$'000	HK$'000
Raw materials	–	3,433
Work in progress	–	1,008
Finished goods	4,116	14,342
	4,116	18,783

23. TRADE AND OTHER RECEIVABLES

	2007	2006
	HK$'000	HK$'000
Trade receivables	10,114	49,916
Less: Allowance for bad and doubtful debts	(2,093)	(21,135)
	8,021	28,781
Other receivables	15,912	2,752
Deposits and prepayments	34,581	2,248
	58,514	33,781

The Group allows an average credit period of 90 days to 180 days to its customers.

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

	2007	2006
	HK$'000	HK$'000
Current to 90 days	3,564	14,729
91 to 180 days	4,046	8,742
181 to 365 days	344	5,310
Over 1 year	67	–
	8,021	28,781

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

23. TRADE AND OTHER RECEIVABLES *(Continued)*

Impairment losses in respect of trade receivables are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written off against trade receivables directly. The movement in the allowance for trade receivables is as follows:

	2007	2006
	HK$'000	*HK$'000*
Balance at beginning of the year	**21,135**	6,265
Impairment loss recognised in profit or loss	**4,324**	14,870
Disposal of subsidiaries	**(23,366)**	–
Balance at end of the year	**2,093**	21,135

At each of the balance sheet dates, the Group's trade debtors were individually determined to be impaired. The individually impaired receivables are recognised based on the credit history of its customers, such as financial difficulties or default in payments, and current market conditions. The Group does not hold any collateral over these balances.

Trade receivables of approximately HK$5,986,000 (2006: HK$21,600,000) that were neither past due nor impaired related to a wide range of customers for whom there was no recent history of default.

Based on past experience, the management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not held any collateral over these balances.

Ageing of trade receivables which are past due but not impaired based on payment due date:

	2007	2006
	HK$'000	*HK$'000*
Current to 90 days	**764**	2,724
91 to 180 days	**860**	2,274
181 to 365 days	**344**	2,183
Over 1 year	**67**	–
Total	**2,035**	7,181

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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24. DEPOSITS PAID FOR ACQUISITION OF SUBSIDIARIES

On 6 November 2007, Super Sino Investment Limited ("Super Sino"), an indirectly wholly-owned subsidiary of the Company entered into a share transfer agreement with an independent third party, Hainan Nanshenghe Company Limited* (海南南聖河實業有限公司) to purchase 51% equity interest in and the shareholder's loan due by Danzhou Lian Shun Tong Water Pipe Company Limited* ("Danzhou Water Pipe") (儋州聯順通自來水管網有限公司) for a consideration of approximately RMB8,680,000. Details of the transaction had been set out in the Company's circular dated 29 November 2007. The transaction has been completed on 22 April 2008. As of 31 December 2007, the Group has paid approximately HK$6,787,000 as deposit for such acquisition.

On 6 November 2007, Super Sino entered into a net asset transfer agreement with the People's Government of Danzhou City, Hainan Province to purchase 49% equity interest in Danzhou Water Pipe and other assets and liabilities of Danzhou City Water Company* (儋州市自來水公司) for a consideration of approximately RMB25,300,000. Details of the transaction had been set out in the Company's circular dated 29 November 2007. The transaction has been completed on 21 February 2008. As of 31 December 2007, the Group has paid approximately HK$20,000,000 as deposit for the acquisition.

On 26 November 2007, Smart Giant Group Limited, a direct wholly-owned subsidiary of the Company entered into an agreement to acquire the entire share capital and a shareholder's loan of Blue Mountain Hong Kong Group Limited for an aggregate consideration of HK$230,000,000. Blue Mountain Hong Kong Group Limited is an investment holding company of which its major associates are engaged in the provision of water supply business and engineering construction work in the PRC. As of 31 December 2007, the Group has paid approximately HK$230,000,000 as deposit and approximately HK$16,361,000 as direct expenses for the acquisition. The transaction has been completed on 18 January 2008. Details of the transaction had been set out in the Company's circular dated 20 December 2007.

On 1 December 2007, Bonus Raider Investments Limited ("Bonus Raider"), a direct wholly-owned subsidiary of the Company entered into an agreement to acquire approximately 67.32% equity interests in iMerchants Limited at an aggregate consideration of approximately HK$198,000,000. iMerchants Limited is a company incorporated in Hong Kong with limited liability whose issued shares are listed on the Growth Enterprise Market of the Stock Exchange. The Group has paid approximately HK$198,000,000 as deposit and approximately HK$542,000 as direct expenses for the acquisition and approximately HK$96,300,000 as deposit for the mandatory cash offer in accordance with Rule 26 of the Hong Kong Code on Takeovers and Mergers as a result of the acquisition. The transaction has been completed on 14 February 2008. Details of the transaction had been set out in the Company's circular dated 25 January 2008.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

25. AMOUNT DUE FROM A RELATED PARTY

	2007	2006
	HK$'000	*HK$'000*
At the balance sheet date	**213**	–
Maximum amount outstanding during the year	**213**	–

The amount due from a related party represents an amount due from Mr. Su Li Xiang, a director of a subsidiary which is unsecured, interest-free and repayable on demand.

26. AMOUNT DUE FROM A MINORITY SHAREHOLDER OF SUBSIDIARIES

The amount due from a minority shareholder of subsidiaries is unsecured, interest-free and repayable on demand.

27. PLEDGED BANK DEPOSITS/CASH HELD AT A FINANCIAL INSTITUTION/BANK BALANCES AND CASH

Bank balances and cash comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less. The deposits carry fixed interest at prevailing market rates.

Cash held at a financial institution represents an amount of HK$30,000,000 (2006: Nil) deposited in a financial institution in Hong Kong carried daily interest rate of 0.0068%.

As at 31 December 2006, pledged deposits had been pledged to secure trust receipt loans and trust receipt acceptance granted to the Group repayable in three months' time and was therefore classified as current assets. The pledged bank deposits were released upon the settlement of relevant banking facilities. The pledged bank deposits at 31 December 2006 carried fixed interest rate at 4.03%.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

28. TRADE AND OTHER PAYABLES

	2007	2006
	HK$'000	*HK$'000*
Current to 30 days	**1,489**	6,615
31 to 90 days	**585**	5,283
91 to 180 days	**741**	1,849
181 to 365 days	**1,559**	1,024
Over 1 year	**868**	2,474
	5,242	17,245
Other payables *(Note)*	**24,528**	61,095
	29,770	78,340

Note: Included in amount for the year ended 31 December 2006 was consideration payables to the former shareholders of two subsidiaries of approximately HK$35,855,000, as considerations to acquire the two subsidiaries, and payable for purchase sewage treatment system of approximately HK$9,387,000.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

29. OBLIGATIONS UNDER FINANCE LEASES

It is the Group's policy to lease certain of its motor vehicles under finance leases. The lease term was four years. Interest rates underlying the obligations under finance leases at 31 December 2006 were fixed at 5.5% per annum. No arrangements have been entered into for contingent rental payments.

	Minimum lease payments		Present value of minimum lease payments	
	2007	2006	**2007**	2006
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Amounts payable under finance leases:				
Within one year	–	164	–	140
In more than one year but not more than two years	–	164	–	140
In more than two years but not more than three years	–	122	–	105
	–	450	–	385
Less: Future finance charge	–	(65)	–	–
Present value of lease obligations	–	385	–	385
Less: Amount due for settlement within one year (shown under current liabilities)			–	(140)
Amount due for settlement after one year			–	245

The Group's obligations under finance leases were secured by the lessor's charge over the leased assets. The finance lease obligations at 31 December 2006 were denominated in functional currency of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

30. BANK BORROWINGS

	2007	2006
	HK$'000	*HK$'000*
Secured bank borrowings repayable within one year	–	6,442

The balance at 31 December 2006 was a fixed-rate borrowing which carried interest at 4% per annum. The borrowing at 31 December 2006 was secured by land and buildings of the Group as disclosed in Note 17 and personal guarantees issued by a director.

31. AMOUNTS DUE TO RELATED PARTIES

The amounts are unsecured, non-interest bearing and repayable on demand.

32. AMOUNTS DUE TO DIRECTORS

The amounts are unsecured, non-interest bearing and repayable on demand.

33. OTHER LOANS

	2007	2006
	HK$'000	*HK$'000*
Government loans:		
Interest-bearing *(Note a)*	8,373	–
Interest-free *(Note b)*	1,114	–
	9,487	–

(a) The amount bears interest of 5% per annum and is unsecured and has no fixed term of repayment.

(b) Interest-free government loans are unsecured and has no fixed term of repayment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

34. SHARE CAPITAL

	2007 Number of shares	2007 Amount HK$'000	2006 Number of shares	2006 Amount HK$'000
Ordinary shares of HK$0.10 each				
Authorised:				
At beginning and end of year	**4,000,000,000**	**400,000**	4,000,000,000	400,000
Issued and fully paid:				
At beginning of year	**1,164,500,000**	**116,450**	734,500,000	73,450
Issue of shares	**530,000,000**	**53,000**	430,000,000	43,000
Exercise of share options	**196,400,000**	**19,640**	–	–
At end of year	**1,890,900,000**	**189,090**	1,164,500,000	116,450

Notes:

(a) On 31 January 2007, the Company entered into a placing and subscription agreement to place up to 230,000,000 shares of the Company at the price of HK$0.49 per share. On 2 February 2007, a total of 230,000,000 shares were issued under such placement arrangement.

(b) On 23 March 2007, the Company entered into a placing agreement to place up to 300,000,000 new shares of the Company at the price of HK$1.06 per share. On 29 March 2007, a total of 300,000,000 shares were issued under such placement arrangement.

(c) During the year ended 31 December 2007, 196,400,000 share options were exercised. Details of which has been set out in Note 46.

(d) On 20 December 2005, the Company entered into a placing agreement to place an aggregate of up to 250,000,000 shares of HK$0.1 each at the placing price of HK$0.11 per share. On 2 February 2006, a total of 250,000,000 shares have been placed.

(e) On 7 November 2006, 180,000,000 new shares of the Company, of par value of HK$0.1 each at the price of HK$0.20 per share, were allotted and issued as part of the consideration to acquire 40% of the equity interests of Onfar International Limited.

All new shares issued during the two years ended 31 December 2006 and 2007 rank pari passu in all respects with other shares in issue.

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35. LONG-TERM BANK AND OTHER BORROWINGS

	Notes	2007 HK$'000	2006 HK$'000
Unsecured borrowing repayable over five years, carrying amount at amortised cost	*(i)*	**938**	857
Secured bank loan	*(ii)*	**32,017**	–
		32,955	857

(i) Pursuant to an agreement entered into between Anhui Dang Shan Water Industry Company Ltd ("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) 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%, and repayable on 28 February 2021.

(ii) The amount represents a bank loan of RMB30,000,000 (equivalent to approximately HK$32,017,000) (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 charge over the subsidiary's revenue from the provision of sewage treatment.

36. LOANS FROM A MINORITY SHAREHOLDER

The loans from a minority shareholder of subsidiaries are unsecured, interest bearing at 6.12% per annum and fully repayable within 5 years.

37. CONVERTIBLE BONDS

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 each year. The convertible bonds may be converted at the option of the convertible bonds holder at a conversion price of HK$1.42 per ordinary share at any time on or after 13 September 2007 and up to 27 July 2012.

Since the conversion price for the bonds is subject to change, the conversion will not result in settlement by the exchange of a fixed number of equity instruments. Therefore, upon application of HKAS 32 and HKAS 39, it was determined that the bonds do not contain any equity component and the entire bonds were designated as "financial liabilities at fair value through profit or loss" which requires that bonds to be carried at fair value at the balance sheet date and the changes in fair values are recognised in the consolidated income statement. During the year, a gain on change in its fair value of approximately HK$58,128,000 is recognised in the consolidated income statement (2006: Nil).

The Company incurred one-off expenses of approximately HK$13,520,000 (2006: Nil) for the issuance of the bonds. Such expenses have been recognised in the consolidated income statement for the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

37. CONVERTIBLE BONDS *(Continued)*

The fair value of the bonds at the balance sheet date was calculated using the market value basis.

	2007
Stock price	HK$0.50
Exercise price	Subject to adjustment but not less than 80% of HK$1.42
Expected volatility	45.94%
Risk fee rate	3.0165%
Option life	4.592 year

38. GOVERNMENT GRANTS

Yichun Water Industry Co. Limited ("Yichun Water"), a subsidiary of the Company, has been granted by the local government of the PRC an aggregate amount of approximately HK$50,787,000 (equivalent to RMB47,586,000) (2006: Nil) for the expansion and construction of water plants and pipelines. As at 31 December 2007, the construction of water plants and pipelines was in progress.

39. ACQUISITION OF SUBSIDIARIES

Year ended 31 December 2007

On 14 May 2007, the Group acquired an additional 60% equity interests in Onfar International Limited. Accordingly, 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 Group contributed revenue of approximately HK$10,252,000 and profit of approximately HK$946,000 to the Group from the 14 May 2007 to 31 December 2007.

On 3 July 2007, the Group acquired 100% of the equity interests in Longwide Investment Limited ("Longwide"). The acquisition has been accounted for using the purchase method. Longwide and its subsidiaries ("Longwide Group") contributed revenue of approximately HK$10,161,000 and loss of approximately HK$2,583,000 to the Group from 3 July 2007 to 31 December 2007.

If the above acquisitions had been completed on 1 January 2007, total Group's turnover for the year from continuing operations would have been increased by approximately HK$54,320,000. 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 acquisitions been completed on 1 January 2007, nor is it intended to be a projection of future results.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

39. ACQUISITION OF SUBSIDIARIES *(Continued)*

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

	2007 Onfar Group fair value *HK$'000*	2007 Longwide Group fair value *HK$'000*	2007 Total fair value *HK$'000*
Net assets acquired:			
Property, plant and equipment, net	76,563	18,483	95,046
Prepaid lease payment for land use rights	9,810	–	9,810
Interests in an associate	–	10,200	10,200
Inventories	6,248	–	6,248
Trade and other receivables	34,992	3,234	38,226
Bank balances and cash	49,694	4,055	53,749
Trade and other payables	(43,238)	(109)	(43,347)
Bank borrowings – repayable within one year	(4,985)	–	(4,985)
Long-term bank and other borrowings	(10,228)	(5,130)	(15,358)
Government grants	(50,786)	–	(50,786)
Minority interests	(38,098)	(10,055)	(48,153)
Net assets	29,972	20,678	50,650
Less: 40% equity interests acquired previously recognised as interest in an associate *(Note 21)*	(11,988)	–	(11,988)
Net assets acquired	17,984	20,678	38,662
Goodwill *(Note 20)*	14,621	32,939	47,560
	32,605	53,617	86,222
Satisfied by:			
Direct cost relating to the acquisition	2,605	162	2,767
Cash consideration paid	30,000	53,455	83,455
	32,605	53,617	86,222

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

39. ACQUISITION OF SUBSIDIARIES *(Continued)*

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition of subsidiaries are as follow:

	2007 Onfar Group *HK$'000*	**2007 Longwide Group** *HK$'000*	**2007 Total fair Value** *HK$'000*
Cash consideration paid	**(30,000)**	**(53,455)**	**(83,455)**
Direct costs relating to the acquisition	**(2,605)**	**(162)**	**(2,767)**
Cash and bank balances acquired	**49,694**	**4,055**	**53,749**
Net inflow (outflow) of cash and cash equivalents in respect of the acquisition of subsidiaries	**17,089**	**(49,562)**	**(32,473)**

Year ended 31 December 2006

On 31 December 2006, the Group acquired 100% of the equity interest of DS Water and 70% of the equity interest of Jining City Heiyuan Water Investment Company Limited ("HY Water"), for considerations of RMB25,198,000 (equivalent to approximately HK$25,113,000) and RMB10,774,000 (equivalent to approximately HK$10,742,000) respectively. The acquisition has been accounted for using the purchase method. The net assets acquired in the transaction and the goodwill arising are as follows:

	2006 DS Water fair value *HK$'000*	**2006 HY Water fair value** *HK$'000*	**2006 Total fair value** *HK$'000*
Net assets acquired:			
Property, plant and equipment, net	28,463	17,005	45,468
Trade and other receivables	1,771	254	2,025
Bank balances and cash	135	2,448	2,583
Trade and other payables	(5,268)	(5,064)	(10,332)
Long-term bank and other borrowings	(857)	–	(857)
Minority interests	–	(4,393)	(4,393)
	24,244	10,250	34,494
Goodwill *(Note 20)*	869	492	1,361
	25,113	10,742	35,855
Satisfied by:			
Other payables to the former shareholders of DS Water and HY Water *(Note 28)*	25,113	10,742	35,855

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

39. ACQUISITION OF SUBSIDIARIES *(Continued)*

Year ended 31 December 2006 *(Continued)*

Net cash inflow arising on acquisition:

	2006
	HK$'000
Cash consideration paid	–
Bank balances and cash acquired	2,583
Net inflow of cash and cash equivalents in respect of the acquisition of subsidiaries	2,583

DS Water and HY Water did not contribute to the Group's turnover or loss for the year ended 31 December 2006 as they were acquired at 31 December 2006. If the acquisitions had been completed on 1 January 2006, total Group's turnover for the year ended 31 December 2006 would have been approximately HK$74,320,000, and loss for the year ended 31 December 2006 would have been approximately HK$95,419,000. 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 acquisitions been completed on 1 January 2006, nor is it intended to be a projection of future results.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

40. DISPOSAL OF SUBSIDIARIES

During the year ended 31 December 2007, the Group disposed the following subsidiaries, the net liabilities of these subsidiaries at the respective dates of disposals were as follows:

	All Favour Limited and its subsidiary *HK$'000*	Pablo and its subsidiaries *HK$'000*	Faith Honest Enterprises Ltd. *HK$'000*	Total *HK$'000*
Net liabilities disposed of:				
Property, plant and equipment	–	15,638	–	15,638
Inventories	–	11,973	–	11,973
Trade and other receivables	–	20,430	–	20,430
Bank balances and cash	–	762	–	762
Trade and other payables	–	(31,913)	–	(31,913)
Tax payables	–	(9,852)	–	(9,852)
Bank borrowings – repayable within one year	–	(6,442)	–	(6,442)
Amounts due to related parties	(23)	(7,514)	(756)	(8,293)
	(23)	(6,918)	(756)	(7,697)
Translation reserve realised on disposal of subsidiaries	–	677	–	677
Gain on disposals	23	6,241	756	7,020
Total consideration *(Note)*	–	–	–	–
Net cash outflow from disposal of subsidiaries	–	(762)	–	(762)

Note: The Group entered into the disposal agreement with an independent third party for the disposal of the entire issued share capital of Pablo for a consideration of HK$1. The impact of Pablo on the Group's results and cash flows in the current and prior periods/year is disclosed in Note 15.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

40. DISPOSAL OF SUBSIDIARIES *(Continued)*

On 28 December 2006, the Group disposed of its entire interest in Mascot Distribution Limited, a wholly-owned subsidiary of the Company. The net liabilities of Mascot Distribution Limited at the date of disposal were as follows:

	2006
	HK$'000
Net liabilities disposed of:	
Property, plant and equipment	265
Inventories	1,700
Trade and other receivables	646
Trade and other payables	(2,747)
	(136)
Gain on disposal	148
Total consideration	12
Satisfied by:	
Cash	12

The subsidiary disposed of during the year ended 31 December 2006 had no significant impact on the turnover and results of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

41. LOSS ON DECONSOLIDATION OF A SUBSIDIARY UNDER A WINDING-UP COURT ORDER

The loss on deconsolidation of a subsidiary under a winding-up court order represented the loss arising on deconsolidation of Technostore Limited ("Technostore"), a subsidiary of the Company, upon the receipt of a winding-up order on Technostore from the High Court of Hong Kong on 7 November 2007. Before its winding-up, the net assets of Technostore at the date of deconsolidation were as follows:

	2007
	HK$'000
Net assets of Technostore:	
Property, plant and equipment	**18**
Bank balances and cash	**515**
Trade and other payables	**(255)**
Amounts due to related parties	**(180)**
Loss on deconsolidation	**98**
Net cash outflow arising from deconsolidation of a subsidiary under winding-up court order	**(515)**

42. MAJOR NON-CASH TRANSACTIONS

(a) During the year ended 31 December 2006, the Company issued 180,000,000 new ordinary shares at par value of HK$0.1 per share at the price of HK$0.2 per share, for a total of HK$36,000,000 to acquire 40% of the equity interest of Onfar International Limited as set out in Note 34.

(b) During the year ended 31 December 2006, the Group acquired the subsidiaries as set out in Note 39, the purchase consideration amounting to approximately HK$35,855,000, which was unpaid at year ended 31 December 2006. This acquisition is not reflected in the consolidated cash flow statement for the year ended 31 December 2006.

43. CAPITAL COMMITMENT

	2007	2006
	HK$'000	*HK$'000*
Capital commitments contracted but not provided for, in respect of acquisition of property, plant and equipment	**25,561**	1,265

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

44. PLEDGED OF ASSETS

Assets with the following carrying amounts have been pledged to secure short-term bank borrowings of the Group (Note 30):

	2007	2006
	HK$'000	*HK$'000*
Freehold land and buildings *(Note 17)*	–	4,540
Pledged bank deposits *(Note 27)*	–	2,061
	–	6,601

In addition, the Group's obligations under finance leases at 31 December 2006 (Note 29) were secured by the lessors' title to the leased assets, which have a carrying amount at 31 December 2006 of HK$440,000.

45. OPERATING LEASE COMMITMENT

The Group leases certain of its factory premises, plant and staff quarters under operating lease arrangements. Leases for properties are negotiated for terms ranging from one to five years. Rental was fixed at the inception of the lease. No provision for contingent rent and terms of renewal were established in the leases.

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

	2007	2006
	HK$'000	*HK$'000*
Within one year	**1,045**	4,872
In the second to fifth year, inclusive	**70**	12,544
More than five years	–	3,174
	1,115	20,590

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

46. 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 31 December 2007, the number of shares in respect of which options had been granted and remained outstanding under the Scheme was 18,000,000 (2006: 98,400,000), representing 0.95% (2006: 8.4%) 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.

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 other eligible persons during both years:

	Outstanding at 1/1/2007	Granted during year	Exercised during year	Cancelled during year	Outstanding at 31/12/2007
Directors	–	28,200,000	(10,200,000)	–	18,000,000
Eligible persons	98,400,000	427,800,000	(186,200,000)	(340,000,000)	–
	98,400,000	456,000,000	(196,400,000)	(340,000,000)	18,000,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

46. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

Equity-settled share option scheme *(Continued)*

During the year ended 31 December 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$40,433,000 (2006: HK$7,635,000).

	Outstanding at 1/1/2006	Granted during year	Exercised during year	Cancelled during year	Outstanding at 31/12/2006
Directors	–	–	–	–	–
Eligible persons	–	98,400,000	–	–	98,400,000
	–	98,400,000	–	–	98,400,000

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 Company's share price 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$40,433,000 for the year ended 31 December 2007 in relation to share options granted by the Company (2006: HK$7,635,000).

The fair value as at 31 December 2006 was calculated using the Black-Scholes pricing model. The inputs into the model were as follows:

	Share options granted on 25 September 2006
Grant date share price	HK$0.167
Exercise price	HK$0.1
Expected volatility	99.96%
Option life	1.5 years
Risk-free rate	effective yield on government bond
Expected dividend yield	0%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

47. RETIREMENT BENEFIT SCHEME

The Group operates a Mandatory Provident Fund Scheme for all qualifying employees in Hong Kong. The assets of the schemes are held separately from those of the Group, in funds under the control of trustees. The Group contributes 5% of relevant payroll costs to the scheme, which contribution is matched by employees.

The employees of the Group's subsidiaries which operates in the PRC are required to participate in the CPS operated by the local municipal governments. These PRC subsidiaries are required to contribute 8% to 10% of its payroll costs to the CPS. The contributions are charged to the income statement as they become payable in accordance with the rules of the CPS.

The total cost charged to consolidated income statement of approximately HK$1,267,000 (2006: HK$647,000) represents contributions payable to these schemes by the Group for the year ended 31 December 2007.

48. PRINCIPAL SUBSIDIARIES

Details of the principal subsidiaries at 31 December 2007, are as follows:

Name of company	Place of incorporation/ operations	Particulars of issued and paid up share capital/ registered capital	Proportion of equity interest held		Principal activities
			Direct	Indirect	
Billion City Investments Limited	British Virgin Islands	1 ordinary share of US$1 each	100%	–	Investment holding
Super Sino	Hong Kong	1 ordinary share of HK$1 each	–	100%	Investment holding
DS Water*	PRC	Registered capital of RMB7,500,000	–	100%	Water Supply
Onfar International Limited	British Virgin Islands	100 ordinary share of US$1 each	–	100%	Investment holding
Yichun* *(Note i)*	PRC	Registered capital of RMB45,500,000	–	51%	Water Supply
Yichun Fangke Waste Water Investment Limited* *(Note i)*	PRC	Registered capital of RMB20,000,000	–	51%	Sewage treatment
Yichun City Water Supply Engineering Limited*	PRC	Registered capital of RMB5,000,000	–	100%	Not yet commenced business

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

48. PRINCIPAL SUBSIDIARIES *(Continued)*

Name of company	Place of incorporation/ operations	Particulars of issued and paid up share capital/ registered capital	Proportion of equity interest held		Principal activities
			Direct	Indirect	
Nourish Gain Investments Limited	British Virgin Islands	1 ordinary share of US$1 each	100%	–	Investment holding
China Ace Investment Limited	Hong Kong	1 ordinary share of HK$1 each	–	100%	Investment holding
HY Water*	PRC	Registered capital of RMB40,000,000	–	70%	Sewage treatment
China Water Industry (HK) Limited	Hong Kong	1 ordinary share of HK$1 each	–	100%	Investment holding
Linyi Fenghuang Water Industry Co. Ltd* *(Note ii)*	PRC	Registered capital of RMB30,000,000	–	60%	Water Supply
Longwide *(Note i)*	Hong Kong	1 ordinary share of HK$1 each	–	100%	Investment holding
Linyi Ganghua Water Industry Company Limited* *(Note i)*	PRC	Registered capital of RMB20,000,000	–	51%	Sewage treatment
South Top Investment Limited	Hong Kong	1 ordinary share of HK$1 each	100%	–	Provision of administrative services
Smart Giant Group Limited *(Note ii)*	British Virgin Islands	1 ordinary share of US$1 each	100%	–	Investment holding
Bonus Raider *(Note ii)*	British Virgin Islands	1 ordinary share of US$1 each	100%	–	Investment holding

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For the year ended 31 December 2007

48. PRINCIPAL SUBSIDIARIES *(Continued)*

Name of company	Place of incorporation/ operations	Particulars of issued and paid up share capital/ registered capital	Proportion of equity interest held		Principal activities
			Direct	Indirect	
Happy Hour Limited	British Virgin Islands	1 ordinary share of US$1 each	100%	–	Investment holding
Mascot Industries Limited	Hong Kong	2 ordinary shares of HK$1 each	–	100%	Trading of watches

The above table lists the subsidiaries of the Company which, in the opinion of the directors of the Company, principally affected the results or assets of the Group. To give details of other subsidiaries would, in the opinion of the directors of the Company, result in particulars of excessive length.

None of the subsidiaries had issued any debt securities subsisting at the end of the year or at any time during the year.

Notes:

(i) Acquired during the year ended 31 December 2007

(ii) Incorporated/established during the year ended 31 December 2007

* The English names are for identification purpose only.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2007

49. BALANCE SHEET OF THE COMPANY

	2007	2006
	HK$'000	*HK$'000*
Non-current assets		
Investments in subsidiaries	–	47,801
Current assets		
Trade and other receivables	**32,228**	172
Amounts due from subsidiaries	**850,832**	79,772
Bank balances and cash	**785**	9
	883,845	79,953
Current liabilities		
Trade and other payables	**993**	1,375
Amounts due to directors	**223**	347
	1,216	1,722
Net current assets	**882,629**	78,231
Total assets less current liabilities	**882,629**	126,032
Non-current liability		
Convertible bonds	**326,872**	–
	555,757	126,032
Capital and reserves		
Share capital	**189,090**	116,450
Share premium	**418,093**	27,905
Share options reserve	**727**	7,635
Contributed surplus	**118,611**	118,611
Accumulated losses	**(170,764)**	(144,569)
	555,757	126,032

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50. POST BALANCE SHEET EVENTS

On 4 February 2008, China Water Industry (HK) Limited entered into a joint venture agreement with Construction Bureau of Yingtan City (the "JV Partner") to establish a joint venture company in Yingtan City in Jiangxi Province of the PRC. The joint venture company will be principally engaged in the provision of water supply and related services in Yingtan City, Jiangxi Province, the PRC. The registered capital of the joint venture company will be approximately RMB82.4 million which will be contributed as to 51% by the Group in cash and 49% by the JV Partner by way of injection of assets. The transaction has not been completed as of the date of issue of these consolidated financial statements. Details of which are set out in the Company's announcement dated 22 February 2008.

FIVE YEARS FINANCIAL SUMMARY

	2003 HK$'000	2004 HK$'000	2005 HK$'000	2006 HK$'000	**2007 HK$'000**
Results					
Turnover	109,440	82,840	61,220	70,134	**94,863**
Finance costs	(279)	(198)	(262)	(494)	**(2,827)**
Loss before tax	(8,264)	(18,807)	(42,541)	(95,406)	**(15,628)**
Income tax expense	(1,272)	406	(1,718)	(336)	**(44)**
Loss for the year attributable to equity holders of the Company (including discontinued operations)	(9,536)	(18,401)	(44,259)	(95,452)	**(24,344)**
Discontinued operations					
Loss for the year from discontinued operations	–	–	–	(70,154)	**(9,349)**
Assets and liabilities					
Property, plant & equipment	41,116	32,576	20,991	64,628	**240,551**
Intangible assets	–	2,825	2,160	–	**–**
Prepaid lease payments	–	–	–	–	**10,143**
Goodwill	–	–	–	1,361	**77,333**
Interest in an associate	–	–	–	36,477	**7,617**
Deposits paid for acquisition of subsidiaries	–	–	–	–	**567,990**
Deferred tax assets	1,312	1,718	–	–	**–**
Net current assets (liabilities)	61,074	56,801	54,861	(43,573)	**132,884**
Assets classified as held for sale	–	–	1,081	–	**–**
	103,502	93,920	79,093	58,893	**1,036,518**
Share capital	41,500	49,500	73,450	116,450	**189,090**
Reserves	62,002	44,420	3,149	(64,722)	**340,601**
Minority interests	–	–	1,960	6,063	**84,475**
Obligations under finance leases	–	–	534	245	**–**
Long-term borrowing	–	–	–	857	**32,955**
Loans from a minority shareholder	–	–	–	–	**11,738**
Covertible bonds	–	–	–	–	**326,872**
Govenment grants	–	–	–	–	**50,787**
	103,502	93,920	79,093	58,893	**1,036,518**
Earnings (loss) per share					
Basic	(2.3 cents)	(3.8 cents)	(7.7 cents)	(9.6 cents)	**(1.4 cents)**