

INTERIM DIVIDEND

The Board has resolved not to declare an interim dividend for the six months ended 30 September 2004.

MANAGEMENT DISCUSSION AND ANALYSIS

Business review

For the period, the Group recorded turnover of approximately HK\$29.4 million (2003: 28.1 million), while loss attributable to shareholders amounted to approximately HK\$8.2 million (2003: 3.1 million). Though the urban water supply and sewage treatment business had recorded profits, the overall business operations remained at a loss owing to severe loss encountered by associates (the Group's share of loss of associates were approximately HK\$3.8 million) and the loss-making electronics business. The loss for the electronics business had been the result of keen competitions in the electronics market, lack of economies of scale and rises in the production costs. The Directors considered it the future way out for the Group to expedite the development of the urban water supply and sewage treatment business, and, with the Group's relevant expertise, to increase the deployment of manpower and resources in the urban water supply and sewage treatment industry, with an aim to realized as soon as possible the Group's turn-around in its business operations. The Group enters the urban water supply and sewage treatment industry carefully and actively, resulting the Group's business heading the positive track. Meantime, the Directors monitored closely and reviewed regularly the performance of the electronics business while formulating strategies to continuously reduce its loss.

Liquidity and financial resources

On 28 April 2004, the Company announced a proposed open offer of new shares on the basis of one offer share for every two shares held on 21 June 2004. The expected gross amount of the open offer is HK\$29.2 million (before expenses). The proposed open offer was approved on the special general meeting on 21 June 2004 and the net proceeds were deposited to the Company's bank account on 19 July 2004. The Company intends to use the net proceeds from the Open offer of about HK\$11 million for its general working capital, as to about HK\$2.3 million for repayment of other payables of the Company, as to about HK\$5.3 million for repayment of the remaining cash consideration for acquisition of two water sewage plants and as to about HK\$9 million for development of water supply business for the Company's joint venture located at Renhua Xian, Guangdong Province, the PRC.

As at 30 September 2004, the Group has used approximately HK\$3 million for repayment of other loans, approximately HK\$ 3 million for repayment of promissory notes, approximately HK\$1.3 million for repayment of other payables of the Company, approximately HK\$3.2 million for repayment of the remaining cash consideration for acquisition of two water sewage plants and approximately HK\$2.5 million has been injected into the Company's joint venture located at Renhua Xian, Guangdong Province, the PRC for development of water supply business.

As at 30 September 2004, the Group had current assets of approximately HK\$45.2 million (31 March 2004: HK\$10.9 million) and current liabilities of approximately HK\$59.8 million (31 March 2004: HK\$ 39.7 million). The Group's current ratio is approximately 0.76 times as at 30 September 2004 as compared with approximately 0.28 times as at 31 March 2004. The Group had total assets of approximately HK\$141 million (31 March 2004: 98.2 million) and total liabilities of approximately HK\$88.2 million (31 March 2004: HK\$68.1 million) representing a gearing ratio (expressed as total liabilities to total assets) of approximately 62.6% as at 30 September 2004 as compared with approximately 69.3% as at 31 March 2004.

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

Prospects

Water is the fundamental natural resource and strategic economic resource for the development of human society and the sustainable utilization of water resource is the uppermost guarantee for the accomplishment of sustainable development of the economic society.

The water services industry is an indispensable emerging industry without life-cycle. From the global angle, the water services market is experiencing its high growth period and thus is possible to achieve higher price earning ratio and stable investment return in the stock market. The production and supply of water, drainage and sewage treatment and etc., all concern the nations' economy and the people's livelihood, and are considered public utilities such as electricity and gas industries and the like, and the focus of development of environmental industries as well. Since its product demand is relatively stable and subject to little economic cycle fluctuations, the overall water services industry is of sound liquidity, stable return and investment-defensive nature.

China is a water-lacking country and her per capita water-use volume is less than 2,200 m³, representing 1/4 of that of the world. As to areas in the northern part, the relevant figure is as low as 990 m³, less than 1/8 of that of the world. Among 669 cities in the country, 400 are lack of water supply, and 110 are severely short of water. Meantime, the utilization of water resource in China is relatively extensive with low water -use rate and serious water wastage. In 2002, the draw-volume/RMB10,000 of GDP of China is 537 m³, four times of the average of the world, while the average recycle rate of industrial water is around 40% as compared to 75% to 85% in the developed countries. Presently, our country is 30 billion to 40 billion m³ lack of water annually, representing the runoff volume of Yellow River in one

year! In the days to come, the demand for water resource will continue to climb in line with the increase in population, the rapid growth of economy and the acceleration of urbanization process, further underlining the contradict of water demand and supply. Water resource, land and oil are considered to be the 3 scarce resources. The price of water in China has been low for years: Starting from the eighties in the previous century, the urban average price of water in China is 10 to 20 cents per ton as compared to the international standard of 7 to 8 dollars per ton, embodying a policy that treats water supply as a kind of grant of social welfare. However, according to economic principle, a scarce resource like water should be of high price, in order to arouse the awareness of water conservation of the Chinese people by price leverage and economic means.

It is stipulated in the State's "Tenth Five-Year" Plan on environmental protection that, by 2005, the domestic sewage centralized treatment rate shall reach 45%, and that of cities with a population of 500,000 or above shall reach 60%; And that by 2010, the sewage treatment rate in all cities shall not be under 60%, and that for municipalities, provincial capitals, municipalities with independent planning and sight-seeing tourism cities shall not be under 70%. It is anticipated that the output value of the water services market in China will increase to RMB 200 billion during the period of the "Tenth Five-year" Plan. Influenced by the above stipulations, by 2010, the annual growth rate of the water services market in China will maintain at 15% or above. Water supply production enterprises and sewage treatment enterprises will become the biggest beneficiaries of water price rises in the future.

Along with the unceasing improvement of urban living standard, urban water supply turns out to be the growth focus of the water supply market. In accordance with the "Tenth Five-Year" Plan and coupled with the vigorous initiatives carried out by relevant authorities of the State in relation to water price reform, conservation of water and protection of water resource, it is believed that the price of tap-water and sewage treatment will see gradual rise, implying a promising prospect for the water services industry of China.

The Group has made investment in the urban water supply and sewage treatment business, and has recorded a revenue of RMB7,500,000 and profit return in the first half-year. It is expected that in the second half-year the revenue and profit from the existing urban water supply and sewage treatment business projects will be increased. Besides, the Group will continue to develop with more initiative the urban water supply and sewage treatment business and to identify and secure quality water-supply and sewage treatment projects by merger and acquisition, with an aim to lay a firm foundation for the Group's long-term development and profitability to reward its shareholders. On the other hand, the Group's senior management have abundant industry expertise and extensive interpersonal relationship, and, by invitation, the Group is fortunate enough to have Mr. Zhou Wen Zhi joined us. Mr. Zhou Wen Zhi was a former vice-minister of the Ministry of Water Resources of China with more than ten years of experience in the construction and development of water conservancy projects. Mr. Zhou Wen Zhi has been appointed the Group's non-executive director, and is believed to be conducive to the Group's identification of quality water conservancy investment projects with his professional knowledge.

Change of name

To reflect the change in the business focus of the Group, the Directors propose to change the English name of the Company from "China Silver Dragon Group Limited" to "China Water Affairs Group Limited" and to adopt the new name Chinese name "中國水務集團有限公司" in place of its current Chinese name "中國銀龍集團有限公司" for identification purposes only. A special general meeting has been held on 6 December 2004 and the proposal has been approved by the shareholder. The adoption of new name is still subject to the approval of the Registrar of Companies in Bermuda. A further announcement in this regard and relating to the change of stock short names will be made when the proposed change of English name of the Company and the adoption of new Chinese name become effective.

Employees and remuneration policies

As at 30 September 2004, the Group had approximately 620 full-time employees. Most of them station in the PRC while the remaining in Hong Kong. The remuneration package of the employees is determined by various factors including the employees' experience and performance, the market condition, industry practice and applicable employment law.

COMPLIANCE WITH CODE OF BEST PRACTICE

In the opinion of the directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules during the six months ended 30 September 2004, except that the independent non-executive directors of the Company are not appointed for specific terms, but are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the provisions of the Company's Bye-laws.