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(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 1129)

ANNOUNCEMENT OF UNAUDITED INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2010

The Board of Directors (the “Board”) of China Water Industry Group Limited (the “Company”) is pleased to announce the unaudited condensed consolidated financial results of the Company and its subsidiary (collectively referred to as the “Group”) for the six months ended 30 June 2010 (the “Interim Period”), together with comparative figures for the corresponding period in 2009. These interim financial statements have not been audited but have been reviewed by the Company’s Audit Committee.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the six months ended 30 June 2010

		Six months ended 30 June	
		2010	2009
	<i>Notes</i>	HK\$’000	HK\$’000
		(Unaudited)	(Unaudited)
Turnover		94,541	128,710
Revenue	4	88,951	83,706
Cost of sales		(49,439)	(58,989)
Gross profit		39,512	24,717
Net gain (loss) on disposal of available-for-sale investments		3,180	(28,612)
Change in fair value of convertible bonds		(22,385)	(131,278)
Gain on disposal of subsidiaries/business		–	17,054
Other operating income		4,687	2,266
Selling and distribution costs		(5,248)	(4,485)
Administrative expenses		(63,972)	(35,460)
Share of results of associates		211	(2,330)
Finance costs		(10,891)	(2,911)
Loss before tax	5	(54,906)	(161,039)
Income tax expense	6	(3,632)	(1,223)
Loss for the period		(58,538)	(162,262)

	Six months ended 30 June	
	2010	2009
	<i>Notes</i> HK\$'000 (Unaudited)	HK\$'000 (Unaudited)
Other comprehensive income (expense) for the period, net of tax		
Share of exchange reserve of an associate	484	—
Exchange difference arising on translation	2,880	2,643
Change in fair value of available-for-sale investments	(19,088)	89,650
Release of investment revaluation reserve upon disposal of available-for-sale investments	(4,346)	—
Total comprehensive expense for the period, net of tax	(78,608)	(69,969)
Loss for the period attributable to:		
Owners of the Company	(55,604)	(161,836)
Non-controlling interests	(2,934)	(426)
	(58,538)	(162,262)
Total comprehensive income (expense) attributable to:		
Owners of the Company	(75,518)	(85,485)
Non-controlling interests	(3,090)	15,516
	(78,608)	(69,969)
Loss per share	7	
Basic and diluted	HK(2.05 cents)	HK(8.45 cents)

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 30 June 2010

		At 30 June 2010 <i>HK\$'000</i> (Unaudited)	At 31 December 2009 <i>HK\$'000</i> (Audited)
	<i>Notes</i>		
Non-current assets			
Property, plant and equipment	9	102,622	103,164
Prepaid lease payments		42,663	42,854
Concession intangible assets		429,712	416,718
Intangible assets		884,447	915,301
Goodwill		250,995	250,995
Available-for-sale investments		79,905	65,040
Interest in an associate		58,548	57,853
Deposit paid for acquisition of subsidiaries		50,901	50,901
		<u>1,899,793</u>	<u>1,902,826</u>
Current assets			
Inventories		15,516	13,304
Trade and other receivables	10	138,282	74,600
Amounts due from customers for contract works		10,975	10,884
Amounts due from a minority shareholder of a subsidiary		238	—
Prepaid lease payments		1,164	1,181
Cash held at financial institutions		101,731	212,474
Bank balances and cash		84,443	65,383
		<u>352,349</u>	<u>377,826</u>
Current liabilities			
Trade and other payables	11	159,061	138,959
Amounts due to customers for contract works		—	657
Bank borrowings – repayable within one year		33,292	33,017
Other loans – repayable within one year		35,979	33,813
Amounts due to minority shareholders of subsidiaries		10,885	8,258
Convertible bonds	12	489,124	466,739
Tax payables		2,286	3,000
		<u>730,627</u>	<u>684,443</u>
Net current liabilities		<u>(378,278)</u>	<u>(306,617)</u>
		<u><u>1,521,515</u></u>	<u><u>1,596,209</u></u>

		At 30 June 2010 <i>HK\$'000</i> (Unaudited)	At 31 December 2009 <i>HK\$'000</i> (Audited)
	<i>Notes</i>		
Capital and reserves			
Share capital	13	270,638	270,638
Reserves		108,190	190,659
Equity attributable to owners of the Company		378,828	461,297
Non-redeemable convertible preference shares of a subsidiary	14	570,096	587,696
Equity component of convertible bonds of a subsidiary	15	84,045	84,045
Non-controlling interests		231,957	210,496
Total equity		1,264,926	1,343,534
Non-current liabilities			
Bank borrowings – due after one year		20,664	23,909
Other loans – due after one year		43,967	44,902
Convertible bonds of a subsidiary	15	125,230	118,427
Government grants		60,541	60,040
Deferred tax liabilities		6,187	5,397
		256,589	252,675
		1,521,515	1,596,209

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL INFORMATION

For the six months ended 30 June 2010

1. COMPANY INFORMATION

China Water Industry Group Limited (the “Company”) was incorporated in the Cayman Islands as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”).

The addresses of the registered office and principal place of business of the Company are Room 1207, 12/F, West Tower, Shun Tak Centre, 168-200 Connaught Road Central, Sheung Wan, Hong Kong.

The Company and its subsidiaries (the “Group”) are principally engaged in provision of water supply and sewage treatment as well as construction services in the PRC; investments in financial products and others.

2. BASIS OF PREPARATION

The condensed consolidated interim financial information have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on the Stock Exchange (the “Listing Rules”) and with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting”, issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”).

The Group reported an unaudited consolidated loss attributable to owners of the Company of approximately HK\$55,604,000 for the period ended 30 June 2010 and had an unaudited consolidated net current liabilities of approximately HK\$378,278,000 as at 30 June 2010. The condition indicates the existence of a material uncertainty which may cast significant doubt on the Group's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liability in the normal course of business. Nevertheless, the directors of the Company are of the opinion that the Group will have sufficient working capital to meet its financial obligations as and when they fall due for the next twelve months from 30 June 2010 following the completion of placing of shares of the Company and the restructuring of the existing convertible bonds as set out in note 21.

3. PRINCIPAL ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial information have been prepared under the historical cost basis, except for certain financial instruments, which are measured at fair values.

The accounting policies used in the condensed consolidated interim financial information are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2009 except for as described below.

In the current interim period, the Group has applied the following new and revised standards, amendments and interpretations ("INTs") (herein collectively referred to as ("new and revised HKFRSs"), issued by the HKICPA.

HKFRSs (Amendments)	Amendment to HKFRS 5 as part of improvements to HKFRSs 2008
HKFRSs (Amendments)	Improvements to HKFRSs 2009
Hong Kong Accounting Standard ("HKAS") 1 (Revised 2007)	Presentation of Financial Statements
HKAS 23 (Revised 2007)	Borrowing Cost
HKAS 32 and HKAS 1 (Amendments)	Puttable Financial Instruments and Obligations Arising on Liquidation
HKAS 1 (Amendment)	Additional Exemptions for First-time Adopters
HKFRS 1 & HKAS 27 (Amendments)	Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate
HKFRS 2 (Amendment)	Vesting Conditions and Cancellations
HKFRS 2 (Revised)	Group Cash-settled Share-based Payment Transactions
HKFRS 7 (Amendment)	Improving Disclosures about Financial Instruments
HKFRS 8	Operating Segments
HK(IFRIC)-INT 9 & HKAS 39 (Amendments)	Embedded derivatives
HK(IFRIC) – INT 13	Customer Loyalty Programmes
HK(IFRIC) – INT 15	Agreements for the Construction of Real Estate
HK(IFRIC) – INT 16	Hedges of a Net investment in a Foreign Operation
HK(IFRIC) – INT 18	Transfers of Assets from Customers

Except as described below, the adoption of the new and revised HKFRSs had no material effect on the condensed consolidated interim financial information of the Group for the current and prior accounting periods.

HKAS 27 (Revised 2008) Consolidated and Separate Financial Statements

The application of HKAS 27 (Revised 2008) has resulted in changes in the Group's accounting policies regarding increases or decreases in ownership interests in subsidiaries of the Group. In prior years, in the absence of specific requirements in HKFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised when appropriate. The impact of decreases in interests in subsidiaries that did not involve loss of control (being the difference between the consideration received and the carrying amount of the share of net assets disposed of) was recognised in profit or loss. Under HKAS 27 (Revised 2008), all increases or decreases in such interests are dealt with in equity, with no impact on goodwill or profit or loss.

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires that the Group derecognises all assets, liabilities and non-controlling interests at their carrying amount. Any retained interest in the former subsidiary is recognised at its fair value at the date the control is lost. A gain or loss on loss of control is recognised in profit or loss as the difference between the proceeds, if any, and these adjustments.

In respect of the deemed disposal during the period of part of the Group's interest in iMerchants, the impact of the change in policy has been that the difference of HK\$6,951,000 between the conversion amount of the non-redeemable convertible preference shares of iMerchants and the increase in the carrying amount of the non-controlling interests has been recognised directly in equity. Had the previous accounting policy been applied, this amount would have been recognised in profit or loss. Therefore, the change in accounting policy has resulted in an increase in the loss for the period of approximately HK\$6,951,000.

The Group has not early applied the following new and revised standards, amendments or interpretations that have been issued but are not yet effective.

HKFRSs (Amendments)	Improvements to HKFRSs 2009 ¹
HKAS 24 (Revised)	Related Party Disclosures ⁴
HKAS 32 (Amendment)	Classification of Rights Issues ²
HKFRS 1 (Amendment)	Limited Exemption from Comparative HKFRS 7 Disclosures for First-time Adopters ³
HKFRS 9	Financial Instruments ⁵
HK(IFRIC)-INT 14 (Amendment)	Prepayments of a Minimum Funding Requirement ⁴
HK(IFRIC)-INT 19	Extinguishing Financial Liabilities with Equity Instruments ³

¹ Amendments that are effective for annual periods beginning on or after 1 July 2010 and 1 January 2011 as appropriate.

² Effective for annual periods beginning on or after 1 February 2010.

³ Effective for annual periods beginning on or after 1 July 2010.

⁴ Effective for annual periods beginning on or after 1 January 2011.

⁵ Effective for annual periods beginning on or after 1 January 2013.

HKFRS 9 Financial Instruments introduces new requirements for the classification and measurement of financial assets and will be effective from 1 January 2013, with earlier application permitted. The standard requires all recognised financial assets that are within the scope of *HKAS 39 Financial Instruments: Recognition and Measurement* to be measured at either amortised cost or fair value. Specifically, debt investments that (i) are held within a business model whose objective is to collect the contractual cash flows and (ii) have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost. All other debt investments and equity investments are measured at fair value. The application of *HKFRS 9* might affect the classification and measurement of the Group's financial assets.

The directors of the Company anticipate that the application of the other new and revised standards, amendments or interpretations will have no material impact on the condensed consolidated interim financial information.

4. SEGMENT INFORMATION

The Group's operating segments, based on information reported to the chief operating decision maker who are directors of the Company, for the purposes of resource allocation and performance assessment are as follows:

(a)	Provision of water supply and sewage treatment as well as construction services	Provision of water supply and sewage treatment and construction of water supply and sewage treatment infrastructure
(b)	Investments in financial products	Investments in financial and investment products
(c)	All others	Mainly represents manufacturing and trading of ceramic sewage materials and others

The unaudited segment information about these businesses is presented below:

For the six months ended 30 June (Unaudited)

	Provision of water supply and sewage treatment as well as construction services		Investments in financial products		All others		Total	
	2010	2009	2010	2009	2010	2009	2010	2009
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Sales to external customers	82,553	80,367	–	–	6,398	3,339	88,951	83,706
Segment results	15,833	2,405	(27,692)	(28,611)	2,358	(527)	(9,501)	(26,733)
Unallocated corporate income and expenses							(45,405)	(134,306)
Loss before tax							(54,906)	(161,039)

Segment loss represents the loss from each segment without allocation of central administrative costs, change in fair value of convertible bonds, directors' and supervisors' salaries, interest income and finance costs. This is the measure reported to the chief operating decision maker for the purposes of resources allocation and segment performance assessment.

The followings is an analysis of the Group's assets by operating segments:

	30 June 2010 HK\$'000 (Unaudited)	31 December 2009 HK\$'000 (Audited)
Provision of water supply and sewage treatment as well as construction services	918,332	864,420
Investments in financial products	1,144,872	1,247,145
All others	34,627	29,070
Total segment assets	2,097,831	2,140,635

5. LOSS BEFORE TAX

	Six months ended 30 June	
	2010	2009
	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)
Loss before tax has been arrived at after charging (crediting):		
Staff costs including directors' emoluments		
– salaries, wages and other benefits	18,966	19,789
– retirement benefits scheme contributions	3,724	1,180
Total staff costs	22,690	20,969
Amortisation of prepaid lease payments for land use rights	547	652
Amortisation of concession intangible assets (included in cost of sales)	7,482	10,978
Amortisation of an intangible asset	30,854	–
Impairment loss on trade and other receivables	2	1,089
Cost of inventories recognised as expenses	16,601	10,133
Depreciation of property, plant and equipment	2,722	2,993
Minimum lease payments under operating leases	1,901	1,677
(Gain) loss on disposal of property, plant and equipment	(18)	117
Bank interest income	(79)	(112)
Net exchange (gain) loss	(2)	138

6. INCOME TAX EXPENSE

	Six months ended 30 June	
	2010	2009
	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)
PRC Enterprise Income Tax ("EIT")		
– current period	2,842	1,223
Deferred tax	790	–
	3,632	1,223

Hong Kong Profits Tax is calculated at 16.5% (six months ended 30 June 2009: 16.5%) of the estimated assessable profit for the six months ended 30 June 2010.

Hong Kong Profits Tax has not been provided for in the condensed consolidated interim financial information for the six months ended 30 June 2010 and 2009 as there was no estimated assessable profit derived from Hong Kong for both periods.

Pursuant to the relevant laws and regulations in the PRC, certain subsidiaries are exempted from PRC EIT for two years from the first profit making year, followed by a 50% reduction for the next three years. The relevant tax rates for the Group's subsidiaries in the PRC range from 15% to 25% (six months ended 30 June 2009: 15% to 25%).

7. LOSS PER SHARE

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

	Six months ended 30 June	
	2010 HK\$'000 (Unaudited)	2009 HK\$'000 (Unaudited)
Loss		
Loss for the period attributable to the owners of the Company for the purposes of basic loss per share	(55,604)	(161,836)
Effect of dilutive potential shares:		
– Interest on convertible bonds	481	481
– Change in fair value of convertible bonds	22,385	131,278
Loss for the purposes of diluted loss per share	<u>(32,738)</u>	<u>(30,077)</u>
Number of shares	'000	'000
Weighted average number of ordinary shares for the purpose of basic loss per share	2,706,379	1,914,966
Effect of dilutive potential shares:		
– Share options issued by the Company (<i>Note</i>)	–	–
– Conversion of convertible bonds	338,908	338,908
Weighted average number of ordinary shares for the purpose of diluted loss per share	<u>3,045,287</u>	<u>2,253,874</u>

Note: The computation of diluted loss per share does not assume the exercise of the Company's outstanding share options as exercise price of those options is higher than the average market price of shares for the periods ended 30 June 2010 and 2009.

Diluted loss per share was same as the basic loss per share for the six months ended 30 June 2010, as the effect of the conversion of the Company's outstanding share options and convertible bonds as well as the outstanding convertible bonds and non-redeemable preference shares issued by iMerchants was anti-dilutive for the six months ended 30 June 2010.

Diluted loss per share was same as the basic loss per share for the six months ended 30 June 2009, as the effect of the conversion of the Company's outstanding share options and convertible bonds was anti-dilutive for the six months ended 30 June 2009.

8. DIVIDENDS

No dividends were paid or proposed during the six months ended 30 June 2010 and 2009, nor has any dividend been proposed since the end of reporting period (six months ended 30 June 2009: nil).

9. PROPERTY, PLANT AND EQUIPMENT

During the six months ended 30 June 2010, the Group acquired property, plant and equipment amounted to approximately HK\$795,000 (six months ended 30 June 2009: approximately HK\$3,392,000) and disposed of property, plant and equipment with carrying amount of approximately HK\$302,000 (six months ended 30 June 2009: approximately HK\$25,450,000).

10. TRADE AND OTHER RECEIVABLES

	At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
Trade receivables	27,823	14,983
Less: impairment loss recognised	(5,839)	(5,807)
	<u>21,984</u>	<u>9,176</u>
Other receivables	116,750	76,619
Less: impairment loss recognised	(14,450)	(14,400)
Deposits and prepayment	13,998	3,205
	<u>138,282</u>	<u>74,600</u>

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

An aged analysis of trade receivables net of impairment loss recognised, based on invoice date was as follows:

	At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
Within 90 days	9,097	3,537
91 to 180 days	9,468	4,889
181 to 365 days	2,799	710
Over 1 year	620	40
	<u>21,984</u>	<u>9,176</u>

11. TRADE AND OTHER PAYABLES

The following is an analysis of trade payables, presented based on the invoice date:

	At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
Within 30 days	2,481	5,067
31 to 90 days	1,388	1,907
91 to 180 days	4	555
181 to 365 days	752	587
Over 1 year	2,882	2,464
	<u>7,507</u>	<u>10,580</u>
Other payables	81,905	61,323
Interest payables	69,649	67,056
	<u>159,061</u>	<u>138,959</u>

12. CONVERTIBLE BONDS

At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
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Convertible bonds issued by the Company:

At the beginning of the period/year	466,739	262,335
Change in fair value of convertible bonds	22,385	204,404
At the end of the period/year	489,124	466,739

On 3 August 2007, the Company issued convertible bonds ("CB I") in aggregate principal amounts of HK\$385 million. CB I bears interest at the rate of 0.25% per annum, starting from 3 August 2007, payable semi-annually in arrear on 3 February and 3 August each year. CB I 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.

The conversion price was subsequently adjusted to HK\$1.136 on 3 February 2008 in accordance with the terms and conditions stated in the bond purchase agreement dated 30 July 2007.

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 end of the reporting period and the changes in fair values are recognised in the consolidated statement of comprehensive income.

The fair value of the bonds at the end of each reporting period was calculated using the market value basis. Major parameters adopted in the calculation of the fair value are summarised below:

	At 30 June 2010	At 31 December 2009
Stock price	HK\$0.10	HK\$0.232
Exercise price	Subject to adjustment but not less than 80% of HK\$1.42	Subject to adjustment but not less than 80% of HK\$1.42
Expected volatility	84.91%	53.02%
Risk-free rate	0.765%	1.117%
Option life	2.095 years	2.592 years

13. SHARE CAPITAL

	At 30 June 2010 (Unaudited)		At 31 December 2009 (Audited)	
	Number of shares	Amount HK\$'000	Number of shares	Amount HK\$'000
Authorised capital:				
Ordinary shares of HK\$0.1 each				
At beginning of the period/year	8,000,000,000	800,000	4,000,000,000	400,000
Increase during the period/year (note 1)	–	–	4,000,000,000	400,000
	8,000,000,000	800,000	8,000,000,000	800,000
Convertible preference shares of HK\$0.1 each (note 1)	2,000,000,000	200,000	2,000,000,000	200,000
	10,000,000,000	1,000,000	10,000,000,000	1,000,000
Issued and fully paid:				
At beginning of the period/year	2,706,379,000	270,638	1,890,900,000	189,090
Issue of shares (note 2)	–	–	815,479,000	81,548
	2,706,379,000	270,638	2,706,379,000	270,638

Note:

- (1) Pursuant to an ordinary resolution passed at the annual general meeting held on 29 June 2009, the Company's authorised share capital was increased from HK\$400,000,000 to HK\$1,000,000,000 by the creating of 4,000,000,000 ordinary shares of HK\$0.1 each and 2,000,000,000 convertible preference shares of HK\$0.1 each.
- (2) On 19 June 2009, pursuant to a placing and subscription agreement entered into with existing shareholders, the Company placed out 365,000,000 new ordinary shares of HK\$0.1 each in the Company at a price of HK\$0.33 per share. A sum of net amount approximately HK\$116,910,000 was raised and used as working capital of the Group.

On 6 August 2009, pursuant to a placing and subscription agreement entered into with existing shareholders, the Company placed out 450,479,000 new ordinary share of HK\$0.1 each in the Company at a price of HK\$0.295 per share. A sum of net amount approximately HK\$128,990,000 was raised and used as working capital of the Group.

All new shares issued during the year ended 31 December 2009 ranked *pari passu* in all respects with other shares in issue.

14. NON-REDEEMABLE CONVERTIBLE PREFERENCE SHARES OF A SUBSIDIARY

	Number of shares '000	Amount HK\$'000
Authorised:		
At 1 January 2009 and 31 December 2009		
Non-redeemable convertible preference shares of HK\$0.2 each	4,000,000	800,000
Subdivision of preference share of HK\$0.2 each into five shares of HK\$0.04 each (<i>note</i>)	16,000,000	—
	<u>20,000,000</u>	<u>800,000</u>
At 31 December 2009 and 30 June 2010, HK\$0.04 each		
Issued and fully paid:		
At 1 January 2009	—	—
Issue of preference shares of a subsidiary, HK\$0.2 each	2,938,478	587,696
Subdivision of preference share of HK\$0.2 each into five shares of HK\$0.04 each (<i>note</i>)	11,753,912	—
	<u>14,692,390</u>	<u>587,696</u>
At 31 December 2009, HK\$0.04 each		
Conversion during the period	(440,000)	(17,600)
	<u>14,252,390</u>	<u>570,096</u>
At 30 June 2010, HK\$0.04 each		

Note: Pursuant to an ordinary resolution passed by the iMerchants' shareholders at an extraordinary general meeting held on 30 October 2009, the existing issued and unissued for both ordinary and non-redeemable convertible preference shares of HK\$0.2 each in the share capital of iMerchants are subdivided into 5 shares of HK\$0.04 each. The authorised share capital of iMerchants was remained at HK\$1,200,000,000. The share subdivision took place on 2 November 2009.

15. CONVERTIBLE BONDS OF A SUBSIDIARY

On 23 October 2009, iMerchants issued zero-couple convertible bonds ("CB II") with an aggregate principal amount of HK\$200,000,000 to vendors as a partial consideration for the acquisition of a subsidiary. CB II entitled the holders to convert the bonds into ordinary shares of iMerchants at any time between the date of issue of the bonds and their settlement date on 23 October 2014 in multiples of HK\$1,000,000 at the conversion price of HK\$0.2 (subject to adjustment) per conversion share. The conversion price was subsequently adjusted to HK\$0.04 per share as a result of the share subdivision of iMerchants on 30 October 2009. No conversion shall be made, if immediately upon such conversion, the bondholder and its parties acting in concert with in aggregate hold more than 9.9% of the issued share capital of iMerchants from time to time; and/or the public float of iMerchants' shares is less than 15% of the total issued shares of iMerchants. iMerchants has an early redemption option to redeem in whole or in part at par before the maturity date by serving seven days' prior written notice, any amount of the bonds remains outstanding on the maturity date shall be redeemed at its then outstanding amount.

The convertible bonds contain two components, liability and equity elements. The equity element is presented in equity heading "equity component of convertible bonds of a subsidiary". The effective interest rate of the liability component is 11.52% per annum.

The movement of CB II is as follows:

	Liability component HK\$'000	Equity component HK\$'000	Total HK\$'000
At date of issue	115,955	84,045	200,000
Imputed interest charge for the year	2,472	–	2,472
At 31 December 2009	118,427	84,045	202,472
Imputed interest charge for the period	6,803	–	6,803
At 30 June 2010	<u>125,230</u>	<u>84,045</u>	<u>209,275</u>

16. DEEMED PARTIAL DISPOSAL OF INTEREST IN A SUBSIDIARY

On 8 and 9 June 2010, an aggregate amount of 440,000,000 ordinary shares of iMerchants were issued and allotted upon the conversion of non-redeemable preference shares of iMerchants with an aggregate principal amount of HK\$17,600,000 at an issue price of HK\$0.04 each (the “Conversion”). After the Conversion, the Group’s equity interests in iMerchants were diluted by approximately 9.43% from 76.66% to 67.23%. The difference between the increase in the non-controlling interests and the conversion of the amount of the non-redeemable convertible preference shares of iMerchants with an amount of approximately HK\$6,951,000 was recognised in other reserve.

17. CAPITAL COMMITMENT

	At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
Capital commitments contracted but not provided for, in respect of acquisition of concession intangible assets and property, plant and equipment	<u>443</u>	<u>7,514</u>

18. OPERATING LEASE COMMITMENTS

At the end of the reporting period, the Group had future minimum lease payments under non-cancellable operating leases which fall due as follows:

	At 30 June 2010 HK\$'000 (Unaudited)	At 31 December 2009 HK\$'000 (Audited)
Within one year	1,960	3,242
In the second to fifth years, inclusive	<u>19</u>	<u>803</u>
	<u>1,979</u>	<u>4,045</u>

19. SHARE-BASED PAYMENT TRANSACTIONS

The Company has a share option scheme for eligible directors and employees of the Group. Details of the share options outstanding are as follows:

	Number of share options Six months ended 30 June	
	2010	2009
Outstanding at the beginning of the period	18,000,000	18,000,000
Lapsed during the period	(10,000,000)	—
Outstanding at the end of the period	<u>8,000,000</u>	<u>18,000,000</u>

No share options were granted/exercised during the six months ended 30 June 2010 and 2009.

During the period ended 30 June 2010, one eligible employee had resigned all the positions from the Group and share options granted to the employee were then lapsed.

20. DISPOSAL OF SUBSIDIARIES/BUSINESS

- (a) On 2 April 2009, the Group disposed of its 100% interests in Longwide Investment Limited and its subsidiaries (the “Longwide Group”) and a shareholder’s loan amounting to approximately HK\$57,000 to Bright Blue Investments Limited, an independent third party, at a consideration of approximately HK\$50,000,000. The net assets of Longwide Group at the date of disposal were as follows:

	HK\$’000
Net assets disposed of:	
Property, plant and equipment	22,191
Prepaid lease payments	33,190
Concession intangible assets	205,109
Inventories	2,008
Trade and other receivables	23,733
Bank balances and cash	3,032
Trade and other payables	(84,470)
Amount due to a minority shareholder of a subsidiary	(163,074)
Amount due to the shareholder	(57)
Loan from a minority shareholder of a subsidiary	(3,379)
Deferred tax liabilities	(735)
Non-controlling interests	(19,239)
	<u>18,309</u>
Shareholder’s loan disposed of	57
Exchange reserve realised on disposal of subsidiaries	(5,007)
Attributable goodwill	28,087
Gain on disposal	<u>8,554</u>
Total consideration	<u>50,000</u>
Satisfied by:	
Cash	<u>50,000</u>
Net cash inflow arising on disposal:	
Cash consideration received	50,000
Bank balances and cash disposed of	<u>(3,032)</u>
	<u>46,968</u>

Note:

The Longwide Group disposed of during the six months ended 30 June 2009 had contributed approximately HK\$8,066,000 to the Group's turnover and contributed approximately HK\$7,283,000 to the Group's loss for that period.

- (b) On 15 April 2009, the Group disposed of its assets and liabilities of a branch of Jining City Haiyuan Water Treatment Company Ltd* ("Jining Haiyuan"), an indirect non wholly owned subsidiary of the Company to an independent third party at a consideration of approximately HK\$10,000,000. The assets and liabilities of Jining Haiyuan at the date of disposal were as follows:

	<i>HK\$'000</i>
Net assets and liabilities disposed of:	
Property, plant and equipment	2,922
Concession intangible assets	28,016
Inventories	7
Trade and other receivables	1,844
Bank balances and cash	599
Trade and other payables	(31,022)
Amount due to a minority shareholder of a subsidiary	(104)
Deferred tax liabilities	(70)
Non-controlling interests	(658)
	<u>1,534</u>
Exchange reserve realised on disposal of business	(34)
Gain on disposal	<u>8,500</u>
Total consideration	<u><u>10,000</u></u>
Satisfied by:	
Cash	<u><u>10,000</u></u>
Net cash inflow arising on disposal:	
Cash consideration received	10,000
Bank balances and cash disposed of	<u>(599)</u>
	<u><u>9,401</u></u>

Note:

Jining Haiyuan disposed of during the six months ended 30 June 2009 had contributed approximately HK\$1,442,000 to the Group's turnover and contributed approximately HK\$89,000 to the Group's loss for that period.

21. EVENTS AFTER THE END OF THE INTERIM PERIOD

- (a) On 9 August 2010, Boost Skill Investments Limited (the "Vendor") which is one of the shareholders of the Company, the placing agent and the company entered into a top-up placing and subscription agreement (the "Agreement"). Pursuant to the Agreement, the Vendor agreed to place through the placing agent on a best effort basis, up to 265,476,000 ordinary shares at a price of HK\$0.108 per share. The Vendor conditionally agreed to subscribe for 265,476,000 ordinary shares of the Company at a price of HK\$0.108 per share.

The top-up placing has been completed on 12 August 2010.

- (b) On 13 August 2010, the Company entered into agreements with the investors which collectively holding approximately 79% of CB I (the “Majority Investors”), pursuant to which the Majority Investors have agreed to a consensual restructuring of their respective rights and obligations under CB I.

The total consideration payable to the Majority Investors by the Company is approximately HK\$403,000,000 in cash and in kind in the form of a new convertible bond due in 2012 in the aggregate principal amount of HK\$337,000,000. Such total consideration shall be payable by the Company to Majority Investors in a series of installments commencing from August 2010 and ending in August 2012. Details of this transaction are stated in an announcement of the Company dated 13 August 2010.

22. CONTINGENT LIABILITY

Super Sino Investment Limited (“Super Sino”), an indirectly wholly-owned subsidiary of the Company

On 6 November 2007, the People’s Government of Danzhou City and Super Sino entered into a net asset transfer agreement, pursuant to which all assets and liabilities of Danzhou City Water were transferred to Super Sino. On 26 June 2008, Super Sino was notified that Agricultural Bank of China, Danzhou Branch (“the Plaintiff”) filed a claim regarding the liabilities transferred by Danzhou City Water with the Court against Danzhou City Water, Super Sino, Danzhou Urban Development Corporation and the People’s Government of Danzhou City for the repayment of the loan principal of approximately HK\$29,848,000 (equivalent to RMB26,000,000) (31 December 2009: HK\$29,601,000) and the interests of approximately HK\$48,212,000 (equivalent to RMB41,996,000) (31 December 2009: HK\$46,949,000) arising from the defendants of Danzhou City Water and Super Sino to the plaintiff.

On 13 November 2009, the Court issued a civil verdict, pursuant to which Super Sino was ordered to fully repay the loan principal of RMB26,000,000 together with the interest thereon.

On 17 December 2009, the Plaintiff made on appeal to the Higher People’s Court of Hainan Province court seeking the fulfilment of the guarantee responsibility of Danzhou Urban Development Corporation. Therefore, this litigation is still in the second instance for the final sentence to be made by the Higher People’s Court of Hainan Province. As advised by the Company’s legal counsel, the verdict issued by the Court is not legally binding before the sentence of the Higher People’s Court of Hainan Province. Following the issue of the verdict, the Plaintiff and Super Sino agreed to resolve the issue by way of mediation, and reached a verbal agreement thereon. The relevant settlement agreement will be duly entered into after the review, report and approval procedures have been completed by the Plaintiff in accordance with its relevant procedures. As at the reporting date, the directors of the Company are discussing the settlement arrangement with the Plaintiff and there is no demand for settlement from the Plaintiff at the moment. The principal of the said loan and the interest thereon have been included in the Group’s condensed consolidated interim financial information. The directors of the Company are of the view that the aforesaid litigation is unlikely to have any significant material financial impact on the Group.

23. RELATED PARTY TRANSACTIONS

The balances and transactions with related parties at the end of reporting period are disclosed elsewhere in the condensed consolidated interim financial information.

Compensation of key management personnel

The remuneration of directors and other members of key management during the period was as follows:

	2010 <i>HK\$’000</i> (Unaudited)	2009 <i>HK\$’000</i> (Unaudited)
Short-term benefits	2,590	2,021
Post-employment benefits	54	40
	<u>2,644</u>	<u>2,061</u>

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE

Financial results

For the six month ended 30 June 2010, the Group recorded an unaudited consolidated net loss of HK\$58.54 million which represented a substantial recovery of HK\$103.72 million compared to the net loss of HK\$162.26 million in the same period last year. The decrease in loss was mainly attributable to the decrease of HK\$108.89 million from the change in fair value of Convertible Bonds (“CB”) and the significant improvement of HK\$31.79 million from the disposal of the available-for-sale investments. The net loss for the interim period was mainly due to the following items:

- a loss of HK\$22.38 million from the change in the fair value of the CB; and
- the amortization of an intangible asset amounting to HK\$30.85 million being allocated to the administrative expenses.

The loss before these items was HK\$5.31 million.

Revenue and gross profit

For the six month ended 30 June 2010, the Group recorded a continuing growth in revenue and gross profit, which amounted to HK\$88.95 million and HK\$39.51 million respectively. This represented a growth of 6.26% in revenue and 59.86% in gross profit compared to the same period last year. Revenue and gross profit were mainly attributable from the water supply segment. For the period under review, the main revenue contributors were Yichun Water Industry Co., Ltd (“Yichun Water”), Danzhou Qingyuan Water Industry Company Limited* (“Danzhou Water”) and Yingtian Water Supply Co., Ltd (“Yingtian Water”), which collectively accounted for 83.44% of consolidated turnover.

Net gain on disposal of available-for-sale investments

Net gain from the disposal of available-for-sale investments rose significantly to HK\$3.18 million from a loss of HK\$28.61 million of the same period last year. This gain was mainly contributed by the disposal of the equity investments held by iMerchants Limited (“iMerchants”), a subsidiary of the Group which is listed in the Growth Enterprise Market of the Stock Exchange.

Other operating income

Other operating income comprised of bank interest income of HK\$0.08 million and contributions from several water supply plants of HK\$4.61 million. The total amount of other operating income for the Group had increased by HK\$2.42 million.

Selling and distribution costs

The increase in selling and distribution costs were due to full operation in trading of the ceramic materials for sewage treatment process while only two months operation had been included in the last interim period.

Administrative expenses

Administrative expenses were increased by HK\$28.51 million to HK\$63.97 million (2009: HK\$35.46 million). This was mainly resulted from amortization of an intangible asset. The Group had obtained an exclusive right to receive management fee equivalent to 70% of the net profits of Shenzhen Careall Capital Investment Co., Ltd. (“Careall Capital”) through the acquisition of Supreme Luck International Limited (“Supreme Luck”). Pursuant to the HKAS 38 Intangible Assets, the exclusive right is deemed to be an intangible asset which shall be amortized over its estimated useful life. As such, the amortization cost thereon of HK\$30.85 million was recognized.

Share of profit from associate

The Group had acquired 35% equity interests in Jinan Hongquan Water Production Co., Ltd (“Jinan Hongquan”). For the period under review, the Group has shared a post-acquisition profit from Jinan Hongquan of HK\$0.21 million.

Finance cost

Finance costs were mainly interest payments to banks and other borrowings of HK\$3.61 million and to the convertible bondholders of HK\$7.28 million (2009: HK\$2.91 million). The increase of HK\$7.98 million was mainly due to imputed interest expenses of HK\$6.80 million on the zero coupon CB of HK\$200 million which was issued by iMerchants last year. Imputed interest expenses is as a result of the accounting treatment and does not affect the actual cash flow of the Group.

BUSINESS SEGMENTS REVIEW

Water supply business analysis

During the interim period, the Group’s revenue and profit from water supply business had grown steadily and continuously. The revenue from the water supply operation and construction including water related installation works and meter installation amounted to approximately HK\$72.69 million (2009: HK\$64.13 million), representing 13.35% increase as compared with the same period last year. The corresponding total gross profit was HK\$33.35 million (2009: HK\$25.14 million).

The Group owned water supply projects in various provinces across China, including provinces such as Jiangxi, Anhui, Shandong and Hainan.

Sewage treatment business analysis

Revenue from sewage treatment business amounted to approximately HK\$9.11 million (2009: HK\$8.18 million). Gross profit from sewage treatment business was approximately HK\$2.21 million (2009: HK\$3.16 million). The Group’s sewage treatment plants were located in Yichun City, Jiangxi Province and Jining City, Shandong Province.

As at 30 June 2010, the Group owned five water supply plants and two sewage treatment plants in mainland China. The aggregate water supply capacity had reached 2,015,000 tonnes per day. The sewage treatment plants were capable of disposing 180,000 tonnes sewage water per day. Furthermore, the Group is in the process of acquiring two sewage treatment plants in Guangdong Province and one water supply plant in Hebei Province. These acquisitions, upon completion, will increase the Group’s daily sewage treatment and water supply capacities by 50,000 tonnes and 55,000 tonnes, respectively.

Investment in financial products and the manufacturing and trading of ceramic sewage treatment materials businesses

iMerchants (stock code: 8009), a company listed in the Growth Enterprise Market in Hong Kong, is currently 67.23% owned by the Group. The principal activities of iMerchants are engaged in the investment of financial and investment products and the manufacturing and trading of ceramic materials for the sewage treatment process in mainland China.

The performance of financial investments recorded a loss of HK\$27.69 million for the interim period (2009: loss of HK\$28.61 million). The loss was mainly arising from taken amortization cost of HK\$30.85 million on intangible asset. To minimize the risk of the fluctuations and uncertainties associated with the direct investment in financial and investment products, the management of iMerchants is in the process of shifting the focus to direct investment in natural resources and the investment in company that provides management services in the financial sector in mainland China through the cooperation with Careall Capital.

The ceramic sewage treatment materials business had recorded a profit of HK\$2.36 million for the interim period (2009: loss of HK\$0.53 million). As the supply of the ceramic sewage treatment materials is remaining relatively constant and the demand is continuing to grow in mainland China, it is believed that this new business will have a huge development potential and a promising prospect.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2010, the Group has cash and bank balance including cash held at financial institutions of HK\$186.17 million (2009: HK\$277.86 million). The decrease was mainly due to funds utilized in investment of equity securities and deposits paid for potential investments. The Group has had steady cash flow generating from the water supply business segment.

Total liabilities of the Group as at 30 June 2010 were HK\$987.22 million (2009: HK\$937.12 million). They mainly comprised of the Convertible Bonds (“CB”) of HK\$614.35 million (2009: HK\$585.17 million), bank and other borrowings of HK\$133.90 million (2009: HK\$135.64 million), and government grants of HK\$60.54 million (2009: HK\$60.04 million). The CB was denominated in HK dollars, while others were denominated in Renminbi and the interest rates of which were fixed.

The Group’s gearing ratio as at 30 June 2010 was 43.83% (2009: 41.09%). The ratio was calculated by dividing total liabilities of HK\$987.22 million over total assets of the Group of HK\$2,252.14 million.

At as 30 June 2010, the Group had net current liabilities of HK\$378.28 million (2009: HK\$306.62 million). The current portion of CB amounting to HK\$489.12 million, which represented 66.94% of the total current liabilities. Pursuant to the bond purchase agreement dated 30 July 2007, the holders of CB have the right to demand the Company to redeem all CB on 3 August 2010. On 13 August 2010, the Company entered into Definitive Agreements with the majority bondholders representing 79% of the Existing CB holders for restructuring of existing bonds issued in 2007 and issuing of new bonds in 2010 (for details, refer to the Company’s announcement dated 13 August 2010). Simultaneously, the Company and the minority bondholders representing 21% of the Existing CB holders are still in the process of finalizing the restructuring terms and conditions. On the other hand, the board is also considering various fund raising alternatives to strengthen the capital base of the Company. The Board is confident that the Group will be able to meet its financial obligation as and when they fall due and has sufficient working capital to support future operational needs.

CAPITAL RAISING

During the period ended 30 June 2010, the Company has not conducted any fund raising activities. Subsequent to the interim period, the Company and the Kingston Securities Limited (“Placing Agent”) entered into the Top-up Placing and Subscription Agreement on 9 August 2010, to place up to 265,476,000 Top-up Placing shares at HK\$0.108 per Top-up Placing share on a best effort basis. At the same date, the Company entered into the New Placing Agreement with the Placing Agent to place up to 275,796,000 New Placing Shares at HK\$0.108 per new share. The Top-up Placing was completed on 12 August 2010 and approximately HK\$27.67 million had been generated therefrom. As of the report date, the New Placing has not been completed. The proceeds raised from fund raising exercise is intended to spend on general working capital purpose.

During the period ended 30 June 2010, the Group has incurred capital expenditures amounting to HK\$16.78 million (2009: HK\$207.21 million), while HK\$16.39 million had been used for acquisitions of water supply and water supply equipment in the PRC.

FOREIGN EXCHANGE RISK

The Group’s exposure to foreign exchange risk is minimal as most of the Group’s subsidiaries operate in the PRC and most of the transactions, assets and liabilities are denominated in Renminbi. Accordingly, the Group does not have derivative financial instruments to hedge its foreign currency risks.

CAPITAL COMMITMENTS

As at 30 June 2010, the Group has the capital commitments contracted but not provided for acquisition of property, plant and equipment approximately HK\$0.44 million (2009: HK\$7.51 million).

CONTINGENT LIABILITIES

As at 30 June 2010, the group did not have any significant contingent liabilities (2009: Nil).

EMPLOYEES AND REMUNERATION POLICES

As at 30 June 2010, the Group has employed approximately 912 full-time employees (2009: 884 full-time employees). Most of them stationed 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.

PENDING LITIGATION

(i) Technostore Limited, a subsidiary of the Company

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

Following court hearings regarding the winding-up proceeding in previous years, on 29 August 2008, the court made an order to appoint Kenny Tam & Company, Certified Public Accountant as a liquidator of the Company. The Liquidator, Happy Hour Limited and Mr. Mao to become members in the Committee of Inspection (“COI”). The matter is still in the liquidation process up to the report date and is being handled by the Official Receiver’s Office. As of the report date, the latest development in the liquidation process reported by the Liquidator was that a COI meeting convened on 19 May 2010 and would follow with the distribution of dividends without their shareholders’ commitment or an estimation of a specific time frame. The Liquidator is then finalizing the papers and working for the last COI meeting, which will be happened in next few months. The directors of the Company believe that no material future outflows resources from the Group is expected and sufficient provision on assets related to Technostore have been provided. It is unlikely that there will be a material adverse financial impact on the Group.

(ii) Super Sino Investment Limited, an indirect wholly-owned subsidiary of the Company

On 6 November 2007, the People’s Government of Danzhou and Super Sino Investment Limited (“Super Sino”) entered into an assets and liabilities transfer agreement, pursuant to which the assets and liabilities of Danzhou City Water Company* (儋州市自來水公司) were transferred to Super Sino. On 26 June 2008, Agricultural Bank of China Danzhou Branch instituted proceedings with Hainan Intermediate People’s Court against Danzhou City Water Company, Super Sino and the People’s Government of Danzhou (a third party) regarding the abovementioned transfer of the relevant liabilities, claiming for the principal of RMB26 million and the interest thereon of RMB40.84 million repayable by Danzhou City Water Company and Super Sino (as defendants). On 13 November 2009, the First Intermediate People’s Court of Hainan Province issued a civil verdict, pursuant to which Super Sino was ordered to fully repay the loan principal of RMB26 million together with the interest thereon. As Agricultural Bank of China Danzhou Branch as plaintiff appealed that it is improper to release the guarantee responsibility of Danzhou Urban Development Corporation under the first-instance sentence, therefore, the relevant disputes is still in the second instance for the final sentence to be made by the Higher People’s Court of Hainan Province. Following the issue of the verdict, however, Agricultural Bank of China Danzhou Branch and Super Sino agreed to resolve the issue by way of mediation, and reached a verbal agreement thereon. The relevant settlement agreement will be duly entered into after the review, report and approval procedures have been completed by the plaintiff according to relevant procedures. It is expected that the settlement agreement will be reached, the interest of the said loan will be reduced and the repayment period will be extended. The principal of the said loan and the interest thereon have been included in the financial statements of the Group. The directors of the Company are of the view that the aforesaid litigation is unlikely to have any significant material financial impact on the Group.

Save and except for this, the Company is not aware of any other significant proceedings instituted against the Company.

MAJOR EVENTS DURING THE PERIOD UNDER REVIEW

Acquisition of subsidiaries

On 18 September 2009, Swift Surplus Holdings Limited (“Swift Surplus”) entered into the agreement with Sihui South China Waterworks Development Co., Ltd.* (“Sihui South China”) (四會市華南水務發展有限公司), Shenzhen City South China Waterworks Group Co., Ltd.* (“Shenzhen City South China”) (深圳市華南水務集團有限公司) and Da Xin Waterworks Management (Huizhou) Co., Ltd.* (“Da Xin Waterworks”) (達信水務管理(惠州)有限公司), pursuant to which the Swift Surplus has conditionally agreed to acquire 70% of the registered capital of Foshan City Gaoming Huaxin Sewage Treatment Company Ltd.* (“Gaoming Huaxin”) (佛山市高明區華信污水處理有限公司); 70% of the registered capital of Tangshan City Hongxiang Waterworks Limited* (“Hongxiang”) (唐山市鴻翔水務有限公司); 100% interest of Boluo Phase II Project Company (“Boluo Phase II”) (博羅二期項目公司) respectively, at a consideration of HK\$170 million. The Group has paid HK\$50.90 million as a deposit for the acquisition and the remaining amount will be paid upon the completion of the transaction. This acquisition has not been completed as of this report date. Subsequent to the year, the relevant parties for the aforementioned acquisition, entered into the Supplemental Agreement on 22 April 2010 to extend the long stop date of the acquisition of the Sale Interests to a date falling on or before 31 October 2010. Upon completion of the acquisition, there will be an additional 2 sewage treatment plants and one water supply plant added into the Group. The transaction has not been completed.

Deemed partial disposal of interest in a subsidiary

On 8 and 9 June 2010, an aggregate amount of 440,000,000 ordinary shares of iMerchants were issued and allotted upon the conversion of non-redeemable preference shares of iMerchants with an aggregate principal amount of HK\$17.60 million at an issue price of HK\$0.04 each (the “Conversion”). After the Conversion, the Company’s equity interests in iMerchants were further diluted by approximately 9.43% from 76.66% to 67.23%.

MAJOR EVENTS SUBSEQUENT THE PERIOD UNDER REVIEW

Letter of Intent

On 3 August 2010, iMerchants through its wholly-owned subsidiary, entered into a non-legally binding memorandum of understanding with a Vendor, an independent third party, in relation to possible acquisition of the Vendor's target company for the possible acquisition of not less than 70% of interest in the registered capital of the project company at a total consideration of not more than HK\$980 million. The project company currently has the right to construct and operate a project relating to exploration and exploitation of natural gas in the PRC (the "Phase I Project") and will acquire from a large oil and gas producer and supplier in the PRC the right to construct and operate three other projects relating to exploration and exploitation of natural gas in the PRC (the "Phase II Project").

Restructuring of Existing Convertible Bonds issued in 2007 and Issue of New HK dollars New Bonds in 2010

On 13 August 2010, the Company entered into Definitive Agreements relating to restructuring of the Existing CB with the bondholders which collectively holding approximately 79% of the Existing CB ("the Majority Investors"). The total consideration payable by the Company in respect of the Existing CB is approximately HK\$403 million comprising of approximately HK\$66 million in cash payable in installments, HK\$162 million in aggregate principal amount of New CB and HK\$175 million in aggregate principal amount of Repurchase CB. The New CB issued for the Existing CB will be convertible into Shares at the initial Conversion Price of HK\$0.15 per Share. Such total consideration shall be payable by the Company to Investors in a series of installments commencing from August 2010 and ending in August 2012.

The Company with the bondholders which collectively holding approximately 21% of the Existing CB ("the Minority Investors") are still in the process of finalizing the final documentation. Further announcement regarding the terms of the Minority Investors' restructuring will be published once the relative documentation being signed.

PROSPECTS

China's water industry has been provided with a tremendous driving power and potentials of development to a scale that have never been experienced before. The main reason behind this is that the Chinese government has implemented the state policy to attract both domestic and foreign investments by ensuring reasonable return of investments from advocating and supporting a gradual increase in water price so as to build a sustainable economic water consumption society. Furthermore, it is to promote marketization reform of this industry. Water prices have been raised in most of China's large and medium-sized cities since last year. At the same time, benefiting from the enormous economy-stimulating package and the water resource protection plan adopted by the Chinese government, as well as the expansion of urban population driven by the state policy of speeding up urbanization in new development of the countryside, the infrastructure construction in the water supply and the environmental protection in sewage treatment sectors are continuously expanding with a booming demand. All these have offered excellent opportunities and favorable conditions for the accelerated growth of our principal businesses.

After 4 years of developing new businesses in the major cities of mainland China, both our water supply and sewage treatment capacities have been expanding. As a result, operating income and profits continue to increase. With the extensive experience of our management team and the

concerted efforts of all our subsidiaries, we have been providing continuous support to our invested enterprises in the reinforcement of expanding income sources and reducing operating expenses, and seeking value-added services such as water meter replacement and pipe maintenance while reducing production costs and operation expenses, with an aim to broaden our profit margin. In parallel, we are lobbying with the local governments to increase water prices to the expected levels as well as to implement the hierarchical rating system. These measures will have a positive impact to our business revenue and profit margin. The Board believes that our operating results will turn over a new page and reach a higher level with the continuous promotion of our water business and the expansion of the related businesses.

As the issue of the Group's debt is gradually solved, there are large domestic/overseas enterprises showing strong intention to forge strategic cooperation. In future, apart from equity financing, the Group will seek domestic banks to obtain loan facilities as well as to raise funds through different channels via strategic investors. The capital raised will further expand the scale of our water treatment facilities, strengthen the technological transformation to improve water quality and accelerate the acquisition and merger of water projects with good investment returns and growth potentials. We shall aim to accomplish the expected investment scale and the profitability goals of our water projects, to develop the Group into a large-scale water conglomerate with nationwide influence, and to bring satisfactory investment return to our shareholders and investors.

SUPPLEMENTARY INFORMATION

INTERIM DIVIDENDS

The Board does not recommend the payment of interim dividend for the six month ended 30 June 2010 (six months ended 30 June 2009: Nil).

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS IN SECURITIES

As at 30 June 2010, the interests and short positions of the Directors and Chief Executive of the Company, or their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong, the "SFO") which had been notified of the Company and The Stock Exchange of Hong Kong Limited (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 of 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
Chu Yin Yin, Georgiana	Beneficial owner	5,432,000	5,432,000 (L)	0.20%
Yang Bin	Interest of controlled corporation	450,479,000	450,479,000 (L) (Note)	16.64%

For the purpose of this section, the shareholding percentage in the Company is calculated on the basis of 2,706,379,000 Shares in issue as at 30 June 2010.

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

Note: These China Water Shares are held by Boost Skill Investments Limited (“Boost Skill”) (as to 265,479,000 China Water Shares) and its wholly owned subsidiaries, Favor Jumbo Investments Limited (“Favor Jumbo”) (as to 130,000,000 China Water Shares) and Sure Ability Limited (“Sure Ability”) (as to 55,000,000 China Water Shares). Mr. Yang Bin is interested in 60% of the equity interest in Boost Skill.

(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)
Chu Yin Yin, Georgiana	0.335	11 January 2007 to 10 January 2017	3,000,000	0.11
Liu Bai Yue	0.420	17 January 2007 to 16 January 2017	5,000,000	0.18

Note: For the purpose of this section, the shareholding percentage in the Company is calculated on the basis of 2,706,379,000 Shares in issue as at 30 June 2010.

Save as disclosed above, as at 30 June 2010, none of the directors or Chief executive of the Company had any interest or short position in any shares, underlying shares or debenture 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 which they were taken or deemed to have under SFO) or 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.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2010, 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 and 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 was directly or indirectly interested in 5% 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
Li Jian Ping	Interest of controlled corporation	450,479,000 (Note 1)	16.64%
Boost Skill Investments Limited	Interest of controlled corporation	185,000,000 (Note 2)	6.84%
	Beneficial owner	265,479,000	9.80%
Abax Arhat Fund	Interest of controlled corporation	228,873,239 (Note 3)	8.46%
Abax Claremont Limited	Interest of controlled corporation	228,873,239 (Note 3)	8.46%
Abax Global Capital	Interest of controlled corporation	228,873,239 (Note 3)	8.46%
Abax Global Opportunities Fund	Interest of controlled corporation	228,873,239 (Note 3)	8.46%
Abax Upland Fund, LLC	Interest of controlled corporation	228,873,239 (Note 3)	8.46%
Abax Lotus Limited	Beneficial owner	228,873,239 (Note 3)	8.46%

Note 1: These China Water Shares are held by Boost Skill Investments Limited (“Boost Skill”) (as to 265,479,000 China Water Shares), Favor Jumbo Investments Limited (“Favor Jumbo”) (as to 130,000,000 China Water Shares) and Sure Ability Limited (“Sure Ability”) (as to 55,000,000 China Water Shares). Mr. Yang Bin, an executive Director, and Mr. Li Jian Ping is interested in 60% and 40% respectively of the equity interest in Boost Skill.

Note 2: These China Water Shares are held by Favor Jumbo (as to 130,000,000 China Water Shares) and Sure Ability (as to 55,000,000 China Water Shares).

Note 3: These 228,873,239 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 4: The shareholding percentage in China Water is calculated on the basis of 2,706,379,000 China Water Shares in issue as at 30 June 2010.

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 30 June 2010, 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 5% or more of the normal value of any class of shares carrying 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.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed under the heading "Share Option Scheme" below, at no time during the period 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.

SHARE OPTION SCHEME

The Company had adopted Share Option Scheme on 17 January 2002 (the “Scheme”). During the six months ended 30 June 2010, no shares options were granted by the Company. Other than the said Scheme, the Company and its subsidiaries have not adopted any share option scheme. Details of the movements in the share options during the period ended 30 June 2010 under the Scheme are as follows:

Name or category of participant	Date of grant	Outstanding as at 1 January 2010	Granted during the year	Exercised during the year	Lapsed during the year	Outstanding as at 30 June 2010	Exercisable period	Exercise Price per share of the Company HK\$
<i>Directors</i>								
Chu Yin Yin, Georgiana	11 January 2007	3,000,000	–	–	–	3,000,000	11 January 2007 to 10 January 2017	0.335
Liu Bai Yue	17 January 2007	5,000,000	–	–	–	5,000,000	17 January 2007 to 16 January 2017	0.420
		<u>8,000,000</u>				<u>8,000,000</u>		
Other eligible participant (Note)	11 January 2007	10,000,000	–	–	(10,000,000)	–	11 January 2007 to 10 January 2017	0.335
Total as at 31 December 2009		<u>18,000,000</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>8,000,000</u>		

Note: On 21 November 2008, Mr. Sze Chun Ning, Vincent (“Mr. Sze”) had resigned as an Executive Director and deputy managing director of the Company but remains as a director of subsidiaries of the Company. Mr. Sze had resigned all the positions in subsidiaries in May 2010, the share options were then lapsed.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY’S SECURITIES

During the six months ended 30 June 2010, the Company had not redeemed, and neither the Company nor any of its subsidiaries had purchased or sold any of the Company’s listed securities.

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.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, as at the date of this interim report, the Company has maintained the prescribed public float under the Listing Rules.

CORPORATE GOVERNANCE

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

During the six months ended 30 June 2010, the corporate governance practices adopted by the Company has complied with the code provisions set out in the Code of Corporate Governance Practices contained in Appendix 14 of the Listing Rules (the "CGP Code") except the following deviation from the following provisions of the CGP Code:

- Code provision A4.1 stipulates that non-executive Directors should be appointed for a specific term. However, none of the existing non-executive Directors of the Company (including independent non-executive) is appointed for a specific term since all non-executive Directors of the Company (including independent non-executive) are subject to retirement by rotation and re-election at annual general meetings for the Company in line with the Company's Articles of Association. The Company considers that sufficient measures have been taken to ensure that the Company's corporate governance practices are no less exacting than those in the CGP Code.

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 throughout the six months ended 30 June 2010.

AUDIT COMMITTEE

The Audit Committee comprises 3 independent non-executive Directors of the Company, has reviewed with the management of the Company the accounting principles and practices adopted by the Group and discussed auditing internal controls and financial reporting matters including the review of the unaudited interim financial statements for the six months ended 30 June 2010.

REMUNERATION COMMITTEE

The Remuneration Committee comprises 2 independent non-executive Directors of the Company and 1 executive Director of the Company, is responsibility for reviewing and evaluating the remuneration policies of executive Directors and senior management and making recommendations to the Board from time to time.

INVESTMENT COMMITTEE

The Investment Committee consists of 5 Directors, namely Mr. Li Yu Gui (Committee Chairman), Mr. Yang Bin, Mr. Liu Bai Yue, Mr. Li Wen Jun and Mr. Chang Kin Man. The role of Investment Committee is to oversee the Company's strategic and investment policy on a regular basis and to advise the Board on the investment of the Company including asset allocation and new investment proposal.

PUBLICATION OF THE INTERIM RESULTS AND REPORT

The interim results announcement is published on the websites of the Company (www.chinawaterind.com) and Hong Kong Exchanges and Clearing Limited (<http://www.hkex.com.hk>). The interim report of the Company for 2010 containing all information required by the Listing Rules will be dispatched to Shareholders and made available on the above websites in due course.

APPRECIATION

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

By order of the Board
China Water Industry Group Limited
Li Yu Gui
Chairman

Hong Kong, 26 August 2010

As at the date of this announcement, the board of directors of the Company comprises Mr. Li Yu Gui, Mr. Yang Bin, Mr. Liu Bai Yue, Ms. Chu Yin Yin, Georgiana and Mr. Li Wen Jun, all being executive directors, and Mr. Chang Kin Man, Mr. Wu Tak Lung and Mr. Gu Wen Xuan, all being independent non-executive directors.

** For identification purpose only*