

EURO TECH HOLDINGS CO LTD

Form 20-F

June 30, 2010

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## **FORM 20-F**

### **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2009**

Commission file number 000-22113

**EURO TECH HOLDINGS COMPANY LIMITED**

(Exact name of Registrant as specified in its charter)

**EURO TECH HOLDINGS COMPANY LIMITED**

(Translation of Registrant's name into English)

**British Virgin Islands**

(Jurisdiction of incorporation or organization)

**18/F Gee Chang Hong Centre, 65 Wong Chuk Hong Road, Hong Kong**

(Address of principal executive offices)

**T.C. Leung,**

**FAX: 852-28734887**

**18/F Gee Change Hong Centre,**

**65 Wong Chuk Hong Road,**

**Hong Kong**

(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Name of each exchange on which registered: NASDAQ

Ordinary Shares, \$0.01 par value

Securities registered or to be registered pursuant to Section 12(g) of the Act.

**Not Applicable**  
(Title of Class)

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

**Not Applicable**  
(Title of Class)

Indicate the number of issued and outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report. 11,544,711 Ordinary Shares.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

If this is an annual or transitional report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued  
by the International Accounting Standards Board

Other

If  Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes  No

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Explanatory Note

In addition to the financial statements of Euro Tech Holdings Company Limited (the Company) attached are the financial statements of two companies that are twenty percent (20%) owned by the Company, Zhejiang Tialan Desulfurization and Dust Removal Co. Ltd. (Blue Sky) and Zhejiang Jia Huan Electronic Co. Ltd. (Jia Huan). The rules of the Securities and Exchange Commission require that the Company file the financial statements of Blue Sky and Jia Huan.

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**INTRODUCTION**

In this Form 20-F, reference to us, we, the Company and Euro Tech are to Euro Tech Holdings Company Limited and its subsidiaries unless otherwise expressly stated or the context otherwise requires.

**Forward Looking Statements**

This annual report contains forward looking statements. Additional written or oral forward looking statements may be made by the Company from time to time in filings with the Securities and Exchange Commission (the SEC or the Commission) or otherwise. Such forward looking statements are within the meaning of that term in Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). Such statements may include, but not be limited to, projections of revenues, income, or loss, capital expenditures, plans for future operations, financing needs or plans, and plans relating to products or services of the Company, as well as assumptions relating to the foregoing. The words believe, expect, anticipate, estimate, project, and similar expressions identify forward looking statements, which speak only as of the date the statement was made. Forward looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by, or underlying the forward looking statements. Statements in this Annual Report, including those contained in the sections entitled Part I, Item 3D. Risk Factors and Item 5. Operating and Financial Review and Prospects and the notes to the Company's Consolidated Financial Statements, describe factors, among others, that could contribute to or cause such differences.

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**GLOSSARY**

The following glossary of terms may be helpful in understanding the terminology used in this Annual Report.

Ambient Air:	Atmospheric air (outdoor as opposed to indoor air).
Anaerobic:	Treating waste water biologically in the absence of air.
Atomic Spectrometer:	An analytical instrument used to measure the presence of an element in a substance by testing a sample which is aspirated into a flame and atomized. The amount of light absorbed or emitted is measured. The amount of energy absorbed or emitted is proportional to the concentration of the element in the sample.
Coalescer:	A process that coalesces smaller oil particles to form larger oil particles that can readily float to a tank's surface.
Colorimeter:	An analytical instrument that measures substance concentration by color intensity when the substance reacts to a chemical reagent.
Flow Injection Analyzer:	An analytical instrument with a special sampling system that uses a continuous stream of reagent(s) into which fluid samples are injected.
Human Machine Interface Software:	A type of software to interface (or coordinate) the interaction between machine or equipment and a human being.
Lamella:	Synthetic media installed in a clarifier tank to assist in particle flocculation (coming together in a floc or flakes )
Mass Spectrometer:	An analytical instrument that separates and identifies chemical constituents according to their mass-to-charge ratios and is used to identify organic compounds.
Membrane Biological Reactor (MBR):	A suspended-growth bioreactor combined with a membrane liquid/solids separation unit. The MBR uses an advanced membrane technology that treats biological wastes to a quality level which in many industries is sufficient for reuse or low-cost disposal to sewers.
Moving Bed Biofilm Reactor (MBBR)	A biological wastewater treatment process that uses synthetic plastic media floating or fixed in the aeration stage of the treatment process to increase the contact area between the wastewater and the biomass (bacteria). The result is a higher efficiency of treatment in a unit volume of wastewater, hence smaller footprint. An additional advantage is reduction of the amount of sludge produced.
Multi-Channel Digital Recorder:	A device that measures and records more than one input of a digitized signal (signal in the form of pulses).
pH Controller:	A process instrument that measures and controls the acidity or alkalinity of a fluid.
Reagent:	A chemical substance used to cause a chemical reaction and detect another substance.
Sequential Batch Reactor (SBR):	A waste-water treatment process that combines aeration and settling in one reactor tank thus saving on space. Used for the treatment of industrial waste-water as well as municipal sewage. The SBR is a batch process that is ideal for waste-waters of changing characteristics.





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(Amounts expressed in thousands, except share and per share data and unless otherwise stated)

The selected consolidated income statement data for years ended December 31, 2009, 2008 and 2007, and the selected consolidated balance sheet data as of December 31, 2009 and 2008 set forth below are derived from audited consolidated financial statements of the Company included herein and should be read in conjunction with, and are qualified in their entirety by reference to such financial statements, including the notes thereto and Item 5. Operating and Financial Review and Prospects. The selected consolidated income statement data for the years ended December 31, 2006 and 2005 and the selected consolidated balance sheet data as of December 31, 2006 and 2005 set forth below are derived from audited consolidated financial statements of the Company which are not included herein.

	2009 US\$	2008 US\$	2007 US\$	2006 US\$	2005 US\$
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	7,025	7,146	9,387	9,160	5,362
Working capital(1)	8,203	8,583	10,099	10,267	6,931
Total assets	26,244	28,278	25,482	19,975	17,377
Short-term debt(2)	0	0	0	0	0
Net assets	18,932	18,979	17,958	12,990	9,754
Capital Stock	122	122	120	94	74

(1) Current assets minus current liabilities.

(2) Short-term debt includes short-term borrowings and current portion of long-term bank loans.

	2009 US\$	2008 US\$	2007 US\$	2006 US\$	2005 US\$
<b>Income Statement Data:</b>					
Revenue	27,336	31,738	27,230	27,161	31,250
Cost of revenue	(20,876)	(24,154)	(20,398)	(20,606)	(24,681)
Gross profit	6,460	7,584	6,832	6,555	6,569
Selling and Administrative Expenses	(6,608)	(7,214)	(6,566)	(5,961)	(5,418)
Operating (loss)/income	(148)	370	266	594	1,151
Interest Income	37	45	256	95	35

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Other income, net	71	145	142	146	172
(Loss)/Income before taxes	(40)	560	664	835	1,358
Income taxes	(218)	(321)	(144)	(156)	(328)
Equity in profit of affiliates	595	273	247		21
Net income	337	512	767	679	1,051
Less: net income attributable to non-controlling interest	(305)	(363)	(345)	(318)	(318)
Net income attributable to the Company	32	149	422	361	733
Net income per Ordinary Share Basic	0.01	0.01	0.04	0.04	0.11
Diluted	0.01	0.01	0.03	0.03	0.07
Weighted Average Number of Ordinary Shares Outstanding					
Basic	11,632,460	11,824,153	11,105,556	8,047,911	6,598,201
Diluted	11,896,537	12,212,058	12,095,335	10,787,420	10,698,482

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The Company maintains its books and records in United States dollars ( US\$ ). Its subsidiaries, retail shops and affiliates maintain their books and records either in US\$, Hong Kong dollars ( HK\$ ) or in Chinese Renminbi ( RMB ).

The Hong Kong dollar is freely convertible into other currencies (including the US dollar). Since 1983, the Hong Kong dollar has effectively been officially linked to the US dollar at the rate of approximately HK\$7.80 = US\$1.00. However, the market exchange rate of the Hong Kong dollar against the US dollar continues to be influenced by the forces of supply and demand in the foreign exchange market. Exchange rates between the Hong Kong dollar and other currencies are influenced by the rate between the US dollar and the Hong Kong dollar.

Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates. From 1994 through 2004, the official exchange rate for the conversion of Renminbi to U.S. dollars has generally been stable and maintained at the rate of approximately RMB8.30 = US\$1.00. However, in 2007, 2008 and 2009 the Renminbi appreciated and at the end of 2009, 2008 and 2007, the exchange rates were approximately RMB 6.8282 = US\$1.00, RMB 6.8251 = US\$1.00 and RMB 7.3141 = US\$1.00, respectively. The value of the Renminbi fluctuates and is subject to changes in PRC political and economic conditions.

The high, low and average exchange rate set forth below:

	Rate at Period End	Low	High	Average
<b>US\$ to RMB</b>				
Fiscal 2005	8.0734	8.0566	8.2666	8.2033
Fiscal 2006	7.8175	7.7845	8.0715	7.9819
Fiscal 2007	7.3141	7.2941	7.8062	7.6172
Fiscal 2008	6.8251	6.7480	7.2941	6.9623
Fiscal 2009	6.8282	6.7880	6.8430	6.8409

<b>US\$ to HK\$</b>				
Fiscal 2005	7.7535	7.7431	7.8116	7.7779
Fiscal 2006	7.7794	7.7502	7.7946	7.7690
Fiscal 2007	7.8049	7.7488	7.9102	7.8026
Fiscal 2008	7.7507	7.7480	7.8174	7.7874
Fiscal 2009	7.7551	7.7474	7.7617	7.7522

<b>The Following Months</b>	Low	High	Average
<b>US\$ to RMB</b>			
July 2009	6.8200	6.8348	6.8421
August 2009	6.8015	6.8351	6.8421
September 2009	6.7880	6.8290	6.8390
October 2009	6.7950	6.8290	6.8364
November 2009	6.7930	6.8287	6.8356
December 2009	6.7926	6.8293	6.8362

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US\$ to HK\$			
July 2009	7.7485	7.7507	7.7508
August 2009	7.7485	7.7521	7.7513
September 2009	7.7485	7.7513	7.7510
October 2009	7.7485	7.7503	7.7506
November 2009	7.7485	7.7503	7.7507
December 2009	7.7486	7.7582	7.7536

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**Item 3D. Risk Factors**

You should carefully consider all of the information set forth in this annual report and the following risk factors. The risks below are not the only ones we face. Additional risks not currently known by us or that we deem immaterial may also impair our business operations. Our business, financial condition or results of operations could be materially adversely effected by any of these risks. This annual report also contains forward looking statements that involve risks and uncertainties. Our results could materially differ from those anticipated in these forward looking statements as a result of certain factors, including the risks we face as described below and elsewhere. See Forward Looking Statements.

**Certain Risks Relating To Doing Business In Hong Kong And The People's Republic Of China (the PRC or China).**

**PRC Sovereignty Over Hong Kong Still Developing.**

The Company's executive and principal offices are located in Hong Kong, a Special Administrative Region of China (or SAR; Hong Kong is sometimes herein referred to as the Hong Kong SAR).

As provided in the Sino-British Joint Declaration on the Question of Hong Kong (the Joint Declaration) and the Basic Law of the Hong Kong SAR of China (the Basic Law), the Hong Kong SAR is provided a high degree of autonomy except in foreign and defense affairs. The PRC's political system and policies are not practiced in Hong Kong. Under this principle of one country, two systems, Hong Kong maintains a legal system that is based on common law and is different from that of the PRC.

The Company's results of operations and financial condition may be influenced by the political situation in Hong Kong and by the general state of the Hong Kong economy. See Economic Stability Uncertain.

There can be no assurance that these past or any prospective future changes in political, economic or commercial conditions in Hong Kong and the PRC will not result in a material adverse effect upon the Company.

**Economic Stability Uncertain.**

Most economies in the Far East had suffered from an economic instability. There can be no assurance that there be a recovery, most especially in light of the recent global economic downturn. Continued growth in the PRC is dependent upon an adequate supply of energy. There is no assurance that adequate supplies of energy can be developed or found to fuel the PRC's continued economic growth.

**The PRC's Economic, Political And Social Conditions.**

The PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth in the past thirty years, growth has been uneven, both geographically and among the various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by changes in applicable tax regulations.

The PRC economy appears to be moving from a planned economy to a more market-oriented economy. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in the PRC are still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over the PRC's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. These actions, as well as future actions and policies of the PRC government, could materially and adversely effect our business and operations.

The success of the Company's activities in the PRC depends on the Company's continued ability to overcome circumstances specifically effecting the industrial sector, including the relatively poor infrastructure, road transportation and communications network and an uncertain legal and regulatory environment.

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**Economic Reforms May Not Continue Or Impact Positively On The Company; Changing Business Environment.**

Over the past several years, the PRC's government has pursued economic reform policies including encouraging private economic activities and decentralization of economic deregulation. The PRC government may not continue to pursue these policies or may significantly alter them to our detriment from time to time without notice. Changes in policies by the PRC government resulting in changes in laws, regulations, or their interpretation, or the imposition of confiscatory taxes, restrictions on currency conversion and imports could materially and adversely effect our business and operating results. The nationalization or other expropriations of private enterprises by the PRC government could result in a loss of our investments in actual funds and time and effort, in China.

The Company's results at times may also be adversely effected by: (1) changes in political, economic and social conditions in the PRC; (2) changes in government policies such as changes in laws and regulations (or their interpretation); (3) the introduction of additional measures to control inflation; (4) changes in the rate or method of taxation; (5) imposition of additional restrictions on currency conversion remittances abroad; (6) reduction in tariff protection and other import restrictions; and (7) a return to the more centrally-planned economy that existed previously.

**We Are Subject To International Economic And Political Risks, Over Which We Have Little Or No Control.**

Doing business outside the United States subjects us to various risks, including changing economic and political conditions, exchange controls, currency fluctuations, armed conflicts and unexpected changes in United States and foreign laws relating to tariffs, trade restrictions, transportation regulations, foreign investments and taxation. We have no control over most of these risks and other unforeseeable risks and may be unable to anticipate changes in international economic and political conditions and, therefore, unable to alter our business practice in time to avoid the adverse effect of any of these changes.

**The Current Financial Crisis and Deteriorating Economic Conditions May Have A Material Adverse Impact on Our Business and Financial Conditions.**

Worldwide economies have been deteriorating recently. Global markets have experienced significant turmoil and upheavals characterized by extreme volatility and declines in prices and securities and commodities, diminished credit availability, inability to access capital markets, waves of bankruptcies, rising unemployment and declining consumer and business confidence.

We cannot predict the short and long-term impact of these events on our business and financial condition that may be materially and adversely effected.

**Uneven Economic Growth.**



The PRC's economy has experienced significant growth in recent years, but that growth has been uneven among various geographic regions and economic sectors. Economic reforms and growth in the PRC have been more successful in certain provinces than in others, and the continuation or increase of such disparities could adversely effect political or social stability. The PRC's economy experienced a slowdown in the fourth quarter of 2008 as a result of the global economic crisis with a gradual recovery in the latter half of 2009 and the first quarter of 2010. There can be no assurance that the PRC's economy will continue to grow, that if there is growth, such growth will be steady and uniform, or that if there is a slowdown, such a slowdown will not have a negative effect on our business.

**PRC Inflation.**

In recent years, the PRC has not experienced significant inflation, and thus inflation has not had a significant effect on our business historically. In response to the increased inflation rate during 2004, the Chinese government announced measures to restrict lending and investment in the PRC in order to reduce inflationary pressure on the PRC's economy; and the inflation rate was reduced in 2005 and 2006, escalated in 2007 and 2008 at a rate of 5.9% and was reduced by 0.7% in 2009. Efforts by the PRC to curb inflation may also curb economic growth, increase our overhead costs and adversely affect our sales. If the PRC rate of inflation continues to increase, the Chinese government may introduce further measures intended to reduce the inflation rate in the PRC. Any such measures adopted by the Chinese government may not be successful in reducing or slowing the increase in the PRC's inflation rate. Sustained or increased inflation in the PRC may have an adverse impact on the PRC's economy and may materially and adversely affect our business and financial results.

**Uncertain Legal System And Application Of Laws.**

The legislative trend in the PRC over the past decade has been to enhance the protection afforded to foreign investment and allow for more active control by foreign parties of foreign invested enterprises. There can be no assurance

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that this will continue. In addition, as the PRC economy, business and commercial framework and legal system all continue to develop, that development may adversely affect the Company's activities in the PRC or the ability of the Company to enter into Sino-foreign agreements.

**PRC Legal System Business Laws Developing.**

The PRC does not yet possess a comprehensive body of business law or a consolidated body of laws governing foreign investment enterprises. As a result, the enforcement, interpretation and implementation of existing laws, regulations or agreements may be sporadic, inconsistent and subject to considerable discretion. The PRC's judiciary has not had sufficient opportunity to gain experience in enforcing laws that exist, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. As the legal system develops, entities such as the Company may be adversely affected by new laws, changes to existing laws (or interpretations thereof) and preemption of provincial or local laws by national laws. Even when adequate law exists in the PRC, it may not be possible to obtain speedy and equitable enforcement of the law.

**Government Currency Controls.**

The PRC government imposes control over its foreign currency reserves in part through direct regulation of the conversion of its currency, Renminbi ( RMB ) into foreign exchange and through restrictions on foreign imports. The conversion of RMB into Hong Kong and United States Dollars ( U.S. Dollars ) must be based on rates set by the People's Bank of China ( PBOC ), which rates are set daily based on the previous day's Chinese interbank foreign exchange market rate with reference to current exchange rates on the world financial markets.

Currently, the RMB is permitted to fluctuate within a narrow band against the U.S. dollar. Exchange rate fluctuations may adversely effect the Company because of increases in overhead costs, adverse effects on sales, foreign currency denominated liabilities, and may materially adversely effect the value, translated into U.S. dollars, of the Company's net fixed assets situated and to be situated in the PRC, earnings and dividends.

**Foreign Currency Risk.**

The Company operates in Hong Kong, the PRC and trades with both local and overseas customers, and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to purchases in, Hong Kong dollar, Renminbi and Euro. Foreign exchange risk arises from committed and unmatched future commercial transactions, such as confirmed import purchase orders and sales orders, recognized assets and liabilities, and net investment in the PRC operations. The Company uses derivative financial instruments such as foreign exchange contracts to hedge certain foreign currency exposures. There can be no assurances that the Company's hedging strategies will be adequate to avoid this foreign exchange risk.

**Turbulent Relations With The United States Of America ( United States ).**

Differences between the United States and PRC governments on some political issues continue occasionally to color the relationship. These occasional controversies could materially and adversely effect our business and operations. Political or trade friction between the two countries could also materially and adversely effect the market price of our Ordinary Shares, whether or not they adversely effect our business.

**Certain Risks Relating To The Company s Business**

**Decline in Revenues; Operating Loss; Loss Before Income Taxes.**

In Fiscal 2008, the Company had revenues of approximately US\$31,738, 000, operating income of approximately US\$370,000 and income before income taxes of approximately US\$560,000. In Fiscal 2009, the Company had revenues of approximately US\$27,336,000, an operating loss of approximately US\$148,000 and a loss before income taxes of approximately US\$40,000. The Company primarily attributes the revenue reduction, operating loss and loss before income taxes in Fiscal 2009 to the global economic downturn and having key suppliers selling their products through China suppliers other than the Company.

As the global economic downturn appears to be continuing and the Company may face further competition by having key suppliers selling their products through China suppliers other than the Company, there can be no assurance that the Company s revenues will not decline further and losses will not increase.

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**We Have Made And May Make Further Acquisitions Without Your Approval.**

Although we endeavor to evaluate the risks inherent in any particular acquisition, there can be no assurance that we will properly or accurately ascertain all such risks. We will have virtually unrestricted flexibility in identifying and selecting prospective acquisition candidates and in deciding if they should be acquired for cash, equity or debt, and in what combination of cash, equity and/or debt.

We have taken and are seeking to take equity positions in related businesses. We will not seek stockholder approval for any additional acquisitions unless required by applicable law and regulations. Our stockholders will not have an opportunity to review financial and other information on acquisition candidates prior to consummation of any acquisitions under almost all circumstances.

Investors will be relying upon our management, upon whose judgment the investor must depend, with only limited information concerning management's specific intentions.

There can be no assurance that the Company will locate and successfully complete any such additional acquisitions, or any acquisition will perform as anticipated, will not result in significant unexpected liabilities or will ever contribute significant revenues or profits to the Company or that the Company will not lose its entire investment in any acquisition.

**Dependence Upon Management.**

The Company is dependent upon the services of its executive officers, in particular Mr. T.C. Leung, the Chairman of the Company's Board of Directors and its Chief Executive Officer. The business of the Company could be adversely effected by the loss of services of, or a material reduction in the amount of time devoted to the Company by its executive officers. The Company does not maintain Key Man life insurance on the lives of any of its officers and directors. See Item 6. Directors, Senior Management and Employees.

**Adverse Impact Upon The Company Of PRC's Credit Restrictions.**

The Company faces increasing competition from other distributors of substantially similar products and manufacturers themselves, both foreign and Chinese. The Company faces its principal competition from foreign manufacturers and other distributors of their products situated in Hong Kong and the PRC. Competition may cause purchaser demands for price reductions and reduced profit margin.

**Competition With Vendors.**

As the Company assembles products of the kind that it presently distributes, the Company may directly compete with certain of its vendors. Any such direct competition may adversely affect its relationship with its vendors. See Item 4. Information on the Company.

**Dependence On Vendors; Lack Of Long Term Arrangements; Loss of Vendors.**

The Company distributes supplies manufactured by a number of vendors, including , Thermo Fisher Scientific Group ( Thermo ), Siemens Water Technologies Group ( Siemens ), Hach Company - Lachat Instruments ( Hach ) and Caliper Life Sciences Inc ( Caliper ), that are the Company s largest suppliers, pursuant to short term arrangements. Although alternative sources of supply exist, there can be no assurance that the termination of the Company s relationship with any of the above or other vendors would not have an adverse effect on the Company s operations due to the Company s dependence on these vendors. A substantial number of the Company s suppliers have been selling their products into China directly and through other distributors. During Fiscal 2009 our sales, expressed as a percentage of total sales, to Hong Kong increased by 10% while our sales to the PRC decreased by 9% when compared to Fiscal 2008. The 10% increase in sales to Hong Kong was primarily due to an increase in sales of Thermo s products. The 9% decrease in sales to the PRC was primarily due to the global economic downturn and additional sales by out key suppliers in the PRC through distributors other than the Company. A loss of a substantial vendor or substantial number of our other vendors and/or our competing with them would have a material adverse effect on our revenues from trading activities.

**Risks Relating To The Company Itself; Control By T.C. Leung; Potential Conflict Of Interests.**

T.C. Leung, the Company s Chairman of the Board and Chief Executive Officer, as a practical matter, is able to nominate and cause the election of all the members of the Company s Board of Directors, control the appointment of its officers and the day-to-day affairs and management of the Company. As a consequence, Mr. Leung can have the Company managed in a manner that would be in his own interests and not in the interests of the other shareholders of the Company. See Item 7. Major Shareholders and Related Party Transactions and Item 6. Directors, Senior Management and Employees.

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**Certain Legal Consequences Of Incorporation In The British Virgin Islands; Rights Of Shareholders Not As Extensive As In U.S. Corporations.**

Principles of British Virgin Islands ( BVI ) corporate law relating to such matters as the validity of the Company procedures, the fiduciary duties of management and the rights of the Company s shareholders may differ from those that would apply if the Company were incorporated in a jurisdiction within the United States.

The rights of shareholders under British Virgin Islands law are not as extensive as the rights of shareholders under legislation or judicial precedent in many United States jurisdictions. Under United States law, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. United States shareholder action must be taken in good faith and actions by controlling shareholders in a United States jurisdiction and executive compensation which are obviously unreasonable may be declared null and void.

The BVI law protecting the interests of the minority shareholders is not as protective in all circumstances as the law protecting minority shareholders in United States jurisdictions. The shareholders of the Company may have more difficulty in protecting their interests in the face of actions by the Company s Board of Directors, and may have more limited rights, than they might have as shareholders of a company incorporated in many United States jurisdictions.

**Anti-Takeover Provisions.**

The Company has 5,000,000 shares of blank check preferred stock authorized. The blank check preferred stock is intended to strengthen the Company s ability to resist an unsolicited takeover bid and may be deemed to have an anti-takeover effect. The Board of Directors has the right to fix the rights, terms and preferences at the time of issue of blank check preferred stock without further action by our shareholders.

**Uncertainty Of Enforcing United States Judgments.**

There is some uncertainty whether BVI courts would enforce judgments of the courts of the United States and of other foreign jurisdictions, or enforce actions brought in the BVI which are based upon the securities laws of the United States. A final monetary judgment obtained in the United States will be treated as a cause of action in itself by the BVI courts so that no retrial of the issues would be necessary, provided that material preconditions are met and the proceedings pursuant to which judgment was obtained were not contrary to the rules of natural justice.

All of the Company s directors and executive officers reside outside of the United States, service of process upon the Company and such persons may be difficult to effect in the United States upon all such directors and officers.

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All of the Company's assets are and will be located outside of the United States, in Hong Kong and the PRC, and any judgment obtained in the United States may not be enforced in those jurisdictions. Hong Kong courts will not directly enforce against the Company or such persons judgments obtained in the United States. There is also substantial doubt as to the enforceability in the PRC of actions to enforce judgments of the United States courts arising out of or based on the ownership of the securities, including judgments arising out of or based on the civil liability provisions of United States federal or state securities laws or otherwise. See Certain Legal Consequences of Incorporation in the British Virgin Islands; Rights of Shareholders not as Extensive as in U.S. Corporations.

### **Being A Foreign Private Issuer Exempts Us From Certain Securities And Exchange Commission ( Commission ) And NASDAQ Capital Markets ( NASDAQ ) Requirements.**

We are a foreign private issuer within the meaning of rules promulgated under the Securities Exchange Act of 1934 (the Exchange Act ). As such, with certain limitations, we are exempt from certain provisions applicable to United States public companies including: (1) the rules under the Exchange Act requiring the filing with the Commission of quarterly reports on Form 10-Q or current reports on Form 8-K; (2) the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect of a security registered under the Exchange Act; (3) the provisions of Regulation FD aimed at preventing issuers from making selective disclosures of material information; and (4) the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and establishing insider liability for profits realized from any short-swing trading transaction (i.e., a purchase and sale, or sale and purchase, of the issuer's equity securities within less than six months. Because of these exemptions, investors are not afforded the same protections or information generally available to investors holding shares in public companies organized in the United States.

### **Our Securities Must Continue To Meet Qualitative And Quantitative Listing Maintenance Criteria For NASDAQ.**

Our securities are quoted and traded on the NASDAQ Capital Market. There can be no assurance that we will continue to meet both the qualitative and quantitative criteria for continued quotation and trading of our securities on the

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NASDAQ Capital Market. One of NASDAQ's listing requirements is the maintenance of a closing bid price of US\$1.00 per share. During periods of time in 2008 and 2009 the Company was not in compliance with that requirement but NASDAQ had generally suspended that requirement and others due to market conditions and/or the US\$1.00 per share bid price was not met for a sufficient period of time to cause a NASDAQ deficiency action.

If we are unable to meet the continued quotation criteria of the NASDAQ Capital Market and are suspended from trading on these markets, our securities could possibly be traded in the over-the-counter market and be quoted in the so-called "pink sheets" or, if then available, the OTC Bulletin Board. In such an event, an investor would likely find it more difficult to dispose of, or even obtain accurate quotations of, our securities. See "We Are Also Required To Meet Certain, But Not All Corporate Governance Criteria Applicable to NASDAQ Listed Issuers."

**We Are Also Required To Meet Certain, But Not All, Corporate Governance Criteria Applicable To NASDAQ Listed Issuers.**

Although, in the past, we have been able to satisfy corporate governance criteria applicable to NASDAQ's Capital Market, those criteria are difficult to comply with and include, among other things: (a) a heightened degree of independence of members of the board of directors with independent directors to, among other things: hold regular meetings among themselves only; (b) establishment of a code of conduct addressing compliance with laws; and (c) a limit on payments to independent directors and their family members (other than for services on the board of directors).

These corporate governance requirements and a strict definition of "independent director" make it more difficult to find independent directors for our Board of Directors. There is intense competition for qualified independent directors, including those persons with accounting experience and financial statement acumen to serve on audit committees. We believe that continued compliance with the corporate governance requirements applicable to NASDAQ listed issuers may be difficult and increase our costs and expenses as the costs of finding and compensating independent directors escalate and the costs of administering their new powers and responsibilities is an added financial burden. If we are unable to attract and keep a sufficient number of independent directors willing to take on the responsibilities imposed by such rules on what we believe to be commercially reasonable terms, our securities may be delisted from NASDAQ. (See "Being a Controlled Company Exempts Us From Certain Other Corporate Governance Criteria Applicable to NASDAQ Listed Issuers.")

**Being A Controlled Company Exempts Us From Certain Other Corporate Governance Criteria Applicable To NASDAQ Listed Issuers.**

As a result of T.C. Leung, the Company's Chairman of the Board and Chief Executive Officer beneficially owning in excess of the majority voting power of our Ordinary Shares, we are a "controlled company" as that term is defined in rules and regulations applicable to NASDAQ listed issuers. As a "controlled company", we are not required to comply with certain NASDAQ corporate governance criteria including, among other things, the requirements that the majority of our Board be independent directors, and their having the authority to approve director nominations and executive officer compensation.

**We Are Not Subject To Various Corporate Governance Measures, Which May Result In Shareholders Having Limited Protections.**



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Recent Federal legislation, including the Sarbanes-Oxley Act of 2002 ( SOX ), has resulted in the adoption of various corporate governance measures by securities exchanges and NASDAQ designed to promote the integrity of the corporate management and the securities markets.

Being a controlled company, we are exempt from many, but not all, of those requirements. Furthermore, the absence of such practices with respect to our Company may leave our shareholders without protections against interested director transactions, conflicts of interest and similar matters.

### **We May Be Exposed To Potential Risks Relating To Our Internal Controls Over Financial Reporting And Having Those Controls Attested To By Our Independent Auditors.**

Pursuant to Section 404 of SOX, the SEC adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports, including Form 20-F. In addition, the independent registered public accounting firm auditing a company's financial statements must also attest to and report on management's assessment of the effectiveness of a company's internal controls over financial reporting as well as the operating effectiveness of a company's internal controls. We were not subject to these requirements for the fiscal year ended December 31, 2009 as a result of temporary rules adopted by the SEC. We are evaluating our internal control systems in order to allow our independent auditors attest to, our internal controls, as a required part of our Annual Report on Form 20-F beginning with that report required when the temporary rules cease being effective.

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While we expect to expend significant resources in developing the necessary documentation and testing procedures required by SOX, there is a risk that we will not comply with all of these requirements. There can be no assurance that we will receive a positive attestation from our independent auditors.

In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner or we are unable to receive a positive attestation from our independent auditors with respect to our internal controls, investors and others may lose confidence in the reliability of our financial statements, our ability to obtain equity or debt financing could suffer and the market price of our shares could decline.

**The Market Price Of Our Securities Has Been Fluctuating Widely.**

During the past several years, the market price of our Ordinary Shares has fluctuated widely on occasion. Except for the recent price declines that the Company attributes to the current global economic downturn, the Company knows of no reason for these wide fluctuations. See Item 9.C- Markets.

**There Are Risks In Purchasing Low-Priced Securities.**

If our securities were to be suspended or delisted from the NASDAQ Capital Market, they could be subject to rules under the Exchange Act which impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established clients and accredited investors (for example, individuals with a net worth in excess of US\$1,000,000 or an annual income exceeding US\$200,000 or US\$300,000 together with their spouses). For transactions covered by such rules, a broker-dealer must make a special suitability determination of the purchaser and have received the purchaser's written consent to the transaction prior to the sale. Consequently, such rules may affect the ability of broker-dealers to sell our securities and the ability to sell any of our securities in any secondary market that may develop for such securities.

In the event our securities are no longer listed on the NASDAQ Capital Market or are not otherwise exempt from the provisions of the SEC's penny stock rules, such rules may also affect the ability of broker-dealers and investors to sell our securities.

**There Is No Assurance Of A Continued Public Market For Our Securities.**

There can be no assurance that a trading market for our Ordinary Shares will continue.

**We May Be Considered To Be A Passive Foreign Investment Company For The 2009 Calendar Year And May Be A Passive Foreign Investment Company For Future Years, Which Would Result In Adverse U.S. Federal Income Tax Consequences To U.S. Holders Of**

**Our Ordinary Shares.**

A non-U.S. corporation will be considered a passive foreign investment company ( PFIC ) for U.S. income tax purposes, for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) at least 50% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income. The annual PFIC determination to be made by a U.S. holder of our ordinary shares is an inherently factual determination and there is limited guidance regarding the application of the PFIC rules to specific situations. We currently hold a substantial amount of cash and cash equivalents, and investments in PRC enterprises, and the value of our goodwill and other assets may be based in part on the market price of our ordinary shares, which has experienced significant fluctuations. Although the determination of PFIC status is subject to factual uncertainties because it depends upon the valuation of our ordinary shares, as well as our goodwill and other assets and income, we are uncertain if we would be considered to be a PFIC for 2009. In addition, as the determination of PFIC status is made on an annual basis and depends on variables over which we have limited control, there can be no assurance that we will not be a PFIC for 2010 or any future years. If we are a PFIC in any year, U.S. Holders will be subject to certain adverse United States federal income tax consequences, as discussed in *Item 10 Taxation United States Federal Income Taxation*.

**ITEM 4. INFORMATION ON THE COMPANY**

***Item 4A. History and Development of the Company***

The Company was organized under the laws of the British Virgin Islands on September 30, 1996 for the purposes of raising capital and for acquiring all the outstanding capital stock of Euro Tech (Far East) Limited, a Hong Kong corporation involved in the distribution of advanced water treatment equipment ( Far East ). In March 1997, the Company acquired all the issued and outstanding capital stock of Far East and it became a wholly-owned subsidiary and was the primary operational entity of the Company.

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During Fiscal 2005, we completed our plan to increase our equity position in Yixing Pact Environmental Technology Company Limited ( Yixing ) and Pact Asia Pacific Limited ( Pact ), a company engaged in water and waste-water treatment solution business. We had previously owned thirty (30%) percent of their capital stock. With the addition of twenty-one (21%) percent of Pact's and Yixing's capital stock in October 2005, they became our majority-owned subsidiaries. In January 2010, we acquired an additional two percent (2%) interest in Pact, increasing our ownership to fifty-three (53%) percent of Pact. The foregoing purchases of Yixing and Pact were made from Tamworth Industrial Limited ( Tamworth ).

Pact and Yixing, situated in Shanghai, specialize in the design, manufacture and operation of water and waste-water treatment plants in several industries situated in China. Pact and Yixing, through associates and business alliances, also conduct similar operations in the Middle East.

In November of 2006 we established Shanghai Euro Tech Environmental Engineering Company Ltd. ( Shanghai Environmental ) as a wholly-owned subsidiary under the laws of the People's Republic of China, to carry on our environmental engineering department with that line of business and its personnel transferred from our subsidiary, Euro Tech (Far East) Ltd. Shanghai Environmental is focusing on our water and waste-water treatment engineering business and is planned to be the home of our planned expansion into the air pollution control business.

China's rapid economic growth had led it to become one of the world's largest emitters of sulfur dioxide. The damage due to acid rain caused by sulfur dioxide is vast, and is also affecting the neighboring countries as air currents transport sulfur dioxide. To tackle these environmental and geo-political issues, China has established targets to reduce key pollutants, namely, sulfur dioxide, nitrogen oxides and suspended particulates. Heavy polluters are being warned to reduce their emissions or face penalties. We believe that as a result, the demand of desulphurization and dust removal equipment will increase accordingly.

In August 2007, Far East acquired a 20% equity interest in Zhejiang Tianlan Desulfurization and Dust-Removal Co. Ltd. ( BlueSky ), founded in 2000, for approximately US\$4,648,000. Blue Sky provides design and general contracting services, equipment manufacturing, installation, testing and operation management for the purification treatment of industrial waste gases (specifically as desulphurization, flue gas de-nitration, dust removal) emitted from various boilers and industrial furnaces of power plants, steelworks and chemical plants. By securing an equity stake in BlueSky's business, we have a strategic partner to work within China's environmental protection business. With BlueSky's technology and technical support, we believe we are able to provide services and environmental solutions not only for water and waste-water treatment but also for air pollution control for industrial clients in China.

In January 2008, we acquired a 20% equity interest in Zhejiang Jia Huan Electronic Co. Ltd., ( Jia Huan ) for approximately US\$2,610,000. Jia Huan has been in the environmental protection business since 1969. Approximately 95% of Jia Huan's business is related to air pollution control and less than 5% is related to water and wastewater treatment. Jia Huan designs and manufactures automatic control systems and electric voltage control equipment for electrostatic precipitators which are used as air purification equipment for power plants, cement plants and incinerators to remove and collect dust and pollutants from exhaust stacks.

**Item 4B. Business Overview**

The Company had been primarily a distributor of a wide range of advanced water treatment equipment (including chlorination equipment), laboratory instruments, analyzers, test kits and related supplies and power generation equipment (including recorders and power quality

analyzers). The Company acts as an exclusive and non-exclusive distributor for well-known manufacturers of such equipment, primarily to commercial customers and governmental agencies or instrumentalities in Hong Kong and the PRC.

The Company distributes products through its Hong Kong headquarters, its retail shops and representative offices located in Beijing, Shanghai, Guangzhou, Chongqing, Xi'An, Shenyang, Wuhan, Fuzhou, Chengdu and Urumqi and through non-exclusive arrangements with independent sub-distributors located in Hong Kong, the PRC and Macau.

We are in the process of shifting our emphasis from the distribution of instruments and equipment to engineering and manufacturing activities. Revenues from our trading activities have fallen-off as a substantial number of our suppliers have been selling their products into China directly and through other distributors. Many of these other distributors are local Chinese companies and can operate with a lower overhead. In Fiscal 2008, revenues and net income generated from our environmental engineering department and our majority owned subsidiaries, Pact and Yixing (companies engaged in the water and waste water treatment solution business), more than offset our falling trading revenues. However, in Fiscal 2009, that was no longer the case as Pact's and Yixing's Revenues declined as a result of the global economic downturn.

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Laboratory instruments, analyzers and test kits are used to analyze the chemical content and ascertain the level of impurities or other contaminants in water. The Company distributes analytical re-agents and chemicals to support testing systems of laboratory and portable instruments, process analyzers and portable test kits and assist in the analysis process. The Company offers a wide variety of test kits to test water quality. The Company believes that these portable test kits are easy to use and preadapted for rugged field use. These test kits are used to monitor drinking water distribution systems.

Laboratory and portable instruments generally consist of analytical instruments including, but not limited to the following: spectrophotometers, colorimeters, turbidimeters, ion-selective electrodes, chemical oxygen demand apparatus, digestion apparatus, and precision re-agent dispensing devices which are used to test and monitor impurities and contaminants in water systems. See Glossary.

The Company also distributes continuous-reading process analyzers, process turbidimeters, pH controllers and analyzer accessories. These products are generally used to monitor and control drinking water quality to ensure that water treatment procedures comply with regulatory standards. See Glossary.

To allow the Company to bid on larger water, waste-water and power generation projects, we acquired Pact and Yixing ( Pact-Yixing ) and continue our search for other engineering companies and/or a system integrator (a company that provides hardware, software and solutions in the field of engineering) or enter into a joint venture with a third party to work in connection with our process control and engineering department.

Pact-Yixing have completed a substantial number of industrial water and waste-water treatment projects in the PRC. The majority of these projects are for large multinational manufacturing facilities for clients from the USA, Europe and Japan. Process design as well as mechanical and electrical engineering are completed in-house and manufacturing contracted to approved fabricators of components. Fabrication drawings are also done in-house for submittal to said fabricators under the supervision of Pact-Yixing's quality control engineers.

Pact-Yixing clients cover a varied spectrum of industries covering semiconductor, pharmaceutical, petrochemicals, auto and auto parts, steel, food and beverage and beauty products.

The water and waste-water treatment processes applied at Pact-Yixing cover chemical, physical, biological and membrane separation. A combination of those processes are normally used to treat a specific industrial process feed or effluent. With respect to the water treatment side of Pact-Yixing's business, they design and build filtration equipment, ion-exchange softeners and demineralizers, reverse osmosis, electro-deionization, chemical treatment systems and package type mobile water treatment plants. As for waste-water treatment, Pact-Yixing design and build biological treatment systems, oil coalescers, dissolved air flotation, lamella clarifiers, chemical reactor tanks, ultrafiltration, microfiltration, dewatering systems and package type mobile sewage treatment plants. Biological treatment plants cover both aerobic and anaerobic processes. State-of-the-art aerobic processes of SBR (sequential batch reactors) and MBR (membrane biological reactors) are technologies also covered by Pact-Yixing. See Glossary.

In 2006, Pact-Yixing commenced selling water and waste-water treatment equipment. The equipment are components of systems traditionally marketed by Pact-Yixing. The equipment are partially manufactured to Pact-Yixing's in-house design and partially procured from approved Chinese suppliers. PACT and Engineering FZC ( PACTFZC ), a Middle Eastern water treatment company based in Dubai, and a third party agreed to form a joint venture. In June 2007, the joint venture, Pact Environmental Equipment Co. Limited (the JV ), was registered in the PRC

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without the parties entering into a written joint venture agreement. PACT invested US\$300,000 and has a 60% controlling interest of the JV, PACTFZC, majority owned by George Hayek, the Company's Managing Director and the third party each invested US\$100,000 in consideration for 20% interests. The JV's products cover equipment used for screening, grit removal, clarification, aeration, sequential batch reactors, membrane bioreactors, sludge dewatering and sludge conveying.

In February 2010, Pact entered into an agreement with a stainless steel manufacturer providing for an aggregate of up to \$3,800,000 to be paid to Pact, of that aggregate amount a US\$749,000 down payment has been paid, for the engineering, design, supply, equipping, installation, personnel training and commissioning of waste water treatment, direct water cooling, indirect cooling tower water, potable water treatment and industrial water treatment systems in Jiangsu, China. The target dates for the completion of the various systems run from the end of January 2011 through March 2011. The balance of contract price is payable in varying installments upon the completion of certain thresholds and the buyer's acceptance of the thresholds being met.

The Company believes that the Pact-Yixing business is complementary to the Company's business as the Company continues to sell and market products of others. The Company expects that with this acquisition it may be able to gain a competitive advantage by offering customers and potential customers not only hardware but solutions to engineering problems as well. The Company continues to seek to make a similar acquisition of an engineering company specializing in air pollution control or other complementary environmental protection fields or in the power generation field.

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A purpose of this acquisition was to reconfirm our direction to place a greater emphasis on developing an engineering solution business, instead of relying on its then current activities.

**Product Distribution and Other Services**

**Scientific Instruments.** The Company distributes analytical instruments, environmental monitoring instruments and general purpose laboratory instruments. Analytical instruments include, but are not limited to, chromatographs, mass spectrometers, flow injector analyzers, refractometers and atomic spectrometers. Environmental monitoring instruments include both air and water quality monitoring instruments. Air quality monitoring instruments are generally divided into those which monitor ambient (i.e., atmospheric) air, and those which monitor pollution sources. Additionally, the Company offers general purpose laboratory instruments including a variety of water quality monitoring and analysis equipment, such as continuous reading process analyzers, process turbidimeters, pH controllers, and test kits for monitoring chemical content in water (i.e., chlorine, fluorides, etc.). See Glossary.

Customers for the analytical instruments include government agencies, academic and research institutions and major laboratories. The Company also distributes products to beverage producers and restaurants, including water quality test kits to more than twelve bottling plants of a well known United States soft drink producer, which are located in the PRC; water quality monitoring instruments to well known United States fast food franchisor's restaurants located in Hong Kong and the PRC, and package analyzers to the various PRC plants of a substantial worldwide Belgian brewer. Each such soda producer, restaurant and beer bottler does not account for a significant portion of our sales.

Customers for air and water quality monitoring instruments also include government agencies such as the Hong Kong Environmental Protection Department, which uses a Company distributed water quality monitoring system to monitor the water quality of Hong Kong's Victoria Harbor, more than ten water treatment plants located in the PRC (including sites at Beijing, Tianjin, Guangzhou and Wuhan), and supplied toxicity analyzers to various environmental monitoring centres throughout China through China's Ministry of Environmental Protection (MEP).

The Company derived approximately, 67.2%, 52.4% and 38.7% of its revenues from the sale of Scientific Instruments during Fiscal 2009, Fiscal 2008 and Fiscal 2007, respectively.

**Process Control and Engineering Products.** The Company provides process control systems specifically designed for the industrial needs of clients including sensors, temperature gauges, pressure gauges, power and energy consumption meters, flow meters, valves, temperature and pressure transmitters and control devices, temperature and pressure calibrators, moisture, power, energy and harmonic analyzers. Chlorination disinfection systems are also distributed by Far East in conjunction with water treatment, sewage discharge and swimming pool water treatment. Customers for the foregoing distributed products include government water supply agencies, water treatment facilities, power and electric companies, petrochemical plants and instrument manufacturers. For example, the Company distributes chlorination disinfection systems to water plants located in Guangdong, PRC.

In conjunction with the distribution of products such as programmable logic controllers, telemetry units and SCADA systems and software, the Company also provides systems engineering to government agencies, waste-water treatment and power generation plants and beverage producers. Specific services provided include automated control system design, the operation and management of various waste-water, water



and power generation projects. We endeavor to introduce, develop, and promote new and advanced technologies, products, and appropriate technical developments from abroad. We have also been cooperating with established technology companies and engage in systems and special projects in Programmable Logic Control, Telemetry unit, SCADA systems, Human Machine Interface Software and Sequential Event Recording.

The Company derived approximately 17.8%, 19.3% and 23.0% of its revenues from the sale of Process Control and Engineering Products during Fiscal 2009, Fiscal 2008 and Fiscal 2007, respectively.

**Energy Conservation, And Related Products.** The Company distributes general testing and measuring equipment including multi-channel digital and analogue recorders, signal amplifiers and calibration equipment for energy conservation, renewable energy equipment, power quality analyzers, continuous emissions monitoring systems and air pollution control systems to industries including power plants, railway and aero-space industries, utilities, educational institutions and telecommunications companies. The Company derived approximately 13.2%, 27.1% and 36.9% of its revenues from the sale of these Energy Conservation and Related Products during Fiscal 2009, Fiscal 2008 and Fiscal 2007, respectively.

**Technical Support.** The Company's technical support staff provides customers with maintenance, installation assistance, and calibration services, and assists sales personnel in giving technical advice to and performing product demonstrations for customers. Technical Support services derived approximately 1.8%, 1.2% and 1.4% of its revenues from Technical Support Operations during Fiscal 2009, Fiscal 2008 and Fiscal 2007, respectively.

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**Customers.** During Fiscal 2009, the Company distributed products to in excess of 1,000 customers, including sub-distributors, located in Hong Kong, the PRC and Macau such as the Hong Kong Environmental Protection Department, Hong Kong Water Supplies Department, Government Laboratory, Drainage Services Department, China's National Environmental Protection Agency, various Environmental Monitoring Centers in the PRC. Government Laboratory and Water Supplies Department of Hong Kong accounted for 17.5% and 9.3% of the Company's revenues during Fiscal 2009. The Company does not believe that any single customer or sub-distributor is material to its operations.

## **Manufacturing and Product Assembly Operations**

The Company, through its PRC Corporation, Shanghai Euro Tech Limited established in 1999 in the Pudong Jin Qiao Export Processing Zone of Shanghai, engages in the development, production, sales and servicing of environmental equipment, including the development of modern laboratory analyzers, on-line measuring equipment and other analyzers for chemicals. Our products are tailor-made for the diversified needs of equipment users. Main products include Infrared Photometric Oil Analyzer (IPOA), COD analyzers, Total Organic Carbon Analyzer, turbidity meters, total suspended solid analyzers, dissolved oxygen analyzers, various types of spectrophotometers as well as a full spectrum of matching chemical reagents. In late 2005, we began offering two new turbidity meters, manufactured by the Company. One of the new turbidimeters is directed at water treatment plants, environmental monitoring status, hydrological stations and the second is directed at beer and other beverage processing facilities and it analyzes the particles contained in the beverage. In November 2006, we began actively marketing our Total Organic Carbon (TOC) analytical instrument that measures the degree of the pollution level of drinking water, ground water and waste water. Our TOC analyzer has been three and a half years in research, development and field testing of prototypes sold to our customers. We had made some modifications to this product to improve the quality and obtained updated Chinese Metrology Certification, a certificate issued by Bureau of Quality and Technical Supervision in November 2007 and began selling this modified TOC in 2008. We have also upgraded other existing instruments and developed a quick response Chemical Oxygen Demand (COD) test instrument for use on surface water, underground water and domestic and industrial wastewater. In 2008 we introduced a Flue Gas Emissions Analyzer for use in environmental compliance monitoring. We also developed energy meters (devices measuring electric energy consumption and corresponding carbon dioxide emissions) and water toxicity analysis instruments. In 2010, we started to develop a nondispersive infrared sensor (NDIR) for flue gases.

The Company believes that by establishing product assembly operations in the PRC will not only increase revenues, expand its customer base, but also its net income since the Company believes it will enjoy higher overall profit margins by assembling certain products which it now distributes rather than by only purchasing the finished product from vendors.

## **Sources of Supply**

The Company distributes products manufactured by a substantial number of major American, European and Japanese corporations, including Thermo, Siemens, Hach and Caliper, which are the Company's largest suppliers, with purchases from them accounting for approximately 10%, 7%, 8% and 10%, respectively of the Company's sales during Fiscal 2008 and approximately 21%, 13%, 10% and 10%, respectively of the Company's sales during Fiscal 2009. The Company has exclusivity agreements for specified geographic areas with many of its suppliers for certain products. Those agreements do not encompass all products distributed by the Company or all of the market areas serviced by the Company. In addition, some of these agreements are memorialized not as formal contracts but rather through other acknowledgements or correspondence which may contain a vague, if any, description of the terms and conditions of such agreement or arrangement, and therefore may be unenforceable. The Company's Letter of Authorization with Thermo is valid until December 31, 2010. The Company's agreement with Siemens shall remain in force for an indefinite period of time, unless either party may terminate the agreement without cause by giving the other party 6 months prior written notice. The Company's agreement with Caliper is terminable on ninety days notice by either party. In May 2010, Caliper sold most of its products distributed by the Company to another international manufacturer. Although alternative sources of supply exist, there can be no assurance that the termination of the Company's relationship with any of the above or other vendors would not have an adverse effect on operations.

**Future Planning and Expansion**

We continuously search for other companies engaged in manufacturing the above products and equipment and in engineering companies which design and build pollution control systems. We anticipate that the costs of any such acquisition would be drawn from our general working capital and, possibly, by private sales of our securities including the potential exercise by officers and directors of their options. We have no commitments or indications of interest for the private sales of our securities.

We are planning to expand our activities in the air pollution control business by forming joint ventures, investing or acquiring some interests in other companies involved in (i) the dust removal and/or (ii) the flue gas desulphurization for power plant industries and other similar industries.

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Our plans for the near term also include continued use of our retail shops to sell low-tech products and our own products. We believe that these shops are operating with a lower overhead than the rest of the Company; and we believe that the continued low-tech product sales through our retail shops coupled with our on-line product sales will allow us to continue to offer products at lower prices than our competitors.

Having low-tech products offered through our retail shops and the availability of on-line product offerings are anticipated to allow our sales force to focus on high-tech and other products requiring personal or telephone contact directly with customers and potential customers.

The Company believes that by assembling the products it distributes, it may realize increased gross profit margins and greater revenues and net income than if it remains only a product distributor. During the next twelve months, we intend to assemble and/or manufacture additional products, especially those related to the air pollution and energy conservation sectors and seek opportunities with our suppliers to assemble their products, secure manufacturing and/or assembly facilities and seek another manufacturer of analytical instruments to acquire.

**Regulatory Environment**

Concerns about and awareness of pollution problems and environmental issues have grown at all levels of PRC government as the PRC experienced economic growth. Environmental protection laws and strict regulations have been enacted and are buttressed by increased budget allocations for environmental regulation, monitoring and enforcement. The PRC's primary environmental protection agency is the Ministry of Environmental Protection (MEP), under which there are Environment Protection Bureaus in each city and county. According to oral information received by management from MEP, under bureau management, there are two environment monitoring systems: one system consists of over 2,200 monitoring stations to collect and analyze the environmental data of each city and county; another system consists of over 2,500 stations to monitor specific industrial districts or factories which have been identified as major pollution sources due to their non-compliance with environmental regulations. The PRC government has established ambitious targets in its 12th Five-Year Program (2011-2015) to slash emissions of pollutants, including sulfur dioxide emissions and COD, by 10%. The PRC government passed a law requiring power distributors to combat global warming. A central government fund, financed by a national tariff increase, will subsidize the tariff gap between more expensive renewable energy and the national average tariff. Preferential policies also encourage construction of renewable energy projects, projects in poorer interior regions that are often rich in water, solar and wind resources. The Company has supplied water and air quality monitoring and analytic instruments to these monitoring stations for several years. There can be no assurance that the agencies will continue to use the Company's products for these purposes, or that other market competitors will not enter the market with superior products, distribution systems or more competitive prices. See Competition.

**Competition**

The Company faces competition from other distributors of substantially similar products as well as the manufacturers of such products, and in both foreign and Chinese markets. The Company faces its principal competition from manufacturers and other distributors of its core products located in Hong Kong and the PRC. Moreover, the Company has implemented plans to assemble products of the kind that it presently distributes (see -Product Assembly Operations ). Assembly operations have developed to the stage where some products have already been presented to the market and the Company is in direct and unavoidable competition with certain of its vendors. There can be no assurance that the existence of this direct competition will not impair the Company's ability or such competitor's willingness to continue providing other products for continued distribution by the Company and that such a development would not materially adversely effect the Company's core business.

During Fiscal 2009, Fiscal 2008 and Fiscal 2007, the Company's gross profit margins were approximately 24%~~24%~~, and 25%, respectively. The Company believes that it competes with the PRC manufacturers on the basis of quality and technology. The Company believes it offers foreign-manufactured products which are of higher quality and use more advanced technology than products manufactured in the PRC. The Company believes that it competes with foreign manufacturers and other distributors of their products on the basis of the Company's more extensive distribution network and an established reputation. Pact-Yixing focuses on a market of providing water and waste water treatment services to multinational companies. The Company competes in this market based upon the quality of its products and having a knowledgeable staff.

#### **Website**

The Company, through its subsidiary, ChinaH2O.com Limited, a Hong Kong corporation, has a internet platform. The website is located at (<http://www.chinah2o.com>). The website is directed at environmental businesses in China. The website provides environmental news, directories of western suppliers, potential clients in China, advertisement space and business opportunities. The business and other activities generated by ChinaH2O.com Limited

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have had a synergistic effect with those of the Company indirectly by feeding market information, sales leads and tender information to the Company.

**Sales and Marketing**

The Company distributes products through its principal office located in Hong Kong and its representative PRC offices located in Beijing, Shanghai and Fuzhou. During 2007, the Company closed one representative office and consolidated their personnel into our retail shop, as the office did not financially contribute to the Company as anticipated. The Company has a marketing and sales force of 62 people who are paid a salary plus a sales based commission. The Company's offices also coordinate the sales efforts of approximately fifty other companies located in the PRC which act as sub-distributors. These sub-distributors are engaged on a non-exclusive basis to distribute the products of other distributors. Each of the fifty sub-distributors accounted for less than two (2%) percent of the Company's sales during Fiscal 2007 through Fiscal 2009.

Following the opening of our first retail shop in Shanghai in 2001, (closed in 2007 but absorbed into our own Shanghai Euro Tech Trading (Shanghai Limited)), Euro Tech retail outlets are now found in a number of major cities in the PRC, including Beijing and Guangzhou. Our staff at these shops assists customers in selecting the equipment, auxiliary parts and products to suit customer specifications. Equipment that needs to be repaired or provided with routine maintenance can be returned to us via these shops, as our retail shops, except for the Beijing shop, are also maintenance centers. The Company has found the six existing shops to be useful as demonstration locations easily accessed by local customers who can pay in local currency while off the shelf sales are made which move its inventory more readily. In addition to the shops, we also have four branches or representative offices of these shops. All of the foregoing are perceived by the Company to have had a positive impact on its business reputation while reducing the Company's dependency on sub-distributors who may not be loyal to the Company and distribute products of our competitors. As foreign entities are not generally permitted to own these facilities, these shops are owned by non-officer/director, employees of the Company with funds from the Company through non-fixed term loans aggregating approximately US\$144,000 bearing a nominal rate of interest. The shops do not have financing from other sources. There can be no assurance that these shops will continue to be economically viable, that the Company will not sustain losses in connection with the loans to the shops; or the shops will result in any significant revenues or profits for the Company. Also, similar shops may be established by our competitors and/or third parties.

Foreign entities are now permitted to own retail shops in some regions of PRC. The Company has established three wholly-owned retail shops in Chongqing, Xi An and Guangzhou. During 2007, we closed the Wuhan representative office, merging personnel into our Wuhan shop. During 2008, we closed a Guangzhou representative office, merging personnel into our Company owned retail shop in that city. During 2009, we closed the retail shop in Guangzhou owned by non-officer/director, employees of the Company. We will continue to consolidate our operations by combining the retail shops and representative offices in the same cities or close shops and offices that do not appear to be contributing to the Company as expected.

These shops (or their representative offices) were opened on the following dates:

Retail Shops

Owned by non-officer/director, employees of the Company:

Beijing	October 2001
Wuhan	November 2002
Shenyang	December 2002

Owned by the Company:

Chongqing	November 2006
Xi'An	April 2007
Guangzhou	April 2008

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Representative Offices

ChengDu	March 2007
Urumqi	October 2007

**Item 4C. Organizational Structure**

The Company presently wholly owns Far East, a Hong Kong corporation, which, in turn, owns the following corporations:

**Wholly-Owned**

- Euro Tech Trading (Shanghai) Limited a People's Republic of China corporation
- Euro Tech (China) Limited a Hong Kong corporation
- ChinaH2O.com Limited a Hong Kong corporation
- Shanghai Euro Tech Limited a People's Republic of China corporation
- Shanghai Euro Tech Environmental Engineering Company, Ltd. a People's Republic of China corporation
- Chongqing Euro Tech Rizhi Technology Company, Limited a People's Republic of China corporation
- Rizhi Euro Tech Instrument (Shaanxi) Company Limited a People's Republic of China corporation
- Guangzhou Euro Tech Environmental Equipment Company Limited a People's Republic of China corporation

**Majority Owned**

- Yixing Pact Environmental Technology Company Limited a PRC corporation
- Pact Asia Pacific Limited a BVI corporation ( PACT ).

Other



Pact Environmental Equipment Co. Limited a PRC joint venture, 60% owned by PACT.

The Company's wholly-owned subsidiary and primary operational arm is Far East, which it acquired in March 1997. Far East has engaged in the distribution of various industrial control equipment, which continues to be the core business of the Company, since its inception in 1971.

**Item 4D. Property, Plant and Equipment**

The Company maintains an executive office at 18/F Gee Chang Hong Centre, 65 Wong Chuk Hang Road, Hong Kong. The Company occupies approximately 12,800 square feet of office and warehouse storage space under a two (2) year lease that expires in May 2011 with a monthly rental payments of approximately US\$8,140. The warehouse storage space is used to hold products for distribution to our customers via common carriers.

In August 1995, the Company purchased approximately 1,200 square feet of space in a building in Hong Kong. This property is now rented out to a third party.

The Company also maintains representative offices within the PRC in the cities of Beijing, Shanghai and Fuzhou. The Beijing and Shanghai sales offices are owned by the Company. The Fuzhou sales office is rented pursuant to a short-term lease of approximately US\$509 per month.

Euro Tech Trading (Shanghai) Ltd. has two offices rented pursuant to short term leases, at an aggregate monthly rental of approximately US\$1,436. Shanghai Euro Tech Limited's premises are rented pursuant to a short term lease for a monthly rental of approximately US\$2,458. Shanghai Euro Tech Environmental Engineering Company, Ltd's premises are also rented pursuant to a short term lease for a monthly rental of approximately US\$1,128.

Pact occupies a 700 square meter facility in Shanghai, pursuant to a 3 year lease expiring in January 2012, providing for a monthly rental of approximately US\$6,542.

The Company's registered office in the British Virgin Islands is located at TrustNet Chambers, P.O. Box 3444, Road Town, Tortola, British Virgin Islands and its telephone number is (284) 494-5296.

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**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

**Overview**

The Company is engaged in two different major activities, namely Product Distribution, and Manufacturing and Environmental Services.

The Company is primarily a distributor of a wide range of advanced water treatment equipment (including chlorination equipment), laboratory instruments, analyzers, test kits and related supplies and power generation equipment (including recorders and power quality analyzers).

The Company, through its PRC corporation, Shanghai Euro Tech Limited established in 1999 in the Pudong Jin Qiao Export Processing Zone of Shanghai, engages in the development, production, sales and servicing of environmental protection equipment, and energy conservation and related products.

The Company, through its majority owned subsidiaries, Pact and Yixing, its wholly-owned subsidiary, Shanghai Environmental, and its affiliates, BlueSky and Jia Huan, engages in water and waste-water treatment engineering business and air pollution control business.

The Company's operations are located almost entirely within, and revenues are almost entirely generated from Hong Kong and the PRC. The Company derived approximately 28% and approximately 71% of its revenue from Hong Kong and the PRC, respectively in Fiscal 2009. Net income decreased approximately US\$117,000, or 78%, in Fiscal 2009 to US\$32,000, compared to US\$149,000 in Fiscal 2008, primarily due to a decrease in total revenue of approximately US\$4,402,000 as an impact of the global financial crisis.

The Company continued to consolidate its trading business by combining some of its regional sales efforts in the PRC with the retail shops and using online ordering in the PRC to sell the Company's products. The Company manufactures and sells its own developed products such as Infrared Photometric Oil Analyzer, turbidity instruments, spectrophotometers and the Total Organic Analyzer. The Company intends to assemble and/or manufacture additional products in the future and seek opportunities with its suppliers to assemble their products, secure manufacturing and/or assembly facilities and seek another manufacturer of analytical instruments to acquire.

The Company continued to accept more engineering projects in water and waste-water industries and also in power generation industries. The Company intends to continue its search for acquisition candidates of other firms engaged in engineering and/or system integration or enter into a joint venture with a third party to work in connection with its process control and engineering department.

**Item 5A. Operating Results**

**Background - Political and Economic Conditions in Hong Kong and the People's Republic of China**

The Company's operations are located almost entirely within, and revenues are almost entirely generated from Hong Kong and the PRC. Set forth below are the approximate percentage of the Company's sales made to customers in the PRC and Hong Kong for the fiscal years indicated:

<b>Fiscal Year</b>	<b>PRC</b>	<b>Hong Kong</b>
2007	79%	20%
2008	80%	18%
2009	71%	28%

Sales to customers situated in Macau and elsewhere through Fiscal 2009 were nominal. This makes the Company particularly susceptible to changes in the political and economic climate of either Hong Kong or the PRC.

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**Hong Kong.** Hong Kong has been one of the prime centers for commercial activity and economic development recently in Southeast Asia. On July 1, 1997, sovereignty over Hong Kong was transferred from the United Kingdom to the PRC. As provided in the Sino-British Joint Declaration and the Basic Law, the Hong Kong SAR is provided a high degree of autonomy except in foreign and defense affairs. The Basic Law provides that the Hong Kong SAR is to have its own legislature, legal and judicial system and full economic autonomy for 50 years after the transfer of sovereignty. Based on the current political conditions and the Company's understanding of the Basic Law, the Company does not believe that the transfer of sovereignty over Hong Kong has had or will have an adverse impact on its financial and operating environment. Although the Chinese government has pledged to maintain the economic and political autonomy of Hong Kong over its internal affairs, there is no assurance that such pledge will continue to be honored if there are changes in the Chinese political or economic climate. Sales in Hong Kong, expressed as a percentage of our revenue increased by 10% in Fiscal 2009 as compared with Fiscal 2008. This increase was primarily due to an increase in sales of Thermo's products to Hong Kong's Government Laboratories. See Item 3D. Key Information Risk Factors.

**PRC.** The PRC has been a socialist state since 1949. For more than half a century, the PRC's economy has been, and presently continues to be, a socialist economy operating under government controls promulgated under various State Plans adopted by central Chinese government authorities and implemented, to a large extent, by provincial and local authorities which may set production and development targets. However, since approximately the early 1980s, the PRC's national government has undertaken certain reforms to permit greater provincial and local economic autonomy and private economic activities. Any change in political or economic conditions may substantially adversely affect these reform initiatives and, in turn, the Company. Sales in the PRC, expressed as a percentage of total revenue decreased by 9% in Fiscal 2009 as compared with Fiscal 2008. This decrease was primarily due to the global economic downturn and additional sales by our key suppliers in the PRC through distributors other than the Company. See Item 3D. Key Information Risk Factors.

**Results from Operations**

The following operating and financial review should be read in conjunction with the Consolidated Financial Statements and notes thereto appearing elsewhere in this Annual Report. All financial data referred to in the following discussion has been prepared in accordance with accounting principles generally accepted in the United States ( US GAAP ).

The following table presents selected statement of operations data expressed in thousands of US\$ and as a percentage of revenue for the Company's fiscal years indicated below:

	2009		2008		2007		2006		2005	
Revenue	27,336	100%	31,738	100%	27,230	100%	27,161	100%	31,250	100%
Cost of revenue	20,876	76.4%	24,154	76.1%	20,398	74.9%	20,606	75.9%	24,681	79.0%
Gross Profit	6,460	23.6%	7,584	23.9%	6,832	25.1%	6,555	24.1%	6,569	21.0%
Selling and administrative Expenses	6,608	24.2%	7,214	22.7%	6,566	24.1%	5,961	21.9%	5,418	17.3%
Income before income Taxes	(40)	-0.1%	560	1.8%	664	2.4%	835	3.1%	1,358	4.3%
Income taxes	218	0.8%	321	1.0%	144	0.5%	156	0.6%	328	1.0%
Equity in profit of Affiliates	595	2.2%	273	0.9%	247	0.9%		0.0%	21	0.0%
Net income	337	1.2%	512	1.6%	767	2.8%	679	2.5%	1,051	3.3%
Net income attributable to Non-controlling interest	(305)	1.1%	(363)	1.1%	(345)	1.3%	(318)	1.2%	(318)	1.0%
Net income attributable to The Company	32	0.1%	149	0.5%	422	1.5%	361	1.3%	733	2.3%

**Fiscal Year Ended December 31, 2009 Compared to Fiscal Year Ended December 31, 2008**

*Revenue; Gross Profit and Cost of Revenue.* Revenue decreased by approximately US\$ 4,402,000 or 13.9% to approximately US\$27,336,000 in Fiscal 2009 from approximately US\$31,738,000 in Fiscal 2008. The revenue from trading and manufacturing activities decreased by approximately US\$3,113,000 and the revenue from engineering activities decreased by US\$1,289,000. These decreases were due primarily to the global economic downturn and additional key suppliers selling into the China market through distributors other than the Company. Pact-Yixing's revenues of approximately US\$8,654,000 and US\$9,260,000 were included in our revenues in Fiscal 2009 and Fiscal 2008, respectively.

Gross profits decreased by approximately US\$1,124,000 or 14.8% to approximately US\$6,460,000 for Fiscal 2009 as compared to approximately US\$7,584,000 for Fiscal 2008. During Fiscal 2009, the Company's cost of revenue was approximately US\$20,876,000, or 76.4% of revenues, in comparison to approximately US\$24,154,000, or 76.1% for Fiscal 2008. Cost of revenue expressed as a percentage of revenue increased by 0.3% in Fiscal 2009 as compared with

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Fiscal 2008. The slight gross profit margin percentage decrease was due principally to greater competition in a poor economic environment. Yixing-Pact contributed approximately US\$2,384,000 to our gross profit margin in Fiscal 2009, a decrease of approximately US\$226,000 from Fiscal 2008.

*Selling and Administrative Expenses.* Selling and administrative expenses were approximately US\$6,608,000 in Fiscal 2009, an decrease of approximately US\$606,000 or 8.4% from approximately US\$7,214,000 in Fiscal 2008. The decrease was principally due to the decrease of expenses for trading and manufacturing activities of approximately US\$484,000 as the Company continued to consolidate its trading business.

*Equity in Profit of Affiliates.* Equity in profit of affiliates of approximately US\$595,000 represented our share of net profit after taxes of BlueSky and Jia Huan.

*Interest Income.* Interest income decreased by approximately US\$8,000 or 17.8% to approximately US\$37,000 in Fiscal 2009 from approximately US\$45,000 for Fiscal 2008. The decrease was primarily due to the drop in interest rates.

*Other Income.* Other income decreased by approximately US\$74,000 or 51% to approximately US\$71,000 in Fiscal 2009 from approximately US\$145,000 in Fiscal 2008. The decrease in other income was principally due to a decrease of foreign exchange gain of approximately US\$73,000.

*Income Taxes.* Taxes decreased by US\$103,000 to approximately US\$218,000 in Fiscal 2009 from approximately US\$321,000 in Fiscal 2008. This increase was primarily the result of decreased taxable profits.

*Net Income.* Income from continuing operations decreased by approximately US\$117,000 or 78.5% to approximately US\$32,000 in Fiscal 2009 from approximately US\$149,000 in Fiscal 2008. The decrease was primarily due to the decrease in gross profit resulting from the drop in total revenues as the effect of global financial crisis that had a significant negative impact on the Company's business in China, partially offset by the decrease in selling and administrative expenses. As a consequence, our income before income taxes declined by approximately \$600,000 from Fiscal 2008 to Fiscal 2009, resulting in a loss before income taxes of approximately (\$40,000) in Fiscal 2009. This \$600,000 decline was partially offset by an increase in our equity in the profits of our affiliates. Increase profit contribution from affiliates and other factors discussed above.

**Fiscal Year Ended December 31, 2008 Compared to Fiscal Year Ended December 31, 2007**

*Revenue; Gross Profit and Cost of Revenue.* Revenue increased by approximately US\$ 4,508,000 or 16.5% to approximately US\$31,738,000 in Fiscal 2008 from approximately US\$27,230,000 in Fiscal 2007. The revenue from engineering activities increased by approximately US\$3,079,000 as a result of an increase in the number of engineering contracts completed, whilst revenues from trading and manufacturing

activities increased by approximately US\$1,429,000 resulting from increases in sales of products for environmental pollution and food safety analysis application. Pact-Yixing's revenues of approximately US\$9,260,000 and US\$6,981,000 were included in our revenues in Fiscal 2008 and Fiscal 2007, respectively.

Gross profits increased by approximately US\$752,000 or 11.0% to approximately US\$7,584,000 for Fiscal 2008 as compared to approximately US\$6,832,000 for Fiscal 2007. During Fiscal 2008, the Company's cost of revenue was approximately US\$24,154,000, or 76.1% of revenues, in comparison to approximately US\$20,398,000, or 74.9% for Fiscal 2007. Cost of revenue expressed as a percentage of revenue increased by 1.2% in Fiscal 2008 as compared with Fiscal 2007. The gross profit margin percentage decrease was due principally to a decrease in gross profit margin percentage for engineering activities as material prices generally increased in Fiscal 2008. Yixing-Pact contributed approximately US\$2,610,000 to our gross profit margin in Fiscal 2008, an increase of approximately US\$484,000 from Fiscal 2007.

*Selling and Administrative Expenses.* Selling and administrative expenses were approximately US\$7,214,000 in Fiscal 2008, an increase of approximately US\$648,000 or 9.9% from approximately US\$6,566,000 in Fiscal 2007. The increase was principally due to the increase of Yixing-Pact expenses of approximately US\$307,000 as a result of increases in expenses related to its increased revenue. These expenses included a staff increase from 57 in Fiscal 2007 to 76 in Fiscal 2008. The PRC inflation rate of 5.9%, the average appreciation rate of 6% for RMB against the US\$ in 2008 and increases in stock-based compensation expenses of US\$69,000 also contributed to the increase in selling and administrative expenses.

*Equity in Profit of Affiliates.* Equity in profit of affiliates of approximately US\$273,000 represented our share of net profit after taxes of BlueSky and Jia Huan.

*Interest Income.* Interest income decreased by approximately US\$211,000 or 82.4% to approximately US\$45,000 in Fiscal 2008 from approximately US\$256,000 for Fiscal 2007. The decrease was primarily due to the significant drop in interest rates and decrease in average bank deposit balances during Fiscal 2008 compared to Fiscal 2007 resulting from

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funds used in acquiring affiliates.

*Other Income.* Other income increased by approximately US\$3,000 or 0.2% to approximately US\$145,000 in Fiscal 2008 from approximately US\$142,000 in Fiscal 2007. The increase in other income was principally due to an increase of foreign exchange gain of approximately US\$16,000.

*Income Taxes.* Taxes increased by US\$177,000 to approximately US\$321,000 in Fiscal 2008 from approximately US\$144,000 in Fiscal 2007. This increase was primarily the result of increased taxable profits.

*Net Income.* Income from continuing operations decreased by approximately US\$273,000 or 65% to approximately US\$149,000 in Fiscal 2008 from approximately US\$422,000 in Fiscal 2007. The decrease was primarily due to the decrease in interest income and the increase in selling and administrative expenses, partially offset by the increase in gross profit.

**Item 5B. Liquidity and Capital Resources**

The Company has primarily used its funds to finance accounts receivable, inventories, and capital expenditures including purchases of property, office furniture and equipment, computers and calibration equipment. The Company has historically met its cash requirements from cash flows from operations, short-term borrowings, bank lines of credit, and long-term mortgage bank loans. The Company expects, but can make no assurances that its present cash reserves, cash from operations, existing available bank credit facilities and proceeds from the issuance of our ordinary shares pursuant to stock option exercises would be sufficient to fund its future capital expenditure requirements. Working capital at the end of Fiscal 2009 and Fiscal 2008 were approximately US\$8,203,000 and US\$8,583,000, respectively.

During Fiscal 2009, the Company generated net cash of approximately US\$240,000 from its operating activities from net income and decreases in inventories, accounts receivable, prepayments and other current assets while funding a decrease in accounts payable.

During Fiscal 2009 and Fiscal 2008, the Company used approximately US\$124,000 and US\$3,163,000 in investing activities, respectively. The Company used approximately US\$118,000 and US\$99,000 to purchase facilities and equipment in Fiscal 2009 and Fiscal 2008, respectively. During Fiscal 2009 and Fiscal 2008, the Company used approximately US\$73,000 and US\$56,000, respectively, as restricted cash to issue performance guarantees to its customers through its banks. During Fiscal 2009 and Fiscal 2008, Yixing-Pact paid dividends of approximately US\$147,000 and US\$NIL, respectively to non-controlling interest shareholders. During Fiscal 2008, the Company used approximately US\$2,610,000 to acquire a 20% equity interest in Jia Huan. During Fiscal 2007, the Company used approximately US\$4,151,000 to acquire 20% equity interest in Blue Sky. Additionally, a final payment of US\$692,000 was made in June 2009, based on Blue Sky's net profits for its fiscal year ended December 31, 2008. During Fiscal 2009 and Fiscal 2008, the Company received dividends of approximately US\$58,000 and US\$294,000, respectively from Blue Sky and approximately US\$149,000 and US\$Nil, respectively from Jia Huan.



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The Company received approximately US\$6,000 and US\$51,000, respectively, in Fiscal 2009 and Fiscal 2008 from financing activities resulting from the issuance of its ordinary shares resulting from the exercise of stock options. The Company used approximately US\$253,000 and US\$44,000, respectively, in Fiscal 2009 and Fiscal 2008 for financing the purchase of its ordinary shares as treasury stock. The Company had various banking facilities available for overdraft, import and export credits and foreign exchange contracts from which the Company could have accessed up to approximately US\$2,564,000 at December 31, 2009. The aforementioned available credit facilities were obtained on the conditions that, among other things, the Company not create a charge or lien on its other assets in favor of third parties without such bank's consent, and the Company maintaining a certain level of net worth.

Cash decreased from approximately US\$7,146,000 at the end of Fiscal 2008 to approximately US\$7,025,000 at the end of Fiscal 2009. The principal reasons for the decrease in cash were the payment of dividends to non-controlling interest shareholders of Pact-Yixing and purchase of its ordinary shares as treasury stock. The Company plans to use cash on hand primarily to expand its manufacturing plant and environmental engineering business by investing in product research and development and financing larger engineering projects.

The Company's net accounts receivable decreased from approximately US\$6,707,000 at the end of Fiscal 2008 to approximately US\$6,063,000 at the end of Fiscal 2009. This was principally the result of the collection of the receivables and decrease in sales revenue during Fiscal 2009.

The Company's inventory decreased from approximately US\$2,600,000 at the end of Fiscal 2008 to approximately US\$1,347,000 at the end of Fiscal 2009 due to some engineering sales orders completed before the year end.

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The Company's capital expenditures were approximately US\$99,000 and US\$118,000 in Fiscal 2008 and Fiscal 2009, respectively. Capital expenditures during Fiscal 2008 and Fiscal 2009 were incurred primarily in connection with the purchase of office equipment, furniture and fixtures. The Company continues to seek targets for acquisition and facilities for assembly operations or engineering companies. If such acquisitions are indeed made, the Company may expect to incur significantly larger capital expenditures, for which the Company presently intends, but as to which no assurance can be made, to use existing cash reserves, cash from operations, available bank credit facilities and proceeds from the issuance of our ordinary shares to fund such capital expenditures.

**Goodwill**

Goodwill related to the engineering segment which is profitable. As of December 31, 2009, we completed the annual impairment test. Based on the result of the first step of the test, the Company determined that there was no impairment of goodwill.

**Anticipated Future Resources and Uses of Cash**

The Company has historically funded its working capital, capital expenditure, investing and expansions needs from operations, available bank credit facilities and proceeds from the issuances of our ordinary shares and expects to continue funding its Fiscal 2009 these requirements from operations, available bank credit facilities and proceeds from the exercise of options. The Company may use its funds to acquire other businesses, make equity investments in related business, form strategic alliances with third parties, invest in product research and development, or expand its sales offices or, with third parties, seek to acquire new products or businesses or form strategic alliances. The Company expects, but can make no assurances that its present cash reserves, cash from operations and existing available bank credit facilities would be sufficient to fund its future cash requirements.

**Inflation**

The Company believes generally declining rates of inflation in the PRC have had a positive effect on its results from operations. As a result of the recent rise in the rate of inflation in the PRC, we anticipate increases in the overhead costs of our PRC affiliates and offices. The Company believes, although no assurance can be given, that as credit restrictions are gradually lifted, it will be able to increase prices in the market for its products and thus realize increased profit margins.

**Critical Accounting Policies**

*Revenue Recognition*

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Pursuant to the revenue recognition criteria set forth in Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 104: Revenue Recognition, the Company recognizes revenue when it is realized or realizable and earned. The Company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, the product has been delivered, the sales price is fixed or determinable and collectability is reasonably assured. For certain products where installation is necessary, revenue is recognized upon completion of installation. Revenue earned from customer support, which represents a minor percentage of total revenues, is recognized when such services are provided.

Revenues and profits in long term fixed price contracts or engineering income are recorded under the percentage of completion method in accordance with FASB ASC Subtopic 605-35, Revenue Recognition Construction Type and Production Type Contracts, (previously SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts). This approach relies on estimates of total expected direct costs of completion, which are compared to actual direct costs incurred to date to arrive at an estimate of revenue and profit earned to date. Recognized revenue and profit are subject to revisions as the contract progresses to completion. Revisions to profit estimate are reflected in income in the period in which the facts that give rise to the revision become known. For any contract where it is identified that a loss will be incurred, the full loss will be recognized immediately.

### *Inventory Valuation*

The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional write-downs may be required.

### *Deferred Taxes*

As part of the process of preparing its consolidated financial statements, the Company is required to estimate its income taxes and tax bases of assets and liabilities in each of the jurisdictions in which it operates. This process involves the Company estimating its current tax exposure together with assessing temporary differences resulting from its differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheet. The Company must then assess the likelihood that its deferred tax assets will be recovered from future taxable income, and, to the extent the Company believes that recovery is more unlikely than likely, it must establish a valuation allowance. To the extent the Company establishes a valuation allowance

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or increases this allowance in a period, it must include an expense within the tax provision in the statement of operations.

*Recent Accounting Pronouncements*

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (now codified within ASC 855-10, *Subsequent Events* (ASC 855-10)). ASC 855-10 provides general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 is applicable for interim or annual periods after June 15, 2009. In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-09, *Subsequent Events*, which is codified as ASC 855, *Amendments to Certain Recognition and Disclosure Requirements*. This Update amends the ASC 855-10, to replace the term *public entity* with the term *an SEC filer*, in order to avoid potential conflict with some of the Securities and Exchange Commission's (SEC) guidance. All of the amendments in this Update are effective immediately. The application of ASC 855 did not have a material effect on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, (now codified within ASC 105, *Generally Accepted Accounting Principles* (ASC 105)). ASC 105 establishes the Codification as the single source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Following this statement, FASB will not issue new standards in the form of statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will serve only to: (1) update the Codification; (2) provide background information about the guidance; and (3) provide the bases for conclusions on the change(s) in the Codification. ASC 105 was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification supersedes all existing non-SEC accounting and reporting standards. The adoption of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position.

In August 2009, FASB issued ASU 2009-5 *Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value* (ASU 2009-5). ASU 2009-5 provides amendments to Subtopic 820-10, *Fair Value Measurements and Disclosures-Overall*, for the fair value measurement of liabilities. ASU 2009-5 clarifies that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value. ASU 2009-5 was effective for the Company for interim and annual periods ending after September 30, 2009. The adoption of ASU 2009-5 did not have a material impact on the Company's consolidated results of operations or financial position.

In December 2009, FASB issued ASU 2009-17 *Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (ASU 2009-17). ASU 2009-17 amends the FASB ASC for the issuance of FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*. The amendments in ASU 2009-17 replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. ASU 2009-17 also requires additional disclosures about an enterprise's involvement in variable interest entities. ASU 2009-17 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of ASU 2009-17 to have a material impact on its consolidated results of operations or financial position.

In January 2010, FASB issued ASU 2010-01, *Entity, which is codified as ASC 505, Accounting for Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force)*. The amendments in this Update clarify that the stock

portion of a distribution to shareholders that allow them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance thus eliminating the diversity in practice. The amendments in this Update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The application of ASC 505 did not have a material effect on the Company's consolidated financial statements.

In January 2010, FASB issued ASU 2010-02 Accounting and Reporting for Decreases in Ownership of a Subsidiary- a Scope Clarification (ASU 2010-2). ASU 2010-2 addresses implementation issues related to the changes in ownership provisions in the Consolidation Overall Subtopic (Subtopic 810-10) of the FASB Accounting Standards Codification, originally issued as FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements. Subtopic 810-10 establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. An entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. The gain or loss includes any gain or loss associated with the difference between the fair value of the retained investment in the subsidiary and its carrying amount at the date the subsidiary is deconsolidated. In contrast, an entity is required to account for a decrease in ownership

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interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. ASU 2010-2 is effective for the Company starting January 1, 2010. The Company does not expect the adoption of ASU 2010-2 to have a material impact on the Company's consolidated results of operations or financial position.

In January 2010, FASB issued ASU 2010-6 Improving Disclosures about Fair Measurements ( ASU 2010-6 ). ASU 2010-6 provides amendments to subtopic 820-10 that require separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the presentation of separate information regarding purchases, sales, issuances and settlements for Level 3 fair value measurements. Additionally, ASU 2010-6 provides amendments to subtopic 820-10 that clarify existing disclosures about the level of disaggregation and inputs and valuation techniques. ASU 2010-6 is effective for financial statements issued for interim and annual periods ending after December 15, 2010. The Company does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated results of operations or financial position.

The Company does not believe that any other recently issued and adopted, but not yet effective, accounting standards should have a material effect on the accompanying financial statements.

**Item 5C. Research and Development, Patents and Licenses**

During Fiscal 2009, Fiscal 2008 and Fiscal 2007, the Company expensed approximately US\$99,000, US\$89,000 and US\$47,000, respectively, on the development of its products. It is anticipated that an additional US\$150,000 in research and development costs will be expended on similar projects and potential research and development projects for the development of air and water testing equipment and monitoring equipment during Fiscal 2010.

**Item 5D. Trend Information**

There are increasing demands in the PRC for clean water, clean air, greater industrial pollution controls, waste management and electricity. We also see additional distributors competing with us. However, given the political situation in the PRC, trends could quickly disappear and we do not know if they will continue in the future. We note that, as evidenced by our acquisition of Pact-Yixing, we are placing greater emphasis on developing our engineering solution business in an effort to capitalize on these increased demands (clean water, pollution controls and waste management).

The Company believes that the expenses incurred in product development may result in increases in revenue but such increases are unlikely to allow for a recovery of the expenses for approximately the next two years.

**Item 5E. Off Balance Sheet Arrangements**

None.

**Item 5F. Tabular Disclosure of Contractual Obligations**

<b>Contractual Obligations</b>	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Operating Leases	US\$ 224,000	US\$ 175,000	US\$ 49,000		
Total Contractual Cash Obligations	US\$ 224,000	US\$ 175,000	US\$ 49,000		

**6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****Item 6A. Directors and Senior Management**

Information concerning the Directors and Executive Officers of the Company are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
T.C. Leung	66	Chairman of the Board of Directors and Chief Executive Officer
Jerry Wong	51	Director and Chief Financial Officer
Alex Sham	44	Director

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Name	Age	Position
Y.K. Liang	78	Director
Ka Chong Cheang	81	Director
Xu Hong Wang	42	Director
Li Da Weng	65	Director

Set forth below is a brief background of the executive officers and directors based upon the information supplied by them to the Company:

**T.C. Leung** has been Chief Executive Officer and Chairman of the Board of Directors of both the Company and Far East since their inception. Before establishing Far East, Mr. Leung was an engineer for English Electric in England, from 1965 to 1968, and Lockheed Aircraft in Hong Kong, from 1968 to 1970. Mr. Leung also served as managing director of Eurotherm (Far East) Ltd. ( Eurotherm ) between 1971 and 1992. From 1988 until he retired in February 2005, Mr. Leung had also served as managing director of Eurotherm Hong Kong. Mr. Leung received a Masters degree in Business Administration from the University of East Asia, Macau in 1986 and is a Chartered Engineer, a title bestowed upon a member of the Council of Engineering Institutions in the United Kingdom.

**Jerry Wong** has served as Director and Chief Financial Officer of Far East since 1994 and has been with Far East since 1987. Mr. Wong has been the Chief Financial Officer and a Director of the Company since its inception. From 1985 until 1987, Mr. Wong worked for MUA Agencies Ltd., a subsidiary of a Hong Kong publicly listed company engaged in the insurance business, as deputy manager of its secretarial, legal and accounting department. From 1981 until 1985, Mr. Wong served as a senior accountant in Price Waterhouse-Hong Kong. He is a Fellow of the Association of Chartered Certified Accountants in the United Kingdom and a Certified Public Accountant in Hong Kong.

**Alex Sham** has been a Director of the Company since its inception. Mr. Sham joined Far East in 1988 and has been its Sales Manager since 1993 and became a Director of Far East in 1996. Mr. Sham received a Bachelor of Science in Applied Chemistry from Hong Kong Baptist University in 1990. Prior to joining Far East, Mr. Sham was employed by the Environmental Protection Department of the Hong Kong Government from 1986 until 1988. Mr. Sham received a Master s Degree in Business Administration from the University of Adelaide in 2003.

**Y.K. Liang** has been a Director of the Company since February 1998. Mr. Liang is a director of Wong Liang Consultants Ltd. ( Consultants ) and a member of the certified public accounting firm of Y.K. Liang & Co. ( LCO ). Mr. Liang has been associated with both Consultants and LCO for more than the past five years. Consultants is a general business consulting firm.

**Ka Chong Cheang** has been a Director of the Company since December 2005. From 1952 until 1977, he had been shipping manager for John Swire & Sons (Hong Kong) Ltd., a firm engaged in the importing and exporting shipping industry. For more than the past five years, Mr. Chong has been a business consultant.

**Xu Hong Wang** has been a director of the Company since August 2002. Mr. Wang is the East China sales manager of Euro Tech (Far East) Limited, a wholly-owned subsidiary of the Company, since mid 1994. From mid 1997 until joining Euro Tech, he was employed as a Research Associate and Lecturer at the Analysis and Research Center of Shanghai s Tongji University. Wang Xu Hong received Bachelor s and Master s



degrees in Science from Fudan University in 1984 and 1988, respectively.

**Li Da Weng**, from 1993 until January 2005, was the General Director of the Yangtze Valley Water Resources Protection Bureau ( YVWRPB ). He was employed by the YVWRPB in various positions, for more than 25 years, before he became the General Director in 1993. Since 2005, he has been the Secretary General of Yangtze Forum, a group of governments, businesses, universities and research institutes meeting on occasion to discuss issues on protecting and developing the Yangtze River, and since 1994 he has been a member of the Science and Technical Committee of Changjiang Water Resources Commission. Mr. Li Da Weng graduated from Hengyang Mining and Metallurgy College (now known as Nanhua University) in 1965 with a Bachelor's Degree in Analytical Chemistry. From December 1981 to December 1983, he was a visiting scholar at the Canada's Centre for Inland Waters, National Water Research Institute.

Directors of the Company serve until the next annual meeting of shareholders of the Company and until their successors are elected and duly qualified. Officers of the Company are elected annually by the Board of Directors and serve at the discretion of the Board of Directors.

None of the Company's directors, officers or beneficial owners of ten percent or more of its Common Stock are required to file any reports pursuant to Section 16(a) of the Exchange Act.

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The Company had 2 meetings of its Board of Directors during Fiscal 2009, while its Audit Committee had 4 meetings during Fiscal 2009.

There are no material legal proceedings involving any director, officer or affiliate of the Company, owner of record or beneficially of more than five percent of the Company's Common Stock or any associate of any of the foregoing.

**Key Employees**

**George Hayek**, Managing Director. He is the founder of Pact and Yixing and is a civil engineer (1967) and post-graduate certificate holder in sanitary engineering and environmental management from the American University of Beirut and the University of California at Irvine (in 1971 and 1988, respectively). Since 1971, he has occupied several key posts in water and waste-water treatment companies in the USA, the UK, Spain, Cyprus, The Middle East, Southeast Asia and the last 14 years in the PRC. From 1998 to date, he has been the managing director of Pact. His international experience helped Pact in securing most of the contracts with European and American multinational industries in the PRC.

**Yvonne Xia** manages Pact and Yixing's Procurement Department, as well as assisting the managing director in management of the various departments. She joined Pact-Yixing at the time of their formation in 1998. Ms. Xia is an environmental engineering graduate from Qing Hua University of Beijing (1989) and an EMBA graduate from the Olin School of Management of the Washington University (2003). She has several positions of increasing responsibility, including management of engineering, sales, procurement and projects while with Pact-Yixing.

**Item 6B. Compensation**

The following table sets forth certain summary information with respect to the compensation paid by the Company and its subsidiaries, for services rendered in all capacities to the Company and its subsidiaries during Fiscal 2009, Fiscal 2008 and Fiscal 2007 to the Chairman of the Board and Chief Executive Officer and a Key Employee of the Company. No other executive officer or employee received in excess of US\$100,000 as cash compensation during those fiscal periods.

**SUMMARY COMPENSATION TABLE**

		Salary US\$	Bonus US\$
T.C. Leung, Chairman of the Board of Directors and Chief Executive Officer	2009	154,000	
	2008	154,000	
	2007	155,000	
George Hayek	2009	110,000	
	2008	110,000	

**Compensation of Directors.** Directors of the Company do not receive compensation for their services as directors; however, the Board of Directors may authorize the payment of compensation to directors for their attendance at regular and annual meetings of the Board and for attendance at meetings of committees of the Board as is customary for similar companies. Directors will be reimbursed for their reasonable out-of-pocket expenses incurred in connection with their duties to the Company.

**Pension Plan.** Prior to December 1, 2000, the Company had only one defined contribution pension plan for all its Hong Kong employees. Under this plan, all employees were entitled to pension benefits equal to their own contributions plus 50% to 100% of individual fund account balances contributed by the Company, depending on their years of service with the Company. The Company was required to make specific contributions at approximately 10% of the basic salaries of the employees to an independent fund management company.

With the introduction of the Mandatory Provident Fund Scheme, a defined contribution scheme managed by an independent trustee on December 1, 2000, each of the Company and its employees who joined the Company subsequently makes monthly contributions to the scheme at 5% of the employee's cash income as defined under the Mandatory

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Provident Fund legislation. Contributions of both the Company and its employees are subject to a maximum of HK\$1,000 per month and thereafter contributions are voluntary and are not subject to any limitation. The Company and its employees made their first contributions in December 2000.

As stipulated by the rules and regulations in the PRC, the Company contributes to state-sponsored retirement plans for its employees in the PRC. The Company contributes approximately 10% to 22% of the basic salaries of its employees, and has no further obligations for the actual payment of pension or post-retirement benefits beyond the annual contributions. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees.

During the years ended December 31, 2009, 2008 and 2007, the aggregate contributions of the Company to the aforementioned pension plans and retirement benefit schemes were approximately US\$327,000, US\$291,000 and US\$245,000 respectively.

**Management Option Plan.** The Company had authorized the issuance of Options to purchase up to an aggregate of 4,586,400 Ordinary Shares (the Management Options) to its officers, directors and employees as the Company's Chairman of the Board and Chief Executive Officer may direct. The Management Options became exercisable on March 14, 1998 and expired on March 14, 2007.

The following executive officers and directors of the Company had exercised the Management Options at prices/price ranges as indicated below prior to the end terms of the options.

Name of Executive Officers and Directors	Number of Shares		Price Range
	Exercised		
T.C. Leung	3,423,600		US\$1.221 - 1.6789
Alex Sham	163,800		US\$1.221 - 1.6789
Jerry Wong	173,204		US\$1.221 - 1.6789
C.P. Kwan	24,570		US\$1.221

**Company Option Plans.** The Company's 2000 Officers and Directors Plan and 2002 Officers and Directors Plan (collectively referred to as the Officers Plans) provide for the grant of options to acquire Ordinary Shares to the Company's executive officers and directors and persons holding the same positions with the Company's subsidiaries. The 2000 Employees Plan and 2002 Employees Plan (collectively referred to as the Employees Plan) provides for the grant of options to acquire Ordinary Shares to key employees of the Company and its subsidiaries. A 2000 Stock Option Plan provided for the issuance of options to officers, directors, directors and employees as the Company's Chairman of the Board of Directors and Chief Executive Officer may direct (the 2000 Stock Option Plan). All foregoing plans are collectively referred to as the Plans.

1,195,740, 692,580 and 1,637,160 shares had been originally authorized for issuance under the 2000 Stock Option Plan, Employees Plan and the Officers Plans, respectively.

The Board of Directors or a committee (the Committee) appointed by the Board of Directors administers the Plans. The Board of Directors or the Committee also has the authority to delegate decisions with respect to Options granted to key employees under the Employees Plan who are not elected officers or directors of the Company or its subsidiaries and to delegate decisions with respect to key employees to the Chief Executive Officer.

Any decision by the Committee or the Chief Executive Officer to grant an award under the Plans is subject to ratification by the Board of Directors of the Company. The Board is also to ratify any decision that effects the terms or conditions of options awarded to elected officers or directors of the Company or its subsidiaries.

In the event that the Ordinary Shares of the Company are subdivided or consolidated as a result of a reorganization, stock split, payment of a stock dividend, reverse stock split or other change in the Company's capitalization, the Committee or the Board of Directors has the authority to make appropriate adjustments in the Ordinary Shares available for issuance under the Plans, the number of shares subject to options that may have been or may be awarded to any participant in any 12 month period, the price, number of Ordinary Shares or kind of securities subject to outstanding options, or the terms of such options in order to prevent dilution or enlargement of rights under the options. In addition, the Board may also change the kind of securities available for grant under the Plans to reflect any such corporate changes.

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The Committee or the Chief Executive Officer has the discretion to determine which employees constitute key employees to whom options will be awarded under the Employees Plan.

The Committee or Chief Executive Officer, as the case may be, determines the number of Ordinary Shares subject to options to be granted.

The purchase price per share of the Ordinary Shares to be paid upon the exercise of the option must be at least 100% of the fair market value of an Ordinary Shares on the date on which the option was granted. Under the Plans, if the Ordinary Shares are principally traded on a national securities exchange or the Nasdaq Global Market or Capital Market at the time of grant, the Company is required to use, at fair market value, the average of the closing prices of the Ordinary Shares for the ten consecutive trading days immediately before the date of grant. If the Ordinary Shares are traded on a national securities exchange or the Nasdaq Stock Global Market or Capital Market, but no closing prices are reported for such ten-day period, or if the Ordinary Shares are principally traded in the over-the-counter market, the Company is required to use, as fair market value, the average of the mean between the bid and asked prices reported for the Company's Ordinary Shares at the close of trading during such ten-day period before the date of grant. If the Ordinary Shares are traded neither on a national securities exchange, one of the Nasdaq's Markets nor in the over-the-counter market or if bid and asked prices are otherwise not available, the fair market value of the Ordinary Shares on the date of grant will be determined in good faith by the Committee or the Board of Directors, as the case may be.

The Board of Directors or the Committee, as the case may be, or, to the extent that such authority has been delegated to the Chief Executive Officer, the Chief Executive Officer determines, at the time of grant, when each option granted under the Plans will become exercisable. Notwithstanding the foregoing, all options held by a key employee of the Company or its subsidiaries become immediately exercisable, whether or not exercisable at the time, upon the death or disability.

No option is to be exercisable more than ten years from the date the option is granted.

Payment of Exercise Price for Options. Under the Plans, payment for shares purchased upon exercise of an option may be made by any of the following methods, subject to certain requirements: (1) in cash, paid by either the optionholder or a broker to whom the optionee has tendered the option; (2) in Ordinary Shares valued at the fair market value of such shares on the date of exercise, provided that such shares were held by the optionholder for not less than six months prior to the date of exercise of the option; (3) by any other medium of payment that the Board, Committee or the Chief Executive Officer, as applicable, has authorized at the time of grant (other than the withholding of shares issuable upon the exercise of options); or (4) by any combination of the preceding methods.

Transfer Of Options. Under the Plans, an option may not be sold, assigned or otherwise transferred except to:

- the spouse or lineal descendant of a plan participant;
- the trustee of a trust for the primary benefit of a plan participant's spouse or lineal descendant;
- a partnership of which a plan participant and lineal descendants are the only partners; or
- a charitable organization.

These assignments are only permitted if the assigning optionee does not receive any compensation in connection with the assignment and the assignment is expressly approved by the Board or Committee, as the case may be.

The Company indemnifies the members of any Committee and its delegates and the Chief Executive Officer against (1) reasonable expenses incurred in connection with the defense of any action, suit or proceeding to which they may be a party by reason of any action taken or failure to act in connection with the Plans, and (2) all amounts paid by them in settlement of or satisfaction of a judgment entered in any such action, suit or proceeding, except in cases where such a person is adjudged liable for gross negligence or gross misconduct in the performance of his or her duties.

The Board may terminate, suspend, or amend the Plans at any time without the authorization of shareholders to the extent allowed by law or the rules of any market on which the Company's shares are then listed or quoted.

The table below shows, as to each of the executive officers and directors of the Company and as to all executive officers and directors of the Company as a group, the aggregate amounts of Ordinary Shares remaining (unexercised), subject to such options granted under the Plans.

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Names of Executive Officers and Directors	Shares Subject To the (Remaining) Plans Options	Per Share Exercise Price (US\$)
T.C. Leung	170,000(1)	0.5857
Xu Hong Wang	10,920(2)	0.5787
	31,500(2)	0.8191
All executive officers and Directors as a group	212,420	0.5787-0.8191(3)

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(1) Granted pursuant to the 2002 Officers and Directors Plan.

(2) Granted pursuant to the 2000 Employees Plan.

(3) Price range.

The foregoing options will expire in August 2010.

As of December 31, 2009, 1,541,920 options had been exercised, including 300,300 options, 397,300 options and 205,800 options exercised by Mr. Leung at prices of US\$0.5787, US\$0.5857 and US\$0.8191 per share, respectively and 42,000 options exercised by Xu Hong Wang at a price of US\$0.587 per share.

#### 2007 Officers and Directors Stock Option and Incentive Plan

A total of 880,000 ordinary shares had been reserved for issuance under the Company's 2007 Officers and Directors Stock Option and Incentive Plan (the 2007 D&O Stock Options). All the 672,000 options granted to the executive officers and directors of the Company were surrendered and cancelled in 2008. The Company plans to make no further use of this plan.

The Company has set forth in this Report all required disclosure of additional compensation to its executive officers and directors including personal benefits and securities or properties paid or distributed which was not offered on the same terms to all full time employees during Fiscal 2007, Fiscal 2008 and Fiscal 2009.





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Changes in outstanding options under various plans mentioned above were as follows:

	2009		As of December 31, 2008		2007	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of year	583,470	0.84	1,290,840	1.74	3,938,296	1.32
Granted			205,000	2.56	499,000	3.27
Cancelled	(51,200)	(0.87)	(704,000)	(3.07)	(451,210)	(1.58)
Exercised	(10,000)	(0.59)	(208,370)	(0.60)	(2,695,246)	(1.44)
Outstanding, end of year	522,270	0.85	583,470	0.84	1,290,840	1.74
Exercisable, end of year	522,270	0.85	583,470	0.84	791,840	0.78

As of December 31, 2009, the options outstanding and exercisable had exercise prices in the range of US\$0.5787 to US\$3.33 and a weighted average unexpired life of approximately 1.7 years.

As of December 31, 2009	Shares	Intrinsic Value US\$ '000
Total outstanding in-the-money options	482,270	719
Total vested in-the-money options	482,270	719

The total intrinsic value of share option exercised for the twelve months ended December 31, 2009, 2008 and 2007 were approximately \$8,000, \$374,000 and \$3,492,000, respectively. As of December 31, 2009, there was no unrecognized stock-based compensation expense related to unvested stock options.

The Group adopted the provisions of ASC 718-10, which requires us to recognize expense related to the fair value of our stock-based compensation awards, including employee stock options.

The Black-Scholes option-pricing model requires the input of subjective assumptions, including the expected volatility of stock price. Because changes in subjective input assumptions can materially effect the fair value estimate, in directors' opinion, the existing model may not necessarily provide a realizable measure of the fair value of the stock options.

**Item 6C.****Board Practices**

The term of each of the Company's directors expires at the election and qualification of their successors at the next annual meeting of the Company's shareholders, anticipated to be held in August of this year. Of the Company's seven directors, all were re-elected at the Company's last annual meeting of shareholders in September 2009.

The Board has a standing Audit Committee to assist the Board in carrying out its duties. The Audit Committee has a written charter approved by the Board. The chair of the Audit Committee determines the meeting agenda of the Audit Committee. The Audit Committee members receive materials in advance of Committee meetings allowing them to prepare for the meeting.

During Fiscal 2009, the Audit Committee met 4 times, being attended by all members.

The Audit Committee assists the Board in monitoring the Company's financial accounting, controls, planning and reporting. Among its duties, the Audit Committee:

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- reviews the Company's auditing, accounting and financial reporting process;
- reviews the adequacy of the Company's internal controls;
- reviews the independence, fee arrangements, audit scope, and performance of the Company's independent auditors, and recommends the appointment or replacement of independent auditors to the Board of Directors;
- reviews and approves all non-audit work, if any, to be performed by the auditors;
- reviews the scope of our internal auditing and the adequacy of the organizational structure and qualifications of the internal auditing staff;
- reviews, before release, the audited financial statements and operating and financial review and prospects contained in the Company's Annual Report on Form 20-F, and recommends that the Board of Directors submit these items to the shareholders' meeting for approval;
- provides an open avenue of communication among the Company's independent auditors, financial and senior management, the internal audit function and the Board of Directors;
- reviews and updates the Company's Code of Business Conduct and Ethics and ensure that there is a system to enforce same and that this Code complies with all applicable rules and regulations;
- ensures that the Company's management and auditors assess current financial reporting issues and practices; and
- reviews and pre-approves both audit and non-audit services to be provided by the Company's auditors.

The Audit Committee is currently composed of Y.K. Liang, Ka Chong Cheang and Li Da Weng. The Audit Committee's financial expert is Y.K. Liang. The Board has determined that the membership of the Audit Committee meets the current independence requirements of the NASDAQ listing standards as same applies to private foreign issuers and the applicable rules and regulations of the SEC.

**Item 6D.****Employees**

At June 1, 2010, the Company (exclusive of Yixing-Pact) had approximately 137 full-time employees. At December 31, 2009, 2008 and 2007, staffing levels were approximately as follows:

	2009	2008	2007
Marketing and sales	54	61	65
Administrative	48	49	49
Technical	38	39	32
Total full time employees	140	149	146

At June 1, 2010 Pact and Yixing had approximately 207 full-time employees. At December 31, 2009, 2008 and 2007, respectively, staffing levels were approximately as follows: Engineers; 50, 54, and 35, Administrative Persons; 20, 22 and 22.

The Company is not subject to any collective bargaining agreement and believes that its relations with its employees are good. The Company's Management consists of its officers and directors.

Table of Contents**Item 6E. Share Ownership**

With respect to the share ownership of the directors and senior management of the Company, reference is made to Item 7. Major Shareholders and Related Party Transactions.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS****Item 7A. Major Shareholders**

The following table sets forth, as of June 1, 2010, certain information concerning beneficial ownership of the Company's voting shares that date, with respect to (i) each person known to the Company to own 5% or more of the outstanding Ordinary Shares, (ii) each director and executive officer of the Company, and (iii) all officers and directors of the Company as a group:

	<b>Amount and Nature of Beneficial Ownership(3)</b>	<b>Approximate Percentage Of Ordinary Shares Owned</b>
T.C. Leung (1)(2)(3)	6,118,998	52.2%
Pearl Venture Ltd.(1)(2)	1,478,675	12.8%
Alex Sham(1)	295,480	2.6%
Jerry Wong(1)	191,766	1.7%
Y.K. Liang(1)	*	*
Xu Hong Wang(1)(3)	82,420	0.7%
Ka Chong Cheang(1)	*	*
Li Da Weng(1)	*	*
All Executive Officers And Directors of the Company as a group (7 persons)(2) (3)	6,688,664	56.9%

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\* Denotes Nil

(1) The address for the Company's officers and directors is c/o Euro Tech (Far East) Ltd., 18/F Gee Chang Hong Centre, 65 Wong Chuk Hang Road, Hong Kong. The address for Pearl is Columbus Centre Building, Wichhams Cay, Road Town, Tortola, British Virgin Islands.

- (2) Includes shares of the Company's Common Stock owned of record by Pearl, which is a trust established for the benefit of Mr. Leung. Also includes those Company Ordinary Shares owned of record by Regent, of which Pearl is the majority shareholder .
- (3) Gives effect to the exercise of the 2000 Officers and Directors Plan, 2000 Employees Plan and 2002 Officers and Directors Plan Options owned of record by such persons and which have vested or will vest within six (6) months of the date of this Report. See Item 6B. Compensation.

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**Item 7B. Related Party Transactions**

See Item 4.B. Business Overview - Business for the discussion of the formation of the joint venture. Pact Environmental Equipment Co. Limited in June 2007.

See Item 6B. Compensation.

**ITEM 8. FINANCIAL INFORMATION**

**Item 8A. Consolidated Statements and Other Financial Information**

Item 8A.1 See Item 18.

Item 8A.2 See Item 18.

Item 8A.3 See Report of Independent Registered Public Accounting Firms, pages F-2 and F-3.

Item 8A.4 We have complied with this requirement.

Item 8A.5 Not applicable.

Item 8A.6 Not applicable.

Item 8A.7 Legal Proceedings.

The Company is not a party to any material legal proceedings.



Item 8A.8 Dividend Policy.

The Company has not paid cash dividends to date. The payment of cash dividends, if any, in the future is within the discretion of the Board of Directors. The payment of cash dividends, if any, in the future will depend upon the Company's earnings, capital requirements and financial conditions and other relevant factors. The Company's Board of Directors does not presently intend to declare any cash dividends in the foreseeable future, but instead intends to retain all earnings, if any, for use in the Company and Far East's business operations.

**Item 8B. Significant Changes**

There has not been any significant change since the date of the annual financial statements included in this Report.

**ITEM 9. THE OFFERING AND LISTING**

**Item 9A. Listing Details**

The Company has one class of securities presently registered: Ordinary Shares. These securities are presently traded on the NASDAQ's Capital Market under the trading symbols CLWT, and have so traded since the Company's Public Offering in March 1997.

The high and low prices for the Ordinary Shares in the periods indicated, as reported by NASDAQ, are set forth below:

Years Ended December 31,	Low US\$	High US\$
2005	2.700	6.590
2006	1.680	5.740
2007	1.81	5.14
2008	0.66	3.15
2009	0.40	4.22

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<b>Quarters Ended</b>	<b>Low US\$</b>	<b>High US\$</b>
March 31, 2008	1.93	3.04
June 30, 2008	1.70	3.15
September 30, 2008	1.13	2.30
December 31, 2008	0.66	1.46
March 31, 2009	0.40	1.09
June 30, 2009	0.64	1.76
September 30, 2009	0.81	1.69
December 31, 2009	1.36	4.22
March 31, 2010	1.75	2.68

<b>The Following Months</b>	<b>Low US\$</b>	<b>High US\$</b>
January 2010	1.80	2.68
February 2010	1.75	2.35
March 2010	1.97	2.38
April 2010	1.92	2.57
May 2010	1.50	1.94

The Ordinary Shares were held by approximately 39 holders of record as of June 1, 2010. Based upon information received from broker-dealers, clearing firms and others, the Company believes that it has in excess of 1,900 beneficial holders of its Ordinary Shares.

**Item 9C. Markets**

See Item 9A. Listing Details.

**ITEM 10. ADDITIONAL INFORMATION****Item 10A. Share Capital**

**Authorized Capital.** The authorized capital of the Company is US\$250,000 comprised of 20,000,000 Ordinary Shares and 5,000,000 shares of Preferred Stock. As of December 31, 2009, there were 11,544,711 Ordinary Shares and no shares of Preferred Stock, issued and outstanding. As of December 31, 2009 approximately 667,320 Ordinary Shares were held by the Company as treasury stock and are non-voting. All of the Company's shares of capital stock have a par value of US\$0.01 per share.

Holders of the Company's Ordinary Shares are entitled to one vote for each whole share on all matters to be voted upon by shareholders, including the election of directors. Holders of Ordinary Shares do not have cumulative voting rights in the election of directors. All shares of

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Ordinary Shares are equal to each other with respect to liquidation and dividend rights. Holders of Ordinary Shares are entitled to receive dividends if and when declared by the Company's Board of Directors out of funds legally available under British Virgin Islands law. In the event of the liquidation of the Company, all assets available for distribution to the holders of Ordinary Shares are distributable among them according to their respective share holdings. All of the outstanding shares of Ordinary Shares of the Company are duly authorized, validly issued, fully paid and non-assessable.

Pursuant to the Company's Memorandum and Articles of Association and pursuant to the laws of the British Virgin Islands, the Company's Memorandum and Articles of Association may be amended by a resolution of the Board of Directors without shareholder approval. This includes amendments to increase or reduce the authorized capital stock of the Company or to increase or reduce the par value of its shares. The ability of the Company to amend its Memorandum and Articles of Association without shareholder approval could have the effect of delaying, deterring or preventing a change in control of the Company without any further action by the shareholders including but not limited to, a tender offer to purchase the Common Stock at a premium over then current market prices.

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Under United States law, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. Shareholder action must be taken in good faith and actions by controlling shareholders which are obviously unreasonable may be declared null and void. The British Virgin Islands law protecting the interests of the minority shareholders is not as protective in all circumstances as the law protecting minority shareholders in United States jurisdictions. While British Virgin Islands law does not permit a shareholder of a British Virgin Islands company to sue its directors derivatively, *i.e.*, in the name of and for the benefit of the Company, and to sue the Company and its directors for his benefit and the benefit of others similarly situated, the circumstances in which any such action may be brought that may be available in respect of any such action may result in the rights of shareholders of a British Virgin Island company being more limited than those rights of shareholders in a United States company.

The Board of Directors of the Company, without further shareholder action, may issue shares of Preferred Stock in any number of series and may establish as to each such series the designation and number of shares to be issued and the relative rights and preferences of the shares of each series, including provisions regarding voting powers, redemption, dividend rights, rights upon liquidation and conversion rights. The issuance of shares of Preferred Stock by the Board of Directors could adversely effect the rights of holders of Ordinary Shares by, among other matters, establishing preferential dividends, liquidation rights and voting power. The Company has not issued any shares of Preferred Stock and has no present intention to issue shares of Preferred Stock. The issuance thereof could discourage or defeat efforts to acquire control of the Company through acquisition of Ordinary Shares.

***Item 10B. Memorandum and Article of Association***

Set forth below is a summary of the material provisions of our Memorandum and Articles of Association (the Articles) and the British Virgin Islands ( BVI ) International Business Companies Act of 1984 relating to the shares. This description does not purport to be complete and is qualified in its entirety by reference to BVI statutory law and to the Articles.

**Share Register and Voting Restrictions.** The Company maintains a share register at its registered office in the BVI. The Company's registered number is 200960. The objects of the Company are to engage in any act or activity that is not prohibited under any law of the BVI. Under the Articles, the Company is not required to treat the holder of a registered share in the Company as a shareholder until that person's name has been entered in the share register. The holders of Ordinary Shares have one vote for each Ordinary Share held of record. The holders of Preferred Shares have such voting powers, full or limited, or no voting powers and such restrictions as may be stated and expressed in the resolution providing for the issuance of the Preferred Shares.

**Shareholders Meeting.** The directors of the Company may convene meetings of the shareholders of the Company at such times and in such manner and places within or outside the BVI as the directors consider necessary or desirable. Upon the written request of the shareholders holding ten (10%) percent or more of the outstanding voting shares in the Company the directors must convene a meeting of shareholders.

A shareholder may participate at a meeting of shareholders by telephone or other electronic means, as long as all shareholders participating in the meeting are able to hear each other.

A meeting of shareholders is duly constituted if, at the commencement of the meeting, there are present in person or by proxy not less than fifty (50%) percent of the votes of the shares or class series of shares entitled to vote on resolutions of shareholders to be considered at the meeting.

If a quorum is not present, the meeting, if convened upon the requisition of shareholders, shall be dissolved; in any other case it shall stand adjourned to the next business day at the same time and place or to such other time and place as the directors may determine, and if at the adjourned meeting there are present in person or by proxy not less than one third of the votes of the shares or each class or series of shares entitled to vote on the resolutions to be considered by the meeting, those present shall constitute a quorum but otherwise the meeting shall be dissolved.

Any action that may be taken by the shareholders at a meeting may also be taken by a resolution of shareholders consented to in writing or by written electronic communication, without the need for any notice, but if not a unanimous writing, a copy of such resolution shall be sent to all non-consenting shareholders.

**Net Profits and Dividends.** Under BVI law, dividends may only be declared and paid out of surplus, such that after payment of dividends the Company must be able to satisfy its liabilities as they become due in the ordinary course of business and the realizable value of the assets of such company must not be less than the sum of its liabilities (other than deferred taxes and capital). There are no other BVI restrictions regarding dividends.

**Pre-emptive Rights.** The holders of Ordinary Shares and Preferred Shares are not entitled to any pre-emptive or similar rights.

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**Conflict of Interests.** No agreement or transaction between the Company and one or more of its directors or any person in which any director has a financial interest or to whom any director is related, including as a director of that other person, is void and avoidable for this reason only, or by reason only that the director is present at the meeting of directors, or at the meeting of the committee of directors that approves the agreement or transaction, or that the vote or consent of the director is counted for that purpose, if the material facts of the interest of each director in the agreement or transaction and his interest in or relationship to any other party to the agreement or transaction are disclosed in good faith, or are known by the other directors. A director who has an interest in any particular business to be considered at a meeting of directors or shareholders may be counted for purposes of determining whether the meeting is duly constituted.

**Repurchase of Shares.** The Company may purchase, redeem or otherwise acquire and hold its own shares, but only out of surplus or in exchange for newly issued shares of equal value. Subject to provisions to the contrary in:

- (a) the designations, powers, preferences, rights, qualifications, limitations and restrictions with which the shares were issued; or
  
- (b) the subscription agreement for the issue of the shares,

the Company may not purchase, redeem or otherwise acquire its own shares without the consent of shareholders whose shares are to be purchased, redeemed or otherwise acquired.

Generally, no purchase, redemption or other acquisition of shares shall be made unless the directors determine that immediately after purchase, redemption or other acquisition the Company will be able to satisfy its liabilities as they become due in the ordinary course of its business and the realizable value of the assets of the Company will not be less than the sum of its total liabilities, other than deferred taxes, as shown in the books of account, and its capital and, in the absence of fraud, the decision of the directors as to the realizable value of the assets of the Company is conclusive, unless a question of law is involved.

**Duration, Liquidation, Merger.** The Company shall continue until wound-up and dissolved by a resolution of shareholders, or under the terms of any insolvency or liquidation laws in force in the BVI. Under BVI law the Company may merge with another company, including a parent company or subsidiary, incorporated in the BVI, or in a jurisdiction outside of the BVI where the laws of that jurisdiction permit the merger. A merger must be authorized by the directors of the Company and approved by the shareholders.

**Board of Directors.** The business and affairs of the Company are managed by the directors who may exercise all such powers of the Company as are not by BVI law or by the Company's Articles reserved to the shareholders of the Company.

*Item 10C.*

*Material Contracts*

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On April 29, 2007, Far East entered into a subscription agreement with Blue Sky and Blue Sky's management shareholders to purchase twenty (20%) percent of the equity capital of Blue Sky (the Blue Sky Agreement) for a total of US\$4,700,000 of which US\$4,000,000 was paid in August 2007 with a final payment of US\$692,000 paid in Fiscal 2008. The Blue Sky Agreement contains certain provisions requiring Far East's written consent prior to Blue Sky; taking on new shareholders, pledging or selling assets, declaring a dividend, amending its constitution, guaranteeing the obligations of third parties, engaging in any transaction having a material adverse effect on its financial status or outlook, voluntarily winding up its affairs, dismissing management or changing their rates of compensation, appointing directors and similar provisions. Far East also has the right to and has appointed a non-executive director to Blue Sky, who does not participate in the day to day management of Blue Sky. In the event Blue Sky sells additional shares, Far East has the right to maintain its 20% interest by paying the same price as any proposed purchaser. Pursuant to the Blue Sky Agreement, in March 2008, Blue Sky declared a dividend to be paid in December 2008, to its shareholders. Blue Sky's dividends to Far East were US\$294,000 in 2008. As part of the Blue Sky Agreement, Far East agreed that if it was able and circumstances permit, it would undertake the obligation of guaranteeing loans of not more than US\$2,900,000 for Blue Sky.

On January 20, 2008, pursuant to a subscription agreement, of July 18, 2007, with Jia Huan and Jia Huan's management shareholders, Far East purchased twenty (20%) percent of the equity capital of Jia Huan for US\$2,500,000 (the Jia Huan Agreement). The Jia Huan Agreement contains certain provisions requiring Far East's written consent prior to Jia Huan; taking on new shareholders, pledging or selling assets, declaring a dividend, amending its constitution, guaranteeing the obligations of third parties, engaging in any transaction having a material adverse effect on its financial status or outlook, voluntarily winding up its affairs dismissing management or changing their rates of compensation, appointing directors and similar provisions. Far East, also has the right to and has appointed a non-executive director who does not participate in the day to day management of Jia Huan. In the event Jia Huan sells additional shares, Far East has the right to maintain its 20% interest by paying the same price as any proposed purchaser.

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As part of its acquisitions of Yixing and Pact, the Company granted the minority shareholders of both entities the right to require the Company to purchase the remaining securities of Yixing and Pact pursuant to a formula that would obligate the Company to pay the minority shareholders approximately US\$1,795,000. On January 2, 2010, the Company purchased an additional two (2%) of Pact for approximately US\$73,000.

There has been no further indication to the Company from the minority shareholders that they desire to sell their shares. See Item 4A. History and Development of the Company and Item 4B. Business Overview .

**Item 10D. Exchange Controls**

There are no exchange control restrictions on payment of dividends on the Company's Ordinary Shares or on the conduct of the Company's operations either in Hong Kong, where the Company's principal executive offices are located, or the British Virgin Islands, where the Company is incorporated. There are no British Virgin Islands laws which impose foreign exchange controls on the Company or that effect the payment of dividends, interest, or other payments to non-resident holders of the Company's securities. British Virgin Islands laws and the Company's Memorandum and Articles of Association impose no limitations on the right of non-resident or foreign owners to hold the Company's securities or vote the Company's Ordinary Shares. The PRC government has established a unified exchange rate system and system of exchange controls to which the Company is subject.

**Item 10E. Taxation**

BVI

The Company is exempted from taxation in the British Virgin Islands.

HONG KONG

The Company's subsidiaries organized in Hong Kong, Far East, Euro Tech (China) Limited and ChinaH2O.com Limited, provide for Hong Kong profits tax at a rate of 16.5% in 2009 on the basis of their income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for profits tax purposes.

PRC

Euro Tech Trading (Shanghai) Limited, a subsidiary of the Company, provides for PRC Enterprise Income Tax at a rate of 20% (a rate currently levied by the Pudong Local Tax Bureau despite the National Tax Bureau Rate of 25%), after offsetting losses brought forward, if any, on the basis of its income for financing reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.



In accordance with the relevant income tax laws and regulations applicable to foreign investment enterprises in the PRC, Shanghai Euro Tech Limited ( SET ), a subsidiary of the Company, is exempt from PRC Enterprise Income Tax of 15% for two years starting from 2008, after offsetting losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2009, SET had an assessable loss brought forward of US\$313,386 as agreed by the local tax authority to offset its profits for the coming years. This loss will expire in five years.

According to the relevant PRC tax rules and regulations, Shanghai Euro Tech Environmental Engineering Limited is exempt from the PRC Enterprise Income Tax of 20% for two year period that ended in 2009, followed by a 50% reduction for the next three years thereafter. Chongqing Euro Tech Rizhi Technology Co., Ltd, Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd and Guangzhou Euro Tech Environmental Equipment Co., Ltd provide for PRC Enterprise Income Tax at a rate of 25%, after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

According to the relevant PRC tax rules and regulations, Yixing Pact Environmental Technology Co., Ltd is registered in Shanghai as Foreign Owned Enterprise that is entitled to a tax rate of 25%. Pact Asia Pacific Limited is situated in the British Virgin Islands where there are no taxes imposed on it. However, part of its profits is subject to Hong Kong profits tax at a rate of 16.5% in Fiscal 2009 as to those profits earned in Hong Kong.

Variable Interest Entities ( VIES ), as defined by the Financial Accounting Standards Board are included in the consolidated financial statements, where applicable, of the Company and its subsidiaries (the Group ). VIES of the Group provide for PRC Enterprise Income Tax at a rate of 25%, after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

As of December 31, 2009, certain VIEs had aggregated assessable losses carried forward of US\$151,706 as agreed by the local tax authority.

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The Company's effective tax rate for Fiscal 2009, was a weighted average statutory tax rate of 533%. Principal adjustments to this statutory tax rate was a valuation allowance of 295% for Fiscal 2009.

On March 16, 2007, the PRC National People's Congress passed the China Corporate Income Tax Law ( Income Tax Law ), which became effective January 1, 2008 and applies a unified income tax rate for foreign invested enterprises and domestic enterprise. The Income Tax Law is effective immediately for companies previously subject to higher taxation rates and provides a five-year transition period from its effective date for those enterprises which were established before the effective date of the new tax law and previously entitled to a preferential tax treatment.

On December 26, 2007, the State Council and on February 20, 2008 the Ministry of Finance issued implementation guidelines ( Guidelines ) setting out how the transition of tax rates will occur. The Guidelines state that those enterprises which enjoyed a preferential tax rate of 15% are eligible for a graduated rate increase to 25% over the 5-year period beginning from January 1, 2008. The applicable rates under such an agreements for such enterprises are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011, 2012 and thereafter, respectively. In addition, foreign investment manufacturing enterprises which have not fully utilized any preferential tax treatments, such as tax holidays or reduced rates of taxation, will be able to continue to receive them during the transitional period. The Group has applied the new rate in relation to deferred tax balances.

Effective January 1, 2007, the Company adopted FASB ASC Subtopic 740-10 Income Taxes - Overall, (FIN No. 48, Accounting for Uncertainty in Income Taxes. ). In accordance with ASC 740-10, the Company recognizes tax benefits that satisfy a greater than 50% probability threshold and provides for the estimated impact of interest and penalties for such tax benefits.

**PRC statutory reserve.**

Under the relevant PRC laws and regulations, the Company's PRC subsidiaries are required to appropriate certain percentages of their respective net income to two statutory funds i.e. the statutory reserve fund and the statutory staff welfare fund. The PRC subsidiaries also appropriated certain amount of their net income to an expansion fund.

(i) Statutory reserve funds

Pursuant to applicable PRC laws and regulations, the Company's PRC subsidiaries are required to allocate at least 10% of their net income to the statutory reserve funds until such funds reaches 50% of their respective registered capital. The statutory reserve funds can be utilized upon the approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such funds be maintained at a minimum of 25% of the companies' registered capital.

(ii) Statutory welfare funds

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Pursuant to applicable PRC laws and regulations, the Company's PRC subsidiaries are required to allocate certain amounts of their respective net income to the staff welfare funds determined by the Company. The staff welfare funds can only be used to provide staff welfare facilities and other collective benefits to their employees. This fund is non-distributable other than upon liquidation of the PRC subsidiaries.

### (iii) Expansion funds

The expansion reserve shall only be used to make up losses, expand the Company's PRC respective subsidiaries' production operations, or increase the capital of the respective subsidiaries. The expansion fund can be utilized upon approval by relevant authorities, to be converted into registered capital and issue bonus capital to existing investors, provided that such funds be maintained at a minimum of 25% of the respective companies' registered capital.

### UNITED STATES FEDERAL INCOME TAXATION

The following discussion is a summary of the material United States federal income tax considerations that may be relevant to the purchase, holding, ownership, disposition or sale of our ordinary shares.

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This discussion is general in nature and does not discuss all aspects of U.S. federal income taxation which may be important to particular investors in light of their individual circumstances, including investors subject to special U.S. taxation rules, such as: (a) banks (b) dealers in securities or currencies; (c) insurance companies; (d) Tax-exempt organizations; (e) persons holding our ordinary shares as part of hedging, conversion, constructive sale, straddle or other integrated transactions; (f) traders in securities that have elected the mark-to-market method of accounting; (g) persons who own 5% or more of our shares; (h) U.S. persons whose functional currency is not the U.S. dollar; or (i) Non-U.S. Holders (as defined below).

The discussion below is based upon the provisions of the Internal Revenue Code of 1986, as amended, or the Code, and U.S. Treasury regulations (including temporary and proposed regulations), rulings and judicial decisions thereunder as of the date hereof. Such authorities are subject to change, possibly on a retroactive basis, which may result in U.S. federal income tax consequences different from those discussed below.

**A U.S. Holder holding or considering acquiring or disposing of our ordinary shares is urged to consult his or her own tax advisor concerning the U.S. federal, state, local and non-U.S. income and other tax consequences of the holding, ownership, purchase, disposition or sale of our ordinary shares in light of such U.S. Holder's particular circumstances.**

A U.S. Holder for purposes of this discussion is a beneficial owner of ordinary shares that is, for U.S. federal income tax purposes: (a) a citizen or resident of the United States; (b) a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States, any state thereof, or the District of Columbia; (c) an estate the income of which is subject to U.S. federal income taxation, regardless of its source; or (d) a trust if it is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

A beneficial owner of our ordinary shares that is not a U.S. Holder is referred to herein as a Non-U.S. Holder.

If a partnership holds our ordinary shares, the tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. A partner of a partnership holding our ordinary shares is urged to consult its own tax advisor regarding an investment in our ordinary shares.

*Passive foreign investment company rules.* In general, we will be a passive foreign investment company for any taxable year in which either (a) at least 75% of our gross income is passive income or (b) at least 50% of the value (determined on the basis of a quarterly average) of our assets is attributable to assets that produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person), annuities and gains from assets that produce passive income. If we own at least 25% by value of the equity shares of another corporation, we will be treated for purposes of the passive foreign investment company tests as owning a proportionate share of the assets of the other corporation, and as receiving directly a proportionate share of the other corporation's income. The tax rules do not clearly indicate whether our contractual arrangements with our VIES would be treated as ownership of equity in such entities.

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The annual PFIC determination to be made by a U.S. Holder of our ordinary shares is an inherently factual determination and there is limited guidance regarding the application of the PFIC rules to specific situations. Although the determination of PFIC status is subject to factual uncertainties because it depends upon the valuation of our ordinary shares as well as our goodwill and other assets and income. In addition, as the determination of PFIC status is made on an annual basis and depends on variables over which we have limited control, there can be no assurance that we will not be classified as a PFIC for 2010 or any future calendar years. If we are a PFIC in any year, U.S. Holders would be subject to the tax regime described in the following paragraphs.

If we are a passive foreign investment company for any taxable year during which a U.S. Holder has an equity interest in us, such U.S. Holder will be subject to special tax rules in any future taxable year. Unless the U.S. Holder makes a mark-to-market election, those special rules will apply to (a) excess distributions and (b) gain from the sale or other disposition of stock. Excess distributions are defined generally as the excess of the amount received with respect to the equity interests in the taxable year over 125% of the average annual distributions received in the shorter of either the three previous years or a U.S. Holder's holding period before the taxable year. Under these special tax rules:

- the gain or excess distribution will be allocated ratably over the holding period for the ordinary shares;

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- the amount allocated to the taxable year in which the gain or excess distribution is realized and to years before we became a PFIC will be taxed as ordinary income;
- the amount allocated to each other taxable year, with certain exceptions, will be taxed at the highest tax rate in effect for that year; and
- the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such other taxable year.

We do not intend to provide information necessary for U.S. Holders to make qualified electing fund elections, which if available could materially affect the tax consequences of the ownership and disposition of our ordinary shares.

In certain circumstances, instead of being subject to the excess distribution rules discussed above, a U.S. Holder may make an election to include gain on ordinary shares of a passive foreign investment company as ordinary income under a mark-to-market method, provided that ordinary shares are regularly traded on a qualified exchange. The mark-to-market election is available only for ordinary shares that are regularly traded within the meaning of U.S. Treasury regulations on certain designated U.S. exchanges and foreign exchanges that meet trading, listing, financial disclosure and other requirements to be treated as a qualified exchange.

If a U.S. Holder makes a mark-to-market election, the U.S. Holder will include each year as ordinary income, rather than capital gain, the excess, if any, of the fair market value of the U.S. Holder's ordinary shares at the end of the taxable year over such U.S. Holder's adjusted basis in the ordinary shares and will be permitted an ordinary loss in respect of the excess, if any, of the adjusted basis of these ordinary shares over their fair market value at the end of the taxable year, but limited to the extent of the net amount previously included in income as a result of the mark-to-market election. A U.S. Holder's basis in the ordinary shares will be adjusted to reflect any such income or loss amounts.

Furthermore, if we were a PFIC or, with respect to a particular U.S. Holder, were treated as a PFIC for the taxable year in which we paid a dividend or the prior taxable year, the favorable dividend rate with respect to dividends paid to certain non-corporate U.S. Holders would not apply. If a U.S. Holder has held our ordinary shares at any time when we were a PFIC, such U.S. Holder must generally file an annual report with his or her federal income tax return.

**A U.S. Holder is urged to consult his or her tax advisor concerning the U.S. federal income tax consequences of an investment in our ordinary shares under the passive foreign investment company rules.**

*Sale, exchange or other disposition of our ordinary shares.* Subject to the application of the passive foreign investment company rules, as discussed above, upon the sale, exchange or other disposition of ordinary shares, a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized upon the sale, exchange or other disposition and the adjusted tax basis of the U.S. Holder in the ordinary shares. The capital gain or loss generally will be long-term capital gain or loss if, at the time of sale, exchange or other disposition,

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the U.S. Holder has held the ordinary share for more than one year. Net long-term capital gains of non-corporate U.S. Holders, including individuals, are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations.

Gains realized on the disposition of our ordinary shares could be subject to PRC withholding tax. Any gain or loss recognized by a U.S. Holder on a disposition of our ordinary shares will generally be treated as U.S.-source income or loss for foreign tax credit limitation purposes. A U.S. Holder that is eligible for the benefits of the Treaty may be able to elect to treat disposition gain that is subject to PRC taxation as foreign-source gain and claim a credit in respect of the tax. The rules governing foreign tax credits are complex, and U.S. Holders should consult their tax advisers regarding the creditability of foreign taxes in their particular circumstances.

### ***Item 10H. Documents on Display***

The documents that are exhibits to or incorporated by reference in this annual report can be read at the U.S. Securities and Exchange Commission's public reference facilities at 100 F Street, N.E., Washington, DC 20549-2001 or on the Commission's website: [www.sec.gov](http://www.sec.gov).

### ***Item 10I. Subsidiary Information***

For information on the Company's subsidiaries see Item 4C. The separate financial statements of Blue Sky and Jia Huan, as required under Regulation S-X 210.3-09, entities in which the Company owns a 20% equity interest are attached hereto.

## **ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's primary risk exposures arise from changes in interest rates and foreign currency exchange rates.

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*Foreign Currency Risks*

The Company is exposed to risk from changing foreign currency exchange rates. The Company's sales are denominated either in HK dollar or RMB. The majority of the Company's expenses and cost of revenue are denominated in HK dollars, followed by RMB, US dollars, Japanese yen and the Euro. The Company is subject to a variety of risks associated with changes among the relative value of the US dollar, HK dollar, RMB, Japanese yen and the Euro. The Company does not currently adequately hedge its foreign exchange positions. Any material increase in the value of the HK dollar, RMB, Japanese yen and the Euro relative to the US dollar would increase the Company's expenses and cost of revenue and therefore would have a material adverse effect on the Company's business, financial condition and results of operations.

*Inflation*

The Company cannot accurately determine the precise effect of inflation on its operations, it does not believe inflation has had a material effect on sales or results of operations during the past several years. Efforts by the PRC to curb inflation may also curb economic growth, increase our overhead costs and adversely affect our sales. If the PRC rate of inflation continues to increase, the Chinese government may introduce further measures intended to reduce the inflation rate in the PRC. Any such measures adopted by the Chinese government may not be successful in reducing or slowing the increase in the PRC's inflation rate. Sustained or increased inflation in the PRC may have an adverse impact on the PRC's economy and may materially and adversely affect our business and financial results.

The Company is currently not exposed to material future earnings or cash flow exposures from changes in interest rates on debt obligations as the Company had no bank indebtedness in Fiscal 2009. The Company does not currently anticipate entering into interest rate swaps and/or similar instruments.

**PART II**

**ITEM 15. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ( Exchange Act ) as of the end of the period covered by this Annual Report on Form 20-F. Based on such evaluation, they have concluded that as of such date, our disclosure controls and procedures are effective and designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable Securities and Exchange Commission ( SEC ) rules and forms and they effectively ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including, our Chief Executive Officer and Principal Financial Officer, allowing for timely decisions regarding required disclosures.



(b) Management's Annual Report on Internal Control over Financial Reporting

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our Chief Executive Officer and Chief Financial Officer assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, they used the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Based on this assessment, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2009, our internal control over financial reporting is effective based on those criteria. Notwithstanding the foregoing, all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(c) Changes in Internal Controls

There were no changes in our internal controls that occurred during the period covered by our annual report that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

Table of Contents**Item 16A. Audit Committee Financial Expert**

The Committee includes one non-employee director who meets the independence and financial expert requirements and two other members who meet the independence requirements of the NASDAQ listing standards and the rules and regulations of U.S. Securities and Exchange Commission. The Committee includes Messrs. Y.K. Liang, Ka Chong Cheang and Li Da Weng. Mr. Y.K. Liang is the financial expert on that committee.

**Item 16B. Code Of Ethics**

Our Board of Directors has adopted a code of business conduct and ethics that applies to our directors, officers and employees, including certain provisions that specifically apply to our chief executive officer, chief financial officer and any other persons who perform similar functions for us. The Company agrees to undertake to provide to any person without charge, a copy of our code of business conduct and ethics within ten working days after we receive such person's written request.

**Item 16C. Principal Accountant Fees And Services**

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by BDO Limited who were our principal external auditors, for 2009, 2008 and 2007.

	<b>For the Year Ended December, 31</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
	<b>US\$</b>	<b>US\$</b>	<b>US\$</b>
Audit fees(1)	190,000	154,000	189,000
Audit-related fees(2)	Nil	Nil	25,000
Tax fees(3)	6,400	3,800	8,100
All other fees	Nil	Nil	Nil

Our Audit Committee has adopted a pre-approval policy for the engagement of our independent accountant to perform permitted audit and non-audit services. Under this policy, which is designed to assure that such engagements do not impair the independence of our auditors, the Audit Committee pre-approves annually a range of specific audit and non-audit services in the categories of Audit Service, Audit-Related Services, Tax Services and other services that may be performed by our independent accountants, and the maximum pre-approved fees that may be paid as compensation for each pre-approved service in those categories. Any proposed services exceeding the maximum pre-approved fees require specific approval by the Audit Committee.

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(1) Audit fees means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for the audit of our annual financial statements.

(2) **Audit-related fees** means the aggregate fees billed in each of the fiscal years listed for assurance and related services by our principal auditors that are reasonably related to the performance of the audit or review of our financial statements and are not reported under **Audit fees**. Services comprising the fees disclosed under the category of **Audit-related fees** involve principally the performance of certain agreed upon procedures for the years ended December 31, 2007, 2008 and 2009, respectively.

(3) **Tax fees** means the aggregated fees billed in each of the years listed for professional services rendered by our principal auditors for tax compliance, tax advice and tax planning.

**Item 16D. Exemptions From Listing Standards**

The Company is a **Controlled Company** as defined in NASDAQ's corporate governance rules as a majority of our shares are owned by a **control group** consisting of T.C. Leung, Pearl Venture Ltd. and Regent Earnings Limited, who have disclosed their **control group** status in their filings with the Commission. So long as that **controlled company** status remains in effect, the Company will be exempt from certain of NASDAQ corporate governance rules that, including among other things, would require: (a) a majority of our directors be independent; (b) the compensation of our chief executive officer be determined or recommended by independent directors; and (c) director nominations be determined or recommended by independent directors.

The Company believes it is in compliance with NASDAQ's corporate governance rules as in effect and intends to comply with the changes to said rules no later than the date that they become effective.

Table of Contents**Item 16E. Purchases of Equity Securities By Issuer and Affiliated Purchasers.**

During the following months in 2008 and 2009, T.C. Leung, our Chief Executive Officer and principal shareholder, either directly or through an entity beneficially owned by him (Regent), purchased shares in the open market from time to time.

As of May 31, 2010, the Company shares have been purchased by him at prices ranging from US\$0.52 to US\$1.04 with an average price per share of US\$0.78 as more particularly set forth below:

<b>Period</b>	<b>(a) Total Number of Shares Purchased</b>	<b>(b) Average Price Per Share</b>
November 1, 2008 to November 30, 2008	1,300	US\$ 0.95
December 1, 2008 to December 31, 2008	1,100	US\$ 0.91
January 1, 2009 to January 31, 2009	2,900	US\$ 1.00
February 1, 2009 to February 28, 2009	2,000	US\$ 0.52
March 1, 2009 to March 31, 2009	500	US\$ 0.57

In November 2008, the Company adopted a program to repurchase up to 300,000 of its issued and outstanding Ordinary Shares by December 31, 2009. This gave Euro Tech the ability to purchase the shares in the open market or through negotiated or block transactions from time to time based on market and business conditions. Under this program, the Company had the ability to purchase its Ordinary Shares in the open market or through negotiated or block transactions from time to time based on market and business conditions until the end of 2009. As of July 31, 2009, 300,034 of the Company's Ordinary Shares have been purchased by the Company under this program at prices ranging from US\$0.45 to US\$1.19 with an average price per share of US\$0.88 as more particularly described below:

## November 2008 Buy Back Program

<b>Period</b>	<b>(a) Total Number of Shares Purchased</b>	<b>(b) Average Price Paid per Share</b>	<b>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</b>
November 1, 2008 to November 30, 2008	12,691	US\$ 1.06	12,691	287,309

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December 1, 2008 to December 31, 2008	28,350	US\$	1.08	28,350	258,959
January 1, 2009 to January 31, 2009	36,900	US\$	0.99	36,900	222,059
February 1, 2009 to February 28, 2009	41,090	US\$	0.62	41,090	180,969
March 1, 2009 to March 31, 2009	77,320	US\$	0.63	77,320	103,649
April 1, 2009 to April 30, 2009	36,183	US\$	0.98	36,183	67,466
May 1, 2009 to May 31, 2009	20,149	US\$	1.02	20,149	47,317

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June 1, 2009 to June 30, 2009	5,400	US\$	1.21	5,400	41,917
July 1, 2009 to July 31, 2009	41,951	US\$	1.09	41,951	

In July 2009, the Company adopted another program to repurchase up to an additional 300,000 of its issued and outstanding ordinary shares by July 31, 2010. As of May 31, 2010, 34,135 of the Company's Ordinary Shares have been purchased by the Company under this additional program at prices ranging from US\$0.86 to US\$1.73 with an average price per share of US\$1.39 as more particularly described below:

## July 2009 Buy Back Program

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs	
July 1, 2009 to July 31, 2009	100	US\$	1.43	100	299,900
August 1, 2009 to August 31, 2009	13,500	US\$	1.27	13,500	286,400
September 1, 2009 to September 30, 2009	12,535	US\$	1.30	12,535	273,865
October 1, 2009 to October 31, 2009	500	US\$	1.57	500	273,365
May 1, 2010 to May 31, 2010	8,500	US\$	1.69	8,500	264,865

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**PART III**

**ITEM 18. FINANCIAL STATEMENTS**

The following financial statements are filed as part of this annual report on Form 20-F.

Euro Tech Holdings Company Limited

Report of Independent Registered Public Accounting Firm

Consolidated balance sheets

Consolidated statements of income

Consolidated statements of cash flows and changes in shareholders' equity

Zhejiang Jiahuan Electronic Company Limited

Report of Independent Registered Public Accounting Firm

Consolidated balance sheet

Consolidated statement of income.

Cash flows and changes in shareholders' equity

Zhejiang Tianlan Environmental Protection Technology Company Limited

Report of Independent Registered Public Accounting Firm

Consolidated balance sheets

Consolidated statements of income.

Cash flows and changes in shareholders' equity

**ITEM 19. EXHIBITS**

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### Lists of Exhibits

<b>Exhibit No.</b>	<b>Description</b>
1.1	Amended and Restated Memorandum and Articles of Association (1)
1.2	Amendments to Exhibit 3.1 adopted by shareholders on August 15, 2000 (3)
4.5	2000 Officers and Directors Stock Option and Incentive Plan (3)
4.6	2000 Employees Stock Option and Incentive Plan (3)
4.7	Equity Interest Transfer Agreement between Tamworth Industrial Ltd. ( Tamworth ) and Registrant (4)
4.8	Equity Interest Transfer and Shareholders Agreement among Tamworth, Registrant and Pact Asia Pacific Limited (4)
4.10	2002 Officers and Directors Stock Option Plan (6)
4.11	Registrant s Audit Committee Charter (7)
4.12	2007 Officers and Directors Option Plan (8)
8.1	List of Subsidiaries *
10.1	Share Sale and Purchase Agreement between Tamworth Industrial Ltd. And Registrant s subsidiary (5)
10.2	Equity Interest Transfer Agreement between Tamworth Industrial Ltd. And the Registrant s subsidiary (5)
10.3	Share Transfer and Subscription Agreement among Registrant s subsidiary, Zhejiang Jia Huan Limited ( Jia Huan ) and the Management Shareholders of Jia Huan (9)



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10.4	Share Subscription Agreement among Registrant's subsidiary, Zhejiang Tianlan Limited ( Blue Sky ) and the Management Shareholders of Blue Sky (9)
12.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
12.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
13.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *
13.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

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\* Filed Herewith

- (1) Incorporated by reference, previously filed as an Exhibit to Registration Statement, SEC File No. 333-16277 and is incorporated by reference herein.
- (2) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 20-F for its year ended December 31, 1999.
- (3) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 20-F for its year ended December 31, 2000.
- (4) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 6-K filed on February 11, 2002.
- (5) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 6-K, filed on December 8, 2005.
- (6) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 6-K filed on July 24, 2002.
- (7) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 6-K filed on August 19, 2002.
- (8) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 6-K, filed on August 14, 2007.
- (9) Incorporated by reference, previously filed as an Exhibit to Registrant's Report on Form 20-F, filed on June 28, 2008.

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**SIGNATURES**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

**EURO TECH HOLDINGS  
COMPANY LIMITED**  
(Registrant)

/s/ T.C. Leung  
T.C. Leung,  
Chief Executive Officer and Chairman of the Board

Dated: June 28, 2010

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**EURO TECH HOLDINGS COMPANY LIMITED**

**AUDITED CONSOLIDATED BALANCE SHEETS**

**AS OF DECEMBER 31, 2009 AND 2008 AND**

**CONSOLIDATED STATEMENTS OF INCOME,**

**CONSOLIDATED CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY**

**FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007**

**TOGETHER WITH REPORT OF INDEPENDENT REGISTERED**

**PUBLIC ACCOUNTING FIRM**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and shareholders of

Euro Tech Holdings Company Limited

We have audited the accompanying consolidated balance sheets of Euro Tech Holdings Company Limited as of December 31, 2009 and 2008 and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Euro Tech Holdings Company Limited as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Limited

BDO Limited

Hong Kong, June 28, 2010

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2009 AND 2008**

	Note	2009 US\$ 000	2008 US\$ 000
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents		7,025	7,146
Restricted cash		461	388
Accounts receivable, net	6	6,063	6,707
Prepayments and other current assets		618	1,041
Inventories, net	7	1,347	2,600
Taxation recoverable		1	
<b>Total current assets</b>		<b>15,515</b>	<b>17,882</b>
Property, plant and equipment, net	8 & 21(iii)	1,412	1,513
Investments in affiliates	9	8,067	7,679
Goodwill	12	1,060	1,060
Deferred tax assets	4	190	144
<b>Total assets</b>		<b>26,244</b>	<b>28,278</b>
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities:</b>			
Accounts payable		3,884	5,838
Other payables and accrued expenses	10	2,835	2,844
Taxation payable		593	617
<b>Total current liabilities</b>		<b>7,312</b>	<b>9,299</b>
Commitments and contingencies	19		
<b>Shareholders' equity:</b>			
Ordinary share, par value US\$0.01 each, 20,000,000 (2008: 20,000,000) shares authorized; 12,212,031 (2008: 12,202,031) shares issued and outstanding	11	122	122
Additional paid-in capital		9,501	9,495
Treasury stock, 667,320 (2008: 381,692) shares at cost	13	(534)	(281)
PRC statutory reserve	14	222	200
Accumulated other comprehensive income		487	478
Retained earnings		6,989	6,979

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Total Euro Tech shareholders' equity	16,787	16,993
Non-controlling interest	2,145	1,986
Total shareholders' equity	18,932	18,979
Total liabilities and shareholders' equity	26,244	28,278

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007**

	Note	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
<b>Revenues</b>				
Trading and manufacturing		18,326	21,439	20,010
Engineering		9,010	10,299	7,220
Total revenues	21(i) & (ii)	27,336	31,738	27,230
<b>Cost of revenues</b>				
Trading and manufacturing		(14,266)	(16,618)	(15,406)
Engineering		(6,610)	(7,536)	(4,992)
Total cost of revenues		(20,876)	(24,154)	(20,398)
Gross profit		6,460	7,584	6,832
Selling and administrative expenses		(6,608)	(7,214)	(6,566)
Operating (loss)/ income		(148)	370	266
Interest income		37	45	256
Other income, net	3	71	145	142
(Loss)/Income before income taxes and equity in profit of affiliates		(40)	560	664
Income taxes	4	(218)	(321)	(144)
Equity in profit of affiliates		595	273	247
Net income for the year		337	512	767
Less: net income attributable to non-controlling interest		(305)	(363)	(345)
Net income attributable to the Company		32	149	422
<b>Net income per ordinary share</b>				
- Basic		US\$ 0.003	US\$ 0.01	US\$ 0.04
- Diluted		US\$ 0.003	US\$ 0.01	US\$ 0.03
<b>Weighted average number of ordinary shares outstanding</b>				
- Basic	5	11,632,460	11,824,153	11,105,556
- Diluted	5	11,896,537	12,212,058	12,095,335

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007**

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Cash flows from operating activities:			
Net income	32	149	422
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation of property, plant and equipment	202	218	232
Stock based compensation expense		217	148
Loss (Gain) on disposal of property, plant and equipment	10	1	(19)
Minority interest in profits of subsidiaries	305	363	345
Equity in profit of affiliates	(595)	(273)	(247)
Deferred tax assets	(46)	(10)	(96)
(Increase) decrease in current assets:			
Accounts receivable, net	644	(1,739)	(54)
Prepayments and other current assets	423	(129)	(189)
Inventories, net	1,253	(588)	16
Taxation recoverable	(1)	12	
Increase (decrease) in current liabilities:			
Accounts payable	(1,954)	2,726	(1,080)
Other payables and accrued expenses	(9)	(400)	896
Taxation payable	(24)	97	75
Net cash provided by operating activities	240	644	449
Cash flows from investing activities:			
Purchase of property, plant and equipment	(118)	(99)	(250)
Proceeds on disposal of property, plant and equipment	7		43
Dividend received from affiliates	207	294	
Investments in affiliates		(3,302)	(4,151)
Restricted cash for issuance of bank guarantees	(73)	(56)	83
Dividend paid to non-controlling interest	(147)		(140)
Net cash used in investing activities	(124)	(3,163)	(4,415)
Cash flows from financing activities:			
Issuance of ordinary shares on exercise of options	6	51	3,720
Purchase of treasury stock	(253)	(44)	
Cash from issuance of registered capital in subsidiary to non-controlling interest			200
Net cash provided by financing activities	(247)	7	3,920
Effect of exchange rate changes on cash and cash equivalents	10	271	273
Net (decrease)/increase in cash and cash equivalents	(121)	(2,241)	227

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Cash and cash equivalents, beginning of year	7,146	9,387	9,160
Cash and cash equivalents, end of year	7,025	7,146	9,387
	<b>US\$ 000</b>	<b>US\$ 000</b>	<b>US\$ 000</b>
<b>Supplementary information</b>			
Interest received	37	45	256
Interest paid			
Income taxes paid	289	233	166
Shares surrendered for exercise of stock options		73	155

As at December 31, 2007 there was a final consideration of US\$648,000 payable in relation to the acquisition of Zhejiang Tianlan Environmental Technology Co., Ltd. included in other payables and accrued expenses.

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007**

	Number of Ordinary share	Ordinary share US\$ 000	Additional paid-in capital US\$ 000	Treasury stock US\$ 000	Accumulated other comprehensive income US\$ 000	PRC statutory reserve US\$ 000	Retained earnings US\$ 000	Non- controlling interest US\$ 000	Total US\$ 000
Balance as of January 1, 2007	9,375,192	94	5,387	(237)	69	88	6,522	1,067	12,990
Net income							422	345	767
Other comprehensive income:									
Foreign exchange translation adjustment					202			273	475
<b>Total comprehensive income</b>									<b>1,242</b>
Shares surrendered for exercise of stock options	(45,537)	(1)	(154)						(155)
Exercise of stock options	2,695,246	27	3,848						3,875
Transfer of reserve						77	(79)		(2)
Stock-based compensation expense			148						148
Dividend paid to non-controlling interest								(140)	(140)
Balance as of December 31, 2007	12,024,901	120	9,229	(237)	271	165	6,865	1,545	17,958
Net income							149	363	512
Other comprehensive income:									
Foreign exchange translation adjustment					207			78	285
<b>Total comprehensive income</b>									<b>797</b>
Purchase of treasury stock				(44)					(44)
Shares surrendered for exercise of stock options	(31,240)		(73)						(73)
Exercise of stock options	208,370	2	122						124
Transfer of reserve						35	(35)		
Stock-based compensation expense			217						217
Dividend paid to non-controlling interest									
Balance as of December 31, 2008	12,202,031	122	9,495	(281)	478	200	6,979	1,986	18,979

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Net income					32		305	337	
Other comprehensive income:									
Foreign exchange translation adjustment			9				1	10	
Total comprehensive income								347	
Purchase of treasury stock				(253)				(253)	
Shares surrendered for exercise of stock options									
Exercise of stock options	10,000		6					6	
Transfer of reserve					22	(22)			
Stock-based compensation expense									
Dividend paid to non-controlling interest							(147)	(147)	
Balance as of December 31, 2009	12,212,031	122	9,501	(534)	487	222	6,989	2,145	18,932

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1 Organization and principal activities**

Euro Tech Holdings Company Limited (the Company) was incorporated in the British Virgin Islands on September 30, 1996.

Euro Tech (Far East) Limited (Far East) is the principal operating subsidiary of the Company. It is principally engaged in the marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems in Hong Kong and in the People's Republic of China (the PRC).

Details of the Company's significant subsidiaries and affiliates are summarized as follows:

<b>Name</b>	<b>Percentage of equity ownership</b>	<b>Place of incorporation</b>	<b>Principal activities</b>
<b>Subsidiaries:</b>			
Euro Tech (Far East) Limited	100%	Hong Kong	Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems
Euro Tech (China) Limited	100%	Hong Kong	Inactive
ChinaH2O.com Limited	100%	Hong Kong	Internet content provider and provision of marketing services for environmental industry to the Company and its subsidiaries
Euro Tech Trading (Shanghai) Limited	100%	The PRC	Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems
Shanghai Euro Tech Limited	100%	The PRC	Manufacturing of analytical and testing equipment
Shanghai Euro Tech Environmental Engineering Company Limited	100%	The PRC	Undertaking water and waste-water treatment engineering projects

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Chongqing Euro Tech Rizhi Technology Co., Ltd	100%	The PRC	Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems
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Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1 Organization and principal activities (Continued)**

<b>Name</b>	<b>Percentage of equity ownership</b>	<b>Place of incorporation</b>	<b>Principal activities</b>
Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd	100%	The PRC	Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems
Guangzhou Euro Tech Environmental Equipment Co., Ltd	100%	The PRC	Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems
Yixing Pact Environmental Technology Co., Ltd	51%	The PRC	Design, manufacturing and operation of water and waste water treatment machinery and equipment
Pact Asia Pacific Limited	51%	The British Virgin Islands	Producing and selling of environment protection equipment, undertaking environment protection projects and providing relevant technology advice, training and services
<b>Affiliates:</b>			
Zhejiang Tianlan Environmental Protection Technology Co. Ltd. (Formerly known as Zhejiang Tianlan Desulfurization and Dust Removal Co. Ltd.)	20%*	The PRC	Design, general contract, equipment manufacturing, installation, testing and operation management of the treatment of waste gases emitted
Zhejaing Jia Huan Electronic Co. Ltd.	20%**	The PRC	Design and manufacturing automatic control systems and electric voltage control equipment for electrostatic precipitators (air purification equipment)

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\* In the year 2007, the Company acquired 20% equity interest of this company.

\*\* In the year 2008, the Company acquired 20% equity interest of this company.



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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies**

**(a) Basis of Consolidation**

The consolidated financial statements include the accounts of Euro Tech Holdings Company Limited and its subsidiaries (the Group). The financial statements of variable interest entities (VIEs), as defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 810-10, Consolidation (previous FASB Interpretation No. 46 (R), Consolidation of Variable Interest Entities), are included in the consolidated financial statements, if applicable.

The Group identified that certain retail shops established in the PRC qualified as variable interest entities as defined in ASC 810-10. The retail shops are principally engaged in the retailing business of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems. The Company is the primary beneficiary of these retail shops and, accordingly, consolidated their financial statements effective December 31, 2004. The Company has a controlling financial interest in these retail shops and is subject to a majority of the risk of loss from the retailing activities, and is entitled to receive a majority of the retail shops residual returns. Total assets and liabilities of these consolidated VIEs total US\$90,805 and US\$33,952, as of December 31, 2009 and US\$107,386 and US\$66,412, as of December 31, 2008, respectively. The cumulative losses on consolidating these VIEs in the Group's consolidated statement of income in 2009 were US\$43,534 (2008: losses of US\$41,443 and 2007: profits of US\$17,638), including taxes of US\$2,432 (2008: US\$3,126 and 2007: US\$11,118). The assets of the entities consist mainly of cash and bank balances, trade and other receivables, inventories and property, plant and equipment. The creditors of these entities do not have recourse to the general credit of the Group. The Group will provide all of the needed financing for the VIEs.

Investments in business entities in which the Company does not have control, but has the ability to exercise significant influence over operating and financial policies (generally 20-50 percent ownership), are accounted for using the equity method of accounting. All material intercompany balances and transactions have been eliminated on consolidation.

**(b) Subsidiaries**

A subsidiary is a company in which the Company holds, directly or indirectly, more than 50% of its outstanding voting share capital and over which it is able to exercise control.

(c) **Revenue Recognition**

The Group's main source of revenue is the sale of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems. The Company recognizes revenue when the product is delivered and the title is transferred. For certain products where installation is necessary, revenue is recognized upon completion of installation. Revenue earned from customer support services, which represents a minor percentage of total revenues, is recognized when such services are provided.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(c) Revenue Recognition (Continued)**

Revenues and profits in long term fixed price contracts or the engineering income are recorded under the percentage of completion method in accordance with FASB ASC Subtopic 605-35, Revenue Recognition – Construction-Type and Production-Type Contracts, (previously Statement of Position ( SOP ) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts). This approach relies on estimates of total expected direct costs at completion, which are compared to actual direct costs incurred to date to arrive at an estimate of revenue and profit earned to date. Recognized revenue and profit are subject to revisions as the contract progresses to completion. Revisions to profit estimates are reflected in income in the period in which the facts that give rise to the revision become known. For any contract where it is identified that a loss will be incurred, the full loss will be recognized immediately.

**(d) Research and Development Costs**

Research and development costs ( R&D costs) are expensed as incurred. The R&D costs amounted to approximately US\$99,000, US\$89,000 and US\$47,000 for the years ended December 31, 2009, 2008 and 2007 respectively and were included in Selling and Administrative expenses in the Group s consolidated statement of income.

**(e) Advertising and promotional expenses**

Advertising and promotional expenses ( A&P expenses) are expensed as incurred. The A&P expenses amounted to approximately US\$64,000, US\$40,000 and US\$78,000 for the years December 31, 2009, 2008 and 2007 respectively and were included in Selling and Administrative expenses in the Group s consolidated statement of income.

**(f) Taxation**

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The Group accounts for income and deferred tax under the provision of FASB ASC Subtopic 740-10, Income Taxes, (previously Statement of Financial Accounting Standards ( SFAS ) No. 109: Accounting for Income Taxes ), under which deferred taxes are recognized for all temporary differences between the applicable tax balance sheets and the consolidated balance sheet. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. ASC 740-10 also requires the recognition of the future tax benefits of net operating loss carry forwards. A valuation allowance is established when the deferred tax assets are not expected to be realized within a reasonable period of time.

In accordance with ASC 740-10, the Company recognizes tax benefits that satisfy a greater than 50% probability threshold and provides for the estimated impact of interest and penalties for such tax benefits. The Company did not have such uncertain tax positions in 2009, 2008 and 2007.

Deferred tax assets and liabilities are measured using the enacted tax rates expected to be applicable for taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income for the period that includes the enactment date.

Note 4 shows the applicable tax rates for individual subsidiary and variable interest entities, as well as the major temporary differences so recorded.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(g) Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and demand deposits with banks.

**(h) Receivables and Other Assets**

Receivables and other assets are recorded at their nominal values. Doubtful debt allowances are provided for identified individual risks for these line items. If the loss of a certain part of the receivables is probable, doubtful debt allowances are provided to cover the expected loss. Receivables are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

**(i) Inventories**

Inventories are stated at the lower of cost, on the first-in, first-out method, or market value. Costs include purchase and related costs incurred in bringing each product to its present location and condition. Market value is calculated based on the estimated normal selling price, less further costs expected to be incurred for disposal. Provision is made for obsolete, slow moving or defective items, where appropriate.

**(j) Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Gains or losses on disposal are reflected in current operations. Major expenditures for betterments and renewals are capitalized. All ordinary repair and maintenance costs are expensed as incurred. Depreciation of property, plant and equipment is computed using the straight-line method over the assets' estimated useful lives as follows:

Office premises	47 to 51 years
Leasehold improvements	over terms of the leases or the useful lives whichever is less
Furniture, fixtures and office equipment	3 to 5 years
Motor vehicles	4 years
Testing equipment	3 years

**(k) Impairment**

The Group has adopted FASB ASC Subtopic 360-10, Property, Plant, and Equipment, (previously SFAS No. 144: Accounting for Impairment or Disposal of Long-Lived Assets ) which requires impairment losses to be recorded for property, plant and equipment to be held and used in operations when indicators of impairment are present. Reviews are regularly performed to determine whether the carrying value of assets is impaired. The Group determines the existence of such impairment by measuring the expected future cash flows (undiscounted and without interest charges) and comparing such amount to the carrying amount of the assets. An impairment loss, if one exists, is then measured as the amount by which the carrying amount of the asset exceeds the discounted estimated future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value of such assets less costs to sell. Asset impairment charges are recorded to reduce the carrying amount of the long-lived asset that will be sold or disposed of to their estimated fair values. Charges for the asset impairment reduce the carrying amount of the long-lived assets to their estimated salvage value in connection with the decision to dispose of such assets. There were no impairment losses recorded during each of the three years ended December 31, 2009.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(l) Operating Leases**

Leases where substantially all the risks and rewards of ownership of the leased assets remain with the lessors are accounted for as operating leases. Rental payments under operating leases are charged to expense on the straight-line basis over the period of the relevant leases.

**(m) Goodwill**

The Group has adopted FASB ASC Subtopic 350-10, Intangibles – Goodwill and Other (previously SFAS No. 142: Goodwill and other intangible assets ) which assess the possible impairment of goodwill existing at the date of adoption and perform a subsequent impairment test on an annual basis.

**(n) Foreign Currency Translation**

The Company maintains its books and records in United States dollars. Its subsidiaries and affiliates maintain their books and records either in Hong Kong dollars or Chinese Renminbi ( functional currencies ). Foreign currency transactions during the year are translated into the respective functional currencies at the applicable rates of exchange at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the respective functional currencies using the exchange rates prevailing at the balance sheet dates. Gains or losses from foreign currency transactions are recognized in the consolidated statements of income during the year in which they occur. Translation adjustments on subsidiaries' equity are included as accumulated comprehensive income or loss.

**(o) Derivative Instruments and Hedging Activities**

FASB ASC Subtopic 815-10, Derivatives and Hedging, (previously SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ), as amended by SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of

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FASB Statement No. 133, an amendment of FASB Statement No. 133, and SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133, as well as the interpretations of the Derivatives Implementation Group (DIG), are applied as amended by SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. ASC 815-10 contains accounting and reporting standards for hedging accounting and for derivative financial instruments, including certain derivative financial instruments embedded in other contracts.

ASC 815-10 requires that all derivatives be recognized as either assets or liabilities in the consolidated balance sheet and measured at fair value. Depending on the documented designation of a derivative instrument, any change in fair value is recognized either in net income or shareholders equity (as a component of accumulated other comprehensive income).

Fair values of derivative instruments are classified as operating assets or liabilities. Changes in fair value of derivative instruments affecting income are classified as other operating income or expenses. Please see note 17 for additional information regarding the Company's use of derivative instruments.



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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(p) Comprehensive Income**

The Group has adopted FASB ASC Subtopic 220-10, Comprehensive Income, (previously SFAS No. 130: Reporting Comprehensive Income, ) which requires the Group to report all changes in equity during a period, except for those resulting from investment by owners and distribution to owners, in the financial statements for the period in which they are recognized. The Group has presented comprehensive income, which encompasses net income and foreign currency translation adjustments, in the consolidated statement of changes in shareholders' equity.

**(q) Ordinary Share**

Ordinary share refers to the \$0.01 par value capital stock as designated in the Company's Certificate of Incorporation. Treasury stock is accounted for using the cost method. When treasury stock is reissued, the value is computed and recorded using a weighted-average basis.

**(r) Net income per Ordinary Share**

Net income per ordinary share is computed in accordance with FASB ASC Subtopic 260-10, Earnings Per Share, (previously SFAS No. 128 Earnings Per Share ), by dividing the net income by the weighted average number of shares of ordinary share outstanding during the period. The Company reports both basic earnings per share, which is based on the weighted average number of ordinary shares outstanding, and diluted earnings per share, which is based on the weighted average number of ordinary shares outstanding and all dilutive potential ordinary shares outstanding. Outstanding stock options are the only dilutive potential shares of the Company.

**(s) Stock-based Compensation**

The Group adopted the provisions of FASB ASC Subtopic 718-10, Compensation—Stock Compensation, (previously SFAS No. 123 (revised 2004) (SFAS No. 123(R)), Share-Based Payment) which requires the Group to recognize expense related to the fair value of our stock-based

compensation awards, including employee stock options.

**(t) Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(u) Related Parties**

Entities are considered to be related to the Group if the parties, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Group. Related parties also include principal owners of the Group, its management, members of the immediate families of principal owners of the Group and its management and other parties with which the Group may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

**(v) Segment Information**

The Company's segment reporting is prepared in accordance with FASB ASC Subtopic 280-10, Segment Reporting, (previously SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information). The management approach required by ASC 280-10 designates that the internal reporting structure that is used by management for making operating decisions and assessing performance should be used as the source for presenting the Company's reportable segments. The Company categorizes its operations into two business segments: Trading and manufacturing, and Engineering.

**(w) Recent Accounting Pronouncements**

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (now codified within ASC 855-10, *Subsequent Events* (ASC 855-10)). ASC 855-10 provides general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 is applicable for interim or annual periods after June 15, 2009. In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-09, *Subsequent Events*, which is codified as ASC 855, *Amendments to Certain Recognition and Disclosure Requirements*. This update amends the ASC 855-10, to replace the term "public entity" with the term "an SEC filer", in order to avoid potential conflict with some of the Securities and Exchange Commission's (SEC) guidance. All of the amendments in this update are effective immediately. The application of ASC 855 did not have a material effect on the Company's consolidated financial statements.

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In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles", (now codified within ASC 105, Generally Accepted Accounting Principles). ASC 105 establishes the Codification as the single source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Following this statement, FASB will not issue new standards in the form of statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will serve only to: (1) update the Codification; (2) provide background information about the guidance; and (3) provide the bases for conclusions on the change(s) in the Codification. ASC 105 was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification supersedes all existing non-SEC accounting and reporting standards. The adoption of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies (Continued)**

**(w) Recent Accounting Pronouncements (Continued)**

In August 2009, FASB issued ASU 2009-5 Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value ( ASU 2009-5 ). ASU 2009-5 provides amendments to Subtopic 820-10, Fair Value Measurements and Disclosures-Overall, for the fair value measurement of liabilities. ASU 2009-5 clarifies that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value. ASU 2009-5 was effective for the Company for interim and annual periods ending after September 30, 2009. The adoption of ASU 2009-5 did not have a material impact on the Company's consolidated results of operations or financial position.

In December 2009, FASB issued ASU 2009-17 Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities ( ASU 2009-17 ). ASU 2009-17 amends the FASB ASC for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R) . The amendments in ASU 2009-17 replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. ASU 2009-17 also requires additional disclosures about an enterprise's involvement in variable interest entities. ASU 2009-17 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of ASU 2009-17 to have a material impact on its consolidated results of operations or financial position.

In January 2010, FASB issued ASU 2010-01, Entity, which is codified as ASC505, Accounting for Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force) . The amendments in this Update clarify that the stock portion of a distribution to shareholders that allow them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance thus eliminating the diversity in practice. The amendments in this Update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The application of ASC 505 did not have a material effect on the Company's consolidated financial statements.

In January 2010, FASB issued ASU 2010-02 Accounting and Reporting for Decreases in Ownership of a Subsidiary- a Scope Clarification ( ASU 2010-2 ). ASU 2010-2 addresses implementation issues related to the changes in ownership provisions in the Consolidation Overall Subtopic (Subtopic 810-10) of the FASB Accounting Standards Codification , originally issued as FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements. Subtopic 810-10 establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. An entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. The gain or loss includes any gain or loss associated with the difference

between the fair value of the retained investment in the subsidiary and its carrying amount at the date the subsidiary is deconsolidated. In contrast, an entity is required to account for a decrease in ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. ASU 2010-2 is effective for the Company starting January 1, 2010. The Company does not expect the adoption of ASU 2010-2 to have a material impact on the Company's consolidated results of operations or financial position.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

In January 2010, FASB issued ASU 2010-6 Improving Disclosures about Fair Measurements ( ASU 2010-6 ). ASU 2010-6 provides amendments to subtopic 820-10 that require separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the presentation of separate information regarding purchases, sales, issuances and settlements for Level 3 fair value measurements. Additionally, ASU 2010-6 provides amendments to subtopic 820-10 that clarify existing disclosures about the level of disaggregation and inputs and valuation techniques. ASU 2010-6 is effective for financial statements issued for interim and annual periods ending after December 15, 2010. The Company does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated results of operations or financial position.

**3 Other income, net**

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Exchange gain, net	47	120	104
Rental income	24	25	38
	71	145	142

**4 Income taxes**

The Company is exempt from taxation in the British Virgin Islands.

Euro Tech (Far East) Limited, Euro Tech (China) Limited and ChinaH2O.com Limited provided for Hong Kong profits tax at a rate of 16.5% in year 2009 (2008: 16.5%, 2007: 17.5%) on the basis of their income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for profits tax purposes.

Euro Tech Trading (Shanghai) Limited, a subsidiary of the Company, provides for PRC Enterprise Income Tax at a rate of 20% (2008: 18%, 2007: 15%) (a rate currently levied by the Pudong local Tax Bureau despite the rate National Tax Bureau of 25%), after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

In accordance with the relevant income tax laws and regulations applicable to foreign investment enterprises in the PRC, Shanghai Euro Tech Limited ( SET ), a subsidiary of the Company, is exempt from the PRC Enterprise Income Tax for two years starting from 2008, after offsetting

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losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2009, SET had an assessable loss carried forward of US\$313,386 as agreed by the local tax authority to offset its profit for the coming year (2008: US\$242,253). Such loss will expire in 5 years.

According to the relevant PRC tax rules and regulations, Shanghai Euro Tech Environmental Engineering Limited is exempt from the PRC Enterprise Income Tax of 20% (2008: 18%, 2007: 15%) for two years starting from 2007, followed by a 50% reduction for the next three years thereafter. Chongqing Euro Tech Rizhi Technology Co., Ltd, Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd and Guangzhou Euro Tech Environmental Equipment Co., Ltd provide for PRC Enterprise Income Tax at a rate of 25%, after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

According to the relevant PRC tax rules and regulations, Yixing Pact Environmental Technology Co., Ltd is registered in Shanghai as Foreign Owned Enterprise that are entitled to Enterprise Income Tax rate of 25% (2008: 25%, 2007: 27%). Pact Asia Pacific Limited operates in the British Virgin Islands where there are no taxes imposed on it. However, part of its profit is subject to Hong Kong profits tax at a rate of 16.5% (2008: 16.5%, 2007: 17.5%) as the profit is earned in Hong Kong.



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4 Income taxes (Continued)**

VIEs of the Group provide for PRC Enterprise Income Tax at a rate of 25% (2008: 25%, 2007: 33%), after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

As of December 31, 2009, certain VIEs had aggregated assessable losses carried forward of US\$151,706 as agreed by the local tax authority (2008: US\$99,830).

On March 16, 2007, the PRC National People's Congress passed the China Corporate Income Tax Law ( Income Tax Law ), which became effective January 1, 2008 and applies a unified income tax rate for foreign invested enterprises and domestic enterprise. The Income Tax Law is effective immediately for companies previously subject to higher taxation rates and provides a five-year transition period from its effective date for those enterprises which were established before the effective date of the new tax law and previously entitled to a preferential tax treatment.

On December 26, 2007, the State Council and on February 20, 2008 the Ministry of Finance issued implementation guidelines ( Guidelines ) setting out how the transition of tax rates will occur. The Guidelines state that those enterprises which enjoyed a preferential tax rate of 15% are eligible for a graduated rate increase to 25% over the 5-year period beginning from January 1, 2008. The applicable rates under such an agreements for such enterprises are 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011, 2012 and thereafter, respectively. In addition, foreign investment manufacturing enterprises which have not fully utilized any preferential tax treatments, such as tax holidays or reduced rates of taxation, will be able to continue to receive them during the transitional period. The Group has applied the new rate in relation to deferred tax balances.

(Loss)/Income before income taxes/(benefit):

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Domestic (BVI)			
Foreign	(40)	560	664
	(40)	560	664



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4 Income taxes (Continued)**

The provision for income taxes consists of:

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Current tax expenses:			
Domestic (BVI)			
Foreign	264	331	240
Total current provision	264	331	240
Deferred tax benefit:			
Domestic (BVI)			
Foreign	(46)	(10)	(96)
Total deferred provision	(46)	(10)	(96)

The principal reconciling items from income tax computed at the statutory rates and at the effective income tax rates are as follows:

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Computed tax at respective company's statutory tax rate	46	223	75
Change in valuation allowances	121	99	114
Under-provision for income tax in prior years	7		
Others	44	(1)	(45)
Total provision for income tax at effective tax rate	218	321	144

The components of deferred tax assets are as follows:

	2009 US\$ 000	2008 US\$ 000
Deferred tax assets arising from tax losses	528	360
Deferred tax liabilities arising from temporary differences	(4)	(3)
Less: Valuation allowances	(334)	(213)
Net deferred tax assets	190	144



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****5 Net income per ordinary share**

The calculation of the basic and diluted net income per ordinary share is based on the following data:

	<b>2009</b>	<b>2008</b> Number of shares	<b>2007</b>
Weighted average number of ordinary shares for the purposes of basic net income per share	11,632,460	11,824,153	11,105,556
Effect of dilutive potential ordinary shares: Stock options	264,077	387,905	989,779
Weighted average number of ordinary shares for the purposes of diluted net income per share	11,896,537	12,212,058	12,095,335

**6 Accounts receivable**

	<b>2009</b> US\$ 000	<b>2008</b> US\$ 000
Trade receivables	6,081	6,792
Less: Allowance for doubtful debts	(18)	(85)
	6,063	6,707

	<b>2009</b> US\$ 000	<b>2008</b> US\$ 000
Allowance for doubtful debts		
Balance at beginning	85	95
Released/(charged) to costs and expenses	(9)	8
Write off	(58)	(18)
Balance at end	18	85

As of December 31, 2009, accounts receivables in the form of bills receivable under letter of credit through banks amounted to approximately US\$104,000 (2008: US\$50,000).



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****7 Inventories, net**

	<b>2009</b> US\$ 000	<b>2008</b> US\$ 000
Raw materials	167	162
Work in progress	213	365
Finished goods	967	2,073
	1,347	2,600

Management continuously reviews obsolete and slow moving inventories and assesses the inventory valuation to determine if the provision is deemed appropriate. For the year ended December 31, 2009, and 2008, provision for obsolete and slow moving inventories amounted to US\$73,563 and US\$68,758, respectively, which were charged to cost of revenue in Consolidated Statements of Income.

**8 Property, plant and equipment**

	<b>2009</b> US\$ 000	<b>2008</b> US\$ 000
Office premises	2,257	2,257
Leasehold improvements	150	150
Furniture, fixtures and office equipment	939	857
Motor vehicles	162	162
Testing equipment	77	77
	3,585	3,503
Less: Accumulated depreciation	(2,173)	(1,990)
	1,412	1,513

  

	<b>2009</b> US\$ 000	<b>2008</b> US\$ 000	<b>2007</b> US\$ 000
Depreciation charge	202	218	232

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED ACCOUNTS****9 Investments in affiliates**

During the year ended December 31, 2007, the Group acquired 20% equity interests in Zhejiang Tianlan Environmental Protection Technology Co. Ltd, a company incorporated in the PRC for a total consideration of US\$4,648,000. The Group believes that after this acquisition, it has a strategic partner to work with in China for the environmental protection business. With this affiliate's technology and technical support it can now provide services and environmental solutions not only for water and wastewater treatment but also for air pollution control for industrial clients in China. Investments in this affiliate are accounted for using the equity method of accounting.

A summary of the financial information of the affiliate, Zhejiang Tianlan Environmental Protection Technology Co. Ltd, is set forth below:

<b>Balance Sheet:</b>	<b>2009 US\$ '000</b>	<b>2008 US\$ '000</b>
Current assets	15,947	16,952
Non-current assets	6,751	5,504
Total assets	22,698	22,456
Total liabilities	(8,803)	(9,831)
Total shareholders' equity	13,895	12,625
<b>Operating results:</b>	<b>2009 US\$ '000</b>	<b>2008 US\$ '000</b>
Net sales	17,786	14,688
Operating profits	536	1,396
Net profits	272	1,215



Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****9 Investments in affiliates (Continued)**

During the year ended December 31, 2008, the Group acquired 20% equity interests in Zhejiang Jia Huan Electronic Co. Ltd., ( Jia Huan ), a company incorporated in the PRC, for approximately US\$2,610,000. Jia Huan has been in the environmental protection business since 1969 and is based in Jin Hua, Zhejiang. The Group believes that after this acquisition, it has a strategic partner to help it make inroads into the rapidly growing air pollution control market in China. Investments in this affiliate are accounted for using the equity method of accounting.

A summary of the financial information of the affiliate, Zhejiang Jia Huan Electronic Co. Ltd, is set forth below:

<b>Balance Sheet:</b>	<b>2009 US\$ 000</b>	<b>2008 US\$ 000</b>
Current assets	16,705	17,423
Non-current assets	4,820	5,197
Total assets	21,525	22,620
Total liabilities	(8,630)	(11,559)
Total shareholders' equity	12,895	11,061
<b>Operating results:</b>	<b>2009 US\$ 000</b>	<b>2008 US\$ 000</b>
Net sales	11,521	13,571
Operating profits	433	639
Net profits	2,718	152

**10 Other payables and accrued expenses**

Other payables and accrued expenses mainly represent deposits received from customers and accruals for operating expenses.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11 Ordinary share**

During the year ended December 31, 2008, the Company issued 208,370 ordinary shares for stock options exercised and cancelled 31,240 shares surrendered for exercise of stock options.

During the year ended December 31, 2009, the Company issued 10,000 ordinary shares for stock options exercised.

**12 Goodwill**

The Company accounted for the acquisition in accordance with FASB ASC Subtopic 805-10, Business Combinations, (previously SFAS No. 141 Business Combinations ), which resulted in the recognition of goodwill. Goodwill represents the excess of acquisition cost over the estimated fair value of net assets acquired as of October 18, 2005, in relation to the acquisition of Yixing Pact Environmental Technology Co., Ltd and Pact Asia Pacific Limited..

As of December 31, 2009, the Company completed the annual impairment test. (i.e. comparing the carrying amount of the net assets, including goodwill, with the fair value of the Company as of December 31, 2009) Based on the result of the first step of the test, the Company determined that there was no impairment of goodwill as of December 31, 2009.

**13 Treasury stock**

The Company authorized a stock buyback program in December 2000 pursuant to which up to 341,250 shares, but not to exceed US\$281,250 in value, of the Company's ordinary share could be purchased in the open market from time to time as market and business conditions warrant. The Company repurchased a total of 36,445 shares and 304,206 shares of ordinary share during 2000 and 2001 for considerations of approximately US\$16,000 and US\$221,000, respectively.

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The Company authorized a stock buyback program in November 2008 pursuant to which up to 300,000 shares, but not to exceed US\$420,000 in value, of the Company's ordinary share could be purchased in the open market from time to time as market and business conditions warrant. The Company repurchased a total of 41,041 shares and 258,993 shares of ordinary share during 2008 and 2009 for considerations of approximately US\$44,000 and US\$219,000, respectively.

The Company authorized a stock buyback program in July 2009 pursuant to which up to 300,000 shares, but not to exceed US\$420,000 in value, of the Company's ordinary share could be purchased in the open market from time to time as market and business conditions warrant. The Company repurchased a total of 26,635 shares of ordinary share during 2009 for considerations of approximately US\$34,000.

There was no reissuance of treasury stock during each of the three years ended December 31, 2009.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**14 PRC statutory reserve**

Under the relevant PRC laws and regulations, the PRC subsidiaries are required to appropriate certain percentage of their respective net income to two statutory funds i.e. the statutory reserve fund and the statutory staff welfare fund. The PRC subsidiaries also appropriated certain amount of their net income to the expansion funds.

(i) Statutory reserve funds

Pursuant to applicable PRC laws and regulations, the PRC subsidiaries are required to allocate at least 10% of the companies' net income to the statutory reserve funds until such funds reaches 50% of the companies' registered capital. The statutory reserve funds can be utilized upon the approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such funds be maintained at a minimum of 25% of the companies' registered capital.

(ii) Statutory welfare funds

Pursuant to applicable PRC laws and regulations, the PRC subsidiaries are required to allocate certain amount of the companies' net income to the staff welfare funds determined by the Company. The staff welfare funds can only be used to provide staff welfare facilities and other collective benefits to the companies' employees. This fund is non-distributable other than upon liquidation of the PRC subsidiaries.

(iii) Expansion funds

The expansion reserve shall only be used to make up losses, expand the PRC subsidiaries' production operations, or increase the capital of the subsidiaries. The expansion fund can be utilized upon approval by relevant authorities, to convert into registered capital and issue bonus capital to existing investors, provided that such funds be maintained at a minimum of 25% of the companies' registered capital.



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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED ACCOUNTS**

**15 Stock options**

(i) Management Options Plan

A total of 4,586,400 shares of ordinary share have been reserved for issuance under the Company's management option plan (the Management Options). The Management Options provide for the grant of options to its officers, directors and employees as the Company's Chairman of the Board of Directors and Chief Executive Officer may direct.

During the year ended December 31, 2007, 90,090 options and 2,018,916 options under the Management Options with the exercise price of US\$ 1.221 per share and US\$1.6789 per share, respectively, were exercised. All the remaining unexercised options expired in March 2007.

(ii) 2000 Stock Option Plan

A total of 1,195,740 shares of ordinary share have been reserved for issuance under the Company's 2000 Stock Option Plan (the 2000 Stock Options). The 2000 Stock Options provide for the grant of options to its officers, directors and employees as the Company's Chairman of the Board of Directors and Chief Executive Officer may direct.

During the year ended December 31, 2007, 16,380 options and 6,300 options with exercise price of US\$0.5787 and US\$0.6809, respectively, were cancelled. During the same year, 46,410 options and 101,430 options with exercise price of US\$ 0.5787 and US\$0.8191 per share, respectively, were exercised.

During the year ended December 31, 2008, 32,000 options with an exercise price of US\$2.56 per share were granted to its employees. These options were subsequently surrendered and cancelled during the vesting period. During the same year, 24,570 options with exercise price of US\$ 0.5787 per share were exercised.

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During the year ended December 31, 2009, 10,920 options, 22,680 options and 5,000 options with exercise price of US\$0.5787, US\$0.8191 and US\$2.02, respectively, were cancelled.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED ACCOUNTS**

**15 Stock options (Continued)**

(iii) 2002 Employees' Stock Option and Incentive Plan and 2002 Officers' and Directors' Stock Option and Incentive Plan

A total of 294,000 shares and 840,000 shares of ordinary share have been reserved for issuance under the Company's 2002 Employees' Stock Option and Incentive Plan (the 2002 Employee Stock Options) and 2002 Officers' and Directors' Stock Option and Incentive Plan (the 2002 D&O Stock Options), respectively. Both 2002 Employee Stock Options and the 2002 D&O Stock Options provide for the grant of options to its employees as the Company's Chairman of the Board of Directors and Chief Executive Officer may direct.

During the year ended December 31, 2006, 8,400 options with the exercise price of US\$ 0.7618 were cancelled. During the same year, 21,000 options with exercise price of US\$ 0.7618 per share were exercised.

During the year ended December 31, 2007, 8,400 options with the exercise price of US\$ 0.7618 were cancelled. During the same year, 50,400 options and 388,000 options with exercise price of US\$ 0.7618 and US\$0.5857 per share, respectively, were exercised.

During the year ended December 31, 2008, 16,800 options and 167,000 options with exercise price of US\$ 0.7618 and US\$0.5857 per share, respectively, were exercised.

During the year ended December 31, 2009, 12,600 options with exercise price of US\$0.7618 were cancelled. During the same year, 10,000 options with exercise price of US\$0.5857 per share were exercised.

(iv) 2007 Officers' and Directors' Stock Option and Incentive Plan

A total of 880,000 shares of ordinary share have been reserved for issuance under the Company's 2007 Officers' and Directors' Stock Option and Incentive Plan (the 2007 D&O Stock Options). The 2007 D&O Stock Options provide for the grant of options to its directors and officers as the

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Company's Chairman of the Board of Directors and Chief Executive Officer may direct. During the year ended December 31, 2007, the Company granted such options to its officers and directors under the 2007 D&O Stock Options, which allow them to purchase up to 133,000, 66,500, 66,500, 100,000 and 133,000 shares of ordinary share at an exercise price of US\$2.85, US\$4.00, US\$4.05, US\$3.66 and US\$2.66, respectively. The options vested for a period of a six-month period and will expire before end of November 2009. During the same year, no options had been exercised.

During the year ended December 31, 2008, all the 499,000 options granted in 2007 were cancelled. On January 24, 2008, 173,000 options with an exercise price of US\$2.56 per share were granted. These options were subsequently surrendered and cancelled on July 4, 2008.

The Company estimate the fair value of the options granted under the Black-Scholes pricing model.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED ACCOUNTS****15 Stock options (Continued)**

## (iv) 2007 Officers and Directors Stock Option and Incentive Plan (Continued)

Changes in outstanding options under various plans mentioned above were as follows:

	2009		2008		2007	
	Number of options	Weighted average exercise price US\$	Number of options	Weighted average exercise price US\$	Number of options	Weighted average exercise price US\$
Outstanding, beginning of year	583,470	0.84	1,290,840	1.74	3,938,296	1.32
Granted			205,000	2.56	499,000	3.27
Cancelled/Expired	(51,200)	(0.87)	(704,000)	(3.07)	(451,210)	(1.58)
Exercised	(10,000)	(0.59)	(208,370)	(0.60)	(2,695,246)	(1.44)
Outstanding, end of year	522,270	0.85	583,470	0.84	1,290,840	1.74
Exercisable, end of year	522,270	0.85	583,470	0.84	791,840	0.78

As of December 31, 2009, the options outstanding and exercisable had exercise prices in the range of US\$0.5787 to US\$3.33 and a weighted average unexpired life of approximately 1.7 years.

As of December 31, 2009	Shares	Intrinsic Value US\$ '000
Total outstanding in-the-money options	482,270	719
Total vested in-the-money options	482,270	719

The total intrinsic value of share options exercised for the twelve months ended December 31, 2009 and 2008 were approximately \$8,000 and \$374,000, respectively. As of December 31, 2009 there was no unrecognized stock-based compensation expense related to unvested stock

options.

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Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED ACCOUNTS****15 Stock options (Continued)**

The Group adopted the provisions of ASC 718-10, which requires us to recognize expense related to the fair value of our stock-based compensation awards, including employee stock options.

The Black-Scholes option-pricing model is used to estimate the fair value of the options granted. This requires the input of subjective assumptions, including the expected volatility of stock price, expected option term, expected risk-free rate over the expected option term and expected dividend yield rate over the expected option term. Because changes in subjective input assumptions can materially affect the fair value estimate, in directors' opinion, the existing model may not necessarily provide a realizable measure of the fair value of the stock options. Expected volatility is based on historical volatility in the 180 days prior to the issue of the options. Expected option term and dividend yield rate are based on historical trends. Expected risk-free rate is based on US Treasury securities with similar maturities as the expected terms of the options at the date of grant.

The following table summarizes the assumptions used during the years ended December 31, 2008 and 2007:

<b>Assumptions</b>	<b>2008</b>	<b>2007</b>
Expected volatility	75.9-86.7%	75.9-86.7%
Expected dividends		
Expected term (years)	1.25	1.25
Risk-free rate	3.2-4.3%	3.2-4.3%

**16 Pension plan**

Prior to December 1, 2000, the Group had only one defined contribution pension plan for all its Hong Kong employees. Under this plan, all employees were entitled to pension benefits equal to their own contributions plus 50% to 100% of individual fund account balances contributed by the Group, depending on their years of service with the Group. The Group was required to make specific contributions at approximately 10% of the basic salaries of the employees to an independent fund management company.

With the introduction of the Mandatory Provident Fund Scheme, a defined contribution scheme managed by an independent trustee on December 1, 2000, the Group and its employees who joined the Group subsequently make monthly contributions to the scheme at 5% of the

employee's cash income as defined under the Mandatory Provident Fund legislation. Contributions of both the Group and its employees are subject to a maximum of HK\$1,000 per month and thereafter contributions are voluntary and are not subject to any limitation. The Group and its employees made their first contributions in December 2000.

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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED ACCOUNTS**

**16 Pension plan (Continued)**

As stipulated by the rules and regulations in the PRC, the Group contributes to state-sponsored retirement plans for its employees in Mainland China. The Group contributes approximately ranging from 10% to 22% of the basic salaries of its employees, and has no further obligations for the actual payment of pension or post-retirement benefits beyond the annual contributions. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees.

During the years ended December 31, 2009, 2008 and 2007, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately US\$327,000, US\$291,000 and US\$245,000 respectively.

**17 Risk factor and Derivative Instruments**

Financial risk factors

The Group's activities expose it to a variety of financial risks: foreign exchange rate risk and credit risk.

(i) Credit risk

The Group has no significant concentration of credit risk. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any customers. Derivative counterparties and cash transactions are limited to high credit quality banks.

(ii) Foreign exchange risk

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The Group operates in Hong Kong, the PRC and trades with both local and overseas customers, and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to purchases in, Hong Kong dollar, Renminbi and Euro. Foreign exchange risk arises from committed and unmatched future commercial transactions, such as confirmed import purchase orders and sales orders, recognized assets and liabilities, and net investment in the PRC operations. The Group uses derivative financial instruments such as foreign exchange contracts to hedge certain foreign currency exposures.

The Group's prevailing risk management policy is to hedge the net committed transactions (mainly sales and import purchases) in each major currency.

The Company's policy generally permits the use of derivatives if they are associated with underlying assets or liabilities, forecasted transactions, or legally binding rights or obligations. There were no such derivatives during the years ended December 31, 2009 and 2008.



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**EURO TECH HOLDINGS COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED ACCOUNTS**

**18 Related party transactions**

Other than the compensation paid and stock options available to the directors, there were no other transactions with related parties in the years 2009, 2008 and 2007.

**19 Commitments and contingencies**

(i) Operating leases

The Group has various operating lease agreements for office and industrial premises. Rental expenses for the years ended December 31, 2009, 2008 and 2007 were approximately US\$394,000, US\$411,000, and US\$448,000, respectively. Future minimum rental payments as of December 31, 2009, under agreements classified as operating leases with non-cancellable terms amounted to US\$224,000 of which US\$175,000 are payable in the year 2010 and US\$49,000 are payable within years 2011 to 2013. As of December 31, 2008, the future minimum rental payments under agreements classified as operating leases with non-cancellable terms amounted to US\$177,000 of which US\$154,000 are payable in the year 2009 and US\$23,000 are payable within years 2010 to 2012.

(ii) Banking facilities

As at December 31, 2009, 2008 and 2007, the Group had various banking facilities available for overdraft, import and export credits and foreign exchange contracts from which the Group can access up to approximately US\$2,564,000, US\$2,564,000 and US\$4,167,000 respectively, of which approximately US\$260,000, US\$234,000 and US\$138,000 was utilized for issuance of bank guarantees.

(iii) Non-controlling interest put option

The Group granted the non-controlling interest of Yixing Pact Environmental Technology Co., Ltd and Pact Asia Pacific Limited a put option, which is effective from 2009, requiring the Group to acquire part or all remaining securities of these two companies at 5.2 times of their average

net income for the three prior fiscal years.

**20 Fair value of financial instruments**

The carrying values of financial instruments, which consist of cash and cash equivalents, accounts receivable and accounts payable, bills receivable, bills payable, other payables and balances with related companies approximate their fair values due to the short-term nature of these instruments.

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Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED ACCOUNTS****21 Segment information**

(i) The Group reports under two segments: Trading and manufacturing, and Engineering.

Operating income represents total revenues less operating expenses, excluding other expense, interest and income taxes. The identifiable assets by segment are those used in each segment's operations. Intersegment amounts are not significant and are eliminated to arrive at consolidated totals.

	2009 US\$ '000	2008 US\$ '000	2007 US\$ '000
Revenue			
Trading and manufacturing	18,326	21,439	20,010
Engineering	9,010	10,299	7,220
	27,336	31,738	27,230
Operating income			
Trading and manufacturing	(462)	(185)	(57)
Engineering	314	555	323
	(148)	370	266

	2009 US\$ '000	2008 US\$ '000	2007 US\$ '000
Depreciation:			
Trading and manufacturing	172	179	197
Engineering	30	39	35
	202	218	232
Capital Expenditures, Gross			
Trading and manufacturing	81	56	147
Engineering	37	43	103
	118	99	250

	2009 US\$ '000	2008 US\$ '000
Assets		
Trading and manufacturing	10,938	12,754
Engineering	7,239	7,845
Unallocated	8,067	7,679
	26,244	28,278
Liabilities		

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Trading and manufacturing	4,383	6,108
Engineering	2,929	3,191
Unallocated	7,312	9,299

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Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED ACCOUNTS****21 Segment information (Continued)**

(ii) Geographical analysis of revenue by customer location is as follows:

	2009 US\$ 000	2008 US\$ 000	2007 US\$ 000
Revenue -			
The PRC	19,333	25,430	21,595
Hong Kong	7,621	5,745	5,401
Others	382	563	234
	27,336	31,738	27,230

(iii) Long-lived assets (1)

Geographical analysis of long-lived assets is as follows:

	2009 US\$ 000	2008 US\$ 000
Hong Kong	755	810
The PRC	657	703
	1,412	1,513

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(1) Long-lived assets represent property, plant and equipment, net.

(iv) Major suppliers

Details of individual suppliers accounting for more than 5% of the Group's purchases are as follows:

	2009	2008	2007
Thermo Fisher Scientific	21%	10%	5%
Siemens Water Technologies Group	13%	7%	10%
Calipers Life Sciences Inc.	10%	10%	6%
Hach Company - Lachat Instruments	10%	8%	5%
Hioki E.E. Corp.	6%	15%	32%
Stanford Research Systems Inc.	5%	4%	4%

Some of the purchase agreements signed with the Group's suppliers are memorialized. They are not formal contracts and are arranged through other acknowledgements or correspondence which may contain vague description of the terms and conditions of such arrangements, and therefore may be unenforceable.

(iv) Major customers

No revenue from a single customer exceeds 10% of the Group revenue during the years ended December 31, 2009, 2008 and 2007.

## 22 Post balance sheet events

In January 2010, the Group acquired additional 2% equity interests in Yixing Pact Environmental Technology Co., Ltd and Pact Asia Pacific Limited for a total consideration of approximately US\$73,000.

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**ZHEJIANG JIAHUAN ELECTRONIC COMPANY LIMITED**

**AUDITED CONSOLIDATED BALANCE SHEET**

**AS OF DECEMBER 31, 2009 AND**

**CONSOLIDATED STATEMENT OF INCOME,**

**CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY**

**FOR THE YEAR ENDED DECEMBER 31, 2009**

**TOGETHER WITH REPORT OF INDEPENDENT REGISTERED**

**PUBLIC ACCOUNTING FIRM**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and shareholders of

Zhejiang Jiahuan Electronic Co., Ltd.

We have audited the accompanying consolidated balance sheet of Zhejiang Jiahuan Electronic Co., Ltd. as of December 31, 2009 and the related consolidated statement of income, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Zhejiang Jiahuan Electronic Co., Ltd. as of December 31, 2009 and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

This was our first audit of the consolidated financial statements of Zhejiang Jiahuan Electronic Co., Ltd. and, as instructed, the scope of our engagement did not include sufficient procedures with respect to the consolidated financial statements for the preceding year to enable us to express an opinion on the consistency of application of accounting principles.

/s/ BDO Limited

BDO Limited

Hong Kong, June 28, 2010





Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2009 AND 2008**

	Note	2009 RMB 000	(Unaudited) 2008 RMB 000
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		7,183	14,132
Accounts receivable, net	5	67,080	64,349
Notes receivable		1,500	11,142
Other receivables	6	12,281	5,138
Amounts due from shareholders	14	826	181
Short term investments	7	8,200	200
Inventories	8	17,051	23,040
<b>Total current assets</b>		<b>114,121</b>	<b>118,182</b>
Property, plant and equipment, net	9	25,429	27,146
Land use right, net	10	7,430	7,603
Long term investment	7	69	518
<b>Total assets</b>		<b>147,049</b>	<b>153,449</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable		18,280	21,094
Other payables and accrued expenses	11	12,804	18,574
Short term loans	12	20,000	31,000
Amount due to a related company	14	838	896
Income tax payable		427	405
<b>Total current liabilities</b>		<b>52,349</b>	<b>71,969</b>
Other long term liabilities	15	6,609	6,862
<b>Commitments and contingencies</b>			
<b>Shareholders equity</b>			
11,250,000 shares authorised; 11,250,000 shares issued and fully paid; par value RMB1 per share		11,250	11,250
PRC statutory reserves	16	29,461	27,600
Retained earnings		46,236	35,160
<b>Total shareholders equity of Zhejiang Jiahuan Electronic Co., Ltd.</b>		<b>86,947</b>	<b>74,010</b>
Non-controlling interest		1,144	608

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Total equity	88,091	74,618
<b>Total liabilities and shareholders equity</b>	<b>147,049</b>	<b>153,449</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEAR ENDED DECEMBER 31, 2009 AND 2008**

	Note	2009 RMB 000	(Unaudited) 2008 RMB 000
Revenue		78,670	95,994
Cost of revenue		(52,055)	(70,828)
Gross profit		26,615	25,166
Selling and administrative expenses		(22,885)	(24,468)
Operating income		3,730	698
Interest income		99	118
Other income, net	3	15,949	310
Income before income taxes		19,778	1,126
Income taxes	4	(1,080)	(1,065)
Net Income		18,698	61
Net income attributable to non-controlling interest		(136)	(9)
Net income attributable to Zhejiang Jiahuan Electronic Co., Ltd. s shareholders		18,562	52

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEAR ENDED DECEMBER 31, 2009 AND 2008**

	2009 RMB 000	(Unaudited) 2008 RMB 000
Cash flows from operating activities:		
Net income	18,698	61
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortisation of land use right	173	180
Depreciation of property, plant and equipment	2,099	2,074
Gain on disposal of land	(14,892)	
Gain on disposal of investments	(883)	
Increase in allowance for doubtful debts on trade receivables	2,458	3,528
Impairment loss on long term investment		485
Loss on disposal of property, plant and equipment	9	
Recovery of previously written off trade receivables	(707)	
(Increase)/decrease in current assets:		
Accounts receivable, net	(4,482)	(6,918)
Notes receivable	9,642	755
Other receivables	749	(1,528)
Inventories	9,143	2,838
Increase/(decrease) in current liabilities:		
Accounts payable	(5,967)	(8,863)
Other payables and accrued expenses	(5,770)	1,147
Amount due to a related company	(58)	896
Income tax payable	22	(3,011)
Other long term payables	(253)	819
Net cash provided by/(used in) operating activities	9,981	(7,238)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(391)	(1,227)
Purchase of short term investments	(8,000)	
Proceeds from sale of land	7,000	
Proceeds from sale of long term investments	1,332	128
Net cash used in investing activities	(59)	(1,099)
Cash flows from financing activities:		
Repayment of bank borrowings	(11,000)	
Advance of bank borrowings		5,000
Proceeds from issuance of share		8,947
Dividend paid to shareholders	(5,625)	(1,280)
Increase in amounts due from shareholders	(246)	398
Net cash (used in)/provided by financing activities	(16,871)	13,065

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Net (decrease)/increase in cash and cash equivalents	(6,949)	4,728
Cash and cash equivalents, beginning of year	14,132	9,404
Cash and cash equivalents, end of year	7,183	14,132

	RMB 000	RMB 000
Supplementary information		
Interest received	99	118
Interest paid	(1,860)	(2,124)
Income taxes paid	(1,058)	(4,076)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME****FOR THE YEAR ENDED DECEMBER 31, 2009 AND 2008**

	Number of shares	Share Amount RMB 000	PRC statutory reserves RMB 000	Retained earnings RMB 000	Non- controlling interest RMB 000	Total RMB 000
Balance as of January 1, 2009	11,250,000	11,250	27,600	35,160	608	74,618
Net income				18,562	136	18,698
Total comprehensive income						18,698
Retained earnings attributed to non-controlling interest in an acquisition of a subsidiary					400	400
Dividends				(5,625)		(5,625)
Transfer to reserve			1,861	(1,861)		
Balance as of December 31, 2009	11,250,000	11,250	29,461	46,236	1,144	88,091

	Number of shares (Unaudited)	Share Amount RMB 000 (Unaudited)	PRC statutory reserves RMB 000 (Unaudited)	Retained earnings RMB 000 (Unaudited)	Non- controlling interest RMB 000 (Unaudited)	Total RMB 000 (Unaudited)
Balance as of January 1, 2008	10,000,000	10,000	19,900	36,391	599	66,890
Net income				52	9	61
Total comprehensive income						61
Capital injection	1,250,000	1,250	7,697			8,947
Dividends				(1,280)		(1,280)
Transfer to reserve			3	(3)		
Balance as of December 31, 2008	11,250,000	11,250	27,600	35,160	608	74,618

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1 Organisation and principal activities**

Zhejiang Jiahuan Electronic Co., Ltd. (the Company) was established in the People's Republic of China (PRC) as a limited liability company. The principal activities of the Company are design, manufacturing and sales of automatic control systems and electric voltage control equipment for electrostatic precipitators (air purification equipment).

Particulars of the Company's subsidiaries are summarised as follows:

<b>Name</b>	<b>Percentage of equity ownership</b>	<b>Place of incorporation</b>	<b>Principal activities</b>
Jinhua Jiahuan Puzhou New Energy Technology Co., Ltd.	80%	PRC	Design, manufacture and sales of solar and wind power equipment
Zhejiang Jiahuan Xinyu Environmental Protection Co., Ltd.	70%	PRC	Design, manufacture and servicing of environmental equipment

**2 Summary of significant accounting policies****(a) Basis of Consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries (collectively, the Group). In preparing the consolidated financial statements presented herewith, all significant intercompany balances and transactions have been eliminated on consolidation.

**(b) Subsidiaries**

A subsidiary is a company in which the Company holds, directly or indirectly, more than 50% of its outstanding voting share capital and over which it is able to exercise control.

(c) **Revenue Recognition**

Revenue from sale of automatic control systems, electric voltage control equipment, environmental equipment, and solar and wind power equipment is recognised when the product is delivered and the title is transferred. For certain products where installation is necessary, revenue is recognised upon completion of installation.

(d) **Research and Development Costs**

Research and development costs ( R&D costs) are expensed as incurred. The R&D costs amounted to approximately RMB4,368,000 and RMB4,054,000 for the year ended December 31, 2009 and 2008 respectively and were included in Selling and Administrative expenses in the Group s consolidated statement of income.

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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of important accounting policies - Continued**

**(e) Taxation**

The Group accounts for income and deferred tax under the provision of FASB ASC Subtopic 740-10, Income Taxes, (previously Statement of Financial Accounting Standards ( SFAS ) No. 109: Accounting for Income Taxes ). Deferred tax assets and liabilities are recognised for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. ASC 740-10 also requires the recognition of the future tax benefits of net operating loss carry forwards. A valuation allowance is established when the deferred tax assets are not expected to be realised within a reasonable period of time.

Note 4 shows the applicable tax rates for the Company and its subsidiaries, as well as the major temporary differences so recorded.

**(f) Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, demand deposits with banks.

**(g) Investments**

Investments comprise marketable securities which are classified as available-for-sale securities and are carried at fair value with unrealised gains and losses, net of taxes, reported as a separate component of shareholders' equity (deficit). The Company determines any realised gains or losses on the sale of marketable securities on a specific identification method, and records such gains and losses as a component of other income (expense), net in the consolidated statement of income.

**(h) Receivables and Other Assets**

Receivables and other assets are recorded at their nominal values. Doubtful debts allowances are provided for identified individual risks for these line items. If the loss of a certain part of the receivables is probable, doubtful debts allowances are provided to cover the expected loss. Receivables are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

(i) **Inventories**

Inventories are stated at the lower of cost, on the first-in, first-out method, or market value. Costs include purchase and related costs incurred in bringing each product to its present location and condition. Market value is calculated based on the estimated normal selling price, less further costs expected to be incurred for disposal. Provision is made for obsolete, slow moving or defective items, where appropriate.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****2 Summary of important accounting policies - Continued****(j) Property, Plant and Equipment and Land Use Right**

Property, plant and equipment and land use right are stated at cost less accumulated depreciation and amortisation. Gains or losses on disposal are reflected in current operations. Major expenditures for betterments and renewals are capitalised. All ordinary repair and maintenance costs are expensed as incurred.

Land in the PRC is owned by the PRC government. The government in the PRC, according to PRC law, may sell the right to use the land for a specified period of time. Thus, all of the Group's land purchases in the PRC are considered to be leasehold land and classified as land use right. They are amortised on a straight-line basis over the respective term of the right to use the land. The period for right to use was 50 years.

Construction in progress is stated at cost less impairment losses. Cost comprises direct costs of construction as well as borrowing costs capitalised during the periods of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to the appropriate class of property, plant and equipment when substantially all the activities necessary to prepare the assets for their intended use are completed. No depreciation is provided for in respect of construction in progress until it is completed and ready for its intended use.

Depreciation of property, plant and equipment and amortisation of land use right are computed using the straight-line method over the assets estimated useful lives as follows:

Land use right	50 years
Buildings	5 to 20 years
Furniture, fixtures and machineries	3 to 10 years
Motor vehicles	5 to 10 years

**(k) Impairment**

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The Group has adopted FASB ASC Subtopic 360-10, Property, Plant, and Equipment, (previously SFAS No. 144: Accounting for Impairment or Disposal of Long-Lived Assets ) which requires impairment losses to be recorded for property, plant and equipment to be held and used in operations when indicators of impairment are present. Reviews are regularly performed to determine whether the carrying value of assets is impaired.

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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of important accounting policies - Continued**

**(k) Impairment - Continued**

The Group determines the existence of such impairment by measuring the expected cash flows (undiscounted and without interest charges) and comparing such amount to the carrying amount of the assets. An impairment loss, if one exists, is then measured as the amount by which the carrying amount of the asset exceeds the discounted estimated future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value of such assets less costs to sell. Asset impairment charges are recorded to reduce the carrying amount of the long-lived asset that will be sold or disposed of to their estimated fair values. Changes for the asset impairment reduce the carrying amount of the long-lived assets to their estimated salvage value in connection with the decision to dispose of such assets.

The Group determined that there were no impairment losses recorded during each of the two years ended December 31, 2009 and 2008.

**(l) Foreign Currency Translation**

The Group maintains its books and records in Chinese Renminbi ( RMB ), which is the Group's functional currency. Foreign currency transactions during the year are translated into the functional currency at the applicable rates of exchange at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the exchange rates prevailing at the balance sheet date. Gains or losses from foreign currency transactions are recognized in the consolidated statement of income during the year in which they occur.

**(m) Comprehensive Income**

The Group has adopted FASB ASC Subtopic 220-10, Comprehensive Income, (previously SFAS No. 130: Reporting Comprehensive Income, ) which requires the Group to report all changes in equity during a period, except for those resulting from investment by owners and distribution to owners, in the financial statements for the period in which they are recognized. The Group has presented comprehensive income, which encompasses net income, in the consolidated statement of changes in shareholders' equity.





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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of important accounting policies - Continued**

**(n) Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the Group may undertake in the future, actual results may be different from the estimates.

**(o) Related Parties**

Entities are considered to be related to the Company if the parties, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Group. Related parties also include principal owners of the Group, its management, members of the immediate families of principal owners of the Group and its management and other parties with which the Group may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

**(p) Recent Accounting Pronouncements**

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (now codified within ASC 855-10, Subsequent Events ( ASC 855-10 )). ASC 855-10 provides general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 is applicable for interim or annual periods after June 15, 2009. In January 2010, the FASB issued Accounting Standards Update ( ASU ) No. 2010-09, Subsequent Events , which is codified as ASC 855, Amendments to Certain Recognition and Disclosure Requirements . This update amends the ASC855-10, to replace the term public entity with the term an SEC filer , in order to avoid potential conflict with some of the Securities and Exchange Commission's (SEC) guidance. All of the amendments in this update are effective immediately. The application of ASC 855 did not have a material effect on the Company's consolidated financial statements.



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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of important accounting policies - Continued**

**(p) Recent Accounting Pronouncements - Continued**

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, (now codified within ASC 105, Generally Accepted Accounting Principles (ASC 105)). ASC 105 establishes the Codification as the single source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Following this statement, FASB will not issue new standards in the form of statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will serve only to: (1) update the Codification; (2) provide background information about the guidance; and (3) provide the bases for conclusions on the change(s) in the Codification. ASC 105 was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification supersedes all existing non-SEC accounting and reporting standards. The adoption of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position.

In August 2009, FASB issued ASU 2009-5 Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value (ASU 2009-5). ASU 2009-5 provides amendments to Subtopic 820-10, Fair Value Measurements and Disclosures-Overall, for the fair value measurement of liabilities. ASU 2009-5 clarifies that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value. ASU 2009-5 was effective for the Company for interim and annual periods ending after September 30, 2009. The adoption of ASU 2009-5 did not have a material impact on the Company's consolidated results of operations or financial position.

In December 2009, FASB issued ASU 2009-17 Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (ASU 2009-17). ASU 2009-17 amends the FASB ASC for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in ASU 2009-17 replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. ASU 2009-17 also requires additional disclosures about an enterprise's involvement in variable interest entities. ASU 2009-17 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of ASU 2009-17 to have a material impact on its consolidated results of operations or financial position.

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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of important accounting policies - Continued**

**(p) Recent Accounting Pronouncements - Continued**

In January 2010, FASB issued ASU 2010-01, Entity, which is codified as ASC505, Accounting for Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force) . The amendments in this Update clarify that the stock portion of a distribution to shareholders that allow them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance thus eliminating the diversity in practice. The amendments in this Update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The application of ASC 505 did not have a material effect on the Company s consolidated financial statements.

In January 2010, FASB issued ASU 2010-02 Accounting and Reporting for Decreases in Ownership of a Subsidiary- a Scope Clarification ( ASU 2010-2 ). ASU 2010-2 addresses implementation issues related to the changes in ownership provisions in the Consolidation Overall Subtopic (Subtopic 810-10) of the FASB Accounting Standards Codification , originally issued as FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements. Subtopic 810-10 establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. An entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognises a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. The gain or loss includes any gain or loss associated with the difference between the fair value of the retained investment in the subsidiary and its carrying amount at the date the subsidiary is deconsolidated. In contrast, an entity is required to account for a decrease in ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. ASU 2010-2 is effective for the Company starting January 1, 2010. The Company does not expect the adoption of ASU 2010-2 to have a material impact on the Company s consolidated results of operations or financial position.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****2 Summary of important accounting policies - Continued****(p) Recent Accounting Pronouncements - Continued**

In January 2010, FASB issued ASU 2010-6 Improving Disclosures about Fair Measurements ( ASU 2010-6 ). ASU 2010-6 provides amendments to subtopic 820-10 that require separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the presentation of separate information regarding purchases, sales, issuances and settlements for Level 3 fair value measurements. Additionally, ASU 2010-6 provides amendments to subtopic 820-10 that clarify existing disclosures about the level of disaggregation and inputs and valuation techniques. ASU 2010-6 is effective for financial statements issued for interim and annual periods ending after December 15, 2010. The Company does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated results of operations or financial position.

The Group does not believe that any other of the recently issued and adopted, but not yet effective, accounting standards would have a material effect on the accompanying financial statements.

**3 Other income, net**

	Note	2009 RMB 000	(Unaudited) 2008 RMB 000
Exchange gain, net		1	
Gain on disposal of land	(i)	14,892	
Gain on disposal of investments		883	
Rental income	(ii)	73	
Subsidy from government	(iii)	100	310
		15,949	310

(i) The amount represents compensation from PRC government in respect of the recall of the Company's land, of which, cash of RMB7,000,000 was received from the PRC government during the year. The remaining balance of approximately RMB7,892,000, as included in other receivable (note 6), is received subsequent to the year end.

- (ii) Rental income under operating leases is recognised on a straight-line basis over the term of the relevant lease.
  
- (iii) The Group recognises subsidy income when granted by local government authority and are not subject to future return or reimbursement.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4 Income taxes**

The Group provides for PRC Enterprise Income Tax ( EIT ) at a rate of 25% on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC EIT purposes. The Company was recognised as one of the 2008 Hangzhou New and High Technical Enterprise, and is entitled to tax concession to pay a lower tax rate of 15% over 3 years, beginning in 2008.

The provision for income tax consists of:

	<b>2009</b> <b>RMB 000</b>	<b>(Unaudited)</b> <b>2008</b> <b>RMB 000</b>
Current PRC EIT	1,080	1,065
Income taxes	1,080	1,065

The principal reconciling items from income tax computed at the statutory rate and at the effective income tax rate are stated as follows:

	<b>2009</b> <b>RMB 000</b>	<b>(Unaudited)</b> <b>2008</b> <b>RMB 000</b>
Income before income taxes	19,778	1,126
Computed tax at respective company's statutory rate	3,030	179
Tax effect on revenue not subject to tax	(2,400)	
Tax effect on expenses not deductible for tax purposes	447	89
Tax effect on tax loss not recognised	18	
Utilisation of temporary differences previously not recognised		797
Others	(15)	
Total provision for income at effective rate	1,080	1,065

Deferred tax assets/(liabilities) as of December 31, 2009 are as follows:

	2009 RMB 000	(Unaudited) 2008 RMB 000
Deferred tax arising from tax losses	18	
Deferred tax arising from deductible temporary differences	1,548	1,260
Less: Valuation allowances	(1,566)	(1,260)

The Group has recorded a valuation allowance against certain deferred tax assets due to uncertainty surrounding the realisation of these assets. The valuation allowance is related to certain tax losses and the deductible temporary differences due to the unpredictability of future profit streams. Due to the uncertainty surrounding future capital gains, management believes it is more likely than not that these assets will not be realised. The tax losses can be carried forward for a period of five years, which will be expiring on January 1, 2015. The deductible temporary differences can be carried forward indefinitely.



Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****5 Accounts receivable, net**

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Trade receivables	77,421	72,939
Less: Allowance for doubtful debts	(10,341)	(8,590)
	67,080	64,349

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Allowance for doubtful debts:		
Balance at beginning	8,590	5,062
Charged to statement of income	2,458	3,528
Recovered	(707)	
	10,341	8,590

**6 Other receivables**

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Prepayments and other receivables	2,426	2,124
Compensation receivable from PRC government for disposal of land (note 3)	7,892	
Deposits	1,963	3,014
	12,281	5,138

**7 Investments**

	<b>2009</b>	
	<b>Gross unrealised</b>	<b>Fair</b>
	<b>Amortised</b>	

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	cost RMB 000	Gains RMB 000	Losses RMB 000	Value RMB 000
Short term listed investments:				
Equity securities	8,200			8,200
Long term investment:				
Unlisted investment	69			69

	Amortised cost RMB 000	(Unaudited) 2008 Gross unrealised Gains RMB 000	Losses RMB 000	Fair Value RMB 000
Short term listed investments:				
Equity securities	200			200
Long term investment:				
Unlisted investment	518			518

The balance of investments have their market values close to their book balance.

Table of Contents**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****8 Inventories**

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Raw materials	5,374	3,682
Work in progress	6,543	13,032
Finished goods	5,134	6,326
	17,051	23,040

**9 Property, plant and equipment, net**

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Buildings	25,065	24,937
Construction in progress	177	95
Furniture, fixtures and machineries	8,749	9,896
Motor vehicles	1,720	1,720
	35,711	36,648
Less: Accumulated depreciation	(10,282)	(9,502)
	25,429	27,146
Depreciation charge	2,099	2,074

Construction in progress is in relation to the Group's new factory which is currently under construction, and will be depreciated once the property is complete and available for use. The estimated cost to completion which the Group is contractually committed, is approximately RMB3,223,000.

Buildings with a total cost of approximately RMB18,803,000 as of December 31, 2009 were pledged, along with the land use right as discussed below, to secure the short-term loans. In 2008, only the buildings, with the same total cost, were pledged to secure the short-term loans.

**10 Land use right, net**

	<b>2009</b>	<b>(Unaudited)</b>
	<b>RMB 000</b>	<b>2008</b>
		<b>RMB 000</b>
Land use right	8,018	8,018
Less: Accumulated amortisation	(588)	(415)
	7,430	7,603
Amortisation charge	173	180

Land use right with a carrying amount of approximately RMB5,487,000 as of December 31, 2009 was pledged, along with the buildings discussed above, to secure the short-term loans. In 2008, the land use right was not pledged as security for any debt.

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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11 Other payables and accrued expenses**

Other payables and accrued expenses mainly represent deposits received from customers, other taxes payable and accruals for operating expenses.

**12 Short term loans**

The short term loans as of December 31, 2009 bear interest at fixed rates ranging from 4.86% to 5.841% per annum with maturity dates ranging from April 5, 2010 to November 11, 2010 and are secured by the Company's buildings and land use right. Interest paid during the year ended December 31, 2009 and 2008 were approximately RMB1,860,000 and RMB2,124,000 respectively.

**13 Dividends to shareholders**

In the fiscal year ended December 31, 2009 and 2008, the Company declared dividends of RMB5,625,000 and RMB1,280,000 respectively to the shareholders.

**14 Related party**

**Amounts due from shareholders and amount due to a related company**

The amounts due from shareholders and amount due to a related company do not bear any interest, unsecured and do not have clearly defined terms of repayment.

**15 Other long term liabilities**

Other long term liabilities represent accrued staff benefits and subsidies received from the government in relation to an agreement to meet certain profit and turnover targets until the balance can be recognised as reserves of the Group. As the targets are yet to be met, the balance remained in other long term liabilities.

**16 PRC statutory reserves**

Under the relevant PRC laws and regulations, the Group is required to appropriate certain percentage of their respective net income to two statutory funds, namely the statutory reserve fund and the statutory staff welfare fund.

(i) Statutory reserve funds

Pursuant to applicable PRC laws and regulations, the Group is required to allocate at least 10% of the companies' net income to the statutory reserve funds until such funds reaches 50% of the companies' registered capital. The statutory reserve funds can be utilised upon the approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such funds be maintained at a minimum of 25% of the companies' registered capital.

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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**16 PRC reserves - Continued**

(ii) Statutory welfare funds

Pursuant to applicable PRC laws and regulations, the Group is required to allocate certain amount of the companies' net income to the staff welfare funds determined by the Company. The staff welfare funds can only be used to provide staff welfare facilities and other collective benefits to the companies' employees. This fund is non-distributable other than upon liquidation of the Group.

**17 Establishment of subsidiary**

In 2009, the Company has established and invested 80% of equity interests in Jinhua Jiahuan Puzhou New Energy Technology Co., Ltd., a company newly incorporated in the PRC in 2009, for a total consideration of RMB1,600,000. The details of the subsidiary is disclosed in note 1.

**18 Pension plan**

As stipulated by the rules and regulations in the PRC, the Group contributes to the state-sponsored retirement plans for its employees in Mainland China. The Group contributes approximately 26% of the basic salaries of its employees, and has no further obligations for the actual payment of pension or post-retirement benefits beyond the annual contributions. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees.

During the year ended December 31, 2009 and 2008, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately RMB1,243,000 and RMB1,639,000 respectively.

**19 Risk Factor and Derivative Instruments**

Financial risk factors

The Group's activities expose itself mainly to credit risk.

Credit risk

The Group has no significant concentration of credit risk. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any customers. Derivative counterparties and cash transactions are limited to high credit quality banks.



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**ZHEJIANG JIAHUAN ELECTRONIC CO., LTD.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**20 Fair value of financial instruments**

The carrying values of financial instruments, which consist of cash and cash equivalents, accounts receivable and accounts payable, other receivables and payables, balances with shareholders and a related company, and short and long term investments approximate their fair values due to the short-term nature of these instruments.

**21 Subsequent events**

The Group evaluated all events or transactions that occurred after December 31, 2009 up through June 28, 2010, the date the Group issued these consolidated financial statements. During this period, the Group did not have any material recognisable subsequent events.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**AUDITED CONSOLIDATED BALANCE SHEETS**

**AS OF DECEMBER 31, 2009 AND 2008 AND**

**CONSOLIDATED STATEMENTS OF INCOME,**

**CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY**

**FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

**TOGETHER WITH REPORT OF INDEPENDENT REGISTERED**

**PUBLIC ACCOUNTING FIRM**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and owners of

Zhejiang Tianlan Environmental Protection Technology Company Limited

We have audited the accompanying consolidated balance sheets of Zhejiang Tianlan Environmental Protection Technology Company Limited as of December 31, 2009 and 2008 and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 2009 and 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Zhejiang Tianlan Environmental Protection Technology Company Limited as of December 31, 2009 and 2008 and the results of its operations and its cash flows for the years ended December 31, 2009 and 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Limited

BDO Limited

Hong Kong, June 28, 2010

Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****CONSOLIDATED BALANCE SHEETS****AS OF DECEMBER 31, 2009 AND 2008**

	Note	2009 RMB 000	2008 RMB 000
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents		13,031	9,906
Accounts receivable, net	6	73,412	77,697
Amounts due from owners	15	308	303
Prepayments and other current assets		15,787	19,107
Inventories, net	7	1,720	2,058
Income taxes recoverable		969	96
<b>Total current assets</b>		<b>105,227</b>	<b>109,167</b>
Property, plant and equipment, net	8	45,293	35,882
Deferred tax assets		823	219
<b>Total assets</b>		<b>151,343</b>	<b>145,268</b>
<b>Liabilities and owners' equity</b>			
<b>Current liabilities:</b>			
Short term borrowings	9	6,300	7,200
Accounts payable		26,794	19,405
Amounts due to owner	15	720	8,691
Other payables and accrued expenses	10	19,064	16,631
Other taxes payable	5	3,544	1,169
<b>Total current liabilities</b>		<b>56,422</b>	<b>53,096</b>
Commitments and contingencies	16		
<b>Owners' equity:</b>			
Paid-in capital		50,000	50,000
Capital reserve	12	11,374	11,274
PRC statutory reserves	11	7,675	6,152
Retained earnings		21,771	23,435
<b>Total owners' equity of Zhejiang Tianlan Environmental Protection Technology Company Limited</b>		<b>90,820</b>	<b>90,861</b>
Non-controlling interest		4,101	1,311
<b>Total equity</b>		<b>94,921</b>	<b>92,172</b>

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Total liabilities and owners' equity	151,343	145,268
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The accompanying notes are an integral part of these financial statements.

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Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

	Note	2009 RMB 000	2008 RMB 000
Revenue		121,448	106,885
Cost of revenue		(96,891)	(84,056)
Gross profit		24,557	22,829
Selling and administrative expenses		(23,665)	(14,288)
Operating income		892	8,541
Interest income		70	100
Interest expenses		(1,410)	(876)
Other income, net	3	4,106	2,328
Income before income taxes		3,658	10,093
Income taxes	4	(134)	(1,113)
Net income		3,524	8,980
Net income attributable to non-controlling interest		(1,665)	(962)
Net income attributable to Zhejiang Tianlan Environmental Protection Technology Company Limited's owners		1,859	8,018

The accompanying notes are an integral part of these financial statements.

Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

	2009 RMB 000	2008 RMB 000
Cash flows from operating activities:		
Net income	3,524	8,980
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, plant and equipment	1,430	1,152
Loss on disposal of property, plant and equipment	6	19
Deferred tax assets	(604)	(81)
(Increase)/decrease in current assets:		
Accounts receivable, net	4,285	(782)
Amounts due from owners	(5)	(303)
Prepayments and other current assets	3,320	340
Inventories, net	338	(345)
Income taxes recoverable	(873)	(3,294)
Increase/(decrease) in current liabilities:		
Accounts payable	7,389	(1,458)
Amounts due to owners	(7,971)	155
Other payables and accrued expenses	2,433	193
Other taxes payable	2,375	(41)
Net cash provided by operating activities	15,647	4,535
Cash flows from investing activities:		
Purchase of property, plant and equipment	(10,847)	(19,000)
Net cash used in investing activities	(10,847)	(19,000)
Cash flows from financing activities:		
Repayment of bank borrowings	(7,200)	
Advance of bank borrowings	6,300	1,900
Cash from issuance of registered capital in subsidiary to non-controlling interest	1,225	
Capital injection		4,750
Dividend paid to owners	(2,000)	(2,029)
Net cash (used in)/provided by financing activities	(1,675)	4,621
Net increase/(decrease) in cash and cash equivalents	3,125	(9,844)
Cash and cash equivalents, beginning of year	9,906	19,750
Cash and cash equivalents, end of year	13,031	9,906
	RMB 000	RMB 000
Supplementary information		
Interest received	70	100
Interest paid	1,207	664

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Income taxes paid	1,614	4,487
Non-cash transactions		
Accrued interest on amounts due to owners	203	212
Capitalization of amounts due to owners		264

The accompanying notes are an integral part of these financial statements.



Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008**

	<b>Paid-in capital RMB 000</b>	<b>Capital reserve RMB 000</b>	<b>PRC statutory reserves RMB 000</b>	<b>Retained earnings RMB 000</b>	<b>Non- controlling interest RMB 000</b>	<b>Total RMB 000</b>
Balance as of January 1, 2008	25,926	30,334	4,099	27,470	349	88,178
Net income				8,018	962	8,980
Total comprehensive income						8,980
Capital injection	5,014					5,014
Dividend declared				(10,000)		(10,000)
Capitalisation of reserve as paid-in capital	19,060	(19,060)				
Transfer to reserve			2,053	(2,053)		
Balance as of December 31, 2008	50,000	11,274	6,152	23,435	1,311	92,172
Net income				1,859	1,665	3,524
Total comprehensive income						3,524
Acquisition of subsidiary at nil consideration from an owner of the Company (note 15)		100			(100)	
Contribution from non-controlling interest of a subsidiary					1,225	1,225
Dividend declared				(2,000)		(2,000)
Transfer to reserve			1,523	(1,523)		
Balance as of December 31, 2009	50,000	11,374	7,675	21,771	4,101	94,921

The accompanying notes are an integral part of these financial statements.

Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****1 Organization and principal activities**

Zhejiang Tianlan Environmental Protection Technology Company Limited (the Company), formerly known as Zhejiang Tianlan Desulfurization & Dust-removal Company Limited, was incorporated in Hangzhou City, Zhejiang Province, the People's Republic of China ( PRC ) on May 18, 2000 as a wholly domestic owned enterprise with an operating period up to May 17, 2030.

The principal activities of the Company are engaged in flue gas desulphurization, dust removal, flue gas denitration and purification of diversified industrial waster gas.

Details of the Company's subsidiaries are summarized as follows:

Name	Percentage of equity ownership		Place of incorporation	Principal activities
	2009	2008		
Hangzhou Tianlan Environmental Engineering and Design Company Limited (Formerly known as Hangzhou Tianlan Equipments Installation Engineering Company Limited)	100%*	90%	PRC	Provision of maintenance services of environmental protection equipment
Hangzhou Huan Qing Information Technology Company Limited	88%**	88%	PRC	Provision of consulting and training services for environmental industry
Hangzhou Tianlan Environmental Protection Equipments Company Limited	51%	51%	PRC	Manufacturing and installation services of environmental protection equipment

\* In the year 2009, the Company acquired the remaining 10% equity interest of this company.

\*\* As at 31 December 2009, this company was in the process of deregistration.

**2 Summary of significant accounting policies**

**(a) Basis of Consolidation**

The consolidated financial statements include the accounts of Zhejiang Tianlan Environmental Protection Technology Company Limited and its subsidiaries (the Group ). In preparing the consolidated financial statements presented herewith, all significant intercompany balances and transactions have been eliminated on consolidation.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies - Continued**

**(b) Subsidiaries**

A subsidiary is a company in which the Company holds, directly or indirectly, more than 50% of its outstanding voting share capital and over which it is able to exercise control.

**(c) Revenue Recognition**

The Group's main source of revenue is the construction and installation services of environmental protection equipment for flue gas desulfurization, dust removal and flue gas denitration. Revenues are recorded under the percentage of completion method in accordance with FASB ASC Subtopic 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts, (previously Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts). This approach is based on estimates of total efforts expended at completion, which are compared to actual efforts incurred to date to arrive at an estimate of revenue and profit earned to date. Recognized revenue and profit are subject to revisions as the contract progresses to completion. Revisions to profit estimates are reflected in income in the period in which the facts that give rise to the revision become known. For any contract where it is identified that a loss will be incurred, the full loss will be recognized immediately.

**(d) Research and Development Costs**

Research and development costs (R&D costs) are expensed as incurred. The R&D costs amounted to approximately RMB8,238,000 and RMB3,704,000 for the years ended December 31, 2009 and 2008 respectively and were included in Selling and Administrative expenses in the Group's consolidated statements of income.

**(e) Advertising and promotional expenses**

Advertising and promotional expenses ( A&P expenses) are expensed as incurred. The A&P expenses amounted to approximately RMB39,000 and RMB104,000 for the years December 31, 2009 and 2008 respectively and were included in Selling and Administrative expenses in the Group s consolidated statement of income.

**(f) Taxation**

The Group accounts for income and deferred tax under the provision of FASB ASC Subtopic 740-10, Income Taxes, (previously Statement of Financial Accounting Standards ( SFAS ) No. 109: Accounting for Income Taxes ), under which deferred taxes are recognized for all temporary differences between the applicable tax balance sheets and the consolidated balance sheet. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. ASC 740-10 also requires the recognition of the future tax benefits of net operating loss carry forwards. A valuation allowance is established when the deferred tax assets are not expected to be realized within a reasonable period of time.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies - Continued**

**(f) Taxation - Continued**

In accordance with ASC-740-10, the Company recognizes tax benefits that satisfy a greater than 50% probability threshold and provides for the estimated impact of interest and penalties for such tax benefits. The Company did not have such uncertain tax positions in 2008 and 2009.

Deferred tax assets and liabilities are measured using the enacted tax rates expected to be applicable for taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income for the period that includes the enactment date.

Note 4 shows the applicable tax rates for the Company and its subsidiaries, as well as the major temporary differences so recorded.

**(g) Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand and demand deposits with banks.

**(h) Receivables and Other Assets**

Receivables and other assets are recorded at their nominal values. Doubtful debt allowances are provided for identified individual risks for these line items. If the loss of a certain part of the receivables is probable, doubtful debt allowances are provided to cover the expected loss.

Receivables are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

**(i) Inventories**

Inventories are stated at the lower of cost, on the first-in, first-out method, or market value. Costs include purchase and related costs incurred in bringing each product to its present location and condition. Market value is calculated based on the estimated normal selling price, less further costs expected to be incurred for disposal. Provision is made for obsolete, slow moving or defective items, where appropriate.

**(j) Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Gains or losses on disposal are reflected in current operations. Major expenditures for betterments and renewals are capitalized. All ordinary repair and maintenance costs are expensed as incurred. Depreciation of property, plant and equipment is computed using the straight-line method over the assets' estimated useful lives as follows:

Office premises	47-50 years
Leasehold improvements	over terms of the leases or the useful lives whichever is shorter
Plant and machineries	5 to 10 years
Furniture, fixtures and office equipment	5 years
Motor vehicles	5 years

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies - Continued**

**(k) Impairment**

The Group has adopted FASB ASC Subtopic 360-10, Property, Plant, and Equipment, (previously SFAS No. 144: Accounting for Impairment or Disposal of Long-Lived Assets ) which requires impairment losses to be recorded for property, plant and equipment to be held and used in operations when indicators of impairment are present. Reviews are regularly performed to determine whether the carrying value of assets is impaired. The Group determines the existence of such impairment by measuring the expected future cash flows (undiscounted and without interest charges) and comparing such amount to the carrying amount of the assets. An impairment loss, if one exists, is then measured as the amount by which the carrying amount of the asset exceeds the discounted estimated future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value of such assets less costs to sell. Asset impairment charges are recorded to reduce the carrying amount of the long-lived asset that will be sold or disposed of to their estimated fair values. Charges for the asset impairment reduce the carrying amount of the long-lived assets to their estimated salvage value in connection with the decision to dispose of such assets. There were no impairment losses recorded during each of the two years ended December 31, 2009 and 2008.

**(l) Operating Leases**

Leases where substantially all the risks and rewards of ownership of the leased assets remain with the lessors are accounted for as operating leases. Rental payments under operating leases are charged to expense on the straight-line basis over the period of the relevant leases.

**(m) Foreign Currency Translation**

The Group maintains its books and records in Chinese Renminbi ( functional currency ). Foreign currency transactions during the year are translated into the functional currency at the applicable rates of exchange at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency are translated into the functional currency using the exchange rates prevailing at the balance sheet dates. Gains or losses from foreign currency transactions are recognized in the consolidated statements of income during the year in which they occur.

**(n) Comprehensive Income**



The Group has adopted FASB ASC Subtopic 220-10, Comprehensive Income, (previously SFAS No. 130: Reporting Comprehensive Income, ) which requires the Group to report all changes in equity during a period, except for those resulting from investment by owners and distribution to owners, in the financial statements for the period in which they are recognized. The Group has presented comprehensive income, which encompasses net income, in the consolidated statement of changes in shareholders' equity.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies - Continued**

**(o) Paid in capital**

Paid in capital refers to the registered capital paid-up by the owners of the Company. The paid-in capital at both years ended December 31, 2009 and 2008 is RMB50,000,000.

**(p) Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the Group may undertake in the future, actual results may be different from the estimates.

**(q) Related Parties**

Entities are considered to be related to the Group if the parties, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Group. Related parties also include principal owners of the Group, its management, members of the immediate families of principal owners of the Group and its management and other parties with which the Group may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

**(r) Recent Accounting Pronouncements**

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In May 2009, the FASB issued SFAS No. 165, Subsequent Events (now codified within ASC 855-10, Subsequent Events ( ASC 855-10 )). ASC 855-10 provides general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 is applicable for interim or annual periods after June 15, 2009. In January 2010, the FASB issued Accounting Standards Update ( ASU ) No. 2010-09, Subsequent Events , which is codified as ASC 855, Amendments to Certain Recognition and Disclosure Requirements . This update amends the ASC855-10, to replace the term public entity with the term an SEC filer , in order to avoid potential conflict with some of the Securities and Exchange Commission s (SEC) guidance. All of the amendments in this update are effective immediately. The application of ASC 855 did not have a material effect on the Company s consolidated financial statements.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**2 Summary of significant accounting policies - Continued**

**(r) Recent Accounting Pronouncements - Continued**

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, (now codified within ASC 105, Generally Accepted Accounting Principles). ASC 105 establishes the Codification as the single source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Following this statement, FASB will not issue new standards in the form of statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will serve only to: (1) update the Codification; (2) provide background information about the guidance; and (3) provide the bases for conclusions on the change(s) in the Codification. ASC 105 was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification supersedes all existing non-SEC accounting and reporting standards. The adoption of ASC 105 did not have an impact on the Company's consolidated results of operations or financial position.

In August 2009, FASB issued ASU 2009-5 Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value (ASU 2009-5). ASU 2009-5 provides amendments to Subtopic 820-10, Fair Value Measurements and Disclosures-Overall, for the fair value measurement of liabilities. ASU 2009-5 clarifies that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value. ASU 2009-5 was effective for the Company for interim and annual periods ending after September 30, 2009. The adoption of ASU 2009-5 did not have a material impact on the Company's consolidated results of operations or financial position.

In December 2009, FASB issued ASU 2009-17 Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (ASU 2009-17). ASU 2009-17 amends the FASB ASC for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in ASU 2009-17 replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. ASU 2009-17 also requires additional disclosures about an enterprise's involvement in variable interest entities. ASU 2009-17 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of ASU 2009-17 to have a material impact on its consolidated results of operations or financial position.

In January 2010, FASB issued ASU 2010-01, Entity, which is codified as ASC505, Accounting for Distributions to Shareholders with Components of Stock and Cash (A Consensus of the FASB Emerging Issues Task Force). The amendments in this Update clarify that the stock portion of a distribution to shareholders that allow them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance thus eliminating the diversity in practice. The

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amendments in this Update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The application of ASC 505 did not have a material effect on the Company's consolidated financial statements.

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In January 2010, FASB issued ASU 2010-02 Accounting and Reporting for Decreases in Ownership of a Subsidiary- a Scope Clarification ( ASU 2010-2 ). ASU 2010-2 addresses implementation issues related to the changes in ownership provisions in the Consolidation Overall Subtopic (Subtopic 810-10) of the FASB Accounting Standards Codification , originally issued as FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements. Subtopic 810-10 establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. An entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary. Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. The gain or loss includes any gain or loss associated with the difference between the fair value of the retained investment in the subsidiary and its carrying amount at the date the subsidiary is deconsolidated. In contrast, an entity is required to account for a decrease in ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. ASU 2010-2 is effective for the Company starting January 1, 2010. The Company does not expect the adoption of ASU 2010-2 to have a material impact on the Company s consolidated results of operations or financial position.

In January 2010, FASB issued ASU 2010-6 Improving Disclosures about Fair Measurements ( ASU 2010-6 ). ASU 2010-6 provides amendments to subtopic 820-10 that require separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the presentation of separate information regarding purchases, sales, issuances and settlements for Level 3 fair value measurements. Additionally, ASU 2010-6 provides amendments to subtopic 820-10 that clarify existing disclosures about the level of disaggregation and inputs and valuation techniques. ASU 2010-6 is effective for financial statements issued for interim and annual periods ending after December 15, 2010. The Company does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated results of operations or financial position.

**3 Other income, net**

	<b>2009</b>	<b>2008</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Subsidy income (note i)	3,087	1,753
Sales of scrapped materials	352	530
Others	667	45
	4,106	2,328

- (i) The Group recognises subsidy income for R&D projects when granted by institutions and are not probably to be returned or reimbursed.

Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4 Income taxes**

According to relevant PRC tax laws and regulations, entities incorporated in the PRC are subject to Enterprise Income Tax ( EIT ) at a statutory rate of 25% or reduced national EIT rates for certain High and New Technology Enterprises ( HNTE ) on PRC taxable income. Zhejiang Tianlan Environmental Protection Technology Company Limited and Hangzhou Tianlan Environmental Protection Equipments Company Limited are qualified for a reduced statutory rate of 10% on national EIT as a HNTE and accordingly, the applicable tax rate was 15%. Hangzhou Tianlan Environmental Engineering and Design Company Limited and Huangzhou Huan Qing Information Technology Company Limited are entitled to Enterprise Income Tax rate of 25%.

The provision for income taxes consists of:

	2009 RMB 000	2008 RMB 000
Current PRC EIT	739	1,194
Income Taxes	739	1,194
Deferred tax benefit	(605)	(81)
Total deferred provision	(605)	(81)

The principal reconciling items from income tax computed at the statutory rates and at the effective income tax rates are as follows:

	2009 RMB 000	2008 RMB 000
Income before income taxes	3,658	10,093
Computed tax at respective company's statutory tax rate	541	1,410
Change in valuation allowances	19	96
(Over)/under-provision for income tax in prior years	(162)	16
Tax effect on revenue not subject to tax	(676)	(415)
Tax effect on expenses not deductible for tax purposes	412	6
Total provision for income tax at effective tax rate	134	1,113





Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****4 Income taxes - Continued**

The components of deferred tax assets are as follows:

	<b>2009</b>	<b>2008</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Deferred tax assets arising from tax losses	115	96
Deferred tax assets arising from temporary differences allowance for doubtful debts	823	219
Less: Valuation allowances	(115)	(96)
Net deferred tax assets	823	219

**5 Other taxes payable**

Other taxes payable comprises mainly Valued-Added Tax ( VAT ) and Business Tax ( BT ). The Group is subject to output VAT levied at the rate of 17% of the revenue from sales of equipment. The input VAT paid on purchases of materials and other direct inputs can be used to offset the output VAT levied on operating revenue to determine the net VAT payable or recoverable. BT is charged at a rate of 5% on the revenue from installation services.

**6 Accounts receivable**

	<b>2009</b>	<b>2008</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Trade receivables	78,902	78,716
Less: Allowance for doubtful debts	(5,490)	(1,019)
	73,412	77,697

	<b>2009</b>	<b>2008</b>
	<b>RMB 000</b>	<b>RMB 000</b>
Allowance for doubtful debts		
Balance at beginning	1,019	

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Charged to statement of income	4,471	1,019
Balance at year end	5,490	1,019

As of December 31, 2009, accounts receivable in the form of retention receivables and bills receivable under letter of credit through banks amounted to approximately RMB10,453,000 (2008: RMB6,213,000) and RMB7,395,000 (2008: RMB6,195,000) respectively.

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Table of Contents**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****7 Inventories, net**

	<b>2009</b> <b>RMB 000</b>	<b>2008</b> <b>RMB 000</b>
Raw material	1,720	2,058

**8 Property, plant and equipment**

	<b>2009</b> <b>RMB 000</b>	<b>2008</b> <b>RMB 000</b>
Office premises and leasehold improvements	43,260	10,791
Construction in progress		22,713
Furniture, fixtures and office equipment	2,868	1,786
Motor vehicles	2,417	2,417
Plant and machineries	899	899
	49,444	38,606
Less: Accumulated depreciation	(4,151)	(2,724)
	45,293	35,882

	<b>2009</b> <b>RMB 000</b>	<b>2008</b> <b>RMB 000</b>
Depreciation charge	1,430	1,152

**9 Short term borrowings**

The short term loans as of December 31, 2009 bear interest at fixed rates 5.31% (2008: 7.56%) per annum with maturity date on or before September 22, 2010 (2008: September 24, 2009) and are secured by the Company office premises and leasehold improvements. Interest paid during the year ended December 31, 2009 was RMB367,000 (2008: RMB314,000)

**10 Other payables and accrued expenses**

Other payables and accrued expenses mainly represent deposits received from customers and accruals for operating expenses.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**11 PRC statutory reserves**

Under the relevant PRC laws and regulations, the Group are required to appropriate certain percentage of their respective net income to two statutory funds, namely, the statutory reserve fund and the statutory staff welfare fund. The Group also appropriated certain amount of their net income to the expansion funds.

(i) Statutory reserve funds

Pursuant to applicable PRC laws and regulations, the Group are required to allocate at least 10% of the companies' net income to the statutory reserve funds until such funds reaches 50% of the companies' registered capital. The statutory reserve funds can be utilized upon the approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such funds be maintained at a minimum of 25% of the companies' registered capital.

(ii) Statutory welfare funds

Pursuant to applicable PRC laws and regulations, the Group are required to allocate certain amount of the companies' net income to the staff welfare funds determined by the Company. The staff welfare funds can only be used to provide staff welfare facilities and other collective benefits to the companies' employees. This fund is non-distributable other than upon liquidation of the Group.

**12 Capital reserve**

The amount represents the capital contributions from owners.

**13 Pension plan**

As stipulated by the rules and regulations in the PRC, the Group contributes to state-sponsored retirement plans for its employees in Mainland China. The Group contributes approximately ranging from 10% to 22% of the basic salaries of its employees, and has no further obligations for the actual payment of pension or post-retirement benefits beyond the annual contributions. The state-sponsored retirement plans are responsible for the entire pension obligations payable to retired employees.

During the years ended December 31, 2009 and 2008, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately RMB1,177,000 and RMB910,000 respectively.

#### **14 Risk factors**

The Group's activities expose itself mainly to credit risk.

The Group has no significant concentration of credit risk. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any customers.

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**ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**15 Related party**

Amounts due from/(to) owners

The owners, from time to time, receive income and pays expenses on behalf of the Group. The amounts due to owners are unsecured, bear interest at 10% per annum and do not have clearly defined terms of repayment. There were no other transactions with related parties in the years 2009 and 2008 other than disclosed in elsewhere in the financial statements.

Acquisition of subsidiary at nil consideration from an owner of the Company

During the year, the Company received 10% equity interest in Hangzhou Tianlan Environmental Engineering and Design Company Limited from an owner of the Company at nil consideration.

**16 Commitments and contingencies**

Operating leases

Rental expenses for the years ended December 31, 2009 and 2008 were approximately RMB410,000 and RMB573,000 respectively. As of December 31, 2009, the Group has no future minimum lease payments under non-cancellable operating leases are payable in the year 2010. As of December 31, 2008, the future minimum lease payments under non-cancellable operating leases amounted to RMB71,000 are payable in the year 2009.

**17 Fair value of financial instruments**



The carrying values of financial instruments, which consist of cash and cash equivalents, accounts receivable and accounts payable, bills receivable, bills payable, other payables and balances with related companies approximate their fair values due to the short-term nature of these instruments.

**18 Subsequent events**

The Group evaluated all events or transactions that occurred after December 31, 2009 up through June 28, 2010, the date the Group issued these consolidated financial statements. During this period, the Group did not have any material recognisable subsequent events.