

EURO TECH HOLDINGS CO LTD

Form 20-F/A

June 30, 2010

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FORM 20-F/A

Amendment No. 1

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

For the fiscal year ended December 31, 2008

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 Chang 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.

Ordinary Shares, \$0.01 par value

Name of each exchange on which registered: NASDAQ

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

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Not Applicable
(Title of Class)

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

(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.

11,820,339 Ordinary Shares.

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

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 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 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:

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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

As reported in Item 4A of the Annual Report on Form 20-F filed on June 29, 2009 by Euro Tech Holdings Company Limited, a British Virgin Islands corporation (the Company), in August 2007, the Company (through its wholly-owned subsidiary, Euro Tech (Far East) Limited) acquired a 20% equity interest in Zhejiang Tianlan Environmental Protection Technology Co. Ltd. (BlueSky), for approximately US\$4,648,000.

In connection with BlueSky acquisition, the Company is amending our Annual Report on Form 20-F for the fiscal year ended December 31, 2008 to include the requisite financial statements for both Euro Tech Holdings Company Limited and Zhejiang Tianlan Environmental Protection Technology Co. Ltd. This amendment includes only Item 18, the signature page, and the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Exhibits 12.1, 12.2, 13.1 and 13.2).

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<u>ITEM 19.</u>	<u>EXHIBITS</u>	1

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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/A.

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 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

List of Exhibits

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Exhibit No.	Description
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 *

* Filed Herewith

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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/A 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, 2008 AND 2007 AND

CONSOLIDATED STATEMENTS OF INCOME,

CONSOLIDATED CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

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, 2008 and 2007 and the related consolidated statements of operations, shareholders' equity and cash flows for the years ended December 31, 2008, 2007 and 2006. 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 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. The 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2008 and 2007 and the results of its consolidated operations and cash flows for the years ended December 31, 2008, 2007 and 2006, in conformity with generally accepted accounting principles in the United States of America.

/s/ BDO Limited

Hong Kong, June 26, 2009

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

	Note	2008 US\$ 000	2007 US\$ 000
Assets			
Current assets:			
Cash and cash equivalents		7,146	9,387
Restricted cash		388	332
Accounts receivable, net	6	6,707	4,968
Prepayments and other current assets		1,041	912
Inventories, net	7	2,600	2,012
Taxation recoverable			12
Total current assets		17,882	17,623
Property, plant and equipment, net	8 & 21(iii)	1,513	1,622
Investments in affiliates	9	7,679	5,046
Goodwill	12	1,060	1,060
Deferred tax assets	4	144	131
Total assets		28,278	25,482
Liabilities and shareholders' equity			
Current liabilities:			
Accounts payable		5,838	3,112
Other payables and accrued expenses	10	2,844	3,892
Taxation payable		617	520
Total current liabilities		9,299	7,524
Minority interest		1,986	1,545
Commitments and contingencies	19		
Shareholders' equity:			
Ordinary share, par value US\$0.01 each, 20,000,000 (2007: 20,000,000) shares authorized; 12,202,031 (2007: 12,024,901) shares issued and outstanding	11	122	120
Additional paid-in capital		9,495	9,229
Treasury stock, 381,692 (2007: 340,651) shares at cost	13	(281)	(237)
PRC statutory reserve	14	200	165
Accumulated other comprehensive income		478	271
Retained earnings		6,979	6,865
Total shareholders' equity		16,993	16,413

Total liabilities and shareholders' equity	28,278	25,482
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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, 2008, 2007 AND 2006**

	Note	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Revenue				
Trading and manufacturing		21,439	20,010	22,243
Engineering		10,299	7,220	4,918
Total revenue	21(i) & (ii)	31,738	27,230	27,161
Cost of revenue				
Trading and manufacturing		(16,618)	(15,406)	(17,321)
Engineering		(7,536)	(4,992)	(3,285)
Total cost of revenue		(24,154)	(20,398)	(20,606)
Gross profit		7,584	6,832	6,555
Selling and administrative expenses		(7,213)	(6,585)	(5,961)
Operating income		371	247	594
Interest income		45	256	95
Other income, net	3	144	161	146
Income before income taxes, minority interest and equity in profit of affiliates		560	664	835
Income taxes	4	(321)	(144)	(156)
Minority interest in profits of subsidiaries		(363)	(345)	(318)
Equity in profit of affiliates		273	247	
Net income for the year		149	422	361
Net income per ordinary share				
- Basic		US\$ 0.01	US\$ 0.04	US\$ 0.04
- Diluted		US\$ 0.01	US\$ 0.03	US\$ 0.03
Weighted average number of ordinary shares outstanding				
- Basic	5	11,824,153	11,105,556	8,047,911
- Diluted	5	12,212,058	12,095,335	10,787,420

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, 2008, 2007 AND 2006**

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Cash flows from operating activities:			
Net income	149	422	361
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation of property, plant and equipment	218	232	216
Stock based compensation expense	217	148	
Loss (Gain) on disposal of property, plant and equipment	1	(19)	1
Minority interest in profits of subsidiaries	363	345	318
Equity in profit of affiliates	(273)	(247)	
Deferred tax assets	(10)	(96)	
Deferred tax liabilities			(4)
(Increase) decrease in current assets:			
Accounts receivable, net	(1,739)	(54)	553
Prepayments and other current assets	(129)	(189)	(80)
Inventories, net	(588)	16	704
Taxation recoverable	12		30
Increase (decrease) in current liabilities:			
Accounts payable	2,726	(1,080)	(435)
Other payables and accrued expenses	(400)	896	(222)
Taxation payable	97	75	23
Net cash provided by operating activities	644	449	1,465
Cash flows from investing activities:			
Purchase of property, plant and equipment	(99)	(250)	(106)
Proceeds on disposal of property, plant and equipment		43	
Dividend received from affiliates	294		
Investments in affiliates	(3,302)	(4,151)	
Restricted cash for issuance of bank guarantees	(56)	83	(111)
Dividend paid to minority interest		(140)	(135)
Net cash used in investing activities	(3,163)	(4,415)	(352)
Cash flows from financing activities:			
Issuance of ordinary shares on exercise of options	51	3,720	2,607
Purchase of treasury stock	(44)		
Cash from issuance of registered capital in subsidiary to minority interest		200	
Net cash provided by financing activities	7	3,920	2,607
Effect of exchange rate changes on cash and cash equivalents	271	273	78
Net (decrease)/increase in cash and cash equivalents	(2,241)	227	3,798
Cash and cash equivalents, beginning of year	9,387	9,160	5,362
Cash and cash equivalents, end of year	7,146	9,387	9,160
	US\$ 000	US\$ 000	US\$ 000
Supplementary information			
Interest received	45	256	95

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Interest paid			
Income taxes paid	233	166	125
Shares surrendered for exercise of stock options	73	155	168

As at December 31, 2007 there was a final consideration of US\$648,000 payable in relation to the acquisition of Zhejiang Tianlan Desulfurization and Dust Removal 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, 2008, 2007 AND 2006**

	Number of Ordinary share	Ordinary share US\$ 000	Additional paid-in capital US\$ 000	Treasury stock US\$ 000	Accumulated other comprehensive income (loss) US\$ 000	PRC statutory reserve US\$ 000	Retained earnings US\$ 000	Total US\$ 000
Balance as of January 1, 2006	7,363,002	74	2,800	(237)	(10)	72	6,193	8,892
Net income							361	361
Other comprehensive income:								
Foreign exchange translation adjustment					79			79
Total comprehensive income								440
Shares surrendered for exercise of stock options	(36,700)		(168)					(168)
Exercise of stock options	2,048,890	20	2,706					2,726
Transfer of reserve						16	(32)	(16)
Stock-based compensation expense			49					49
Balance as of December 31, 2006	9,375,192	94	5,387	(237)	69	88	6,522	11,923
Net income							422	422
Other comprehensive income:								
Foreign exchange translation adjustment					202			202
Total comprehensive income								624
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
Balance as of December 31, 2007	12,024,901	120	9,229	(237)	271	165	6,865	16,413
Net income							149	149
Other comprehensive income:								
Foreign exchange translation adjustment					207			207
Total comprehensive income								356
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
Balance as of December 31, 2008	12,202,031	122	9,495	(281)	478	200	6,979	16,993

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:

Name	Percentage of equity ownership	Place of incorporation	Principal activities
Subsidiaries:			
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

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Shanghai Euro Tech Environmental Engineering Company Limited	100%	The PRC	Undertaking water and waste-water treatment engineering projects
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
Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd	100%	The PRC	Marketing and trading of water and waste water related process control, analytical and

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			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
Affiliates:			
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)

* 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) Interpretation No. 46 (R) (FIN 46 (R)), are included in the consolidated financial statements, if applicable. In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities and amended it by issuing FIN 46 (R) in December 2003. FIN 46 (R) addresses consolidation by business enterprises of VIEs that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) have equity investors that lack an essential characteristic of a controlling financial interest.

The Group identified that certain retail shops established in the PRC qualified as variable interest entities as defined in FIN 46 (R). 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\$107,386 and US\$66,412, as of December 31, 2008 and US\$150,602 and US\$289,127, as of December 31, 2007, respectively. The cumulative losses on consolidating these VIEs in the Group's consolidated statement of income in 2008 were US\$41,443 (2007: profits of US\$17,638 and 2006: losses of US\$152,723), including taxes of US\$3,126 (2007: US\$11,118 and 2006: US\$6,814). 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 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 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\$89,000, US\$47,000 and US\$55,000 for the years ended December 31, 2008, 2007 and 2006 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\$40,000, US\$78,000 and US\$76,000 for the years December 31, 2008, 2007 and 2006 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 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. SFAS No. 109 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.

Effective January 1, 2007, the Company adopted FIN No. 48, Accounting for Uncertainty in Income Taxes. In accordance with FIN No. 48, 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 2007 and 2008.

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. Valuation allowances are provided for identified individual risks for these line items. If the loss of a certain part of the receivables is probable, valuation 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 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, 2008.

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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 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 cumulative translation adjustments.

(o) Derivative Instruments and Hedging Activities

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 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

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of Statement 133 on Derivative Instruments and Hedging Activities . SFAS No. 133 contains accounting and reporting standards for hedging accounting and for derivative financial instruments, including certain derivative financial instruments embedded in other contracts.

SFAS No. 133 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 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 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 Statement 123 (revised 2004) (Statement 123(R)), Share-Based Payment, which revises Statement 123, Accounting for Stock-Based Compensation using the modified prospective application transition method. Statement 123(R) 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 SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". The management approach required by SFAS No. 131 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 December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" an amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for noncontrolling interests in subsidiaries. This statement requires the reporting of all noncontrolling interests as a separate component of stockholders' equity, the reporting of consolidated net income (loss) as the amount attributable to both the parent and the noncontrolling interests and the separate disclosure of net income (loss) attributable to the parent and to the noncontrolling interests. In addition, this statement provides accounting and reporting guidance related to changes in noncontrolling ownership interests. Other than the reporting requirements described above which require retrospective application, the provisions of SFAS No. 160 are to be applied prospectively in the first annual reporting period beginning on or after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of FAS No. 160 on the consolidated financial statements.

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In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (FAS No. 141 (R)), which replaces FASB Statement No. 141. FAS No. 141 (R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The Statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. FAS No. 141 (R) is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008, which will be the Company's year beginning January 1, 2009. An entity is precluded from implementing Statement 141R early. The Company is

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currently evaluating the potential impact, if any, of the adoption of FAS No. 141 (R) on the consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* - an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 requires additional disclosures about the objectives of using derivative instruments, the method by which the derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations, and the effect of derivative instruments and related hedged items on financial position, financial performance, and cash flows. SFAS No. 161 also requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company has no derivative instruments or hedging activities and this pronouncement is only disclosure-related; accordingly, SFAS 161 has no impact on the Company's financial position, consolidated results of operations or cash flows.

In April 2008, the FASB issued Staff Position (FSP) No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS No. 142-3). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. It is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is not permitted. FSP FAS No. 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives for intangible assets and should be applied to all intangible assets recognized as of, and subsequent to the effective date. The impact of FSP FAS No. 142-3 will depend on the size and nature of acquisitions on or after January 1, 2009.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS No. 165). SFAS No. 165 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. SFAS No. 165 is applicable for interim or annual periods after June 15, 2009. The application of SFAS No. 165 is not expected to have a material effect on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets* - an amendment of FASB Statement No. 140 (SFAS No. 166). SFAS No. 166 seeks to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. SFAS No. 166 is applicable for annual periods after November 15, 2009 and interim periods therein and thereafter. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 166 on the consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS No. 167). SFAS No. 167 seeks to improve financial reporting by enterprises involved with variable interest entities. SFAS No. 167 is applicable for annual periods after November 15, 2009 and interim periods therein and thereafter. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 167 on the consolidated financial statements.

The Company 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.

Table of Contents**EURO TECH HOLDINGS COMPANY LIMITED****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****3 Other income, net**

	2008	2007	2006
	US\$ 000	US\$ 000	US\$ 000
Gain/(loss) on disposal of property, plant and equipment	(1)	19	(1)
Exchange gain, net	120	104	130
Rental income	25	38	17
	144	161	146

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 2008 (2007 and 2006: 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 18% (2007 and 2006: 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 losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2008, SET had an assessable loss carried forward of US\$242,253 as agreed by the local tax authority to offset its profit for the coming year (2007: US\$225,300). 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 18% (2007: 15%) for two years starting from 2007, followed by a 50% reduction for the next three years thereafter.

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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.

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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% (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 17.5% in year 2007 as the profit is earned in Hong Kong.

VIEs of the Group provide for PRC Enterprise Income Tax at a rate of 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, 2008, certain VIEs had aggregated assessable losses carried forward of US\$99,830 as agreed by the local tax authority (2007: US\$118,161).

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.

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

Income before income taxes:

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Domestic			
Foreign	560	664	835
	560	664	835

The provision for income taxes consists of:

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Current tax expenses:			
Domestic			
Foreign	331	240	163
Total current provision	331	240	163
Deferred tax benefit:			
Domestic			
Foreign	(10)	(96)	(7)
Total deferred provision	(10)	(96)	(7)

The reconciliation of the weighted average statutory income tax rate to the effective income tax rate as stated in the consolidated statements of income is as follows:

	2008	2007	2006
Weighted average statutory tax rate	39.8%	11.3%	14.3%
Change in valuation allowances	17.8%	17.1%	5.5%
Over-provision for income tax in prior years	%	%	(0.5)%
Others	(0.3)%	(6.8)%	(0.6)%
Effective tax rate	57.3%	21.6%	18.7%

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The components of deferred tax assets are as follows:

	2008 US\$ 000	2007 US\$ 000
Deferred tax assets arising from tax losses	147	137
Deferred tax liabilities arising from temporary differences	(3)	(6)
Less: Valuation allowances		
Net deferred tax assets	144	131

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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:

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Number of shares			
Weighted average number of ordinary shares for the purposes of basic net income per share	11,824,153	11,105,556	8,047,911
Effect of dilutive potential ordinary shares: Stock options	387,905	989,779	2,739,509
Weighted average number of ordinary shares for the purposes of diluted net income per share	12,212,058	12,095,335	10,787,420

6 Accounts receivable

	2008 US\$ 000	2007 US\$ 000
Trade receivables	6,792	5,063
Less: Allowance for doubtful debts	(85)	(95)
	6,707	4,968

	2008 US\$ 000	2007 US\$ 000
Allowance for doubtful debts		
Balance at beginning	95	86
Released/(charged) to costs and expenses	8	28
Write off	(18)	(19)
Balance at end	85	95

As of December 31, 2008, accounts receivables in the form of bills receivable through banks amounted to US\$50,000 (2007: US\$ 26,000).

7 Inventories, net

	2008	2007
	US\$ 000	US\$ 000
Raw materials	162	76
Work in progress	365	108
Finished goods	2,073	1,828
	2,600	2,012

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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, 2008, and 2007, provision for obsolete and slow moving inventories amounted to US\$68,758 and US\$28,064, respectively, which were charged to cost of revenue in Consolidated Statements of Income.

8 Property, plant and equipment

	2008 US\$ 000	2007 US\$ 000
Office premises	2,257	2,257
Leasehold improvements	150	140
Furniture, fixtures and office equipment	857	776
Motor vehicles	162	173
Testing equipment	77	77
	3,503	3,423
Less: Accumulated depreciation	(1,990)	(1,801)
	1,513	1,622

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Depreciation charge	218	232	216

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

The Group granted the minority shareholder of Yixing Pact Environmental Technology Co., Ltd and Pact Asia Pacific Limited a three-year put option requiring the Group to acquire all remaining securities of these two companies at 5.2 times of their average net income for the three prior fiscal years.

During the year ended December 31, 2007, the Group acquired 20% equity interests in Zhejiang Tianlan Desulfurization and Dust Removal 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 Desulfurization and Dust Removal Co. Ltd, is set forth below:

Balance Sheet:	2008	2007
	US\$ '000	US\$ '000
Current assets	16,952	16,110
Non-current assets	5,504	2,487
Total assets	22,456	18,597
Current and total liabilities	(9,831)	(7,328)
Total shareholders' equity	12,625	11,269

Operating results:	2008	2007
	US\$ '000	US\$ '000
Net sales	14,688	10,535
Operating profits	1,396	2,281
Net profits	1,215	1,927

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

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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:

Balance Sheet:	2008
	US\$ 000
Current assets	17,423
Non-current assets	5,197
Total assets	22,620
Current and total liabilities	(11,559)
Total shareholders' equity	11,061

Operating results:	2008
	US\$ 000
Net sales	13,571
Operating profits	639
Net profits	152

10 Other payables and accrued expenses

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

11 Ordinary share

During the year ended December 31, 2006, the Company issued 2,048,890 ordinary shares for stock options exercised and cancelled 36,700 shares surrendered for exercise of stock options.

During the year ended December 31, 2007, the Company issued 2,695,246 ordinary shares for stock options exercised and cancelled 45,537 shares surrendered for exercise of stock options.

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.

Goodwill

The Company accounted for the acquisition in accordance with 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 as described in Note 9.

As of December 31, 2008, 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, 2008) Based on the result of the first step of the test, the Company believes that there was no impairment of goodwill as of December 31, 2008.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS

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.

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 of ordinary share during 2008 for considerations of approximately US\$44,000.

There was no reissuance of treasury stock during each of the three years ended December 31, 2008.

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, 2006, the Company granted 10,000 shares with the exercise price of US\$1.6789 per share to its officers, directors and employees, which allowed them to purchase up to 10,000 shares of ordinary share. The options expired in March 2007. The Company further cancelled 21,840 options with an exercise price of US\$1.6789. During the same year, 1,015,740 options and 757,000 options under the Management Options with the exercise price of US\$ 1.221 per share and US\$1.6789 per share, respectively, were exercised.

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.

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During the year ended December 31, 2006, 16,380 options with exercise price of US\$0.5787 were cancelled. The Company further granted 40,000 options and 5,000 options under the 2000 Stock Options with an exercise price of US\$3.33 and US\$2.02 per share, respectively, to its officers, directors and employees, which allow them to purchase up to 45,000 shares of ordinary share. The options vested within a six-month period and will expire in August 2010. During the same year, 40,950 options and 214,200 options with exercise price of US\$ 0.5787 and US\$0.8191 per share, respectively, were exercised.

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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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.

(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 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

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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.

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

	2008		2007		2006	
	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	1,290,840	1.74	3,938,296	1.32	5,978,806	1.31
Granted	205,000	2.56	499,000	3.27	55,000	2.91
Cancelled/Expired	(704,000)	(3.07)	(451,210)	(1.58)	(46,620)	(1.13)
Exercised	(208,370)	(0.60)	(2,695,246)	(1.44)	(2,048,890)	(1.33)
Outstanding, end of year	583,470	0.84	1,290,840	1.74	3,938,296	1.32
Exercisable, end of year	583,470	0.84	791,840	0.78	3,923,296	1.32

As of December 31, 2008, 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 2.7 years.

As of December 31, 2008	Shares	Intrinsic Value US\$ '000
Total outstanding in-the-money options	538,470	119,000
Total vested in-the-money options	538,470	119,000

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

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

On January 1, 2006, the Group adopted the provisions of Statement 123 (revised 2004) (Statement 123(R)), Share-Based Payment, which revises Statement 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion 25, Accounting for Stock Issued to Employees. Statement 123(R) 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:

Assumptions	2008	2007
Expected volatility	75.9-86.7%	75.9-86.7%
Expected dividends	0%	0%
Expected term (years)	1.25	1.25
Risk-free rate	3.2-4.3%	3.2-4.3%

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS

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.

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, 2008, 2007 and 2006, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately US\$291,000, US\$245,000 and US\$202,000 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.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS

17 Risk Factor and Derivative Instruments (Continued)

(ii) Foreign exchange risk

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, 2008 and 2007.

18 Related party transactions

A related party is an entity that can control or significantly influence the management or operating policies of another entity to the extent one of the entities may be prevented from pursuing its own interests. A related party may also be any party the entity deals with that can exercise that control. There were no transactions with related parties in the years 2008, 2007 and 2006.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED ACCOUNTS

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, 2008, 2007 and 2006 were approximately US\$411,000, US\$448,000, and US\$404,000, respectively. Future minimum rental payments as of December 31, 2008, 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 each year from 2010 to 2012.

(ii) Banking facilities

As at December 31, 2008, 2007 and 2006, 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\$4,167,000 and US\$4,167,000 respectively, of which approximately US\$234,000, US\$138,000 and US\$726,000 was utilized for issuance of bank guarantees.

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.

21 Segment information

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

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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.

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Revenue			
Trading and manufacturing	21,439	20,010	22,243
Engineering	10,299	7,220	4,918
	31,738	27,230	27,161
Operating income			
Trading and manufacturing	(184)	(76)	(237)
Engineering	555	323	831
	371	247	594

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	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Depreciation:			
Trading and manufacturing	179	197	197
Engineering	39	35	19
	218	232	216
Capital Expenditures, Gross			
Trading and manufacturing	56	147	63
Engineering	43	103	43
	99	250	106

	2008 US\$ 000	2007 US\$ 000
Assets		
Trading and manufacturing	12,754	13,187
Engineering	7,845	7,249
Unallocated	7,679	5,046
	28,278	25,482
Liabilities		
Trading and manufacturing	6,108	4,213
Engineering	3,191	2,663
Unallocated		648
	9,299	7,524

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

	2008 US\$ 000	2007 US\$ 000	2006 US\$ 000
Revenue -			
The PRC	25,430	21,595	22,457
Hong Kong	5,745	5,401	4,324
Others	563	234	380
	31,738	27,230	27,161

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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
Assets			
Current assets:			
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
Total current assets		105,227	109,167
Property, plant and equipment, net	8	45,293	35,882
Deferred tax assets		823	219
Total assets		151,343	145,268
Liabilities and owners' equity			
Current liabilities:			
Short term borrowings	9	6,300	7,200
Accounts payable		26,794	19,405
Amounts due to owners	15	720	8,691
Other payables and accrued expenses	10	19,064	16,631
Other taxes payable	5	3,544	1,169
Total current liabilities		56,422	53,096
Commitments and contingencies	16		
Owners' equity:			
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
Total owners' equity of Zhejiang Tianlan Environmental Protection Technology Company Limited		90,820	90,861
Non-controlling interest		4,101	1,311
Total equity		94,921	92,172

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

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 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**

	Paid-in capital RMB 000	Capital reserve RMB 000	PRC statutory reserves RMB 000	Retained earnings RMB 000	Non- controlling interest RMB 000	Total RMB 000
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

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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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Table of Contents**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 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

	2009	2008
	RMB 000	RMB 000
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.

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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	2008
	RMB 000	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	2008
	RMB 000	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

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The components of deferred tax assets are as follows:

	2009 RMB 000	2008 RMB 000
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

	2009 RMB 000	2008 RMB 000
Trade receivables	78,902	78,716
Less: Allowance for doubtful debts	(5,490)	(1,019)
	73,412	77,697

	2009 RMB 000	2008 RMB 000
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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	2009 RMB 000	2008 RMB 000
Raw materials	1,720	2,058

8 Property, plant and equipment

	2009 RMB 000	2008 RMB 000
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

	2009 RMB 000	2008 RMB 000
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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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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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 rental 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.

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