

EURO TECH HOLDINGS CO LTD

Form 20-F

April 24, 2013

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FORM 20-F

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

For the fiscal year ended December 31, 2012

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)

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18/F Gee Change Hong Centre,  
65 Wong Chuk Hong Road,  
Hong Kong  
(Name, Telephone, Email and/or Facsimile number and  
Address of Company Contact Person)

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

Name of each exchange on which registered: NASDAQ  
Ordinary Shares, no par value

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

Not Applicable  
(Title of Class)

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

Not Applicable  
(Title of Class)

Indicate the number of issued and outstanding shares of each of the issuer's classes of capital or common stock as of

the close of the period covered by the annual report, \*

2,069,223 Ordinary  
Shares.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

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

If this is an annual or transitional report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.  Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No



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Explanatory Note

In addition to the financial statements of Euro Tech Holdings Company Limited (the “Company”) attached are the financial statements of Zhejiang Tianlan Environmental Protection Technology Company Limited (“Blue Sky”). The rules of the Securities and Exchange Commission require that the Company file the financial statements of Blue Sky.

INTRODUCTION

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

Forward Looking Statements

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

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GLOSSARY

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

|                                    |   |
|------------------------------------|---|
| Ambient Air:                       | Atmospheric air (outdoor as opposed to indoor air).   |
| Anaerobic:                         | Treating waste water biologically in the absence of air.  |
| Atomic Spectrometer:               | An analytical instrument used to measure the presence of an element in a substance by testing a sample which is aspirated into a flame and atomized. The amount of light absorbed or emitted is measured. The amount of energy absorbed or emitted is proportional to the concentration of the element in the sample. |
| Coalescer:                         | A process that coalesces smaller oil particles to form larger oil particles that can readily float to a tank's surface.   |
| Colorimeter:                       | An analytical instrument that measures substance concentration by color intensity when the substance reacts to a chemical reagent.  |
| Flow Injection Analyzer:           | An analytical instrument with a special sampling system that uses a continuous stream of reagent(s) into which fluid samples are injected.  |
| Human Machine Interface Software:  | A type of software to interface (or coordinate) the interaction between machine or equipment and a human being.   |
| Lamella:                           | Synthetic media installed in a clarifier tank to assist in particle flocculation (coming together in a "floc" or "flakes")  |
| Mass Spectrometer:                 | An analytical instrument that separates and identifies chemical constituents according to their mass-to-charge ratios and is used to identify organic compounds.  |
| Membrane Biological Reactor (MBR): | A suspended-growth bioreactor combined with a membrane liquid/solids separation unit. The "MBR" uses an advanced membrane technology that treats biological wastes to a quality level which in many industries is sufficient for reuse or low-cost disposal to sewers.  |
| Multi-Channel Digital Recorder:    | A device that measures and records more than one input of a digitized signal (signal in the form of pulses).  |
| Nitrosamines.                      | A group of carcinogenic compounds, which are a component of cigarette smoke, cause cancer in a number of organs, particularly in the liver, kidneys, and lungs.   |
| pH Controller:                     | A process instrument that measures and controls the acidity or alkalinity of a fluid.   |
| Reagent:                           | A chemical substance used to cause a chemical reaction and detect another substance.  |



Sequential Batch  
Reactor (SBR):

A waste-water treatment process that combines aeration and settling in one reactor tank thus saving on space. Used for the treatment of industrial waste-water as well as municipal sewage. The SBR is a batch process that is ideal for waste-waters of changing characteristics.

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## NOTE

AT THE CLOSE OF BUSINESS ON JANUARY 13, 2012, THE COMPANY EFFECTED A REVERSE STOCK SPLIT OF ALL OF ITS OUTSTANDING ORDINARY SHARES OF THE COMPANY AT A RATIO OF TWO (2) ORDINARY SHARES FOR ELEVEN (11) ORDINARY SHARES. IMMEDIATELY UPON THE REVERSE SPLIT BECOMING EFFECTIVE, EVERY ELEVEN (11) ORDINARY SHARES OUTSTANDING PRIOR TO THE REVERSE SPLIT WERE CHANGED AND RECLASSIFIED INTO TWO (2) ORDINARY SHARES. ANY OWNER OF LESS THAN A SINGLE FULL ORDINARY SHARE AFTER THE REVERSE SPLIT RECEIVED CASH IN LIEU OF ANY FRACTIONAL INTEREST. THE INFORMATION CONTAINED HEREIN GIVES RETROACTIVE EFFECT TO THE REVERSE SPLIT FOR ALL PERIODS PRESENTED.

## PART I

## ITEM KEY INFORMATION

3.

## ITEM SELECTED FINANCIAL DATA

3A.

## SELECTED FINANCIAL INFORMATION

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

The selected consolidated statement of operations and comprehensive income/(loss) data for years ended December 31, 2012, 2011 and 2010 and the selected consolidated balance sheet data as of December 31, 2012 and 2011 set forth below are derived from audited consolidated financial statements of the Company included herein and should be read in conjunction with, and are qualified in their entirety by reference to such financial statements, including the notes thereto and "Item 5. Operating and Financial Review and Prospects." The selected consolidated statement of operations and comprehensive income/(loss) data for the years ended December 31, 2009 and 2008 and the selected consolidated balance sheet data as of December 31, 2010, 2009 and 2008 set forth below are derived from audited consolidated financial statements of the Company which are not included herein.

|                           | 2012<br>US\$ | 2011<br>US\$ | 2010<br>US\$ | 2009<br>US\$ | 2008<br>US\$ |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| Balance Sheet Data:       |              |              |              |              |              |
| Cash and cash equivalents | 7,468        | 5,339        | 6,130        | 7,025        | 7,146        |
| Working capital(1)        | 5,706        | 5,730        | 6,444        | 8,203        | 8,583        |
| Total assets              | 24,947       | 23,864       | 25,213       | 26,244       | 28,278       |
| Short-term debt(2)        | 0            | 0            | 0            | 0            | 0            |
| Net assets                | 17,756       | 17,909       | 18,101       | 18,932       | 18,979       |
| Capital Stock             | 123          | 123          | 123          | 122          | 122          |

(1) Current assets minus current liabilities.

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

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|  | 2012<br>US\$ | 2011<br>US\$ | 2010<br>US\$ | 2009<br>US\$ | 2008<br>US\$ |
|--|--------------|--------------|--------------|--------------|--------------|
| Statement of Operations and Comprehensive Income/(loss) Data:              |              |              |              |              |              |
| Revenue  | 21,645       | 20,213       | 22,305       | 27,336       | 31,738       |
| Cost of revenue  | (15,480 )    | (15,322 )    | (16,564 )    | (20,876 )    | (24,154 )    |
| Gross profit   | 6,165        | 4,891        | 5,741        | 6,460        | 7,584        |
| Selling and Administrative Expenses  | (6,224 )     | (6,565 )     | (7,119 )     | (6,598 )     | (7,214 )     |
| Operating (loss)/income  | (59 )        | (1,674 )     | (1,378 )     | (138 )       | 370          |
| Interest Income  | 46           | 60           | 42           | 37           | 45           |
| Other income, net  | 48           | 82           | 9            | 71           | 145          |
| (Loss)/gain on disposal of fixed assets                                    | (22 )        | 328          | 1            | (10 )        | -            |
| Income/(loss) before taxes   | 13           | (1,204 )     | (1,326 )     | (40 )        | 560          |
| Income (taxes)/benefit   | (142 )       | 63           | (154 )       | (218 )       | (321 )       |
| Equity in profit of affiliates   | 9            | 1,131        | 723          | 595          | 273          |
| Net (Loss)/Income  | (120 )       | (10 )        | (757 )       | 337          | 512          |
| Less: net (income)/loss attributable to non-controlling interest           |              |              |              |              |              |
|  | (309 )       | 531          | (330 )       | (305 )       | (363 )       |
| Net (loss)/income attributable to the Company                              | (429 )       | 521          | (1,087 )     | 32           | 149          |
| Other comprehensive (loss)/income  |              |              |              |              |              |
| Net (loss)/income  | (120 )       | (10 )        | (757 )       | 337          | 512          |
| Foreign exchange translation adjustments                                   | -            | 215          | 177          | 10           | 285          |
| Comprehensive (loss)/income  | (120 )       | 205          | (580 )       | 347          | 797          |
| Less: Comprehensive (income)/loss attributable to non-controlling interest |              |              |              |              |              |
|  | (309 )       | 442          | (397 )       | 306          | 441          |
| Comprehensive (loss)/income attributable to the Company                    | (429 )       | 647          | (977 )       | 41           | 356          |
| Net (loss)/income per Ordinary Share-Basic                                 | (0.21 )      | 0.25         | (0.52 )      | 0.015        | 0.07         |
| -Diluted   | (0.21 )      | 0.25         | (0.51 )      | 0.015        | 0.07         |
| Weighted Average Number of Ordinary Shares Outstanding                     |              |              |              |              |              |
| Basic  | 2,070,685    | 2,087,922    | 2,099,894    | 2,114,992    | 2,149,846    |
| Diluted  | 2,076,315    | 2,102,199    | 2,143,375    | 2,163,006    | 2,220,374    |

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

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

currencies are influenced by the rate between the US dollar and the Hong Kong dollar.

Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates. From 1994 through 2004, the official exchange rate for the conversion of Renminbi to U.S. dollars was generally stable and maintained at the rate of approximately RMB 8.30 = US\$ 1.00. However, from 2008 through 2012, the Renminbi has fluctuated and at the end of 2012, 2011, 2010, 2009 and 2008, the exchange rates were approximately, RMB 6.3086 = US\$ 1.00, RMB 6.3585 = US\$ 1.00, RMB 6.6018 = US\$1.00, RMB 6.8282 = US\$ 1.00, and RMB 6.8251 = US\$ 1.00, respectively. The value of the Renminbi fluctuates and is subject to changes in PRC political and economic conditions.

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

|             | Rate at Period End | Low    | High   | Average |
|-------------|--------------------|--------|--------|---------|
| US\$ to RMB |                    |        |        |         |
| Fiscal 2008 | 6.8251             | 6.7480 | 7.2941 | 6.9623  |
| Fiscal 2009 | 6.8282             | 6.7880 | 6.8430 | 6.8409  |
| Fiscal 2010 | 6.6018             | 6.6018 | 6.8344 | 6.7696  |
| Fiscal 2011 | 6.3585             | 6.3318 | 6.6357 | 6.4640  |
| Fiscal 2012 | 6.3086             | 6.2289 | 6.3862 | 6.3116  |

|              |        |        |        |        |
|--------------|--------|--------|--------|--------|
| US\$ to HK\$ |        |        |        |        |
| Fiscal 2008  | 7.7507 | 7.7480 | 7.8174 | 7.7874 |
| Fiscal 2009  | 7.7551 | 7.7474 | 7.7617 | 7.7522 |
| Fiscal 2010  | 7.7827 | 7.7507 | 7.8046 | 7.7689 |
| Fiscal 2011  | 7.7690 | 7.7640 | 7.8090 | 7.7845 |
| Fiscal 2012  | 7.7514 | 7.7501 | 7.7688 | 7.7571 |

| The Following Months |  | Low    | High   | Average |
|----------------------|--|--------|--------|---------|
| US\$ to RMB          |  |        |        |         |
| July 2012            |  | 6.3035 | 6.3862 | 6.3152  |
| August 2012          |  | 6.3162 | 6.3415 | 6.3300  |
| September 2012       |  | 6.3207 | 6.3399 | 6.3320  |
| October 2012         |  | 6.2829 | 6.3283 | 6.3051  |
| November 2012        |  | 6.2679 | 6.2926 | 6.2819  |
| December 2012        |  | 6.2289 | 6.3143 | 6.2905  |

|                |  |        |        |        |
|----------------|--|--------|--------|--------|
| US\$ to HK\$   |  |        |        |        |
| July 2012      |  | 7.7540 | 7.7578 | 7.7562 |
| August 2012    |  | 7.7542 | 7.7576 | 7.7562 |
| September 2012 |  | 7.7516 | 7.7568 | 7.7543 |
| October 2012   |  | 7.7501 | 7.7550 | 7.7517 |
| November 2012  |  | 7.7501 | 7.7523 | 7.7508 |
| December 2012  |  | 7.7501 | 7.7518 | 7.7503 |

## ITEM RISK FACTORS

### 3D.

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

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

PRC Sovereignty Over Hong Kong Still Developing.

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

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

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There appears to be a developing friction between Hong Kong residents pressing for greater democracy and the new government leadership in Beijing. Leadership personnel at Beijing's liaison office in Hong Kong have been abruptly replaced. The new liaison office director has called for Hong Kong to enact new internal security regulations and vowed resistance to any "foreign forces" that may try to intervene in Hong Kong politics. The formula for the preservation of Hong Kong's independent legal and economic system under Chinese sovereignty has been referred to as "one country, two systems." The new liaison office director has been emphasizing the "one country" aspect of the formula stating that China's sovereignty is always to be respected. There appears to be a deep suspicion that Hong Kong's democracy advocates are being manipulated by the United States to cause difficulties at China's doorstep as regional tensions rise, i.e. as China has been asserting territorial claims in the East and South China Seas. The foregoing is raising concerns that civil liberties in Hong Kong may be eroded in the years to come. At this point in time it is not possible to predict if this trend will continue and what effect it will have on the Company, if any.

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

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

**Economic Stability Uncertain.**

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

**The PRC's Economic, Political And Social Conditions: Slowdown In Growth.**

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

The PRC economy appears to be moving from a planned economy to a more market-oriented economy. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in the PRC are still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over the PRC's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Recently, the PRC government predicted a steep slowdown in growth from a 9.2% GDP in 2011 to a 7.5% GDP in 2012 and plans to lower growth to 7.0% GDP in 2015 with a focus on raising the incomes of the average citizen and seek a national economy less driven by investment and more by consumer demand. Although past predictions have not always proven reliable, if these predictions prove accurate, they, as well as future actions and policies of the PRC government, could suffer a material adverse effect.

Also, financial reporting suggests a real estate “bubble” exists in the PRC. If a real estate “bubble” truly exists in the PRC and it bursts, the PRC’s economy and the Company could suffer a material adverse effect.

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

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

Over the past several years, the PRC’s government has pursued economic reform policies including encouraging private economic activities and decentralization of economic deregulation. It appears that the PRC government may not continue to pursue these policies or may significantly alter them to our detriment from time to time without notice. Changes in policies by the PRC government resulting in changes in laws, regulations, or their interpretation, or the imposition of confiscatory taxes, restrictions on currency conversion and imports could materially and adversely affect our business and operating results. Recently, the PRC government predicted that its annual growth rate in imports and exports would drop to 10% compared to more than 24% in 2011. The nationalization or other expropriations of private enterprises by the PRC government could result in a loss of our investments in actual funds and time and effort, in China.



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

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

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

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

Worldwide economies had been deteriorating recently. Global markets have experienced significant turmoil and upheavals characterized by extreme volatility and the volatility in prices and securities and commodities, diminished credit availability, inability to access capital markets, waves of bankruptcies, high unemployment and declining consumer and business confidence. It appears that the worldwide economic deterioration has negatively impacted our revenue and other results of operation. We cannot predict the short and long-term impact of these events on our business and financial condition that may be materially and adversely effected in the future.

Uneven Economic Growth.

The PRC's economy has experienced significant growth in recent years, but that growth has been uneven among various geographic regions and economic sectors. Economic reforms and growth in the PRC have been more successful in certain provinces than in others, and the continuation or increase of such disparities could adversely effect political or social stability. The PRC's economy experienced a slowdown beginning in the fourth quarter of 2008 as a result of the global economic crisis. There can be no assurance that the PRC's economy will grow, that if there is growth, such growth will be steady and uniform. The slowdown has had a negative effect on our business.

PRC Inflation.

In recent years, the PRC has not experienced significant inflation, and thus inflation has not had a significant effect on our business historically. In response to the increased inflation rate during 2004, the Chinese government announced measures to restrict lending and investment in the PRC in order to reduce inflationary pressure on the PRC's economy; and the inflation rate was reduced in 2005 and 2006, escalated in 2007 and 2008 at a rate of 5.9%, was reduced by 0.7% in 2009 and increased by 3.3%, 5.4% and 2.6% in 2010, 2011 and 2012, respectively. Efforts by the PRC to curb inflation may also curb economic growth, increase our overhead costs and adversely affect our sales. Inflationary increases cause a corresponding increase in our general overhead. If the PRC rate of inflation continues to increase, the Chinese government may introduce further measures intended to reduce the inflation rate in the PRC. Any such measures adopted by the Chinese government may not be successful in reducing or slowing the increase in the PRC's inflation rate. A sustained or increased inflation in the PRC may have an adverse impact on the PRC's economy and may materially and adversely affect our business and financial results.

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

The legislative trend in the PRC over the past decade has been to enhance the protection afforded to foreign investment and allow for more active control by foreign parties of foreign invested enterprises. This may not continue. In addition, as the PRC economy, business and commercial framework and legal system all continue to develop, that development may adversely affect the Company's activities in the PRC or the ability of the Company to enter into Sino-foreign agreements.

#### PRC Legal System Business Laws Developing.

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

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Government Currency Controls.

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

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

Foreign Currency Risk.

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

Turbulent Relations With The United States Of America (“United States”).

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

Certain Risks Relating To The Company’s Business

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

In Fiscal 2008, the Company had revenues of approximately US\$ 31,738, 000, operating income of approximately US\$ 370,000 and income before income taxes of approximately US\$ 560,000. Since Fiscal 2008, the Company’s revenues have continued to decline and its losses have increased. The Company primarily attributes the revenue reduction, operating loss and loss before income taxes to the global economic downturn and having key suppliers selling their products through China suppliers other than the Company. Exacerbating these losses in Fiscal 2010 was the further inclination of key suppliers selling their products other than through the Company and the delay of site readiness of several waste water treatment contracts including one site delayed by a fatal traffic accident. A major portion of the operating loss for Fiscal 2011 was principally from Yixing Pact Environmental Technology Company Limited and Pact Asia Pacific Limited for the amount of approximately US\$932,000 as a result of loss of approximately US\$632,000 for its joint venture and research and development expenses of approximately US\$193,000 incurred for its ballast water treatment system. During Fiscal 2012, the Company had revenues of approximately US\$21,645,000, an operating loss of approximately US\$59,000 and a profit before income tax of approximately US\$13,000. The principal reason for the operating loss for Fiscal 2012 was research and development expenses of approximately US\$930,000 incurred for its ballast water treatment system.

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

Future Plans To Increase Revenue ; Decrease Losses and Return To Profitability Uncertain.

The Company has been attempting to stem the decline in revenue by streamlining its activities. The Company has reduced its staff, consolidated offices and is trying to improve staff efficiencies. To date this has not been successful but the Company plans to continue these economizing efforts. Also, land and sea trials will be conducted in China in April and October of this year and, if successful, the Company hopes to receive revenues from orders to retrofit and install its ballast water treatment process into ocean going vessels. There can be no assurance that continuing its streamlining efforts and its testing of its ballast water treatment process will be successful or, if successful, that the process will result in significant revenues to the Company. Even if the Company builds a market for a product or service, the research and development and marketing of that product or service will result in losses to the Company for a significant period of time, even if that product or service ultimately becomes profitable.

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

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

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

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

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

Dependence Upon Management.

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

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

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

Competition With Vendors.

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

Dependence On Vendors: Lack of Long Term Arrangements: Loss of Vendors.

The Company distributes supplies manufactured by a number of vendors, including, Biotage Sweden AB ("Biotage"), Hach Company-Lachat Instruments ("Hach"), Thermo Fisher Scientific Group ("Thermo"), and Stanford Research Systems, Inc. ("Stanford"), that are the Company's largest suppliers, pursuant to short term arrangements. Although alternative sources of supply exist, there can be no assurance that the termination of the Company's relationship with any of the above or other vendors would not have an adverse effect on the Company's operations due to the Company's dependence on these vendors. A substantial number of the Company's suppliers have been selling their products into

China directly and through other distributors. During Fiscal 2009, our sales to Hong Kong, expressed as a percentage of total sales increased by approximately 10%, while our sales to the PRC decreased by approximately 9% when compared to Fiscal 2008. The approximate 10% increase in sales to Hong Kong was primarily due to an increase in sales of Thermo Fisher Scientific Group's products. This change continued into Fiscal 2010. The approximately 9% decrease in sales to the PRC was primarily due to the global economic downturn and additional sales by our key suppliers in the PRC through distributors other than the Company. During Fiscal 2011, our sales revenue from trading activities decreased by approximately 17% as a result of a loss of vendors. During Fiscal 2012, our sales revenue from trading activities slightly decreased by approximately 5% but no significant vendors were lost. A loss of a substantial vendor or substantial number of our other vendors and/or our competing with them would have a material adverse effect on our revenues from trading activities.

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

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

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

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

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

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

Anti-Takeover Provisions.

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

Uncertainty Of Enforcing United States Judgments.

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

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

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

Being A Foreign Private Issuer Exempts Us From Certain Securities And Exchange Commission (“Commission”) And NASDAQ QMX (“NASDAQ”) Requirements.

We are a foreign private issuer within the meaning of rules promulgated under the Securities Exchange Act of 1934 (the “Exchange Act”). As such, with certain limitations, we are exempt from certain provisions applicable to United

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

**Our Securities Must Continue To Meet Qualitative And Quantitative Listing Maintenance Criteria For NASDAQ: Recent Deficiency Cured.**

Our securities are quoted and traded on NASDAQ. There can be no assurance that we will continue to meet both the qualitative and quantitative criteria for continued quotation and trading of our securities on NASDAQ. One of NASDAQ’s listing requirements is the maintenance of a closing bid price of US\$ 1.00 per share. During periods of time in 2008 and 2009 the Company was not in compliance with that requirement but NASDAQ had generally suspended that requirement and others due to market conditions and/or the US\$1.00 per share bid price was not met for a sufficient period of time to cause a NASDAQ deficiency action.



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On September 20, 2011, the Company received a deficiency letter from NASDAQ that the Company was no longer in compliance with NASDAQ's listing maintenance rule for failing to have a bid price of at least US\$ 1.00 per share for the prior thirty trading days. In order to regain compliance, in January 2012, the Company effected a combination or reverse stock split of its issued Ordinary Shares. On February 1, 2012, the Company received a letter from NASDAQ advising that as the bid price for the Company's Ordinary Shares had risen above US\$ 1.00 for the required period of time, the Company was in compliance with NASDAQ's maintenance listing requirements.

On April 17, 2013, the closing price of the Company's Ordinary Shares was US\$2.91. If we are unable to meet the continued quotation criteria of NASDAQ and are suspended from trading on these markets, our securities could possibly be traded in the over-the-counter market and be quoted in the so-called "pink sheets" or, if then available, the OTC Bulletin Board. In such an event, an investor would likely find it more difficult to dispose of, or even obtain accurate quotations of, our securities. See "- We Are Also Required To Meet Certain, But Not All Corporate Governance Criteria Applicable to NASDAQ Listed Issuers."

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

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

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

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

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

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

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

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

We May Be Exposed To Potential Risks Relating To Our Internal Controls Over Financial Reporting.

Pursuant to Section 404 of SOX, the SEC adopted rules requiring public companies to include a report of management on the company’s internal controls over financial reporting in their annual reports, including Form 20-F.

We expend significant resources in developing and maintaining the necessary documentation and testing procedures required by SOX, there is a risk that we will not maintain compliance with all of these requirements.

In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner our ability to obtain equity or debt financing could suffer and the market price of our shares could decline.

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The Market Price Of Our Securities Has Been Fluctuating Widely.

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

There Are Risks In Purchasing Low-Priced Securities.

If our securities were to be suspended or delisted from NASDAQ, they could be subject to rules under the Exchange Act which impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established clients and “accredited investors”. For transactions covered by such rules, a broker-dealer must make a special suitability determination of the purchaser and have received the purchaser’s written consent to the transaction prior to the sale. Consequently, such rules may affect the ability of broker-dealers to sell our securities and the ability to sell any of our securities in any secondary market that may develop for such securities. In the event our securities are no longer listed on NASDAQ or are not otherwise exempt from the provisions of the SEC’s “penny stock” rules, such rules may also affect the ability of broker-dealers and investors to sell our securities.

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

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

We May Be Considered To Be A Passive Foreign Investment Company For The 2012 Calendar Year And May Be A Passive Foreign Investment Company For Future Years, Which Would Result In Adverse U.S. Federal Income Tax Consequences To U.S. Holders Of Our Ordinary Shares.

A non-U.S. corporation will be considered a passive foreign investment company (“PFIC”) for U.S. income tax purposes, for any taxable year if either (i) at least 75% of its gross income is passive income or (ii) at least 50% of the value of its assets (based on an average of the quarterly values of the assets during a taxable year) is attributable to assets that produce or are held for the production of passive income. The annual PFIC determination to be made by a U.S. holder of our ordinary shares is an inherently factual determination and there is limited guidance regarding the application of the PFIC rules to specific situations. We currently hold a substantial amount of cash and cash equivalents, and investments in PRC enterprises, and the value of our goodwill and other assets may be based in part on the market price of our ordinary shares, which has experienced significant fluctuations. Although the determination of PFIC status is subject to factual uncertainties because it depends upon the valuation of our ordinary shares, as well as our goodwill and other assets and income, we are uncertain if we would be considered to be a PFIC for 2012. In addition, as the determination of PFIC status is made on an annual basis and depends on variables over which we have limited control, there can be no assurance that we will not be a PFIC for 2012 or any future years. If we are a PFIC in any year, U.S. Holders will be subject to certain adverse United States federal income tax consequences, and are urged to consult with his or her tax advisor. See “Item 10 Taxation—United States Federal Income Taxation .”

If we become directly subject to the recent scrutiny involving U.S.-listed Chinese companies, we may have to expend significant resources to investigate and/or defend the matter, which could harm our business operations, stock price and reputation and could result in a complete loss of your investment in us.

Recently, U.S. public companies that have substantial operations in China have been the subject of intense scrutiny by investors, financial commentators and regulatory agencies. Much of the scrutiny has centered around financial and accounting irregularities and mistakes, a lack of effective internal controls over financial reporting and, in many cases, allegations of fraud. As a result of the scrutiny, the publicly traded stock of many U.S. listed China-based companies that have been the subject of such scrutiny has sharply decreased in value. Many of these companies are now subject

to shareholder lawsuits and/or SEC enforcement actions that are conducting internal and/or external investigations into the allegations. If we become the subject of any unwarranted scrutiny, even allegations that are not true, we may have to expend significant resources to investigate such allegations and/or defend the Company. Such investigations or allegations will be costly and time-consuming and distract our management from our business plan and could result in our reputation being harmed and our stock price could decline as a result of such allegations, regardless of the truthfulness of the allegations.

ITEM INFORMATION ON THE COMPANY

4.

ITEM HISTORY AND DEVELOPMENT OF THE COMPANY

4A.

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

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During Fiscal 2005, we completed our plan to increase our equity position in Yixing Pact Environmental Technology Company Limited (“Yixing”) and Pact Asia Pacific Limited (“Pact”), companies engaged in water and waste-water treatment solution business. We had previously owned thirty (30%) percent of their capital stock. With the addition of twenty-one (21%) percent of Pact’s and Yixing’s capital stock in October 2005, they became our majority-owned subsidiaries. In January 2010, we acquired an additional two percent (2%) interest in Pact, increasing our ownership to fifty-three (53%) percent of Pact. The foregoing purchases of Yixing and Pact were made from Tamworth Industrial Limited (“Tamworth”). In July 2011, we acquired additional 5% equity interests in Yixing and Pact for a total consideration of approximately US\$ 234,000 from Tamworth.

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

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

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

In August 2007, Far East acquired a 20% equity interest in Zhejiang Tianlan Environmental Protection Technology Company Limited (“Blue Sky”), founded in 2000, for approximately US\$4,648,000. Blue Sky provides design and general contracting services, equipment manufacturing, installation, testing and operation management for the purification treatment of industrial waste gases (specifically as desulphurization, flue gas de-nitration, dust removal) emitted from various boilers and industrial furnaces of power plants, steelworks and chemical plants. By securing an equity stake in Blue Sky’s business, we have a strategic partner to work within China’s environmental protection business. With Blue Sky’s technology and technical support, we believe we are able to provide services and environmental solutions not only for water and waste-water treatment but also for air pollution control for industrial clients in China. Blue Sky’s revenue and net income have steadily increased during Fiscal 2010 and Fiscal 2011. During Fiscal 2012, Blue Sky’s sales orders increased by 27%. However, the delay in implementation of some major projects resulted in decrease in revenues and net incomes. In 2012, to fund its intermediate expansion plans, Blue Sky had submitted an initial public offering application with the appropriate government authorities in China. Blue Sky has recently decided to withdraw the listing plans because of declining profits in Fiscal 2012.

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

ITEM BUSINESS OVERVIEW.

4B.

The Company had been primarily a distributor of a wide range of advanced water treatment equipment (including chlorination equipment), laboratory instruments, analyzers, test kits and related supplies and power generation equipment (including recorders and power quality analyzers). The Company acts as an exclusive and non-exclusive distributor for well-known manufacturers of such equipment, primarily to commercial customers and governmental agencies or instrumentalities in Hong Kong and the PRC.

The Company distributes products through its Hong Kong headquarters, its trading companies and representative offices in Beijing, Shanghai, Guangzhou, Chongqing, Xi´An, Shenyang, and Urumqi.

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

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

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

To allow the Company to bid on larger water, waste-water and power generation projects, we acquired Pact and Yixing (“Pact-Yixing”). The Company believes that the Pact-Yixing business is complementary to the Company’s business as the Company expects to have a competitive advantage by offering customers and potential customers not only hardware but solutions to engineering problems as well.

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

Pact-Yixing clients cover a varied spectrum of industries covering semiconductor, pharmaceutical, petrochemicals, auto and auto parts, steel, food and beverage and beauty products. For example, in February 2010, Pact entered into an agreement with a stainless steel manufacturer providing for an aggregate of up to US\$3,800,000 for the engineering, design, supply, equipping, installation, personnel training and commissioning of waste water treatment, direct water cooling, indirect cooling tower water, potable water treatment and industrial water treatment systems in Jiangsu, China. The systems have been completed as of December 31, 2011. The contract price has now been fully paid.

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

In 2006, Pact-Yixing commenced selling water and waste-water treatment equipment. PACT and Engineering FZC (“PACTFZC”), a Middle Eastern water treatment company based in Dubai, and a third party formed a joint venture. PACT invested US\$300,000 and has a 60% controlling interest of the JV, PACTFZC, majority owned by George Hayek, the Company’s Managing Director and the third party each invested US\$100,000 in consideration for 20% interests. In December 2011, the partners of the JV decided to close the JV due to an unsatisfactory return on their investment. The JV had an operating loss of approximately US\$632,000 in Fiscal 2011 as a result of expenses resulting from the liquidation of the JV, such as severance payments and impairment of inventory, The JV was liquidated and its business is being taken over by Pact-Yixing.

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

During Fiscal 2010, “trading” activities revenue substantially declined. In response, the Company began streamlining operations and further restructured the Company from a trading orientation to manufacturing and engineering activities. Non-profitable or non-strategic retail shops and representative office closed with consequent staff reductions with a focus on trading activity in Hong Kong, Macau and Guangdong.

A fatal traffic accident in September 2010 disrupted the progress of the Guangxi contract and other engineering activities and business opportunities. Five people died, including two members of our project Management Team and an employee of a civil engineering sub-contractor. The Company drew employees from other projects and hired a new sub-contractor. Drawing personnel from other projects delayed those projects as well. Lastly, several waste water treatment projects were delayed as a result of site preparation short comings by the owners. All these factors had a substantive negative impact on the Company’s financial results of operations for Fiscal 2010. The loss to the Company from the traffic accident cannot be financially quantified.



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During Fiscal 2011, revenues from trading activities continued to decline as we continued to lose the right to distribute products, Siemens products, for example. We mainly sold Siemens' water treatment products to Hong Kong's government water supply agency. Our agreement with Siemens terminated at the end of September 2010 and this product loss was the major factor in our Hong Kong sales decline. Anticipating the potential for such losses we had starting economizing by reducing staff, consolidating offices (as early as 2010) while attempting to improve staff productivity. Also revenue from Pact and Yixing declined in 2011 while it experienced a high rate of staff turnover and unfavorable economic conditions caused by the decrease in sales contracts from multinational companies as a result of the European sovereign debt crisis. Engineering expenses increased by US\$0.6 million primarily due to the approximately US\$ 301,000 expended on the liquidation of its Joint Venture. Additionally, approximately US\$ 193,000 was utilized for research and development expenses for the Ballast Water Treatment System (BWTS). The foregoing factors had a substantive negative impact on the Company's Fiscal 2011 financial results of operations.

During Fiscal 2012, there was no loss of major products distribution right, revenues from trading activities slightly declined but the gross profit remained the same as Fiscal 2011. Due to our continuous efforts in economizing by reducing staff, consolidating offices (as early as 2010) while attempting to improve staff productivity, our operating loss from trading activities reduced. Revenue from Pact and Yixing increased in 2012 resulted in operating profit from engineering activities even though approximately US\$ 930,000 was utilized for research and development expenses for the BWTS. In Fiscal 2012, the general manager left and there was no significant sales contracts received for Shanghai — Environmental.

#### Our Strategy for 2013

We are focusing our trading activities in Hong Kong, Macau and Guangdong under a more productive operation. These cities are located close to our Hong Kong headquarters, our customers are more concentrated in these cities rendering customer support easier while incurring less travel expenses and while supporting distributorships in these cities as opposed to distributorships throughout China. We will continue our efforts to control costs to enhance operational efficiency. At the same time we will place greater focus at the manufacturing level on the chemical reagent business that the Company believes is very profitable, and also it is easier to sell. These chemical reagents are manufactured in our Shanghai Plant. These reagents include but are not limited to Chemical Oxygen Demand Analyzers, fine carbon tetrachloride, total nitrogen and free chlorine. These reagents are used by water and used by water and wastewater treatment plants and other industries such as beverage, as consumables by water and wastewater treatment plants, consumables with the water analyzers to monitor the quality of the water/ discharged water. Our target is to have our manufacturing facilities reach "break-even" in Fiscal 2013. Also, during the 1st Quarter of Fiscal 2013, we received 3 engineering contracts worth about US\$ 2.3 million from two foreign companies outside China and one company in China and we feel positive about our ability to expand our worldwide customer base by working closely and actively with some international engineering companies because of Pact and Yixing's competitive prices and the high quality of its services. We will look for opportunities for Shanghai — Environmental to co-operate with Pact and Yixing to generate a synergy effect. We have been investing significant portion of our resources to developing its BWTS for the global market and expects the new BWTS business will generate revenues for coming years of which no assurance can be given.

#### Product Distribution and Other Services

Scientific Instruments. The Company distributes analytical instruments, environmental monitoring instruments, sample pre-treatment equipment and general purpose laboratory instruments. Analytical instruments include, but are not limited to, chromatographs, mass spectrometers, flow injector analyzers, automated sample preparation workstations and atomic spectrometers. Environmental monitoring instruments include both air and water quality monitoring instruments. Air quality monitoring instruments are generally divided into those which monitor ambient (i.e., atmospheric) air, and those which monitor pollution sources. Sample pre-treatment equipment are used to

clean-up the sample prior to chemical analysis for checking pesticides and drug residues in food. Additionally, the Company offers general purpose laboratory instruments including a variety of water quality monitoring and analysis equipment, such as continuous reading process analyzers, process turbidimeters, pH controllers, and test kits for monitoring chemical content in water (i.e., chlorine, fluorides, etc.). See “Glossary.”

Customers for the analytical instruments include government agencies, academic and research institutions, major laboratories and beverage producers, including analytical system to the Hong Kong Government Laboratory for analysis of persistent organic pollutants (POPs) and pesticides in the environment. Customers for air and water quality monitoring instruments also include government agencies. Customers for sample pre-treatment equipment are mainly different laboratories of major cities under Administration of Quality Supervision, Inspection and Quarantine in the PRC. The Company derived approximately 55.3%, 54.4%, and 59.2 of its revenues from the sale of Scientific Instruments during Fiscal 2012, Fiscal 2011 and Fiscal 2010, respectively.

Process Control and Engineering Products. The Company provides process control systems specifically designed for the industrial needs of clients including sensors, temperature gauges, pressure gauges, power and energy consumption meters, flow meters, valves, temperature and pressure transmitters and control devices, temperature and pressure calibrators, moisture, power, energy and harmonic analyzers. Customers for the foregoing distributed products include government water supply agencies, water treatment facilities, power and electric companies, petrochemical plants and instrument manufacturers.

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In conjunction with the distribution of products such as programmable logic controllers, telemetry units and SCADA systems and software, the Company also provides systems engineering to government agencies, waste-water treatment and power generation plants and beverage producers. Specific services provided include automated control system design, the operation and management of various waste-water, water and power generation projects. We endeavor to introduce, develop, and promote new and advanced technologies, products, and appropriate technical developments from abroad. We have also been cooperating with established technology companies and engage in systems and special projects in Programmable Logic Control, Telemetry unit, SCADA systems, Human Machine Interface Software and Sequential Event Recording.

The Company derived approximately 15.1%, 17.0% and 25.2% of its revenues from the sale of Process Control and Engineering Products during Fiscal 2012, Fiscal 2011 and Fiscal 2010, respectively.

Energy Conservation, And Related Products. The Company distributes general testing and measuring equipment including multi-channel digital and analogue recorders, signal amplifiers and calibration equipment for energy conservation, renewable energy equipment, power quality analyzers, continuous emissions monitoring systems and air pollution control systems to industries including power plants, railway and aero-space industries, utilities, educational institutions and telecommunications companies. The Company derived approximately 27.8%, 27.2% and 13.7% of its revenues from the sale of these Energy Conservation and Related Products during Fiscal 2012, Fiscal 2011 and Fiscal 2010, respectively.

Technical Support. The Company's technical support staff provides customers with maintenance, installation assistance, and calibration services, and assists sales personnel in giving technical advice to and performing product demonstrations for customers. Technical Support services derived approximately 1.8%, 1.4% and 1.9% of its revenues from Technical Support Operations during Fiscal 2012, Fiscal 2011 and Fiscal 2010, respectively.

Customers. During Fiscal 2012, the Company distributed products to approximately 1,000 customers, located in Hong Kong, the PRC and Macau such as the Hong Kong Environmental Protection Department, Hong Kong Water Supplies Department, Government Laboratory, Drainage Services Department, and various Environmental Monitoring Centers in the PRC. The Company does not believe that any single customer is material to its operations.

#### Manufacturing and Product Assembly Operations

The Company, through its PRC Corporation, Shanghai Euro Tech Limited established in 1999 in the Pudong Jin Qiao Export Processing Zone of Shanghai, engages in the development, production, sales and servicing of environmental equipment, including the development of modern laboratory analyzers, on-line measuring equipment and other analyzers for chemicals. Our products are "tailor-made" for the diversified needs of equipment users. Main products include Infrared Photometric Oil Analyzer (IPOA), COD analyzers, Total Organic Carbon Analyzer, turbidity meters, total suspended solid analyzers, dissolved oxygen analyzers, various types of spectrophotometers as well as a full spectrum of matching chemical reagents. In late 2005, we began offering new turbidity meters manufactured by the Company. The new turbidimeter is directed at water treatment plants, environmental monitoring status, hydrological stations. In November 2006, we began actively marketing our Total Organic Carbon (TOC) analytical instrument that measures the degree of the pollution. We have also upgraded other existing instruments and developed a quick response Chemical Oxygen Demand ("COD") test instrument for use on surface water, underground water and domestic and industrial wastewater. In 2008 we introduced a Flue Gas Emissions Analyzer for use in environmental compliance monitoring. We also developed energy meters (devices measuring electric energy consumption and corresponding carbon dioxide emissions) and water toxicity analysis instruments. Although it takes substantial time, effort and expense to develop, test and market a product, our sales of the TOC analyzer and the Flue Gas Emissions Analyzer have been nominal to date.

## Sources of Supply

The Company distributes products manufactured by a substantial number of major American, European and Japanese corporations, including Biotage, Hach, Thermo, and Stanford, which are the Company's largest suppliers, with purchases from them accounting for approximately, 7%, 13%, 21% and 6% during Fiscal 2010, 10%, 10%, 7% and 8% during Fiscal 2011 and 17%, 11%, 10% and 7% during Fiscal 2012, respectively. The Company has exclusivity agreements for specified geographic areas with many of its suppliers for certain products. Those agreements do not encompass all products distributed by the Company or all of the market areas serviced by the Company. In addition, some of these agreements are memorialized not as formal contracts but rather through other acknowledgements or correspondence which may contain a vague, if any, description of the terms and conditions of such agreement or arrangement, and therefore may be unenforceable. The Company's agreement with Biotage will be automatically renewed annually until December 31, 2013 and terminable on sixty days' notice by either party and is limited to Hong Kong, Guangdong and Hainan. The Company's agreement with Hach is valid until December 31, 2013. The Company has only an Authorization Letter from Thermo granting the Company rights to sell Thermo's Mass Spec Products in Hong Kong and Macau. The Company has only an Authorization Letter from Stanford appointing the Company as Stanford's sales representative in the PRC and Hong Kong. Although alternative sources of supply exist, there can be no assurance that the termination of the Company's relationship with any of the above or other vendors would not have an adverse effect on operations.

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Future Planning and Expansion

We continuously search for products and equipment with substantial market potential for design and development. For example, international shipping ballast water cargo stowaway species and microorganisms that create unpredictable ecosystem contaminations as ballast water tanks are emptied or refilled at ports of call. The International Maritime Organization (“IMO”) requires that Ballast Water Management (“BWM”) Convention will enter into force 12 months after ratification by 30 States, representing 35 per cent of world merchant shipping tonnage. If and when it goes into force, all ocean going vessels be fitted with dedicated water treatment systems treating ballast water before port-of-call discharge. PACT has been attempting to develop a non-chemical ballast water treatment system since late 2010 and PACT has successfully completed and passed the land based test requirement in 2012, and is currently undergoing for ship board testing and expects to obtain certification in the PRC and comply with IMO convention in fourth quarter of 2013. We anticipate that the costs of any such acquisition or product development would be drawn from our general working capital and, possibly, by seeking strategic partners such as companies in shipping industries or funding raising from substantial investors, and by private sales of our securities. We have no commitments or indications of interest for the private sales of our securities.

The Convention will enter into force 12 months after ratification by 30 States, representing 35 per cent of world merchant shipping tonnage. The adoption of the last set of Guidelines for the uniform implementation of the BWM Convention and the approval and certification of modern ballastwater treatment technologies have removed the last barriers to the ratification of instrument and significant number of countries have indicated their intention to accede to this Convention in the near future.

Our plans for the near term also include use of our “on-line” product sales (via [www.yibaynet.com](http://www.yibaynet.com)) will allow us to continue to offer products at lower prices than our competitors.

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

Regulatory Environment

Concerns about and awareness of pollution problems and environmental issues have grown at all levels of PRC government as the PRC experienced economic growth. Environmental protection laws and strict regulations have been enacted and are buttressed by increased budget allocations for environmental regulation, monitoring and enforcement. The PRC’s primary environmental protection agency is the Ministry of Environmental Protection (MEP), under which there are Environment Protection Bureaus in each city and county. According to oral information received by management from MEP, under bureau management, there are two environment monitoring systems: one system consists of over 2,500 monitoring stations to collect and analyze the environmental data of each city and county; another system consists of over 2,500 stations to monitor specific industrial districts or factories which have been identified as major pollution sources due to their non-compliance with environmental regulations. MEP is considering to adding on-line toxicity as one of the parameters for on-line monitoring stations in China. The PRC government has established ambitious targets in its 12th Five-Year Program (2011-2015) to slash emissions of pollutants, including sulfur dioxide emissions and COD by 8% and ammonia nitrogen and nitrogen dioxide by 10%. The PRC government passed a law requiring power distributors to combat global warming. A central government fund, financed by a national tariff increase, will subsidize the tariff gap between more expensive renewable energy and the national average tariff. Preferential policies also encourage construction of renewable energy projects, projects in poorer interior

regions that are often rich in water, solar and wind resources. The Company has supplied water and air quality monitoring and analytic instruments to these monitoring stations for several years. There can be no assurance that the agencies will continue to use the Company's products for these purposes, or that other market competitors will not enter the market with superior products, distribution systems or more competitive prices. See "Competition."

## Competition

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

During Fiscal 2012, Fiscal 2011 and Fiscal 2010, the Company's gross profit margins were approximately 28%, 24% and 26%, respectively. The Company believes that it competes with the PRC manufacturers on the basis of quality and technology. The Company believes it offers foreign-manufactured products which are of higher quality and use more advanced technology than products manufactured in the PRC. The Company believes that it competes with foreign manufacturers and other distributors of their products on the basis of the Company's more extensive distribution network and an established reputation. Pact-Yixing focuses on a market of providing water and waste water treatment services to multinational companies. The Company competes in this market based upon the quality of its products and having a knowledgeable staff.

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Website

The Company has an internet platform located at (<http://www.chinah2o.com>). The website is directed at environmental businesses in China. The website provides environmental news, directories of western suppliers, potential clients in China, and advertisement space but has not generated sufficient external revenue and is now being operated directly through the Company instead of through a subsidiary deregistered in February 2012.

The Company, through its subsidiary, Euro Tech Trading (Shanghai) Limited, a PRC corporation, has an internet platform. The website is located at (<http://www.yibaynet.com>). The website is an instrument sourcing platform under which potential customers can ask for sales quotations and place orders via internet. It can replace some functions of the closed retail shops.

Sales and Marketing

The Company distributes products through its principal office located in Hong Kong and its representative PRC offices located in Beijing, and its wholly-owned trading/retail companies and their representative offices in Shanghai, Chongqing, Guangzhou, Shenyang, Xi'an and Urumqi. During Fiscal 2010, the Company closed 5 retail outlets and 1 representative office and consolidated some personnel into our remaining representative offices and retail/trading companies, and reducing overall staffing by 24 people. During Fiscal 2011, the Company closed 2 representative offices and consolidated some personnel into our remaining representative offices and retail/trading companies, and reducing overall staffing by 18 people. During Fiscal 2012, we reduced overall staffing by 7 people. During Fiscal 2012, the Company had a marketing and sales force of 32 people who are paid a salary plus a sales-based commission. Our sales staff assists customers in selecting the equipment, auxiliary parts and products to suit customer specifications. We will continue to consolidate our operations by closing companies and offices that do not appear to be contributing to the Company as expected.

Our remaining sales companies are located in: Shanghai, Chongqing, Guangzhou, Shenyang and Xi'an.

Our remaining representative offices are located in: Beijing and Urumqi. The Representative offices are liaison offices of Far East while the sales offices are actually engaged in sales of the Company's products and assisting customers in the use of our products.

Litigation

After the fatal traffic accident in September 2010, the parents of two person who died in the accident, deceased employees of a site the Company was working upon, commenced an action against ten Defendants, including the Company, in the People's Court, Tian Dong Province, Guangxi, PRC. The Plaintiffs alleged that the accident was caused by a vehicle driven by an employee of a civil engineer sub-contractor of the Company, performing Company tasks during the accident and the Company assumed joint and several liability with the driver. The Plaintiffs sought damages of US\$ 64,000 and US\$ 95,000, respectively, and attorney's fees. The Company retained counsel seeking a vigorous defense, denied liability on the grounds that the driver had not been proven to be the employee of the civil engineer sub-contractor and had failed to obey a traffic light. The Tian Dong People's Court issued a verdict dated September 11, 2011 finding, among other things, that the Company was not liable. One of the Plaintiffs has appealed that verdict to the Baise Intermediate People's Court, Guangxi Zhuang Autonomous Region, PRC on November 20, 2011. After the hearing on April 23, 2012, the appellate court issued a verdict dated May 10, 2012 finding, among other things, that the Company was not liable to joint and several liability with the driver, but to bear 30% of the liability of the civil engineer sub-contractor for the amount of US\$52,000. Management is considering not appealing the decision as the chance of success is remote.

The family of a Company employee who died in the accident has asked for additional compensation. However, the Company will only negotiate the compensation after the finalization of the litigation.

ITEM ORGANIZATIONAL STRUCTURE

4C.

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

Wholly-Owned

Euro Tech Trading (Shanghai) Limited --- a People's Republic of China corporation.

Euro Tech (China) Limited --- a Hong Kong corporation.

China H2O.com Limited --- a Hong Kong corporation (Deregistered in February 2012).

Shanghai Euro Tech Limited --- a People's Republic of China corporation.

Shanghai Euro Tech Environmental Engineering Company, Ltd. --- a People's Republic of China corporation.

Chongqing Euro Tech Rizhi Technology Company, Limited --- a People's Republic of China corporation.

Rizhi Euro Tech Instrument (Shaanxi) Company Limited --- a People's Republic of China corporation.

Guangzhou Euro Tech Environmental Equipment Company Limited --- a People's Republic of China corporation.



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Majority Owned

Yixing Pact Environmental Technology Company Limited---a People's Republic of China corporation.  
Pact Asia Pacific Limited---a BVI corporation("Pact").

Other Entities

Pact Environmental Equipment Co. Limited — a PRC joint venture, 60% owned by PACT (liquidated).  
Zhejiang Tianlan Environmental Protection Technology Company Limited — a People's Republic of China corporation.\*  
Zhejiang Jia Huan Electronic Co. Ltd., — a People's Republic of China corporation.\*

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\* A 50 percent or less owned person accounted for by the equity method as defined by SEC rules and regulations.

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

ITEM PROPERTY, PLANT AND EQUIPMENT

4D.

The Company has various operating lease agreements for office and industrial premises. Rental expenses for the year ended December 31, 2012 was approximately US\$291,000. Future minimum rental payments as of December 31, 2012, under the agreements classified as operating leases with non-cancellable terms amounted to US\$262,000 of which US\$232,000 are payable in the year 2013 and US\$30,000 are payable within years 2014 to 2016.

The Company maintains an executive office at 18/F Gee Chang Hong Centre, 65 Wong Chuk Hang Road, Hong Kong. The Company occupies approximately 7,000 square feet of office and warehouse storage space under a two (2) year lease that expires in May 2013 with a monthly rental payments of approximately US\$ 4,744. The warehouse storage space is used to hold products for distribution to our customers via common carriers.

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

The Company's 5 field and representative offices are rented by the Company pursuant to short-term leases aggregating approximately US\$ 2,700 per month.

Euro Tech Trading (Shanghai) Ltd. has two offices rented pursuant to short term leases, at an aggregate monthly rental of approximately US\$ 1,140. Shanghai Euro Tech Limited's premises are rented pursuant to a short term lease for a monthly rental of approximately US\$ 2,730. Shanghai Euro Tech Environmental Engineering Company, Ltd's premises are also rented pursuant to a short term lease for a monthly rental of approximately US\$ 1,250.

Pact occupies a 700 square meter facility in Shanghai, pursuant to a 3 year lease expiring in January 2014, providing for a monthly rental of approximately US\$ 8,065.

In April 2011, the Company sold a building that had been used as representative office in Shanghai. This office was moved to the Company's Pudong location and the building was sold for approximately US\$ 489,000 to an independent third party.

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

ITEM OPERATING AND FINANCIAL REVIEW AND PROSPECTS

5.

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

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

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

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

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## ITEM 5A. OPERATING RESULTS

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

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

| Fiscal Year | PRC | Hong Kong |
|-------------|-----|-----------|
| 2010        | 71% | 28%       |
| 2011        | 75% | 24%       |
| 2012        | 73% | 25%       |

Sales to customers situated in Macau and elsewhere through Fiscal 2012 were nominal. This makes the Company particularly susceptible to changes in the political and economic climate of either Hong Kong or the PRC.

Hong Kong. Hong Kong has been one of the prime centers for commercial activity and economic development recently in Southeast Asia. On July 1, 1997, sovereignty over Hong Kong was transferred from the United Kingdom to the PRC. As provided in the Sino-British Joint Declaration and the Basic Law, the Hong Kong SAR is provided a high degree of autonomy except in foreign and defense affairs. The Basic Law provides that the Hong Kong SAR is to have its own legislature, legal and judicial system and full economic autonomy for 50 years after the transfer of sovereignty. Based on the current political conditions and the Company's understanding of the Basic Law, the Company does not believe that the transfer of sovereignty over Hong Kong has had or will have an adverse impact on its financial and operating environment. Although the Chinese government has pledged to maintain the economic and political autonomy of Hong Kong over its internal affairs, there is no assurance that such pledge will continue to be honored if there are changes in the Chinese political or economic climate. Sales in Hong Kong, expressed as a percentage of our revenue decreased by 4% in Fiscal 2012 as compared with Fiscal 2011. See Item 3D. "Key Information — Risk Factors."

PRC. The PRC has been a socialist state since 1949. For more than half a century, the PRC's economy has been, and presently continues to be, a socialist economy operating under government controls promulgated under various State Plans adopted by central Chinese government authorities and implemented, to a large extent, by provincial and local authorities which may set production and development targets. However, since approximately the early 1980s, the PRC's national government has undertaken certain reforms to permit greater provincial and local economic autonomy and private economic activities. Any change in political or economic conditions may substantially adversely affect these reform initiatives and, in turn, the Company. Sales in the PRC, expressed as a percentage of total revenue decreased by 2% in Fiscal 2012 as compared with Fiscal 2011. See Item 3D. "Key Information — Risk Factors."

### Results from Operations

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

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

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|  | 2012   |        | 2011     |        | 2010     |        | 2009   |        | 2008   |        |
|--|--------|--------|----------|--------|----------|--------|--------|--------|--------|--------|
| Revenue  | 21,645 | 100 %  | 20,213   | 100 %  | 22,305   | 100 %  | 27,336 | 100 %  | 31,738 | 100 %  |
| Cost of revenue  | 15,480 | 71.5 % | 15,322   | 75.8 % | 16,564   | 74.3 % | 20,876 | 76.4 % | 24,154 | 76.1 % |
| Gross Profit   | 6,165  | 28.5 % | 4,891    | 24.2 % | 5,741    | 25.7 % | 6,460  | 23.6 % | 7,584  | 23.9 % |
| Selling and administrative Expenses                        | 6,224  | 28.8 % | 6,565    | 32.5 % | 7,119    | 31.9 % | 6,598  | 24.1 % | 7,214  | 22.7 % |
| Income/(loss) before income Taxes                          | 13     | 0.1 %  | (1,204 ) | -6.0 % | (1,326 ) | -5.9 % | (40 )  | -0.1 % | 560    | 1.8 %  |
| Income taxes/(benefit)                                     | 142    | 0.7 %  | (63 )    | -0.3 % | 154      | 0.7 %  | 218    | 0.8 %  | 321    | 1.0 %  |
| Equity in profit of Affiliates                             | 9      | 0.1 %  | 1,131    | 5.6 %  | 723      | 3.2 %  | 595    | 2.2 %  | 273    | 0.9 %  |
| Net (loss)/income  | (120 ) | -0.6 % | (10 )    | -0.1 % | (757 )   | -3.4 % | 337    | 1.2 %  | 512    | 1.6 %  |
| Net loss/(income) attributable to Non controlling interest | (309 ) | -1.4 % | 531      | 2.6 %  | (330 )   | -1.5 % | (305 ) | -1.1 % | (363 ) | -1.1 % |
| Net (loss)/income attributable to the Company              | (429 ) | -2.0 % | 521      | 2.6 %  | (1,087 ) | -4.9 % | 32     | 0.1 %  | 149    | 0.5 %  |

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Fiscal Year Ended December 31, 2012 Compared to Fiscal Year Ended December 31, 2011

Revenue; Gross Profit and Cost of Revenue. Revenue increased by approximately US\$ 1,432,000 or 7.1% to approximately US\$ 21,645,000 in Fiscal 2012 from approximately US\$ 20,213,000 in Fiscal 2011. The increase was principally due to an increase in revenues from engineering activities of approximately US\$ 2,003,000 which was in excess of the decrease in revenues from trading and manufacturing activities of approximately US\$ 571,000.

Pact-Yixing's revenues of approximately US\$ 9,435,000 and US\$ 5,098,000 were included in our revenues in Fiscal 2012 and Fiscal 2011, respectively.

Gross profits increased by approximately US\$ 1,274,000 or 26.0% to approximately US\$ 6,165,000 for Fiscal 2012 as compared to approximately US\$ 4,891,000 for Fiscal 2011. During Fiscal 2012, the Company's cost of revenue was approximately US\$ 15,480,000, or 71.5% of revenues, in comparison to approximately US\$ 15,322,000, or 75.8% for Fiscal 2011. Cost of revenue expressed as a percentage of revenue decreased by 4.3% in Fiscal 2012 as compared with Fiscal 2011. The gross profit margin percentage increase was due principally to improvement in gross margin of both trading and engineering revenues. Yixing-Pact contributed approximately US\$ 3,591,000 to our gross profit margin in Fiscal 2012, an increase of approximately US\$ 1,879,000 from Fiscal 2011.

Selling and Administrative Expenses. Selling and administrative expenses were approximately US\$ 6,224,000 in Fiscal 2012, a decrease of approximately US\$ 341,000 or 5.2% from approximately US\$ 6,565,000 in Fiscal 2011. The decrease was principally due to the reduction of expenses for trading and manufacturing activities as the Company continued to consolidate its trading business. Pact-Yixing's selling and administrative expenses increased by approximately US\$ 153,000 in Fiscal 2012 as compared to Fiscal 2011 principally as a result of research and development expenses incurred for the Ballast Water Treatment System.

Equity in Profit of Affiliates. Equity in profit of affiliates of approximately US\$ 9,000 in Fiscal 2012, a decrease of approximately US\$ 1,122,000 from approximately US\$ 1,131,000 in Fiscal 2011. The decrease was primarily due to the decline in contribution from Blue Sky as a result of delay in commencement of some major contracts .

Interest Income. Interest income decreased by approximately US\$14,000 or 23.3% to approximately US\$46,000 in Fiscal 2012 from approximately US\$60,000 for Fiscal 2011. The increase was primarily due to the drop in interest rates.

Other Income. Other income increased by approximately US\$ 34,000 or 41.5% to approximately US\$48,000 in Fiscal 2012 from approximately US\$ 82,000 in Fiscal 2011. The increase in other income was principally due to a foreign exchange loss of approximately US\$ 17,000 in Fiscal 2012 as compared to foreign exchange gain of approximately US\$ 26,000 in Fiscal 2011.

Loss/Gain on Disposal of Fixed Assets. Loss on disposal of fixed assets was approximately US\$22,000 in Fiscal 2012. Gain on disposal of fixed assets of approximately US\$ 328,000 in Fiscal 2011 was principally due to the sale of a property in Shanghai.

Income Taxes. Taxes increased by US\$ 205,000 to approximately US\$ 142,000 in tax charges in Fiscal 2012 from approximately US\$63,000 tax credit in Fiscal 2011. This decrease was primarily the result of net taxable profit for Fiscal 2012 as compared to net taxable losses for Fiscal 2011.

Net Income. Income from continuing operations decreased by approximately US\$ 950,000 to a net loss of approximately US\$ 429,000 in Fiscal 2012 from a net income of approximately US\$521,000 in Fiscal 2011. The decrease was primarily due to the there was a non-recurrent gain on disposal of a property in Fiscal 2011 and no profit contribution from Blue Sky.

Fiscal Year Ended December 31, 2011 Compared to Fiscal Year Ended December 31, 2010

Revenue; Gross Profit and Cost of Revenue. Revenue decreased by approximately US\$ 2,092,000 or 9.4% to approximately US\$ 20,213,000 in Fiscal 2011 from approximately US\$ 22,305,000 in Fiscal 2010. The revenue from trading and manufacturing activities decreased by approximately US\$ 2,308,000 and the revenue from engineering activities increased slightly by US \$216,000. The decrease in revenue from trading and manufacturing activities was due primarily to most foreign suppliers want to market and sell their products directly or through many distributors in China instead of using the Company as their sole distributor as in the past. Pact-Yixing's revenues of approximately US\$ 5,098,000 and US\$ 8,334,000 were included in our revenues in Fiscal 2011 and Fiscal 2010, respectively.

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Gross profits decreased by approximately US\$ 850,000 or 14.8% to approximately US\$ 4,891,000 for Fiscal 2011 as compared to approximately US\$5,741,000 for Fiscal 2010. During Fiscal 2011, the Company's cost of revenue was approximately US\$ 15,322,000, or 75.8% of revenues, in comparison to approximately US\$ 16,564,000, or 74.3% for Fiscal 2010. Cost of revenue expressed as a percentage of revenue increased by 1.5% in Fiscal 2011 as compared with Fiscal 2010. The gross profit margin percentage decrease was due principally to drop in gross margin of engineering revenue. Yixing-Pact contributed approximately US\$ 1,712,000 to our gross profit margin in Fiscal 2011, a decrease of approximately US\$ 1,119,000 from Fiscal 2010.

**Selling and Administrative Expenses.** Selling and administrative expenses were approximately US\$ 6,565,000 in Fiscal 2011, a decrease of approximately US\$ 554,000 or 7.8% from approximately US\$ 7,119,000 in Fiscal 2010. The decrease was principally due to the reduction of expenses for trading and manufacturing activities as the Company continued to consolidate its trading business. Pact-Yixing's selling and administrative expenses increased by approximately US\$ 722,000 in Fiscal 2011 as compared to Fiscal 2010 as a result of additional expenses of approximately US\$ 301,000 for the liquidation of its Joint Venture and research and development expenses of approximately US\$ 193,000 for the Ballast Water Treatment System.

**Equity in Profit of Affiliates.** Equity in profit of affiliates of approximately US\$ 1,131,000 in Fiscal 2011, an increase of approximately US\$ 408,000 from approximately US\$ 723,000 in Fiscal 2010. The increase was primarily due to increase in our share of net profit after taxes of Blue Sky.

**Interest Income.** Interest income increased by approximately US\$18,000 or 42.8% to approximately US\$ 60,000 in Fiscal 2011 from approximately US\$ 42,000 for Fiscal 2010. The increase was primarily due to the rise in interest rates.

**Other Income.** Other income increased by approximately US\$ 73,000 or 811.1% to approximately US\$ 82,000 in Fiscal 2011 from approximately US\$ 9,000 in Fiscal 2010. The increase in other income were principally due to a foreign exchange gain of approximately US\$ 26,000 in Fiscal 2011 as compared to foreign exchange loss of approximately US\$ 17,000 in Fiscal 2010, and increase in rental income due to renting out of a property.

**Gain on Disposal of Fixed Assets.** Gain on disposal of fixed assets of approximately US\$ 328,000 in Fiscal 2011 was principally due to the sale of a property in Shanghai.

**Income Taxes.** Taxes decreased by US\$ 217,000 to approximately US\$ 63,000 tax credit in Fiscal 2011 from approximately US\$ 154,000 tax charge in Fiscal 2010. This decrease was primarily the result of net taxable losses for Fiscal 2011.

**Net Income.** Income from continuing operations increased by approximately US\$ 1,608,000 to a net income of approximately US\$ 521,000 in Fiscal 2011 from a net loss of approximately US\$ 1,087,000 in Fiscal 2010. The increase was primarily due to the decrease in selling and administrative expenses resulting from streamlining operations, gain on disposal of a property and increase in profit contribution for Blue Sky despite the decline in total revenues and gross margin percentage.

**ITEM LIQUIDITY AND CAPITAL RESOURCES**  
**5B.**

The Company has primarily used its funds to finance accounts receivable, inventories, and capital expenditures including purchases of property, office furniture and equipment, computers and calibration equipment. The Company has historically met its cash requirements from cash flows from operations, short-term borrowings, bank lines of credit, and long-term mortgage bank loans. The Company expects, but can make no assurances that its present cash

reserves, cash from operations, existing available bank credit facilities and proceeds from the issuance of our ordinary shares pursuant to stock option exercises would be sufficient to fund its future capital expenditure requirements. Working capital at the end of Fiscal 2012 and Fiscal 2011 were approximately US\$ 5,706,000 and US\$ 5,730,000, respectively.

During Fiscal 2012, the Company generated net cash of approximately US\$ 2,794,000 from its operating activities principally as a result of decrease in accounts receivables of approximately US\$ 655,000 and prepayments and other current assets of approximately US\$ 925,000, increase in accounts payable of approximately US\$ 838,000 and other payables of approximately US\$327,000 that was sufficient to cover the net loss of approximately US\$ 429,000. During Fiscal 2011, the Company used net cash of approximately US\$ 1,915,000 in its operating activities as a result of: a net income of US\$ 521,000 plus adjustments of non-cash items of approximately US\$1,826,000 (including depreciation, gain on disposal of assets, non-controlling interest, equity in profit of affiliates) and increases of approximately in prepayments and other current assets of US\$ 150,000, decrease in accounts payable of US\$ 271,000, decrease in other payables of US\$671,000 and changes in other items that failed to be offset by decrease in net inventory of US\$ 737,000.

During Fiscal 2012 and Fiscal 2011, the Company used approximately US\$ 632,000 and generated approximately US\$ 1,097,000 in investing activities, respectively. The Company used approximately US\$ 41,000 and US\$ 63,000 to purchase facilities and equipment in Fiscal 2012 and Fiscal 2011, respectively. During Fiscal 2012 and Fiscal 2011, the Company used approximately US\$ 593,000 and released approximately US\$563,000, respectively, as restricted cash to issue performance guarantees to its customers through its banks in projects requiring performance guarantees. During Fiscal 2011, the Company used approximately US\$ 238,000 to acquire additional 5% equity interest in Pact-Yixing and used approximately US\$ 435,000 to maintain its 20% equity interest in Blue Sky as a result of capital expansion resulting from the issuance of additional shares to employees of Blue Sky.



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During Fiscal 2012 and Fiscal 2011, the Company received dividends of approximately US\$ Nil and US\$ 779,000, respectively, from Blue Sky. The Company used approximately US\$ 33,000 and US\$ 94,000, respectively, in Fiscal 2012 and Fiscal 2011 for financing the purchase of its Ordinary Shares as treasury stock. The Company had various banking facilities available for overdraft, import and export credits and foreign exchange contracts from which the Company could have accessed up to approximately US\$ 1,538,000 at December 31, 2012. The aforementioned available credit facilities were obtained on the conditions that, among other things, the Company not create a charge or lien on its other assets in favor of third parties without such bank's consent, and the Company maintaining a certain level of net worth. We have entered into a new agreement with the bank in March 2012 for various banking facilities available for overdraft, import and export credits and foreign exchange contracts in the limits of approximately US\$ 897,000 and US\$ 641,000, respectively. These credit facilities were obtained on the conditions that, among other things, the Company pledge rented out property of approximately 1,200 square feet in Hong Kong as security, not create a charge or lien on its other assets in favor of third parties without such bank's consent, and the Company maintaining a certain level of net worth.

Cash increased from approximately US\$ 5,339,000 at the end of Fiscal 2011 to approximately US\$ 7,468,000 at the end of Fiscal 2012. The principal reasons for the increase in cash were improvement in working capital position despite the negative cash flows resulting from operating loss

The Company's net accounts receivable decreased from approximately US\$ 3,744,000 at the end of Fiscal 2011 to approximately US\$ 3,089,000 at the end of Fiscal 2012. The amount of receivables subject to collection is expected to be received under normal commercial trading terms.

The Company's inventory slightly increased from approximately US\$ 583,000 at the end of Fiscal 2011 to approximately US\$ 653,000 at the end of Fiscal 2012.

The Company's capital expenditures were approximately US\$ 41,000 and US\$ 63,000 in Fiscal 2012 and Fiscal 2011, respectively. Capital expenditures during Fiscal 2012 and Fiscal 2011 were incurred primarily in connection with the purchase of office equipment, furniture and fixtures. The Company continues to develop new products, for example, non-chemical ballast water treatment system. If such products developments are indeed made, the Company may expect to incur significantly larger capital expenditures, for which the Company presently intends, but as to which no assurance can be made, to use existing cash reserves, cash from operations, available bank credit facilities and proceeds from the issuance of our ordinary shares to fund such capital expenditures. In April 2011, the Company sold a building that had been used as representative office in Shanghai to an independent third party for approximately US\$ 489,000. This office was moved to the Company's Pudong location where the engineering and manufacturing operates as one of its streamlining actions.

#### Goodwill

Goodwill related to the engineering segment which is profitable. As of December 31, 2012, we completed the annual impairment test. Based on the result of the first step of the test, the Company determined that there was no impairment of goodwill.

#### Anticipated Future Resources and Uses of Cash

The Company has historically funded its working capital, capital expenditure, investing and expansions needs from operations, available bank credit facilities and proceeds from the issuances of our ordinary shares and expects to continue funding these requirements from operations and available bank credit facilities. The Company may use its funds to form strategic alliances with third parties, invest in product research and development, or expand its sales offices or, with third parties, seek to acquire new products or businesses or form strategic alliances. The Company

expects, but can make no assurances that its present cash reserves, cash from operations and existing available bank credit facilities would be sufficient to fund its future cash requirements.

#### Inflation

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

#### Critical Accounting Policies

##### Revenue Recognition

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

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Revenues and profits in long term fixed price contracts or engineering income are recognised using 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 primarily based on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated contract costs or losses, if any, are recognised in the period they are determined. Revenues recognised in excess of amounts billed are classified as costs and estimated earnings in excess of billings on uncompleted contracts. Essentially all of such amounts are expected to be billed and collected within one year and are classified as current assets. Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. When reasonably dependable estimates cannot be made, construction contract revenues are recognised using the completed contract method.

#### Inventory Valuation

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

#### Deferred Taxes

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

#### Recent Accounting Pronouncements

On May 12, 2011, the FASB issued ASU 2011-04. The ASU is the result of joint efforts by the FASB and the International Accounting Standards Board (“IASB”) to develop a single, converged fair value framework. Thus, there are few differences between the ASU and its international counterpart, IFRS 13. This ASU is largely consistent with existing fair value measurement principles in U.S. GAAP; however it expands ASC 820’s existing disclosure requirements for fair value measurements and makes other amendments. The ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material effect on the financial position, results of operations or cash flows of the Company.

On June 16, 2011, the FASB issued ASU 2011-05, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material effect on the financial position, results of operations or cash flows of the Company.

In December 2011, FASB issued Accounting Standards Update 2011-11, Balance Sheet - Disclosures about Offsetting Assets and Liabilities” to enhance disclosure requirements relating to the offsetting of assets and liabilities on an entity's balance sheet. The update requires enhanced disclosures regarding assets and liabilities that are presented net or gross in the statement of financial position when the right of offset exists, or that are subject to an enforceable master netting arrangement. The new disclosure requirements relating to this update are retrospective and effective for annual and interim periods beginning on or after January 1, 2013. The update only requires additional disclosures, as such, we do not expect that the adoption of this standard will have a material impact on our results of operations, cash flows or financial condition.

In July 2012, FASB issued Accounting Standards Update 2012-02, Balance Sheet- Intangibles- Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment is an Amendment to FASB Accounting Standards Update 2011-08. The objective of the amendments in this Update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance.

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In February 2013, FASB issued Accounting Standards Update 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force). This guidance requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This stipulates that (1) it will include the amount the entity agreed to pay for the arrangement between them and the other entities that are also obligated to the liability and (2) any additional amount the entity expects to pay on behalf of the other entities. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The amendments in this update are effective for fiscal periods (and interim reporting periods within those years) beginning after December 15, 2013. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

In February 2013, FASB issued Accounting standards update 2013-02, Comprehensive Income Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This update requires an entity to provide information amount the amount reclassified out of accumulated other comprehensive income by component. The entity is also required to disclose significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting periods. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other discourses required under U.S. GAAP that provide additional detail about those amounts. The objective in this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update should be applied prospectively for reporting periods beginning after December 15, 2012. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

Management does not believe that any other recently issued but not yet effective accounting pronouncements, if adopted, would have an effect on the accompanying financial statements.

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

ITEM RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES  
5C.

During Fiscal 2012, Fiscal 2011 and Fiscal 2010, the Company expensed approximately US\$ 930,000, US\$ 200,000 and US\$ 24,000, respectively, on the development of its products. It is anticipated that an additional US\$ 600,000 in research and development costs will be expended on similar projects and potential research and development projects for the development of air and water testing equipment and monitoring equipment during Fiscal 2013.

ITEM TREND INFORMATION.  
5D.

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

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

ITEM OFF BALANCE SHEET ARRANGEMENTS.

5E.

None.

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5F.

| Contractual Obligations            | Total        | Less than 1 Year | 1-3 Years   | 4-5 Years | After 5 Years |
|------------------------------------|--------------|------------------|-------------|-----------|---------------|
| Operating Leases                   | US\$ 262,000 | US\$ 232,000     | US\$ 30,000 | —         | —             |
| Total Contractual Cash Obligations | US\$ 262,000 | US\$ 232,000     | US\$ 30,000 | —         | —             |

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

ITEM 6A. DIRECTORS AND SENIOR MANAGEMENT  
6A.

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

| Name            | Age | Position   |
|-----------------|-----|--|
| T.C. Leung      | 69  | Chairman of the Board of Directors and Chief Executive Officer |
| Jerry Wong      | 54  | Director and Chief Financial Officer                           |
| Alex Sham       | 49  | Director   |
| Y.K. Liang      | 83  | Director   |
| Ka Chong Cheang | 84  | Director   |
| Li Da Weng      | 68  | Director   |

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

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

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

Kong.

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

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

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

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

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

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

The Company had 2 meetings of its Board of Directors during Fiscal 2012, while its Audit Committee had 4 meetings during Fiscal 2012.

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

#### Key Employees

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

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

David YL Leung is the General Manager of Yixing Pact Environmental Technology Ltd, Shanghai. His responsibility includes management of engineering, sales, marketing, projects, and procurement. Before joining PACT, he was the Business Development Manager of Euro Tech (Far East) Ltd, the parent company of Yixing Pact in Hong Kong, and has been working for the parent company for more than 10 years. Mr. Leung has gained a solid sales and marketing experience in distributing power, analytical and scientific testing equipment in Hong Kong and Macao. He has also worked for a high tech Japanese company focus on power and electrical testing instrument in Japan from 2000 and 2001 as a trainee. Mr. Leung is an environmental studies graduate from Carleton University, Ottawa, Canada (1997) with a special focus on Environmental Impact Assessment, and a Master of Management graduate from Macquarie Graduate School of Management, Sydney Australia (2010). Mr. David YL Leung is the son of Mr. T.C. Leung, the Company’s Chief Executive Officer and Chairman.

ITEM EXECUTIVE COMPENSATION.

6B.

From the Company and its subsidiaries, for services rendered in all capacities to the Company and its subsidiaries during Fiscal 2012, T.C. Leung the Chairman of the Board and Chief Executive Officer received a yearly salary of US\$ 154,000 and George Hayek, a Key Employee of the Company, received a yearly salary of US\$ 110,000. David YL Leung, a Key Employee of the Company receives an annual salary of US\$75,000 and is reimbursed for actual travel and lodging expenses in Shanghai. There is no other information with respect to the compensation paid by the Company and its subsidiaries, for services rendered in all capacities to the Company and its subsidiaries during Fiscal 2012 to the Chairman of the Board and Chief Executive Officer and a Key Employee of the Company. No other executive officer or employee received in excess of US\$ 100,000 as compensation during Fiscal 2012.

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

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

With the introduction of the Mandatory Provident Fund Scheme, a defined contribution scheme managed by an independent trustee on December 1, 2000, each of the Company and its employees who joined the Company subsequently makes monthly contributions to the scheme at 5% of the employee's cash income as defined under the Mandatory Provident Fund legislation. Contributions of both the Company and its employees are subject to a maximum of HK\$1,250 per month and thereafter contributions are voluntary and are not subject to any limitation. The Company and its employees made their first contributions in December 2000.

As stipulated by the rules and regulations in the PRC, the Company contributes to state-sponsored retirement plans for its employees in the PRC. The Company contributes approximately 12% 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 year ended December 31, 2012, the aggregate contributions of the Company to the aforementioned pension plans and retirement benefit schemes was approximately US\$ 364,000.

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

217,407, 53,454 and 152,727 shares had been originally authorized for issuance under the 2000 Stock Option Plan, Employees Plan and the Officers Plans, respectively.

No option was exercisable more than ten years from the date the option was granted.

During Fiscal 2012, the sole Officer and Director of the Company to hold options to purchase Ordinary Shares of the Company was T.C. Leung, who held 30,909 options with a per share exercise price of US\$ 3.22. Said options were granted pursuant to the 2002 Officers and Directors Plan and expired in November 2012.

As of December 31, 2012, 280,349 options had been exercised, including 54,600 options, 72,236 options and 37,418 options exercised by Mr. Leung at prices of US\$ 3.18, US\$ 3.22 and US\$ 4.51 per share, respectively.

The Company has set forth in this Report all required disclosure of additional compensation to its executive officers and directors including personal benefits and securities or properties paid or distributed which was not offered on the same terms to all full time employees during Fiscal 2012.

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

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|                                | As of December 31,<br>2012 |  | 2011                    |  | 2010                    |  |
|--------------------------------|----------------------------|--|-------------------------|--|-------------------------|--|
|                                | Number of<br>Options       | Weighted<br>average<br>exercise<br>price | Number<br>of<br>Options | Weighted<br>average<br>exercise<br>price | Number<br>of<br>Options | Weighted<br>average<br>exercise<br>price |
| Outstanding, beginning of year | 36,255                     | 3.36                                     | 46,182                  | 3.36                                     | 94,958                  | 4.68                                     |
| Granted                        | -                          | -  | —                       | —  | —                       | —  |
| Cancelled/Expired              | (36,255 )                  | (3.36 )                                  | (9,927 )                | (3.47 )                                  | (39,517 )               | (6.38 )                                  |
| Exercised                      | (- )                       | (- )                                     | (- )                    | (- )                                     | (9,259 )                | (3.52 )                                  |
| Outstanding, end of year       | -                          | -  | 36,255                  | 3.36                                     | 46,182                  | 3.36                                     |
| Exercisable, end of year       | -                          | -  | 36,255                  | 3.36                                     | 46,182                  | 3.36                                     |

As of December 31, 2012, no options were outstanding and exercisable.

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The total intrinsic value of share option exercised for the twelve months ended December 31, 2012, was approximately US\$ Nil. As of December 31, 2012, there was no unrecognized stock-based compensation expense related to unvested stock options.

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

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

ITEM BOARD PRACTICES

6C.

The term of each of the Company's directors expires at the election and qualification of their successors at the next annual meeting of the Company's shareholders, anticipated to be held in August of this year. Of the Company's seven directors, six were re-elected at the Company's last annual meeting of shareholders in August 2011. The Board has a standing Audit Committee to assist the Board in carrying out its duties. The Audit Committee has a written charter approved by the Board. The chair of the Audit Committee determines the meeting agenda of the Audit Committee. The Audit Committee members receive materials in advance of Committee meetings allowing them to prepare for the meeting.

During Fiscal 2012, the Audit Committee met 4 times, being attended by all members. The Audit Committee assists the Board in monitoring the Company's financial accounting, controls, planning and reporting. Among its duties, the Audit Committee:

- reviews the Company's auditing, accounting and financial reporting process;

- reviews the adequacy of the Company's internal controls;

- reviews the independence, fee arrangements, audit scope, and performance of the Company's independent auditors, and recommends the appointment or replacement of independent auditors to the Board of Directors;

- reviews and approves all non-audit work, if any, to be performed by the auditors;

- reviews the scope of our internal auditing and the adequacy of the organizational structure and qualifications of the internal auditing staff;

- reviews, before release, the audited financial statements and operating and financial review and prospects contained in the Company's Annual Report on Form 20-F, and recommends that the Board of Directors submit these items to the shareholders' meeting for approval;

- provides an open avenue of communication among the Company's independent auditors, financial and senior management, the internal audit function and the Board of Directors;

- reviews and updates the Company's Code of Business Conduct and Ethics and ensure that there is a system to enforce same and that this Code complies with all applicable rules and regulations;

ensures that the Company's management and auditors assess current financial reporting issues and practices; and reviews and pre-approves both audit and non-audit services to be provided by the Company's auditors.

The Audit Committee is currently composed of Y.K. Liang, Ka Chong Cheang and Li Da Weng. The Audit Committee's "financial expert" is Y.K. Liang. The Board has determined that the membership of the Audit Committee meets the current independence requirements of the NASDAQ listing standards as same applies to private foreign issuers and the applicable rules and regulations of the SEC because they are not currently employed by us, and do not fall into any of the enumerated categories of who cannot be considered independent in NASDAQ's listing standards.

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## ITEM EMPLOYEES.

6D.

At April 1, 2013, the Company (exclusive of Yixing-Pact) had approximately 86 full-time employees. At December 31, 2012, 2011 and 2010, staffing levels were approximately as follows:

|                           | 2012 | 2011 | 2010 |
|---------------------------|------|------|------|
| Marketing and sales       | 32   | 34   | 43   |
| Administrative            | 32   | 33   | 39   |
| Technical                 | 27   | 31   | 34   |
| Total full time employees | 91   | 98   | 116  |

At April 1, 2013 Pact and Yixing had approximately 52 full-time employees. At December 31, 2012, 2011 and 2010, respectively, staffing levels were approximately as follows: Engineers; 42, 38 and 50, Administrative Persons; 10, 15 and 22.

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

## ITEM SHARE OWNERSHIP

6E.

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

## ITEM MAJOR SHAREHOLDERS.

7A.

The following table sets forth, as of April 1, 2013, certain information concerning beneficial ownership of the Company's voting shares that date, with respect to (i) each person known to the Company to own 5% or more of the outstanding Ordinary Shares, (ii) each director and executive officer of the Company, and (iii) all officers and directors of the Company as a group:

|                       | Amount and<br>Nature of<br>Beneficial<br>Ownership(3) | Approximate<br>Percentage<br>Of Ordinary<br>Shares Owned |
|-----------------------|---|--|
| T.C. Leung (1)(2)     | 1,059,852   | 51.2%  |
| Pearl Venture Ltd.(1) | 247,068   | 11.9%  |
| Alex Sham(1)          | 53,722  | 2.6%   |
| Jerry Wong(1)         | 34,866  | 1.7%   |
| Y.K. Liang(1)         | *   | *  |
| Ka Chong Cheang(1)    | *   | *  |

|   |           |       |
|---|-----------|-------|
| Li Da Weng(1)   | *         | *     |
| All Executive Officers And Directors of the Company as a group (6 persons)(2) | 1,148,440 | 55.5% |

\* Denotes Nil

- (1) The address for the Company's officers and directors is c/o Euro Tech (Far East) Ltd., 18/F Gee Chang Hong Centre, 65 Wong Chuk Hang Road, Hong Kong. The address for Pearl Venture Ltd. ("Pearl") is Columbus Centre Building, Wichhams Cay, Road Town, Tortola, British Virgin Islands.
- (2) Includes shares of the Company's Common Stock owned of record by Pearl, which is a trust established for the benefit of Mr. Leung.

#### ITEM 7B. RELATED PARTY TRANSACTIONS.

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

See Item 6B. Compensation.



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ITEM FINANCIAL INFORMATION

8.

ITEM CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

8A.

Item See Item 18.  
8A.1

Item See Item 18.  
8A.2

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

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

Item Not applicable.  
8A.5

Item Not applicable.  
8A.6

Item Legal Proceedings. See “- Item 4B. Business Overview-Litigation.”  
8A.7

Item Dividend Policy.  
8A.8

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

ITEM SIGNIFICANT CHANGES

8B.

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

ITEM THE OFFERING AND LISTING

9.

ITEM LISTING DETAILS

9A.

The Company has one class of securities presently registered: Ordinary Shares. These securities are presently traded on the NASDAQ's Capital Market under the trading symbols "CLWT".

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

| Years Ended December 31, | Low<br>US\$ | High<br>US\$ |
|--------------------------|-------------|--------------|
| 2008                     | 3.63        | 17.33        |
| 2009                     | 2.20        | 23.21        |
| 2010                     | 5.49        | 14.74        |
| 2011                     | 2.15        | 9.13         |
| 2012                     | 1.98        | 6.30         |
| Quarters Ended           | Low<br>US\$ | High<br>US\$ |
| March 31, 2011           | 6.22        | 9.13         |
| June 30, 2011            | 4.29        | 8.25         |
| September 30, 2011       | 2.81        | 6.33         |
| December 31, 2011        | 2.15        | 3.52         |
| March 31, 2012           | 1.98        | 6.30         |
| June 30, 2012            | 3.62        | 5.17         |
| September 30, 2012       | 2.93        | 4.10         |
| December 31, 2012        | 2.75        | 5.42         |
| March 31, 2013           | 3.75        | 2.62         |

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| The Following Months | Low<br>US\$ | High<br>US\$ |
|----------------------|-------------|--------------|
| November 2012        | 2.75        | 3.85         |
| December 2012        | 3.52        | 3.99         |
| January 2013         | 2.68        | 3.75         |
| February 2013        | 2.62        | 3.44         |
| March 2013           | 2.64        | 3.36         |

As of April 17, 2013, approximately 891,394 ordinary shares, or 40.00% of our total outstanding ordinary shares, were held by 4 record shareholders in the United States, including approximately 39.96% held by Cede & Co., a large clearing house that holds shares in its name for banks, brokers and institutions in order to expedite the sale and transfer of stock. As of the date hereof, we do not have information on the total number of number of beneficial owners. We have requested such information and intend to include it in the proxy statement in connection with the upcoming annual stockholder meeting.

## ITEM MARKETS.

9C.

See Item 9A. "Listing Details."

## ITEM ADDITIONAL INFORMATION

10.

## ITEM SHARE CAPITAL

10A.

Authorized Capital. The authorized securities of the Company is comprised of 20,000,000 Ordinary Shares and 5,000,000 shares of Preferred Stock. All of the Company's shares of capital stock have no par value. In January 2012, the Company combined (reverse split) all of its issued Ordinary Shares at a ratio of two shares for each eleven shares issued. As of April 1, 2013, there were 2,069,223 Ordinary Shares issued and outstanding with 160,386 held by the Company as treasury shares.

Holders of the Company's Ordinary Shares are entitled to one vote for each whole share on all matters to be voted upon by shareholders, including the election of directors. Holders of Ordinary Shares do not have cumulative voting rights in the election of directors. All shares of Ordinary Shares are equal to each other with respect to liquidation and dividend rights. In the event of the liquidation of the Company, all assets available for distribution to the holders of Ordinary Shares are distributable among them according to their respective share holdings. All of the outstanding shares of Ordinary Shares of the Company are duly authorized, validly issued, fully paid and non-assessable.

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

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

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

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ITEM MEMORANDUM AND ARTICLES OF ASSOCIATION  
10B.

On January 1, 2005 the BVI Business Companies Act, ( as amended, the “BC ACT”) came into force, with the objective of replacing the now repealed International Business Companies Act ( the “IBC” Act ) over a 2 year transitional period. The Company was incorporated under the IBC Act, on January 1, 2007, the Company was automatically re-registered under the BC Act as a BVI Business Company. Companies that were automatically re-registered on January 1, 2007 were not required to submit a new Memorandum and Articles of Association and certain key sections of the IBC Act were “grandfathered” into the BC Act: these are known as the “Transitional Provisions”. The Transitional Provisions ensure that well established and recognized concepts from the IBC Act, such as “ authorized capital; “capital accounts” and “surplus accounts , remain relevant until such time as that company elects to adopt and register a New Memorandum and Articles of Association that fully conform with the BC Act. In November 2011 and January 2012, the Company filed an Amended and Restated Memorandum and Articles of Association with the Registry of Corporate Affairs of the BVI Financial Services Commission that on November 29, 2011 and January 30, 2012 that became as of filing with the BVI authorities to, among other things, (i) not apply the Transitional Provisions and (ii)remove these concepts from the Company’s charter documents eliminating a layer of requirements that would otherwise apply to share divisions (splits), combinations (reverse splits), redemptions and dividends. The Company’s accounting treatment of share capital need not change. Changes in the Company’s Amended and Restated Memorandum are summarized in the Company’s Forms 6-K filed with the SEC on November 30, 2011 and February 6,2012.The foregoing Forms 6-K are hereby incorporated by reference as if fully stated herein. Set forth below is a summary of certain terms of the Amended and Restated Memorandum and Articles of Association and the BC Act relating to the Company’s securities. This description and the descriptions contained in the Forms 6-K incorporated by reference does not purport to be complete and is qualified in its entirety by reference to BVI statutory law and the Amended and Restated Memorandum and Articles of Association.

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

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

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

A meeting of shareholders is duly constituted if, at the commencement of the meeting, there are present in person or by proxy not less than fifty (50%) percent of the votes of the shares or class series of shares entitled to vote on resolutions of shareholders to be considered at the meeting. If a quorum is not present, the meeting, if convened upon the requisition of shareholders, shall be dissolved; in any other case it shall stand adjourned to the next business day at the same time and place or to such other time and place as the directors may determine, and if at the adjourned meeting there are present in person or by proxy not less than one third of the votes of the shares or each class or series of shares entitled to vote on the resolutions to be considered by the meeting, those present shall constitute a quorum but otherwise the meeting shall be dissolved.

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

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

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

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

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

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

ITEM MATERIAL CONTRACTS  
10C.

During the two year period prior to the filing of this Report, the Company did not enter into any material contracts.

ITEM EXCHANGE CONTROLS  
10D.

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

ITEM TAXATION  
10E.

BVI

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

HONG KONG

The Company's subsidiaries organized in Hong Kong, Far East, Euro Tech (China) Limited and ChinaH2O.com Limited, provide for Hong Kong profits tax at a rate of 16.5% in 2012 on the basis of their income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for profits tax purposes.

PRC

On March 16, 2007, the PRC National People's Congress passed the Enterprise 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 24% and 25% for 2011 and 2012 and thereafter, respectively. In addition, foreign investment manufacturing enterprises which have not fully utilised 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 Company has applied the applicable rates in relation to deferred tax balances.

Euro Tech Trading (Shanghai) Limited (“ETTS”), a subsidiary of the Company, provides for PRC Enterprise Income Tax at a rate of 25% after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes. As of December 31, 2012, ETTS had an assessable loss carried forward of US\$ 287,675 as agreed by the local tax authority to offset its profit for the forth coming years. Such loss will expire in 5 years.

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, provides for the PRC Enterprise Income Tax of 25% after offsetting losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2012, SET had an assessable loss carried forward of US\$ 482,340 as agreed by the local tax authority to offset its profit for the forth coming years. Such loss will expire in 5 years.



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According to the relevant PRC tax rules and regulations, Shanghai Euro Tech Environmental Engineering Limited (“SETEE”) provides for the PRC Enterprise Income Tax of 25%, after offsetting losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2012, SETEE had an assessable loss carried forward of US\$ 1,418,936 as agreed by the local tax authority to offset its profit for the forth coming years. Such loss will expire in 5 years. Chongqing Euro Tech Rizhi Technology Co., Ltd, Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd and Guangzhou Euro Tech Environmental Equipment Co., Ltd provide for PRC Enterprise Income Tax at a rate of 25%, after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

According to the relevant PRC tax rules and regulations, Yixing Pact Environmental Technology Co., Ltd is registered in Shanghai as Foreign Owned Enterprise that are entitled to Enterprise Income Tax rate of 25%.

Variable Interest Entities (“VIEs”) of the Company 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.

Under the New Enterprise Income Tax Law and the implementation rules, profits of the PRC subsidiaries earned on or after January 1, 2008 and distributed by the PRC subsidiaries to foreign holding company are subject to a withholding tax at a rate of 10% unless reduced by tax treaty. Aggregate undistributed earnings of the Company’s subsidiaries located in the PRC that are available for distribution to the Company of approximately US\$ 1.9 million at December 31, 2012 are intended to be reinvested, and accordingly, no deferred taxation has been made for the PRC dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. Distributions made out of pre January 1, 2008 retained earnings will not be subject to the withholding tax.

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

|  | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|--|------------------|------------------|------------------|
| Computed tax using respective companies’ statutory tax rates | 31               | (263 )           | (203 )           |
| Change in valuation allowances                               | 166              | 33               | 158              |
| Under-provision for income tax in prior years                | -                | (10 )            | -                |
| Non deductible expenses                                      | (55 )            | 177              | 199              |
| Total provision for income tax at effective tax rate         | 142              | (63 )            | 154              |

PRC statutory reserves.

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 can also appropriate certain amount of their net income to the enterprise expansion fund.

(i) Statutory reserve fund

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 fund until such fund reaches 50% of their respective registered capital. The statutory reserve fund 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 fund be maintained at a minimum of 25% of the companies' registered capital.

Under the PRC laws and regulations, the Company's PRC subsidiaries are restricted in their ability to transfer certain of their net assets to the Company in the form of dividend payments, loans or advances. The amounts restricted include paid-in capital and statutory reserves, as determined pursuant to PRC generally accepted accounting principles, totaling US\$ 3,343,000 as at December 31, 2012.

(ii) Statutory staff welfare fund

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

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(iii) Enterprise expansion fund

The expansion fund shall only be used to make up losses, expand the PRC respective 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 fund be maintained at a minimum of 25% of the companies' registered capital.

#### UNITED STATES FEDERAL INCOME TAXATION

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

This discussion is general in nature and does not discuss all aspects of U.S. federal income taxation which may be important to particular investors in light of their individual circumstances, including investors subject to special U.S. taxation rules.

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

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

Passive foreign investment company rules. A passive foreign investment company ("PFIC") for any taxable year in which either (a) at least 75% of our gross income is passive income or (b) at least 50% of the value (determined on the basis of a quarterly average) of our assets is attributable to assets that produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person), annuities and gains from assets that produce passive income.

The annual PFIC determination to be made by a U.S. Holder of our ordinary shares is an inherently factual determination and there is limited guidance regarding the application of the PFIC rules to specific situations. Although the determination of PFIC status is subject to factual uncertainties because it depends upon the valuation of our ordinary shares as well as our goodwill and other assets and income. In addition, as the determination of PFIC status is made on an annual basis and depends on variables over which we have limited control, there can be no assurance that we will not be classified as a PFIC for 2012 or any future calendar years.

If we are determined to be a PFIC for any taxable year, a U. S. Holder could be treated as owning a proportionate share of some of our subsidiaries and, in the absence of certain elections, will subject to special rules that will have a penalizing effect on certain "excess distributions" (as defined).

A U. S Holder that holds our Ordinary Shares in any year in which we are classified as a PFIC may make a “deemed sale” election with respect to such ordinary shares in a subsequent taxable year in which we are not classified as a PFIC. If you make a valid deemed sale election with respect to your Ordinary Shares, you will be treated as having sold all of your Ordinary Shares for their fair market value on the last day of the last taxable year in which we were a PFIC and such Ordinary Shares will no longer be treated as PFIC stock. You will recognize gain (but not loss), which will be subject to tax as an “excess distribution” received on the last day of the last taxable year in which we were a PFIC. Your basis in the Ordinary Shares would be increased to reflect gain recognized, and your holding period would begin on the day after we ceased to be a PFIC.

Also, a U. S. Holder may be required to file certain forms with the U.S. Treasury Department.

A U.S. Holder will generally recognize capital gain or loss upon the sale or other disposition of our Ordinary Shares in an amount equal to the difference between the amount realized upon the disposition and the holder’s adjusted tax basis in such ordinary shares. Any capital gain or loss will be long-term if the Ordinary Shares have been held for more than one year and will generally be United States source gain or loss for United States foreign tax credit purposes.

Certain U.S. Holders are required to report information to the Internal Revenue Service relating to an interest in “specified foreign financial assets,” including shares issued by a non-United States corporation, for any year in which the aggregate value of all specified foreign financial assets exceeds \$50,000 (or a higher dollar amount prescribed by the Internal Revenue Service), subject to certain exceptions. These rules also impose penalties if a holder is required to submit such information to the Internal Revenue Service and fails to do so.

ITEM DOCUMENTS ON DISPLAY  
10H.

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

ITEM SUBSIDIARY INFORMATION  
10I.

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

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ITEM QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

11.

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

Foreign Currency Risks

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

Inflation

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

The Company is currently not exposed to material future earnings or cash flow exposures from changes in interest rates on debt obligations as the Company had no bank indebtedness in Fiscal 2012. The Company does not currently anticipate entering into interest rate swaps and/or similar instruments.

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## PART II

### ITEM MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITYHOLDERS

14.

In November 2011 and February 2012 the Company restated its Memorandum and Articles of Association. In, January of 2012, the Company combined or reverse split each eleven of its outstanding Ordinary Shares into two shares of its Ordinary Shares. The reason for the foregoing was to comply with NASDAQ's Market place Listing Maintenance Standards.

On September 20, 2011, the Company received a deficiency letter from NASDAQ that the Company was no longer in compliance with NASDAQ's listing maintenance rule for failing to have a bid price of at least US\$ 1.00 per share for the prior thirty trading days. In order to regain compliance, in January 2012, the Company effected a combination or reverse split of its Ordinary Shares.

To facilitate the combination, Company changed the par value of its Ordinary Shares from US\$ 0.01 per share to no par value.

Company had been originally incorporated under the International Business Companies Act (the "IBC" Act). On January 1, 2005 the BVI Business Companies Act, (as amended, the "BC Act") came into force, with the objective of replacing the IBC Act over a 2 year transitional period.

On January 1, 2007, the Company was automatically re-registered under the BC Act as a BVI Business Company. Companies that were so automatically re-registered were not required to submit new Memorandum and Articles of Association and certain key sections of the IBC Act were "grandfathered" into the BC Act. See Item 10B. Memorandum and Articles of Association. In December 2011 and January 2012, the Company filed Amended and Restated Memorandum and Articles of Association with the Registry of Corporate Affairs of the BVI Financial Services Commission to, among other things, (i) not apply the Transitional Provisions and (ii) remove these concepts from the Company's charter documents eliminating a layer of requirements that would otherwise apply to share divisions (splits), combinations (reverse splits), redemptions and dividends. The Company's accounting treatment of share capital need not change. Changes in the Company's Amended and Restated Memorandum are summarized in the Company's Forms 6-K filed with the SEC on November 30, 2011 and February 6, 2012. The foregoing Forms 6-K are hereby incorporated by reference as if fully stated herein. This description and the descriptions contained in the Forms 6-K incorporated by reference do not purport to be complete and are qualified in the entirety by reference to BVI statutory law and the Amended and Restated Memorandum and Articles of Association.

### ITEM CONTROLS AND PROCEDURES

15.

#### (a) Evaluation of Disclosure Controls and Procedures

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

Chief Executive Officer and Principal Financial Officer, allowing for timely decisions regarding required disclosures.

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

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of our consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Our Chief Executive Officer and Chief Financial Officer assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, they used the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2012, our internal control over financial reporting is effective based on those criteria. Notwithstanding the foregoing, all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems were determined to be effective they may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(c) Changes in Internal Controls

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

ITEM AUDIT COMMITTEE FINANCIAL EXPERT  
16A.

The Committee includes one non-employee director who meets the independence and "financial expert" requirements and two other members who meet the independence requirements of the NASDAQ listing standards and the rules and regulations of U.S. Securities and Exchange Commission. The Committee includes Messrs. Y.K. Liang, Ka Chong Cheang and Li Da Weng. Mr. Y.K. Liang is the "financial expert" on that committee. See Mr. Liang's biographical data in "Item 6A. Directors and Senior Management." contained in this Report.

ITEM CODE OF ETHICS  
16B.

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

ITEM PRINCIPAL ACCOUNTANT FEES AND SERVICES.  
16C.

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by Dominic K. F. Chan & Co. ("DKPC") who were are principal external auditors for 2012 and 2011 and BDO Limited who were our principal external auditors for 2010.

For the Year Ended December, 31



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|                       | 2012<br>US\$ | 2011<br>US\$ | 2010<br>US\$ |
|-----------------------|--------------|--------------|--------------|
| Audit fees(1)         | 110,000      | 106,000      | 178,700      |
| Audit-related fees(2) | Nil          | Nil          | Nil          |
| Tax fees(3)           | Nil          | 7,000        | 6,700        |
| All other fees        | Nil          | Nil          | Nil          |

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

- (1) “Audit fees” means the aggregate fees billed in each of the fiscal years listed for professional services rendered by our principal auditors for the audit of our annual financial statements.
- (2) “Audit-related fees” means the aggregate fees billed in each of the fiscal years listed for assurance and related services by our principal auditors that are reasonably related to the performance of the audit or review of our financial statements and are not reported under “Audit fees.” Services comprising the fees disclosed under the category of “Audit-related fees” involve principally the performance of certain agreed upon procedures for the years ended December 31, 2012, 2011 and 2010 respectively.
- (3) “Tax fees” means the aggregated fees billed in each of the years listed for professional services rendered by our principal auditors for tax compliance, tax advice and tax planning.

ITEM EXEMPTIONS FROM LISTING STANDARDS  
16D.

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

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

ITEM PURCHASES OF EQUITY SECURITIES BY ISSUER AND AFFILIATED PURCHASERS.  
16E.

During the period of time from November 2008 through March 2009, T.C. Leung, our Chief Executive Officer and principal shareholder, either directly or through an entity beneficially owned by him (Regent Earning Ltd “Regent”), purchased 1,418 shares in the open market from time to time at prices ranging from US\$ 2.86 to US\$ 5.72, at an average price per share of US\$ 4.29.

In November 2008, the Company adopted a program to repurchase up to 54,546 of its issued and outstanding Ordinary Shares by December 31, 2009. This gave the Company the ability to purchase the shares in the open market or through negotiated or block transactions from time to time based on market and business conditions. Under this program the Company the Company purchased 54,552 of its Ordinary Shares at prices ranging from US\$ 2.48 to US\$ 6.55 with an average price per share of US\$ 4.84.

In July 2009, the Company adopted another program to repurchase up to an additional 54,546 of its issued and outstanding Ordinary Shares by July 31, 2010. As of July 31, 2010, 11,843 of the Company’s Ordinary Shares had been purchased by the Company under this additional program at prices ranging from US\$ 4.73 to US\$ 9.52 with

an average price per share of US\$ 7.54.

In August 2010, the Company adopted another program to repurchase up to an additional 54,546 of its issued and outstanding ordinary shares by August 2, 2011 that was thereafter extended until August 2, 2012. As of March 31, 2012, 32,056 of the Company's Ordinary Shares have been purchased by the Company under this additional program at prices ranging from US\$ 2.20 to US\$ 8.80 with an average price per share of US\$ 5.49 as more particularly described below:

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## August 2010 Buy Back Program

| Period                                  | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|--------------------------------------|----------------------------------|--|--|
| August 1, 2010 to August 31, 2010       | 655                                  | US\$8.36                         | 655  | 53,891   |
| September 1, 2010 to September 30, 2010 | 263                                  | US\$8.20                         | 918  | 53,628   |
| October 1, 2010 to October 31, 2010     | 2,600                                | US\$7.87                         | 3,518  | 51,028   |
| November 1, 2010 to November 30, 2010   | 691                                  | US\$7.76                         | 4,209  | 50,337   |
| December 1, 2010 to December 31, 2010   | 2,273                                | US\$6.88                         | 6,482  | 48,064   |
| January 1, 2011 to January 31, 2011     | 1,036                                | US\$6.82                         | 7,518  | 47,028   |
| February 1, 2011 to February 28, 2011   | 200                                  | US\$7.59                         | 7,718  | 46,828   |
| March 1, 2011 to March 31, 2011         | 364                                  | US\$7.87                         | 8,082  | 46,464   |
| April 1, 2011 to April 30, 2011         | 109                                  | US\$7.70                         | 8,191  | 46,355   |
| May 1, 2011 to May 31, 2011             | 1,818                                | US\$6.82                         | 10,009   | 44,537   |
| June 1, 2011 to June 30, 2011           | 3,013                                | US\$5.37                         | 13,022   | 41,524   |
| July 1, 2011 to July 31, 2011           | 4,186                                | US\$6.07                         | 17,208   | 37,338   |
| August 1, 2011 to August 31, 2011       | 731                                  | US\$6.14                         | 17,939   | 36,607   |

|  |       |          |        |        |
|--|-------|----------|--------|--------|
| September 1, 2011 to<br>September 30, 2011 | 2,987 | US\$4.87 | 20,926 | 33,620 |
| October 1, 2011 to<br>October 31, 2011     | 146   | US\$3.99 | 21,072 | 33,474 |
| November 1, 2011 to<br>November 30, 2011   | 818   | US\$3.67 | 21,890 | 32,656 |
| December 1, 2011 to<br>December 31, 2011   | 1,527 | US\$3.80 | 23,417 | 31,129 |
| January 1, 2012 to<br>January 31, 2012     | 2,686 | US\$3.65 | 26,103 | 28,443 |
| February 1, 2012 to<br>February 29, 2012   | 2,900 | US\$4.27 | 29,003 | 25,543 |
| March 1, 2012 to<br>March 31, 2012         | 3,053 | US\$3.27 | 32,056 | 22,490 |

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PART III

ITEM FINANCIAL STATEMENTS

18.

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

Euro Tech Holdings Company Limited

Report of Independent Registered Public Accounting Firm

Consolidated balance sheets

Consolidated statements of income

Consolidated statements of cash flows and changes in shareholders' equity

Zhejiang Tianlan Environmental Protection Technology Company Limited

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheet

Consolidated Statements of Income,

Cash flows and changes in Shareholders' equity

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## ITEM EXHIBITS

19.

## Lists of Exhibits

Exhibit No. Description

|            |   |
|------------|---|
| 3.1        | Amended and Restated Memorandum and Articles of Association (1)   |
| 3.2        | Amendments to Exhibit 3.1 ( 2)  |
| 4.11       | Registrant's Audit Committee Charter (3)  |
| 8.1        | List of Subsidiaries *  |
| 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 * |
| 101 .INS*# | XBRL Instance Document  |
| 101 .SCH*# | XBRL Taxonomy Extension Schema Document   |
| 101 .CAL*# | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101 .DBF*# | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101 .LAB*# | XBRL Taxonomy Extension Label Linkbase Document   |
| 101 .PRE # | X BRL Taxonomy Extension Presentation Linkbase Document   |

\* Filed with this Annual Report on Form 20-F.

# XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of The Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

1. Incorporated by reference, previously filed as an Exhibit to Registrant's Form 6-K on November 30, 2011.

2. Incorporated by reference, previously filed as an Exhibit to Registrant's Form 6-K on February 6, 2012.
3. Incorporated by reference, previously filed as an Exhibit to Registrant's Form 20-F filed on August 19, 2002



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SIGNATURES

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

EURO TECH HOLDINGS COMPANY LIMITED  
(REGISTRANT)

April 24, 2013

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

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EURO TECH HOLDINGS COMPANY LIMITED

AUDITED CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2012 AND 2011 AND

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME/(LOSS),

CONSOLIDATED STATEMENTS OF CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

TOGETHER WITH REPORT OF INDEPENDENT REGISTERED

PUBLIC ACCOUNTING FIRM

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Report of Independent Registered Public Accounting Firm

To the Directors and Stockholders of  
Euro Tech Holdings Company Limited

We have audited the accompanying consolidated balance sheet of Euro Tech Holdings Company Limited (the “Company”) and its subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive (loss)/income, changes in shareholders’ equity and cash flows for the year ended December 31, 2012 and 2011. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the 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 consolidated 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. An audit includes 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. 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2011 and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Dominic. K.F. Chan & Co.

Dominic. K.F. Chan & Co.,  
Certified Public Accountants  
Hong Kong, China  
April 22, 2013

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Euro Tech Holdings Company Limited

We have audited the accompanying consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the year ended December 31, 2010 of Euro Tech Holdings Company Limited ("the Company"). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the 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. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's Internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of its operations and its cash flows for the year ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Limited

BDO Limited

Hong Kong, June 28, 2011, except for Note 12 as to which the date is April 27, 2012.

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## EURO TECH HOLDINGS COMPANY LIMITED

CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2012 AND 2011

|   | Note        | 2012<br>US\$'000 | 2011<br>US\$'000 |
|---|-------------|------------------|------------------|
| Assets  |             |                  |                  |
| Current assets:   |             |                  |                  |
| Cash and cash equivalents   |             | 7,468            | 5,339            |
| Restricted cash   |             | 839              | 246              |
| Accounts receivable, net  | 6           | 3,089            | 3,744            |
| Prepayments and other current assets  | 7           | 848              | 1,773            |
| Inventories   | 8           | 653              | 583              |
| Total current assets  |             | 12,897           | 11,685           |
| Property, plant and equipment, net  | 9 & 22(iii) | 945              | 1,058            |
| Interests in affiliates   | 10          | 9,772            | 9,763            |
| Goodwill  | 13          | 1,071            | 1,071            |
| Deferred tax assets   | 4           | 262              | 287              |
| Total assets  |             | 24,947           | 23,864           |
| Liabilities and shareholders' equity  |             |                  |                  |
| Current liabilities:  |             |                  |                  |
| Accounts payable  |             | 3,713            | 2,875            |
| Other payables and accrued expenses   | 11          | 2,985            | 2,658            |
| Taxation payable  |             | 493              | 422              |
| Total current liabilities   |             | 7,191            | 5,955            |
| Commitments and contingencies   | 20          | -                | -                |
| Shareholders' equity:   |             |                  |                  |
| Ordinary share, 20,000,000 (2011: 20,000,000) shares authorised;<br>2,229,609 (2011: 2,229,628) shares issued | 12          | 123              | 123              |
| Additional paid-in capital  |             | 9,533            | 9,533            |
| Treasury stock, 160,386 (2011: 151,747) shares at cost  | 14          | (766 )           | (733 )           |
| PRC statutory reserves  | 15          | 311              | 274              |
| Accumulated other comprehensive income  |             | 731              | 731              |
| Retained earnings   |             | 5,905            | 6,371            |
| Equity attributable to shareholders of Euro Tech  |             | 15,837           | 16,299           |
| Non-controlling interest  |             | 1,919            | 1,610            |
| Total shareholders' equity  |             | 17,756           | 17,909           |

|  |        |        |
|--|--------|--------|
| Total liabilities and shareholders' equity | 24,947 | 23,864 |
|--|--------|--------|

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

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## EURO TECH HOLDINGS COMPANY LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS)/INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | Note            | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|---|-----------------|------------------|------------------|------------------|
| Revenues  |                 |                  |                  |                  |
| Trading and manufacturing   |                 | 10,866           | 11,437           | 13,745           |
| Engineering   |                 | 10,779           | 8,776            | 8,560            |
| Total revenues  | 22(i) &<br>(ii) | 21,645           | 20,213           | 22,305           |
| Cost of revenues  |                 |                  |                  |                  |
| Trading and manufacturing   |                 | (8,230 )         | (8,810 )         | (10,861 )        |
| Engineering   |                 | (7,250 )         | (6,512 )         | (5,703 )         |
| Total cost of revenues  |                 | (15,480 )        | (15,322 )        | (16,564 )        |
| Gross profit  |                 | 6,165            | 4,891            | 5,741            |
| Selling and administrative expenses                                     |                 | (6,224 )         | (6,565 )         | (7,119 )         |
| Operating loss  |                 | (59 )            | (1,674 )         | (1,378 )         |
| Interest income   |                 | 46               | 60               | 42               |
| Other income, net   | 3               | 48               | 82               | 9                |
| (Loss)/gain on disposal of fixed assets                                 |                 | (22 )            | 328              | 1                |
| Profit/(loss) before income taxes and equity in profit<br>of affiliates |                 | 13               | (1,204 )         | (1,326 )         |
| Income (taxes)/benefit  | 4               | (142 )           | 63               | (154 )           |
| Equity in profit of affiliates  |                 | 9                | 1,131            | 723              |
| Net (loss) for the year   |                 | (120 )           | (10 )            | (757 )           |
| Less: net (income)/loss attributable to<br>non-controlling interest     |                 | (309 )           | 531              | (330 )           |
| Net (loss)/income attributable to the Company                           |                 | (429 )           | 521              | (1,087 )         |
| Other comprehensive loss  |                 |                  |                  |                  |
| Net loss  |                 | (120 )           | (10 )            | (757 )           |
| Foreign exchange translation adjustments                                |                 | -                | 215              | 177              |
| Comprehensive (loss)/income   |                 | (120 )           | 205              | (580 )           |
|   |                 | (309 )           | 442              | (397 )           |

Less: Comprehensive (income)/loss attributable to  
non-controlling interest

|  |        |     |        |
|--|--------|-----|--------|
| Comprehensive (loss)/income attributable to the<br>Company | (429 ) | 647 | (977 ) |
|--|--------|-----|--------|

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

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## EURO TECH HOLDINGS COMPANY LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE  
(LOSS)/INCOME (CONTINUED)

FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | Note | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|---|------|------------------|------------------|------------------|
| Net (loss)/income per ordinary share                      |      |                  |                  |                  |
| - Basic   |      | \$ US(0.21 )     | \$ US0.25        | \$ US(0.52 )     |
| - Diluted   |      | \$ US(0.21 )     | \$ US0.25        | \$ US(0.51 )     |
| Weighted average number of ordinary shares<br>outstanding |      |                  |                  |                  |
| - Basic   | 5    | 2,070,685        | 2,087,922        | 2,099,894 *      |
| - Diluted   | 5    | 2,076,315        | 2,102,199        | 2,143,375 *      |

\*In connection with a 2 for 11 subsequent reverse stock split on January 13, 2012, the common stock and the computation of Basic and Diluted EPS are adjusted retroactively to reflect the recapitalization change.

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

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## EURO TECH HOLDINGS COMPANY LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|---|------------------|------------------|------------------|
| Cash flows from operating activities:   |                  |                  |                  |
| Net (loss)/income   | (429 )           | 521              | (1,087 )         |
| Adjustments to reconcile net income to net cash provided by/(used in) operating activities: |                  |                  |                  |
| Depreciation of property, plant and equipment   | 130              | 182              | 170              |
| Loss/(gain) on disposal of property, plant and equipment                                    | 22               | (328 )           | (1 )             |
| Non-controlling interest in profits/(loss) of subsidiaries                                  | 309              | (531 )           | 330              |
| Equity in profit of affiliates  | (9 )             | (1,131 )         | (723 )           |
| Deferred tax assets   | 25               | (18 )            | (79 )            |
| Decrease/(increase) in current assets:  |                  |                  |                  |
| Accounts receivable, net  | 655              | (70 )            | 2,389            |
| Prepayments and other current assets  | 925              | (150 )           | (923 )           |
| Inventories   | (70 )            | 737              | (54 )            |
| Increase/(decrease) in current liabilities:   |                  |                  |                  |
| Accounts payable  | 838              | (271 )           | (738 )           |
| Other payables and accrued expenses   | 327              | (671 )           | 418              |
| Taxation payable  | 71               | (185 )           | 14               |
| Net cash provided by /(used in) operating activities  | 2,794            | (1,915 )         | (284 )           |
| Cash flows from investing activities:   |                  |                  |                  |
| Purchase of property, plant and equipment   | (41 )            | (63 )            | (112 )           |
| Proceeds on disposal of property, plant and equipment                                       | 2                | 491              | 9                |
| Purchase of non-controlling interest of subsidiaries  | -                | (238 )           | (73 )            |
| Dividend received from affiliates   | -                | 779              | 76               |
| Investments in affiliates   | -                | (435 )           | (262 )           |
| Restricted cash for issuance of bank guarantees   | (593 )           | 563              | (348 )           |
| Dividend paid to non-controlling interest   | -                | -                | -                |
| Net cash (used in)/provided by investing activities   | (632 )           | 1,097            | (710 )           |
| Cash flows from financing activities:   |                  |                  |                  |
| Issuance of ordinary shares on exercise of options  | -                | -                | 33               |
| Purchase of treasury stock  | (33 )            | (94 )            | (105 )           |
| Net cash used in financing activities   | (33 )            | (94 )            | (72 )            |
| Effect of exchange rate changes on cash and cash equivalents                                | -                | 121              | 171              |
| Net increase/(decrease) in cash and cash equivalents  | 2,129            | (791 )           | (895 )           |
| Cash and cash equivalents, beginning of year  | 5,339            | 6,130            | 7,025            |

|  |          |          |          |
|--|----------|----------|----------|
| Cash and cash equivalents, end of year | 7,468    | 5,339    | 6,130    |
| Supplementary information              | US\$'000 | US\$'000 | US\$'000 |
| Interest received                      | 46       | 60       | 42       |
| Income taxes paid                      | 8        | 176      | 219      |

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

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## EURO TECH HOLDINGS COMPANY LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|  | Number of<br>ordinary<br>share | Ordinary<br>share<br>US\$'000 | Additional<br>paid-in<br>capital<br>US\$'000 | Treasury<br>stock<br>US\$'000 | Accumulated<br>other<br>com-<br>prehen-<br>sive<br>income<br>US\$'000 | PRC<br>statutory<br>reserves<br>US\$'000 | Retained<br>earnings<br>US\$'000 | Non-controlling<br>interest<br>US\$'000 | Total<br>US\$'000 |
|--|--------------------------------|-------------------------------|--|-------------------------------|---|--|----------------------------------|---|-------------------|
| Balance as of<br>January 1, 2010   | 2,220,369                      | 122                           | 9,501  | (534 )                        | 487   | 222                                      | 6,989                            | 2,145                                   | 18,932            |
| Net loss   | -                              | -                             | -  | -                             | -   | -  | (1,087)                          | 330                                     | (757 )            |
| Other<br>comprehensive<br>income: Foreign<br>exchange<br>translation<br>adjustment | -                              | -                             | -  | -                             | 110   | -  | -                                | 67                                      | 177               |
| Purchase of<br>treasury stock  | -                              | -                             | -  | (105 )                        | -   | -  | -                                | -                                       | (105 )            |
| Exercise of stock<br>options   | 9,259                          | 1                             | 32   | -                             | -   | -  | -                                | -                                       | 33                |
| Appropriation of<br>reserves   | -                              | -                             | -  | -                             | -   | 53                                       | (53 )                            | -                                       | -                 |
| Dividend<br>paid/payable to<br>non-controlling<br>interest                         | -                              | -                             | -  | -                             | -   | -  | -                                | (106 )                                  | (106 )            |
| Purchase of<br>non-controlling<br>interest   | -                              | -                             | -  | -                             | 8   | -  | -                                | (81 )                                   | (73 )             |
| Balance as of<br>December 31,<br>2010  | 2,229,628                      | 123                           | 9,533  | (639 )                        | 605   | 275                                      | 5,849                            | 2,355                                   | 18,101            |
| Net loss   | -                              | -                             | -  | -                             | -   | -  | 521                              | (531 )                                  | (10 )             |
| Other<br>comprehensive<br>income: Foreign<br>exchange<br>translation<br>adjustment | -                              | -                             | -  | -                             | 126   | -  | -                                | 89                                      | 215               |
| Purchase of<br>treasury stock  | -                              | -                             | -  | (94 )                         | -   | -  | -                                | -                                       | (94 )             |
| Appropriation of<br>reserves   | -                              | -                             | -  | -                             | -   | (1 )                                     | 1                                | -                                       | -                 |

|   |           |     |       |        |     |     |        |        |        |
|---|-----------|-----|-------|--------|-----|-----|--------|--------|--------|
| Dividend paid/payable to non-controlling interest | -         | -   | -     | -      | -   | -   | -      | (76 )  | (76 )  |
| Purchase of non-controlling interest              | -         | -   | -     | -      | -   | -   | -      | (227 ) | (227 ) |
| Balance as of December 31, 2011                   | 2,229,628 | 123 | 9,533 | (733 ) | 731 | 274 | 6,371  | 1,610  | 17,909 |
| Net loss  | -         | -   | -     | -      | -   | -   | (429 ) | 309    | (120 ) |
| Purchase of treasury stock                        | -         | -   | -     | (33 )  | -   | -   | -      | -      | (33 )  |
| Appropriation of reserves                         | -         | -   | -     | -      | -   | 37  | (37 )  | -      | -      |
| Cancellation of fractional shares                 | (19 )     | -   | -     | -      | -   | -   | -      | -      | -      |
| Balance as of December 31, 2012                   | 2,229,609 | 123 | 9,533 | (766 ) | 731 | 311 | 5,905  | 1,919  | 17,756 |

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

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1 Organisation 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 summarised 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   |
| 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,   |

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1 Organisation and principal activities (Continued)

| Name   | Percentage of equity ownership | Place of incorporation     | Principal activities  |
|--|--------------------------------|----------------------------|---|
| Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd  | 100%                           | The PRC                    | Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems |
| Guangzhou Euro Tech Environmental Equipment Co., Ltd   | 100%                           | The PRC                    | Marketing and trading of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems |
| Yixing Pact Environmental Technology Co., Ltd  | 58%*                           | The PRC                    | Design, manufacture and operation of water and waste water treatment machinery and equipment  |
| Pact Asia Pacific Limited **   | 58%*                           | 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 Environmental Protection Technology Co. Ltd. (Formerly known as Zhejiang Tianlan Desulfurization and Dust-Removal Co. Ltd.) | 20%                            | The PRC                    | Design, general contract, equipment manufacturing, installation, testing and operation management of the treatment of waste gases emitted                                   |
| Zhejaing Jia Huan Electronic Co. Ltd.  | 20%                            | The PRC                    | Design and manufacturing automatic control systems and electric voltage control equipment for electrostatic precipitators (air purification equipment)                      |

\*In the year 2011, the Company additionally acquired 5% equity interest of these two companies.

\*\*The subsidiary of Pact Asia Pacific Limited, Pact Environmental Equipment Co., Ltd was deregistered on January 11, 2013.

\*\*\*The subsidiary was deregistered on February 17, 2012.





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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Euro Tech Holdings Company Limited and its subsidiaries (the “Group”). The financial statements of variable interest entities (“VIEs”), as defined by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Subtopic 810-10, Consolidation (previously FASB Interpretation No. 46 (R), “Consolidation of Variable Interest Entities”), are included in the consolidated financial statements, if applicable. All material intercompany balances and transactions have been eliminated on consolidation.

The Group identified that certain retail shops established in the PRC qualified as variable interest entities as defined in ASC 810-10. The retail shops are principally engaged in the retailing business of water and waste water related process control, analytical and testing instruments, disinfection equipment, supplies and related automation systems. The Company is the primary beneficiary of these retail shops and, accordingly, consolidated their financial statements. 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\$14,204 and US\$3,581, as of December 31, 2012 and US\$15,564 and US\$3,504, as of December 31, 2011, respectively. The cumulative losses on consolidating these VIEs in the Group’s consolidated statement of income in 2012 were US\$275,232 (2011: losses of US\$244,024 and 2010: losses of US\$112,637), including taxes of US\$1,262 (2011: US\$2,222 and 2010: US\$3,826). 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 VIEs do not have a recourse to the general credit of the Group. The Group will provide for all necessary financing for the VIEs.

(b) Subsidiaries and affiliates

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.

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.

(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 recognises revenue when the product is delivered and the title is transferred. For certain products where installation is necessary, revenue is recognised upon completion of installation. Revenue earned from customer support services, which represents a minor percentage of total revenues, is recognised 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 engineering income are recognised using 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 primarily based on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated contract costs or losses, if any, are recognised in the period they are determined. Revenues recognised in excess of amounts billed are classified as costs and estimated earnings in excess of billings on uncompleted contracts. Essentially all of such amounts are expected to be billed and collected within one year and are classified as current assets. Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. When reasonably dependable estimates cannot be made, construction contract revenues are recognised using the completed contract method.

(d) Research and Development Costs

Research and development costs (“R&D” costs) are expensed as incurred. The R&D costs amounted to approximately US\$930,000, US\$200,000 and US\$24,000 for the years ended December 31, 2012, 2011 and 2010 respectively and were included in “Selling and Administrative” expenses in the Group’s consolidated statements of income.

(e) Advertising and promotional expenses

Advertising and promotional expenses (“A&P” expenses) are expensed as incurred. The A&P expenses amounted to approximately US\$21,000, US\$61,000 and US\$63,000 for the years December 31, 2012, 2011 and 2010 respectively and were included in “Selling and Administrative” expenses in the Group’s consolidated statements 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 recognised for all temporary differences between the applicable tax balance sheets and the consolidated balance sheet. Deferred tax assets and liabilities are recognised for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. ASC 740-10 also requires the recognition of the future tax benefits of net operating loss carry forwards. A valuation allowance is established when the deferred tax assets are not expected to be realised within a reasonable period of time.

In accordance with ASC 740-10, the Company recognises 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 2012, 2011 and 2010.

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 recognised in income for the period that includes the enactment date.

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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) Restricted Cash

Restricted cash represents cash deposits retained with banks in the PRC for issuance of performance guarantees to the customers. The amount is expected to be released within one year after the balance sheet date.

## (i) 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.

## (j) 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. Allowance is made for obsolete, slow moving or defective items, where appropriate.

## (k) 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 capitalised. 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  |

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies (Continued)

(l) Impairment

The Group has adopted FASB ASC Subtopic 360-10, Property, Plant, and Equipment, (previously SFAS No. 144: “Accounting for Impairment or Disposal of Long-Lived Assets”) which requires impairment losses to be recorded for property, plant and equipment to be held and used in operations when indicators of impairment are present. Reviews are regularly performed to determine whether the carrying value of assets is impaired. The Group determines the existence of such impairment by measuring the expected future cash flows (undiscounted and without interest charges) and comparing such amount to the carrying amount of the assets. An impairment loss, if one exists, is then measured as the amount by which the carrying amount of the asset exceeds the discounted estimated future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value of such assets less costs to sell. Asset impairment charges are recorded to reduce the carrying amount of the long-lived asset that will be sold or disposed of to their estimated fair values. Charges for the asset impairment reduce the carrying amount of the long-lived assets to their estimated salvage value in connection with the decision to dispose of such assets. There were no impairment losses recorded during each of the three years ended December 31, 2012.

(m) 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.

(n) Goodwill

The Group has adopted FASB ASC Subtopic 350-10, Intangibles – Goodwill and Other (previously SFAS No.142: “Goodwill and other intangible assets”) which requires the performance of an impairment test on an annual basis.

(o) 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 recognised in the consolidated statements of income during the year in which they occur. Translation adjustments on subsidiaries’ equity are included as accumulated comprehensive income or loss.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies (Continued)

(p) Derivative Instruments and Hedging Activities

FASB ASC Subtopic 815-10, Derivatives and Hedging, (previously SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”), as amended by SFAS No. 137, “Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133 – an amendment of FASB Statement No. 133”, and SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities – an amendment of FASB Statement No. 133”, as well as the interpretations of the Derivatives Implementation Group (“DIG”), are applied as amended by SFAS No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities”). ASC 815-10 contains accounting and reporting standards for hedging accounting and for derivative financial instruments, including certain derivative financial instruments embedded in other contracts.

ASC 815-10 requires that all derivatives be recognised 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 recognised 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 18 for additional information regarding the Company’s use of derivative instruments.

(q) 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 recognised. The Group has presented comprehensive income, which encompasses net income and foreign currency translation adjustments, in the consolidated statement of changes in shareholders’ equity.

(r) Ordinary Share

On November 22, 2011, the Company filed Amended and Restated Memorandum and Articles of Association with the Registry of Corporate Affairs of the BVI Financial Services Commission that on November 29, 2011 became effective as of the filing date to amend the Company’s ordinary shares of US\$0.01 par value capital stock to no par value capital stock. 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.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies (Continued)

(s) Net income per Ordinary Share

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

Outstanding stock options are the only dilutive potential shares of the Company.

(t) Stock-based Compensation

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

(u) 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.

(v) 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.



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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies (Continued)

(w) Segment Information

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

(x) Recent Accounting Pronouncements

On May 12, 2011, the FASB issued ASU 2011-04. The ASU is the result of joint efforts by the FASB and the International Accounting Standards Board ("IASB") to develop a single, converged fair value framework. Thus, there are few differences between the ASU and its international counterpart, IFRS 13. This ASU is largely consistent with existing fair value measurement principles in U.S. GAAP; however it expands ASC 820's existing disclosure requirements for fair value measurements and makes other amendments. The ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material effect on the financial position, results of operations or cash flows of the Company.

On June 16, 2011, the FASB issued ASU 2011-05, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material effect on the financial position, results of operations or cash flows of the Company. .

In December 2011, FASB issued Accounting Standards Update 2011-11, Balance Sheet - Disclosures about Offsetting Assets and Liabilities" to enhance disclosure requirements relating to the offsetting of assets and liabilities on an entity's balance sheet. The update requires enhanced disclosures regarding assets and liabilities that are presented net or gross in the statement of financial position when the right of offset exists, or that are subject to an enforceable master netting arrangement. The new disclosure requirements relating to this update are retrospective and effective for annual and interim periods beginning on or after January 1, 2013. The update only requires additional disclosures, as such, we do not expect that the adoption of this standard will have a material impact on our results of operations, cash flows or financial condition.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies (Continued)

(x) Recent Accounting Pronouncements (continued)

In July 2012, FASB issued Accounting Standards Update 2012-02, Balance Sheet- Intangibles- Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment is an Amendment to FASB Accounting Standards Update 2011-08. The objective of the amendments in this Update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance.

In February 2013, FASB issued Accounting Standards Update 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force). This guidance requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This stipulates that (1) it will include the amount the entity agreed to pay for the arrangement between them and the other entities that are also obligated to the liability and (2) any additional amount the entity expects to pay on behalf of the other entities. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The amendments in this update are effective for fiscal periods (and interim reporting periods within those years) beginning after December 15, 2013. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

In February 2013, FASB issued Accounting standards update 2013-02, Comprehensive Income Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This update requires an entity to provide information amount the amount reclassified out of accumulated other comprehensive income by component. The entity is also required to disclose significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting periods. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other discourses required under U.S. GAAP that provide additional detail about those amounts. The objective in this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update should be applied prospectively for reporting periods beginning after December 15, 2012. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

Management does not believe that any other recently issued but not yet effective accounting pronouncements, if adopted, would have an effect on the accompanying financial statements.

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 Other income, net

|                           | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|---------------------------|------------------|------------------|------------------|
| Exchange (loss)/gain, net | (17 )            | 26               | (17 )            |
| Rental income             | 65               | 56               | 26               |
|                           | 48               | 82               | 9                |

## 4 Income taxes

The Company is exempt from taxation in the British Virgin Islands (“BVI”).

On March 16, 2007, the PRC National People’s Congress passed the Enterprise 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 utilised 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 applicable rates in relation to deferred tax balances.

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 2012 (2011 and 2010: 16.5%) 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 (“ETTS”), a subsidiary of the Company, provides for PRC Enterprise Income Tax at a rate of 25% (2011: 24%, 2010: 22%), 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, 2012, ETTS had an assessable loss carried forward of US\$287,675 as agreed by the local tax authority to offset its profit for the forth coming years (2011: US\$169,369). Such loss will expire in 5 years.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4 Income taxes (Continued)

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, 2012, SET had an assessable loss carried forward of US\$482,340 as agreed by the local tax authority to offset its profit for the forth coming years (2011: US\$387,543). Such loss will expire in 5 years.

According to the relevant PRC tax rules and regulations, Shanghai Euro Tech Environmental Engineering Limited (“SETEE”) is exempt from the PRC Enterprise Income Tax for two years starting from 2007, after offsetting losses brought forward, if any, followed by a 50% reduction for the next three years thereafter. As of December 31, 2012, SETEE had an assessable loss carried forward of US\$1,418,936 as agreed by the local tax authority to offset its profit for the forth coming years (2011: US\$1,106,994). Such loss will expire in 5 years. Chongqing Euro Tech Rizhi Technology Co., Ltd, Rizhi Euro Tech Instrument (Shaanxi) Co., Ltd and Guangzhou Euro Tech Environmental Equipment Co., Ltd provide for PRC Enterprise Income Tax at a rate of 25%, after offsetting losses brought forward, if any, on the basis of its income for financial reporting purposes, adjusting for income and expense items which are not assessable or deductible for PRC Enterprise Income Tax purposes.

According to the relevant PRC tax rules and regulations, Yixing Pact Environmental Technology Co., Ltd is registered in Shanghai as Foreign Owned Enterprise that are entitled to Enterprise Income Tax rate of 25% (2011 and 2010: 25%).

VIEs of the Group provide for PRC Enterprise Income Tax at a rate of 25% (2011 and 2010: 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.

Under the New Enterprise Income Tax Law and the implementation rules, profits of the PRC subsidiaries earned on or after January 1, 2008 and distributed by the PRC subsidiaries to foreign holding company are subject to a withholding tax at a rate of 10% unless reduced by tax treaty. Aggregate undistributed earnings of the Company’s subsidiaries located in the PRC that are available for distribution to the Company of approximately US\$1.9 million at December 31, 2012 are intended to be reinvested, and accordingly, no deferred taxation has been made for the PRC dividend withholding taxes that would be payable upon the distribution of those amounts to the Company. Distributions made out of pre January 1, 2008 retained earnings will not be subject to the withholding tax.

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 4 Income taxes (Continued)

Profit/(loss before) income taxes/(benefit):

|                       | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|-----------------------|------------------|------------------|------------------|
| The PRC and Hong Kong | 13               | (1,204 )         | (1,326 )         |

The provision for income taxes consists of:

|                          | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|--------------------------|------------------|------------------|------------------|
| Current tax expenses:    |                  |                  |                  |
| The PRC and Hong Kong    | 117              | (46 )            | 233              |
| Total current provision  | 117              | (46 )            | 233              |
| Deferred tax benefit:    |                  |                  |                  |
| The PRC and Hong Kong    | 25               | (17 )            | (79 )            |
| Total deferred provision | 25               | (17 )            | (79 )            |

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

|  | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|--|------------------|------------------|------------------|
| Computed tax using respective companies' statutory tax rates | 31               | (263 )           | (203 )           |
| Change in valuation allowances                               | 166              | 33               | 158              |
| Under-provision for income tax in prior years                | -                | (10 )            | -                |
| Non deductible expenses                                      | (55 )            | 177              | 199              |
| Total provision for income tax at effective tax rate         | 142              | (63 )            | 154              |

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 4 Income taxes (Continued)

The components of deferred tax assets are as follows:

|                            | 2012<br>US\$'000 | 2011<br>US\$'000 |
|----------------------------|------------------|------------------|
| Tax losses                 | 977              | 811              |
| Temporary differences      | (24 )            | 1                |
| Less: Valuation allowances | (691 )           | (525 )           |
| Net deferred tax assets    | 262              | 287              |

## 5 Net income per ordinary share

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

|   | 2012<br>Number of shares | 2011      | 2010      |
|---|--------------------------|-----------|-----------|
| Weighted average number of ordinary shares for the purposes of basic net income per share   | 2,070,685                | 2,087,922 | 2,099,894 |
| Effect of dilutive potential ordinary shares: Stock options                                 | 5,630                    | 14,277    | 43,481    |
| Weighted average number of ordinary shares for the purposes of diluted net income per share | 2,076,315                | 2,102,199 | 2,143,375 |

## 6 Accounts receivable, net

|                                    | 2012<br>US\$'000 | 2011<br>US\$'000 |
|------------------------------------|------------------|------------------|
| Accounts receivable                | 3,186            | 3,900            |
| Less: Allowance for doubtful debts | (97 )            | (156 )           |
|                                    | 3,089            | 3,744            |

The following is an age analysis of past due account receivables as of December 31, 2012 and 2011:

|                      | 2012<br>US\$'000 | 2011<br>US\$'000 |
|----------------------|------------------|------------------|
| Current              | 1,698            | 2,324            |
| 30-59 days past due  | 440              | 730              |
| 60-89 days past due  | 302              | 92               |
| Greater than 90 days | 649              | 598              |

3,089

3,744

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 7 Prepayments and other current assets

Prepayment and other current assets mainly represent deposits for purchases and services, rental and utilities deposits, and prepaid expenses. The other current assets also include cost of estimated earnings in excess of billing.

## Cost and estimated earnings in excess of billings

|   | 2012<br>US\$'000 | 2011<br>US\$'000 |
|---|------------------|------------------|
| Contracts costs incurred plus estimated earnings  | 3,785            | 8,604            |
| Less: Progress billings                           | (3,684 )         | (8,098 )         |
| Cost and estimated earnings in excess of billings | 101              | 506              |

## 8 Inventories

|                  | 2012<br>US\$'000 | 2011<br>US\$'000 |
|------------------|------------------|------------------|
| Raw materials    | 147              | 142              |
| Work in progress | 59               | 74               |
| Finished goods   | 447              | 367              |
|                  | 653              | 583              |

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, 2012, and 2011, provision for obsolete and slow moving inventories amounted to US\$10,000 and US\$209,000, respectively, which were charged to cost of revenue in Consolidated Statements of Income.

## 9 Property, plant and equipment

|  | 2012<br>US\$'000 | 2011<br>US\$'000 |
|--|------------------|------------------|
| Office premises                          | 1,866            | 1,866            |
| Leasehold improvements                   | 158              | 151              |
| Furniture, fixtures and office equipment | 616              | 636              |
| Motor vehicles                           | 162              | 162              |
| Testing equipment                        | 87               | 84               |
|  | 2,889            | 2,899            |
| Less: Accumulated depreciation           | (1,944 )         | (1,841 )         |
|  | 945              | 1,058            |

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 9 Property, plant and equipment (Continued)

|                     | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|---------------------|------------------|------------------|------------------|
| Depreciation charge | 130              | 182              | 170              |

## 10 Interests in affiliates

Investments in affiliates are accounted for using the equity method of accounting.

The Group acquired 20% equity interests in Zhejiang Tianlan Environmental Protection Technology Co. Ltd, (“Tianlan”), a company incorporated in the PRC for a total consideration of US\$4,648,000 in 2007. In 2010, Tianlan increased its share capital and the Group further invested US\$262,000 in order to maintain the share holding of 20% in Tianlan. In 2011, Tianlan increased its share capital and the Group further invested US\$435,000 in order to maintain the share holding of 20% in Tianlan.

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

| Balance Sheet:             | 2012<br>US\$'000 | 2011<br>US\$'000 |
|----------------------------|------------------|------------------|
| Current assets             | 57,431           | 49,064           |
| Non-current assets         | 9,605            | 10,322           |
| Total assets               | 67,036           | 59,386           |
| Total liabilities          | (42,889 )        | (35,154 )        |
| Total shareholders' equity | 24,147           | 24,232           |
| Operating results:         | 2012<br>US\$'000 | 2011<br>US\$'000 |
| Net sales                  | 44,543           | 45,966           |
| Operating profits          | 616              | 6,899            |
| Net (loss)/profits         | (196 )           | 6,407            |

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 10 Interests in affiliates (Continued)

The Group acquired 20% of the equity interests in Zhejiang Jia Huan Electronic Co. Ltd., (“Jia Huan”), a company incorporated in the PRC, for approximately US\$2,610,000 in 2008. Jia Huan has been in the environmental protection business since 1969 and is based in Jin Hua, Zhejiang.

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

| Balance Sheet:             | 2012<br>US\$'000 | 2011<br>US\$'000 |
|----------------------------|------------------|------------------|
| Current assets             | 17,371           | 16,645           |
| Non-current assets         | 5,650            | 5,402            |
| Total assets               | 23,021           | 22,047           |
| Total liabilities          | (9,893 )         | (9,295 )         |
| Total shareholders' equity | 13,128           | 12,752           |
|                            | 2012<br>US\$'000 | 2011<br>US\$'000 |
| Operating results:         |                  |                  |
| Net sales                  | 12,631           | 8,151            |
| Operating profits/(losses) | 74               | (903 )           |
| Net profits/(losses)       | 243              | (749 )           |

## 11 Other payables and accrued expenses

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

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

12 Ordinary share

During the year ended December 31, 2010, the Company issued 9,259 ordinary shares for stock options exercised.

During the year ended December 31, 2012 and 2011, there was no movement with the Company's issued ordinary shares and the outstanding share.

On January 13, 2012, the company effected a two-for-eleven reverse split of its issued ordinary shares. The information contained herein reflects retroactive effect of the reverse stock split for all period presented.

13 Goodwill

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

As of December 31, 2012, 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, 2012). Based on management's assessment, the Company determined that there was no impairment of goodwill as of December 31, 2012.

14 Treasury stock

The Company authorised a stock buyback program in July 2009 pursuant to which up to 54,546 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 4,843 shares and 7,000 shares of ordinary share during 2009 and 2010 for considerations of approximately US\$34,000 and US\$55,233, respectively.

The Company authorised a stock buyback program in August 2010 pursuant to which up to 54,546 shares, but not to exceed US\$450,000 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 6,482 shares of ordinary share during 2010 for considerations of approximately US\$49,000. The Company repurchased a total of 16,935 shares of ordinary share during 2011 for considerations of approximately US\$94,000. The Company repurchased a total of 8,639 shares of ordinary share during 2012 for considerations of approximately US\$33,000.

There was no reissuance of treasury stock during each of the three years ended December 31, 2012.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

15 PRC statutory reserves

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 can also appropriate certain amount of their net income to the enterprise expansion fund.

(i) Statutory reserve fund

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 fund until such fund reaches 50% of the companies' registered capital. The statutory reserve fund can be utilised upon the approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the companies, provided that such fund be maintained at a minimum of 25% of the companies' registered capital.

Under the PRC laws and regulations, the Company's PRC subsidiaries are restricted in their ability to transfer certain of their net assets to the Company in the form of dividend payments, loans or advances. The amounts restricted include paid-in capital and statutory reserves, as determined pursuant to PRC generally accepted accounting principles, totaling US\$3,343,000 as at December 31, 2012 (2011:US\$3,280,000).

(ii) Statutory staff welfare fund

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 fund determined by the Company. The staff welfare fund 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) Enterprise expansion fund

The expansion fund 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 utilised upon approval by relevant authorities, to convert into registered capital and issue bonus capital to existing investors, provided that such fund 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 FINANCIAL STATEMENTS

16 Stock options

(i) 2000 Stock Option Plan

A total of 217,407 shares of ordinary share have been reserved for issuance under the Company's 2000 Stock Option Plan (the "2000 Stock Options"). The 2000 Stock Options provide for the grant of options to its officers, directors and employees as the Company's Chairman of the Board of Directors and Chief Executive Officer may direct.

During the year ended December 31, 2010, 6,205 options with the exercise price of US\$3.18 per share were exercised. All the remaining unexercised options expired in August 2010.

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

A total of 53,454 shares and 152,727 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 provided 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, 2009, 2,291 options with exercise price of US\$4.19 per share were cancelled. During the same year, 1,818 options with exercise price of US\$3.22 per share were exercised.

During the year ended December 31, 2010, 1,527 options with exercise price of US\$4.19 per share were cancelled. During the same year, 3,054 options with exercise price of US\$4.19 per share were exercised.

During the year ended December 31, 2011, 2,291 options and 7,636 options with exercise price of US\$4.19 and US\$3.18 per share, respectively, were cancelled.

During the year ended December 31, 2012, all the remaining unexercised options expired in November 2012.

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 16 Stock options (Continued)

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:

|                                | 2012      | Weighted | 2011     | Weighted | 2010      | Weighted |
|--------------------------------|-----------|----------|----------|----------|-----------|----------|
|                                | Number    | average  | Number   | average  | Number    | average  |
|                                | of        | exercise | of       | exercise | of        | exercise |
|                                | options   | price    | options  | price    | options   | price    |
|                                |           | US\$     |          | US\$     |           | US\$     |
| Outstanding, beginning of year | 36,255    | 3.36     | 46,182   | 3.36     | 94,958    | 4.68     |
| Granted                        | -         | -        | -        | -        | -         | -        |
| Cancelled/Expired              | (36,255 ) | (3.36 )  | (9,927 ) | (3.47 )  | (39,517 ) | (6.38 )  |
| Exercised                      | -         | -        | -        | -        | (9,259 )  | (3.52 )  |
| Outstanding, end of year       | -         | -        | 36,255   | 3.36     | 46,182    | 3.36     |
| Exercisable, end of year       | -         | -        | 36,255   | 3.36     | 46,182    | 3.36     |

As of December 31, 2012, there was no options outstanding.

The total intrinsic value of share options exercised for the twelve months ended December 31, 2012 and 2011 were approximately US\$Nil and US\$Nil, respectively. As of December 31, 2012 there was no unrecognised stock-based compensation expense related to unvested stock options.

The Group adopted the provisions of ASC 718-10, which requires us to recognise 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 realisable 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.





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## EURO TECH HOLDINGS COMPANY LIMITED

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### 17 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 contributions range from 12% 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, 2012, 2011 and 2010, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately US\$364,000, US\$455,000 and US\$390,000 respectively.

#### 18 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 FINANCIAL STATEMENTS

18 Risk factor and Derivative Instruments (Continued)

Financial risk factors (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, recognised 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, 2012 and 2011.

19 Related party transactions

Other than compensation to directors and stock options available to the directors, there were no transactions with other related parties in the years 2012, 2011 and 2010.

20 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, 2012, 2011 and 2010 were approximately US\$291,000, US\$356,000 and US\$384,000, respectively. Future minimum rental payments as of December 31, 2012, under agreements classified as operating leases with non-cancellable terms amounted to US\$262,000 of which US\$232,000 are payable in the year 2013 and US\$30,000 are payable within years 2014 to 2016.

(ii) Banking facilities

As at December 31, 2012, 2011 and 2010, the Group had various banking facilities available for overdraft, import and export credits and foreign exchange contracts from which the Group can draw up to approximately US\$1,538,000, US\$1,154,000 and US\$2,564,000 respectively, of which approximately US\$285,000, US\$474,000 and US\$188,000 was utilised for issuance of bank guarantees.

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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

20 Commitments and contingencies (Continued)

(iii) Non-controlling interest put option

The Group granted the non-controlling interest of Yixing Pact Environmental Technology Co., Ltd and Pact Asia Pacific Limited a put option, which is effective from 2009, requiring the Group to acquire part or all remaining shares of these two companies at a purchase price per share calculated by 5.2 times of their average net income for the three prior fiscal years divided by total number of shares outstanding at the time of exercise of such option.

(iv) Litigation

Statements of claim were issued by Yu-Cheng Ling and Xue-Mei Huang (“Plaintiff A”), and Nian-Chong Luo and Li-Shan Cen (“Plaintiff B”) as the plaintiffs against Shanghai Euro Tech Environmental Engineering Company Limited (“SETEE”) as one of the ten defendants (“Defendants”) in civil claims at the People’s Court of TianDong Province, Guangxi, PRC.

Plaintiff A and Plaintiff B claimed against Defendants for total compensations of approximately US\$64,000 and US\$95,000, respectively, for their sons died in a serious fatal traffic accident in September 2010 on the ground that one of the drivers of the accident, (employee of SETEE’s sub-contractor) was performing SETEE’s jobs during the traffic accident and therefore SETEE is liable to assume joint and several liability. The case was heard in court on April 28, 2011. The Tian Dong People’s Court issued a verdict dated September 11, 2011 finding, among other things, that the Company was not liable. One of the Plaintiffs has appealed that verdict to the Baise Intermediate People’s Court, Guangxi Zhuang Autonomous Region, PRC in November 20, 2011. After the hearing on April 23, 2012, the appellate court issued a verdict dated May 10, 2012 finding, among other things, that the Company was not liable to joint and several liability with the driver, but to bear 30% of the liability of the civil engineer sub-contractor for the amount of US\$52,000. Management considers not to appeal as the chance of success is remote.

21 Fair value of financial instruments

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

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22 Segment information

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

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

|                                | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|--------------------------------|------------------|------------------|------------------|
| Revenue                        |                  |                  |                  |
| Trading and manufacturing      | 10,866           | 11,437           | 13,745           |
| Engineering                    | 10,779           | 8,776            | 8,560            |
|                                | 21,645           | 20,213           | 22,305           |
| Operating (loss)/income        |                  |                  |                  |
| Trading and manufacturing      | (301 )           | (720 )           | (1,590 )         |
| Engineering                    | 401              | (802 )           | 354              |
| Unallocated corporate expenses | (159 )           | (152 )           | (142 )           |
|                                | (59 )            | (1,674 )         | (1,378 )         |
|                                |                  |                  |                  |
|                                | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
| Depreciation:                  |                  |                  |                  |
| Trading and manufacturing      | 88               | 137              | 132              |
| Engineering                    | 42               | 45               | 38               |
|                                | 130              | 182              | 170              |
| Capital Expenditures, Gross    |                  |                  |                  |
| Trading and manufacturing      | 12               | 44               | 52               |
| Engineering                    | 29               | 19               | 60               |
|                                | 41               | 63               | 112              |
|                                |                  |                  |                  |
|                                |                  | 2012<br>US\$'000 | 2011<br>US\$'000 |
| Assets                         |                  |                  |                  |
| Trading and manufacturing      |                  | 6,211            | 6,215            |
| Engineering                    |                  | 18,736           | 17,649           |
|                                |                  | 24,947           | 23,864           |
| Liabilities                    |                  |                  |                  |
| Trading and manufacturing      |                  | 2,615            | 2,315            |
| Engineering                    |                  | 4,576            | 3,640            |
|                                |                  | 7,191            | 5,955            |

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## EURO TECH HOLDINGS COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22 Segment information (Continued)

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

|           | 2012<br>US\$'000 | 2011<br>US\$'000 | 2010<br>US\$'000 |
|-----------|------------------|------------------|------------------|
| Revenue - |                  |                  |                  |
| The PRC   | 15,867           | 15,100           | 15,891           |
| Hong Kong | 5,511            | 4,891            | 6,150            |
| Others    | 267              | 222              | 264              |
|           | 21,645           | 20,213           | 22,305           |

(iii) Long-lived assets(1)

Geographical analysis of long-lived assets is as follows:

|           | 2012<br>US\$'000 | 2011<br>US\$'000 |
|-----------|------------------|------------------|
| Hong Kong | 583              | 630              |
| The PRC   | 362              | 428              |
|           | 945              | 1,058            |

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

(iv) Major suppliers

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

|            | 2012 |   | 2011 |   | 2010 |   |
|------------|------|---|------|---|------|---|
| Supplier A | 17   | % | 10   | % | 7    | % |
| Supplier B | 11   | % | 10   | % | 13   | % |
| Supplier C | 10   | % | 7    | % | 21   | % |
| Supplier D | 7    | % | 8    | % | 6    | % |
| Supplier E | 6    | % | 6    | % | 4    | % |
| Supplier F | 6    | % | 15   | % | 7    | % |

(v) Major customers

No revenue from a single customer exceeds 10% of the Group revenue during the years ended December 31, 2012, 2011 and 2010.



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EURO TECH HOLDINGS COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

23 Subsequent events

The Company has evaluated all events or transactions that occurred through the date the consolidated financial statements were issued, and has determined that there were no material recognizable nor subsequent events or transactions which would require recognition or disclosure in the consolidated financial statements.

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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED  
AUDITED CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2012 AND 2011 AND  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME/(LOSS)  
CONSOLIDATED STATEMENTS OF CASH FLOWS AND CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010  
TOGETHER WITH REPORT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM

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Report of Independent Registered Public Accounting Firm

To the Directors and Stockholders of  
Zhejiang Tianlan Environmental Protection Technology Company Limited

We have audited the accompanying consolidated balance sheet of Zhejiang Tianlan Environmental Protection Technology Company Limited (the "Company") and its subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive (loss)/income, changes in shareholders' equity and cash flows for the year ended December 31, 2012 and 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the 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 consolidated 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. An audit includes 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. 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated balance sheets of the Company and its subsidiaries as of December 31, 2012 and 2011 and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Dominic. K.F. Chan & Co.

Dominic. K.F. Chan & Co.,  
Certified Public Accountants  
Hong Kong, China  
April 22, 2013

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Zhejiang Tianlan Environment Protection Technology Company Limited

We have audited the accompanying consolidated statements of operations and comprehensive income, changes in shareholders' equity and cash flows for the year ended December 31, 2010 of Zhejiang Tianlan Environment Protection Technology Company Limited ("the Company"). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the 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. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's Internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of its operations and its cash flows for the year ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Limited

BDO Limited  
Hong Kong, June 28, 2011

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2012 AND 2011

|  | Note | 2012<br>RMB'000 | (Restated)<br>2011<br>RMB'000 |
|--|------|-----------------|-------------------------------|
| Assets                                 |      |                 |                               |
| Current assets:                        |      |                 |                               |
| Cash and cash equivalents              |      | 22,668          | 38,434                        |
| Accounts receivable, net               | 6    | 226,370         | 187,763                       |
| Amounts due from owners                | 18   | -               | 2                             |
| Prepayments and other current assets   | 7    | 104,368         | 76,860                        |
| Inventories                            | 8    | 9,154           | 8,612                         |
| <b>Total current assets</b>            |      | <b>362,560</b>  | <b>311,671</b>                |
| Property, plant and equipment, net     | 9    | 49,093          | 52,938                        |
| Intangible asset, net                  | 10   | 2,693           | 2,851                         |
| Land use right, net                    | 11   | 6,335           | 6,484                         |
| Deferred tax assets                    |      | 2,513           | 3,297                         |
| <b>Total assets</b>                    |      | <b>423,194</b>  | <b>377,241</b>                |
| Liabilities and shareholders' equity   |      |                 |                               |
| Current liabilities:                   |      |                 |                               |
| Short term borrowings                  | 12   | 60,000          | 41,000                        |
| Accounts payable                       |      | 177,212         | 133,475                       |
| Other payables and accrued expenses    | 13   | 26,036          | 28,537                        |
| Other taxes payable                    | 5    | 1,828           | 13,407                        |
| Income tax payable                     |      | 5,684           | 6,887                         |
| <b>Total current liabilities</b>       |      | <b>270,760</b>  | <b>223,306</b>                |
| Commitments and contingencies          | 19   | -               | -                             |
| Shareholders' equity:                  |      |                 |                               |
| Share capital 61,200,000 shares issued |      | 61,200          | 61,200                        |
| Paid-in capital                        |      | -               | -                             |
| Capital reserve                        | 15   | 43,189          | 43,189                        |
| PRC statutory reserves                 | 14   | 4,274           | 4,272                         |
| Retained earnings                      |      | 36,640          | 37,881                        |
|  |      | <b>145,303</b>  | <b>146,542</b>                |

Equity attributable to shareholders of Zhejiang Tianlan Environmental  
Protection Technology Company Limited

|  |         |         |
|--|---------|---------|
| Non-controlling interest                   | 7,131   | 7,393   |
| Total shareholders' equity                 | 152,434 | 153,935 |
| Total liabilities and shareholders' equity | 423,194 | 377,241 |

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

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS)/INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | Note | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|---|------|-----------------|-----------------|-----------------|
| Revenue   |      | 281,203         | 291,992         | 166,732         |
| Cost of revenue   |      | (216,362 )      | (208,062 )      | (112,540 )      |
| Gross profit  |      | 64,841          | 83,930          | 54,192          |
| Selling and administrative expenses   |      | (66,902 )       | (40,104 )       | (31,154 )       |
| Operating (loss)/income   |      | (2,061 )        | 43,826          | 23,038          |
| Interest income   |      | 149             | 124             | 60              |
| Interest expenses   |      | (4,496 )        | (1,802 )        | (691 )          |
| Other income, net   | 3    | 7,341           | 5,161           | 6,074           |
| Income before income taxes  |      | 933             | 47,309          | 28,481          |
| Income taxes  | 4    | (2,434 )        | (7,919 )        | (2,768 )        |
| Net (loss)/income   |      | (1,501 )        | 39,390          | 25,713          |
| Net income/(loss) attributable to non-controlling interest  |      | 262             | (1,308 )        | (1,984 )        |
| Net (loss)/income attributable to Zhejiang Tianlan Environmental Protection Technology Company Limited's shareholders |      | (1,239 )        | 38,082          | 23,729          |
| Other comprehensive (loss)/income   |      |                 |                 |                 |
| Net (loss)/income   |      | (1,501 )        | 39,390          | 25,713          |
| Foreign exchange translation adjustments  |      | -               | -               | -               |
| Comprehensive(loss)/income  |      | (1,501 )        | 39,390          | 25,713          |
| Less: Comprehensive income/(loss) attributable to non-controlling interest  |      | 262             | (1,308 )        | (1,984 )        |
| Net (loss)/income attributable to Zhejiang Tianlan Environmental Protection Technology Company Limited's shareholders |      | (1,239 )        | 38,082          | 23,729          |

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

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|---|-----------------|-----------------|-----------------|
| Cash flows from operating activities:   |                 |                 |                 |
| Net (loss)/income   | (1,501 )        | 39,390          | 25,713          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                 |                 |                 |
| Depreciation of property, plant and equipment                                     | 3,017           | 2,694           | 2,398           |
| Amortisation of intangible asset  | 164             | 134             | -               |
| Amortisation of land use right  | 177             | 148             | 546             |
| Loss on disposal of property, plant and equipment                                 | 4,186           | 107             | -               |
| Loss on disposal of intangible asset  | 92              | -               | -               |
| Deferred tax assets   | 784             | (993 )          | (1,481 )        |
| (Increase)/decrease in current assets:  |                 |                 |                 |
| Accounts receivable, net  | (38,607 )       | (92,916 )       | (31,469 )       |
| Amounts due from owners   | 2               | 212             | 94              |
| Prepayments and other current assets  | (27,508 )       | (37,458 )       | (13,581 )       |
| Inventories   | (542 )          | (6,502 )        | (390 )          |
| Income tax recoverable  | -               | -               | 969             |
| Increase/(decrease) in current liabilities:                                       |                 |                 |                 |
| Accounts payable  | 43,737          | 89,956          | 15,340          |
| Amount due to owner   | -               | (1,600 )        | (720 )          |
| Other payables and accrued expenses   | (2,501 )        | (435 )          | 9,909           |
| Other taxes payable   | (11,579 )       | 8,225           | 1,638           |
| Income tax payable  | (1,203 )        | 6,405           | 482             |
| Net cash (used in)/provided by operating activities                               | (31,282 )       | 7,367           | 9,448           |
| Cash flows from investing activities:   |                 |                 |                 |
| Purchase of intangible asset  | (126 )          | (2,985 )        | -               |
| Purchase of property, plant and equipment   | (3,358 )        | (2,690 )        | (15,948 )       |
| Net cash used in investing activities   | (3,484 )        | (5,675 )        | (15,948 )       |
| Cash flows from financing activities:   |                 |                 |                 |
| Repayment of bank borrowings  | (41,000 )       | (20,500 )       | (6,300 )        |
| Advance of bank borrowings  | 60,000          | 51,000          | 10,500          |
| Capital injection   | -               | 6,000           | 8,696           |
| Dividend paid to owners   | -               | (12,785 )       | (6,400 )        |
| Net cash provided by financing activities   | 19,000          | 23,715          | 6,496           |
| Net (decrease)/increase in cash and cash equivalents                              | (15,766 )       | 25,407          | (4 )            |
| Cash and cash equivalents, beginning of year                                      | 38,434          | 13,027          | 13,031          |

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|  |         |         |         |
|--|---------|---------|---------|
| Cash and cash equivalents, end of year | 22,668  | 38,434  | 13,027  |
| Supplementary information              | RMB'000 | RMB'000 | RMB'000 |
| Interest received                      | 149     | 124     | 60      |
| Interest paid                          | 3,920   | 1,802   | 691     |
| Income tax paid                        | 6,348   | 3,229   | 2,858   |
| Income tax refund                      | -       | -       | 60      |

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

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

|   | Share<br>capital | Paid-in<br>capital | Capital<br>reserve | PRC<br>statutory<br>reserves | Retained<br>earnings | Non-controlling<br>interest | Total     |
|---|------------------|--------------------|--------------------|------------------------------|----------------------|-----------------------------|-----------|
|   | RMB'000          | RMB'000            | RMB'000            | RMB'000                      | RMB'000              | RMB'000                     | RMB'000   |
| Balance as of<br>December 31, 2009      | -                | 50,000             | 11,374             | 7,675                        | 21,771               | 4,101                       | 94,921    |
| Net income                              | -                | -                  | -                  | -                            | 23,729               | 1,984                       | 25,713    |
| Capital injection                       | -                | 2,174              | 6,522              | -                            | -                    | -                           | 8,696     |
| Dividend declared                       | -                | -                  | -                  | -                            | (8,000 )             | -                           | (8,000 )  |
| Appropriation of<br>reserves            | -                | -                  | -                  | 3,124                        | (3,124 )             | -                           | -         |
| Balance as of<br>December 31, 2010      | -                | 52,174             | 17,896             | 10,799                       | 34,376               | 6,085                       | 121,330   |
| Net income                              | -                | -                  | -                  | -                            | 38,082               | 1,308                       | 39,390    |
| Dividend paid                           | -                | -                  | -                  | -                            | (12,000 )            | -                           | (12,000 ) |
| Changed to limited<br>company by shares | 60,000           | (52,174 )          | 20,493             | (10,791 )                    | (17,528 )            | -                           | -         |
| Capital injection                       | 1,200            | -                  | 4,800              | -                            | -                    | -                           | 6,000     |
| Dividend paid to<br>NCI                 | -                | -                  | -                  | -                            | (785 )               | -                           | (785 )    |
| Appropriation of<br>reserves            | -                | -                  | -                  | 4,264                        | (4,264 )             | -                           | -         |
| Balance as of<br>December 31, 2011      | 61,200           | -                  | 43,189             | 4,272                        | 37,881               | 7,393                       | 153,935   |
| Net loss                                | -                | -                  | -                  | -                            | (1,239 )             | (262 )                      | (1,501 )  |
| Appropriation of<br>reserves            | -                | -                  | -                  | 2                            | (2 )                 | -                           | -         |
| Balance as of<br>December 31, 2012      | 61,200           | -                  | 43,189             | 4,274                        | 36,640               | 7,131                       | 152,434   |

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

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1 Organisation and principal activities

Zhejiang Tianlan Environmental Protection Technology Company Limited (the “Company”) was incorporated in Hangzhou City, Zhejiang Province, the People’s Republic of China (“PRC”) on May 18, 2000 as a wholly domestic owned enterprise. On August 6, 2007, Euro Tech (Far East) Limited and Beijing International Trust Investment Company Limited acquired 20% and approximately 3% of the equity interest of the Company. Upon the completion of the transaction, the Company changed from a wholly domestic owned enterprise to a sino-foreign joint venture enterprise with an operating period up to August 5, 2037.

On August 30, 2011, the Company changed from a sino-foreign joint venture enterprise to a limited company by shares.

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 summarised as follows:

| Name   | Percentage of equity ownership |      | Place of incorporation | Principal activities  |
|--|--------------------------------|------|------------------------|---|
|  | 2012                           | 2011 |                        |   |
| Hangzhou Tianlan Environmental Engineering and Design Company Limited      | 100%                           | 100% | PRC                    | Provision of maintenance services of environmental protection equipment       |
| Hangzhou Tianlan Environmental Protection Equipments Company Limited       | 51%                            | 51%  | PRC                    | Manufacturing and installation services of environmental protection equipment |
| Shihezi Tianlan Environmental Protection Technology Company Limited<br>( ) | 100%                           | -    | PRC                    | Dormant   |

## 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 desulphurization, 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. This approach primarily based on contract costs incurred to date compared with total estimated contract costs. Changes to total estimated contract costs or losses, if any, are recognised in the period they are determined. Revenues recognised in excess of amounts billed are classified as costs and estimated earnings in excess of billings on uncompleted contracts. Essentially all of such amounts are expected to be billed and collected within one year and are classified as current assets. Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. When reasonably dependable estimates cannot be made, construction contract revenues are recognised using the completed contract method.

(d) Research and Development Costs

Research and development costs ("R&D" costs) are expensed as incurred. The R&D costs amounted to approximately RMB14,890,000, RMB11,560,000 and RMB6,182,000 for the years ended December 31, 2012, 2011 and 2010 respectively and were included in "Selling and Administrative" expenses in the Group's consolidated statements of income.

(e) Advertising and promotional expenses

Advertising and promotional expenses ("A&P" expenses) are expensed as incurred. The A&P expenses amounted to approximately RMB26,000, RMB128,000 and RMB9,700 for the years December 31, 2012, 2011 and 2010 respectively and were included in "Selling and Administrative" expenses in the Group's consolidated statements of income.

(f) Taxation

The Group accounts for income and deferred tax under the provision of FASB ASC Subtopic 740-10, Income Taxes, under which deferred taxes are recognised for all temporary differences between the applicable tax balance sheets and the consolidated balance sheet. Deferred tax assets and liabilities are recognised for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. ASC 740-10 also requires the recognition of the future tax benefits of net operating loss carry forwards. A valuation allowance is established when the deferred tax assets are not expected to be realised within a reasonable period of time.



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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 recognises 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 2012, 2011 and 2010.

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 recognised in income for the period that includes the enactment date.

(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.

According to construction contracts signed with the customers, an amount ranged from 5%-20% of contract sum will only be receivable one year after the final inspection report issued by relevant department of Ministry of Environmental Protection. As of December 31, 2012, accounts receivable in more than one year amounted to RMB12,719,000 (2011:RMBNil and 2010: RMB 71,634,000).

(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. Allowance is made for obsolete, slow moving or defective items, where appropriate.

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 2 Summary of significant accounting policies - Continued

## (j) Property, Plant and Equipment and Land Use Right

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 capitalised. All ordinary repair and maintenance costs are expensed as incurred. Land in the PRC is owned by the PRC government. The government in the PRC, according to PRC Law, may sell the right to use the land for a specific period for time. Thus, all of the Company's land purchases in the PRC are considered to be leasehold land and classified as land use right.

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

|  |  |
|--|--|
| Land use right                           | Over terms of the leases                                       |
| Office premises                          | 47-50 years  |
| Leasehold improvements                   | over terms of the leases or the useful lives whichever is less |
| Plant and machineries                    | 5 to 10 years  |
| Furniture, fixtures and office equipment | 5 years  |
| Motor vehicles                           | 5 years  |

## (k) Intangible Assets

The Company amortizes its intangible assets with definite lives over their estimated useful lives and reviews these assets for impairment. The Company is currently amortizing its acquired intangible assets with definite lives over periods generally ranging between five to twenty years.

## (l) Impairment

The Group has adopted FASB ASC Subtopic 360-10, Property, Plant, and Equipment, 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, 2012.

## (m) Government grant income

Government grant income consisted of receipt of funds to subsidize the investment cost of information technology system development and market development in China. No present or future obligation arises from the receipt of such amount.

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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies - Continued

(n) 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.

(o) 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 recognised in the consolidated statements of income during the year in which they occur.

(p) Comprehensive Income

The Group has adopted FASB ASC Subtopic 220-10, 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 recognised. The Group has presented comprehensive income, which encompasses net income, in the consolidated statement of changes in shareholders’ equity.

(q) Share capital

Paid in capital refers to the registered capital paid-up by the shareholders of the Company. The paid-in capital is RMB52,174,000 at the year ended December 31, 2010.

On August 30, 2011, the Company changed from a sino-foreign joint venture enterprise to a limited company by shares of 60,000,000 shares of RMB1 by converting the registered capital and part of the retained earnings. The remaining balance of the retained earnings were reclassified as capital reserve.

On September 12, 2011, 1,200,000 shares of RMB1 were issued at RMB5 per shares.

At the year end of December 31, 2012 and 2011, there were 61,200,000 shares were issued.

(r) 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.



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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies - Continued

(s) 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.

(t) Recent Accounting Pronouncements

On May 12, 2011, the FASB issued ASU 2011-04. The ASU is the result of joint efforts by the FASB and the International Accounting Standards Board (“IASB”) to develop a single, converged fair value framework. Thus, there are few differences between the ASU and its international counterpart, IFRS 13. This ASU is largely consistent with existing fair value measurement principles in U.S. GAAP; however it expands ASC 820’s existing disclosure requirements for fair value measurements and makes other amendments. The ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material effect on the financial position, results of operations or cash flows of the Company.

On June 16, 2011, the FASB issued ASU 2011-05, which revises the manner in which entities present comprehensive income in their financial statements. The new guidance removes the presentation options in ASC 220 and requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material effect on the financial position, results of operations or cash flows of the Company. .

In December 2011, FASB issued Accounting Standards Update 2011-11, Balance Sheet - Disclosures about Offsetting Assets and Liabilities” to enhance disclosure requirements relating to the offsetting of assets and liabilities on an entity's balance sheet. The update requires enhanced disclosures regarding assets and liabilities that are presented net or gross in the statement of financial position when the right of offset exists, or that are subject to an enforceable master netting arrangement. The new disclosure requirements relating to this update are retrospective and effective for annual and interim periods beginning on or after January 1, 2013. The update only requires additional disclosures, as such, we do not expect that the adoption of this standard will have a material impact on our results of operations, cash flows or financial condition.

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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2 Summary of significant accounting policies - Continued

(t) Recent Accounting Pronouncements - continued

In July 2012, FASB issued Accounting Standards Update 2012-02, Balance Sheet- Intangibles- Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment is an Amendment to FASB Accounting Standards Update 2011-08. The objective of the amendments in this Update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance.

In February 2013, FASB issued Accounting Standards Update 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force). This guidance requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This stipulates that (1) it will include the amount the entity agreed to pay for the arrangement between them and the other entities that are also obligated to the liability and (2) any additional amount the entity expects to pay on behalf of the other entities. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The amendments in this update are effective for fiscal periods (and interim reporting periods within those years) beginning after December 15, 2013. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

In February 2013, FASB issued Accounting standards update 2013-02, Comprehensive Income Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This update requires an entity to provide information amount the amount reclassified out of accumulated other comprehensive income by component. The entity is also required to disclose significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting periods. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other discourses required under U.S. GAAP that provide additional detail about those amounts. The objective in this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this update should be applied prospectively for reporting periods beginning after December 15, 2012. This standard is not expected to have a material impact on the Company's reported results of operations or financial position.

Management does not believe that any other recently issued but not yet effective accounting pronouncements, if adopted, would have an effect on the accompanying financial statements.

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 3 Other income, net

|                             | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|-----------------------------|-----------------|-----------------|-----------------|
| Subsidy income (note i)     | 7,170           | 4,483           | 5,954           |
| Sales of scrapped materials | 31              | 78              | -               |
| Others                      | 140             | 600             | 120             |
|                             | 7,341           | 5,161           | 6,074           |

(i) The Group recognises subsidy income for R&D projects when granted by institutions and are not probably to be returned or reimbursed.

## 4 Income taxes

According to relevant PRC tax laws and regulations, entities incorporated in the PRC are subject to Enterprise Income Tax ("EIT") at a statutory rate of 25% or reduced national EIT rates for certain High and New Technology Enterprises ("HNTE") on PRC taxable income. Zhejiang Tianlan Environmental Protection Technology Company Limited and Hangzhou Tianlan Environmental Protection Equipments Company Limited are classified as HNTE which enjoyed a preferential tax rate of 15%. Hangzhou Tianlan Environmental Engineering and Design Company Limited are subject to Enterprise Income Tax rate of 25%.

The provision for income taxes consists of:

|                       | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|-----------------------|-----------------|-----------------|-----------------|
| Current PRC EIT:      |                 |                 |                 |
| Domestic              | 3,218           | 8,912           | 4,249           |
| Income taxes          | 3,218           | 8,912           | 4,249           |
| Deferred tax benefit: | (784 )          | (993 )          | (1,481 )        |
| Total deferred taxes  | (784 )          | (993 )          | (1,481 )        |

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 4 Income taxes - Continued

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

|  | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|--|-----------------|-----------------|-----------------|
| Income before income taxes                                   | 933             | 47,309          | 28,481          |
| Computed tax using respective companies' statutory tax rates | 140             | 7,096           | 4,289           |
| Under/(over)-provision for income tax in prior years         | 1,358           | 512             | (562 )          |
| Tax effect on revenue not subject to tax                     | (56 )           | (652 )          | (1,027 )        |
| Tax effect on expenses not deductible for tax purposes       | 992             | 963             | 68              |
| Total provision for income tax at effective tax rate         | 2,434           | 7,919           | 2,768           |

The components of deferred tax assets are as follows:

|                              | 2012<br>RMB'000 | 2011<br>RMB'000 |
|------------------------------|-----------------|-----------------|
| Tax losses                   | -               | 348             |
| Allowance for doubtful debts | 2,513           | 2,949           |
| Net deferred tax assets      | 2,513           | 3,297           |

## 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% and 3% on the revenue from technique services and installation services respectively.

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 6 Accounts receivable, net

|                                    | 2012<br>RMB'000 | 2011<br>RMB'000 |
|------------------------------------|-----------------|-----------------|
| Accounts receivable                | 245,892         | 208,558         |
| Less: Allowance for doubtful debts | (19,522 )       | (20,795 )       |
|                                    | 226,370         | 187,763         |

## 7 Prepayments and other current assets

Prepayment and other current assets mainly represent deposits for bidding projects, deposits for purchases and services and prepaid expenses.

The other current assets also include cost of estimated earnings in excess of billing.

## Cost and estimated earnings in excess of billings

|   | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|-----------------|-----------------|
| Contracts costs incurred plus estimated earnings  | 198,706         | 117,105         |
| Less: Progress billings                           | (98,957 )       | (53,574 )       |
| Cost and estimated earnings in excess of billings | 99,749          | 63,531          |

## 8 Inventories

|               | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---------------|-----------------|-----------------|
| Raw materials | 9,154           | 8,612           |

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 9 Property, plant and equipment

|  | 2012<br>RMB'000 | 2011<br>RMB'000 |
|--|-----------------|-----------------|
| Office premises and leasehold improvements | 47,092          | 51,304          |
| Furniture, fixtures and office equipment   | 7,136           | 6,136           |
| Motor vehicles                             | 3,361           | 2,498           |
| Plant and machineries                      | 711             | 672             |
| Construction in progress                   | 298             | -               |
|  | 58,598          | 60,610          |
| Less: Accumulated depreciation             | (9,505 )        | (7,672 )        |
|  | 49,093          | 52,938          |

|                     | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|---------------------|-----------------|-----------------|-----------------|
| Depreciation charge | 3,017           | 2,694           | 2,398           |

## 10 Intangible assets, net

|                                | 2012<br>RMB'000 | 2011<br>RMB'000 |
|--------------------------------|-----------------|-----------------|
| Patents                        | 2,850           | 2,950           |
| Others                         | 161             | 35              |
|                                | 3,011           | 2,985           |
| Less: Accumulated amortisation | (318 )          | (134 )          |
|                                | 2,693           | 2,851           |

|                      | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|----------------------|-----------------|-----------------|-----------------|
| Amortisation expense | 164             | 134             | -               |



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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 11 Land use right, net

|                                | 2012<br>RMB'000 | 2011<br>RMB'000 |
|--------------------------------|-----------------|-----------------|
| Land use right                 | 7,315           | 7,315           |
| Less: Accumulated amortisation | (980 )          | (831 )          |
|                                | 6,335           | 6,484           |

|                      | 2012<br>RMB'000 | 2011<br>RMB'000 | 2010<br>RMB'000 |
|----------------------|-----------------|-----------------|-----------------|
| Amortisation expense | 177             | 148             | 546             |

## 12 Short term borrowings

|   | 2012<br>RMB'000 | 2011<br>RMB'000 |
|---|-----------------|-----------------|
| Bank loan borrowed by the Company (note i)                  | 55,000          | 36,000          |
| Bank loan borrowed by a subsidiary of the Company (note ii) | 5,000           | 5,000           |
|   | 60,000          | 41,000          |

(i) The bank loan is denominated in Renminbi and repayable within 1 year. The bank loan borrowed by the Company as of December 31, 2012 bear interest at fixed rates 6.00% to 7.87% (2011: 5.81% to 7.87%) per annum and are secured by the Company's office premises and leasehold improvements and land use right. Interest paid during the year ended December 31, 2012 was approximately RMB3,137,000 (2011: RMB1,480,000 and 2010: RMB352,000).

(ii) The bank loan is denominated in Renminbi and repayable within 1 year. The bank loan borrowed by a subsidiary of the Company as of December 31, 2012 bear interest at fixed rates 7.50% to 7.87% (2011: 7.54% to 7.87%) per annum and are secured by the subsidiary's office premises and leasehold improvements and land use right. Interest paid during the year ended December 31, 2012 was approximately RMB391,245 (2011: RMB115,000).

## 13 Other payables and accrued expenses

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

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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

14 PRC statutory reserves

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

(i) Statutory reserve fund

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

(ii) Statutory staff welfare fund

Pursuant to applicable PRC laws and regulations, the Group is required to allocate certain amount of the companies' net income to the staff welfare fund determined by the Company. The staff welfare fund 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.

15 Capital reserve

Capital reserve represents capital contributions from shareholders in excess of the paid-in capital amount.

16 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 12% to 14% 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, 2012, 2011 and 2010, the aggregate contributions of the Group to the aforementioned pension plans and retirement benefit schemes were approximately RMB2,564,000, RMB2,331,000 and RMB488,000 respectively.

17 Risk factors

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

The Group has no significant concentration of credit risk. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any customers.



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ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

18 Related party

Amounts due from/(to) owners

The owners, from time to time, obtain business related advances and pay expenses on behalf of the Company. The amounts due to owners are unsecured, interest free and do not have clearly defined terms of repayment. There were no other transactions with related parties in the years 2012 and 2011 other than those disclosed in elsewhere in the financial statements.

19 Commitments and contingencies

Operating leases

The Group has no rental expense during the year ended December 31, 2012 (2011 and 2010: RMBNil). As of December 31, 2012, the Group has no future minimum lease payments under non-cancellable operating leases are payable in the year 2013.

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 Subsequent events

The Company has evaluated all events or transactions that occurred through the date the consolidated financial statements were issued, and has determined that there were no material recognizable nor subsequent events or transactions which would require recognition or disclosure in the consolidated financial statements.

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22. Restatement

The Company corrected an accounting error by restating previously issued financial statements as follow:

CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2011

|                                      | 2011<br>(As originally<br>report)<br>RMB'000 | 2011<br>(Restated)<br>RMB'000 | 2011<br>(Effect of<br>change)<br>RMB'000 |
|--------------------------------------|--|-------------------------------|--|
| Assets                               |  |                               |  |
| Current assets:                      |  |                               |  |
| Cash and cash equivalents            | 38,434                                       | 38,434                        | -  |
| Accounts receivable, net             | 190,392                                      | 187,763                       | (2,629 )                                 |
| Amounts due from owners              | 2  | 2                             | -  |
| Prepayments and other current assets | 84,417                                       | 76,860                        | (7,557 )                                 |
| Inventories                          | 8,612  | 8,612                         | -  |
| Total current assets                 | 321,857                                      | 311,671                       | (10,186 )                                |
| Property, plant and equipment, net   | 52,938                                       | 52,938                        | -  |
| Intangible asset, net                | 2,851  | 2,851                         | -  |
| Land use right, net                  | 6,484  | 6,484                         | -  |
| Deferred tax assets                  | 3,297  | 3,297                         | -  |
| Total assets                         | 387,427                                      | 377,241                       | (10,186 )                                |
| Liabilities and shareholders' equity |  |                               |  |
| Current liabilities:                 |  |                               |  |
| Short term borrowings                | 41,000                                       | 41,000                        | -  |
| Accounts payable                     | 133,475                                      | 133,475                       | -  |
| Other payables and accrued expenses  | 28,438                                       | 28,537                        | (99 )                                    |
| Other taxes payable                  | 13,407                                       | 13,407                        | -  |
| Income tax payable                   | 5,172  | 6,887                         | (1,715 )                                 |
| Total current liabilities            | 221,492                                      | 223,306                       | (1,814 )                                 |

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## ZHEJIANG TIANLAN ENVIRONMENTAL PROTECTION TECHNOLOGY COMPANY LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 22. Restatement (Continued)

|   |         |         |          |
|---|---------|---------|----------|
| Commitments and contingencies   | -       | -       | -        |
| Shareholders' equity:   |         |         |          |
| Share capital 61,200,000 shares issued  | 61,200  | 61,200  | -        |
| Capital reserve   | 55,189  | 43,189  | 12,000   |
| PRC statutory reserves  | 4,272   | 4,272   | -        |
| Retained earnings   | 40,497  | 37,881  | 2,616    |
| Equity attributable to shareholders of Zhejiang Tianlan Environmental Protection Technology Company Limited | 161,158 | 146,542 | 14,616   |
| Non-controlling interest  | 4,777   | 7,393   | (2,616 ) |
| Total shareholders' equity  | 165,935 | 153,935 | 12,000   |
| Total liabilities and shareholders' equity  | 387,427 | 377,241 | 10,186   |

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