

## Chairman's Statement

I am pleased to present the annual results of the Company and its subsidiaries for the year ended 31 December 2004.

### 1. DISCUSSION AND ANALYSIS ON THE GENERAL OPERATIONS DURING THE REPORTING PERIOD

During the reporting period, the PRC government further implemented its strategies with respect to the vision in scientific development and sustainable development, and paid more emphasis as to environmental and resources protection. New enterprises engaged in water operations entered into the sewage treatment industry from overseas and within the PRC. Good operation capabilities became the key to long term profit of the companies engaging in water operation. The competitiveness for companies engaging in water operation were developed around scale of economies, and those that can integrate investment, design, engineering and operation and occupy a leading position in the industry. Such competitiveness also became principal means for these companies engaging in water operation to prevent from risk exposure and to reduce costs.

During the reporting period, as the PRC Government further implemented scientific and sustainable development, environmental protection and resources conservation were emphasized. More foreign and private water enterprises entered the sewage water treatment industry. Favourable operational capacity gradually becomes a key factor for long term profitability of the water enterprises.

During the reporting period, on the basis of the market development conditions, the Company consolidated its existing operation on sewage water treatment plants and the tasks to construct existing sewage water treatment projects. Efforts were devoted to costs management and costs control. By leveraging on the advantages derived from its operations, the Company's business structure was vigorously adjusted, for the purpose of expanding its market share in the operation of sewage water treatment plants. The brand of "Capital Environmental" was professionally improved, and gradually moved towards the goal of becoming a leader in the industry in the PRC.

- (1) During the reporting period, two sewage water treatment plants directly operated by the Company processed a total of 227,000,000 cubic meters of sewage water. Of which, average volume of sewage water processed by Dongjiao Sewage Water Treatment Plant reached 90% of its designed capacity. Jizhuangzi Sewage Water Treatment Plant was basically operating at its full capacity. In a survey on leading sewage water treatment plants in the PRC in 2004 conducted by the National Municipal Investment Industry Association, Dongjiao Sewage Water Treatment Plant ranked the second in 71 urban sewage water treatment plants, and was also awarded the honour of "Best Ten Urban Sewage Water Treatment Plant in China". Guizhou Capital Water Co., Ltd ("Guizhou Capital Water"), a subsidiary of the Company, processed 26,460,000 cubic meters of sewage water during the reporting period, and reached 90% of its designed capacity. The investment in the Company's sewage water treatment engineering projects amounted to approximately RMB440,000,000. Of which, the expansion work for Jizhuangzi Sewage Water Treatment Plant and the work of Xianyanglu Sewage Water Treatment Plant completed its civil engineering work and equipment installation for its water treatment system during the year. Water transmission had commenced and is now in the stage of commissioning and trial operation. The civil engineering work for the principal structures and buildings at Beicang Sewage Water Treatment Plant was fundamentally completed.

## **1. DISCUSSION AND ANALYSIS ON THE GENERAL OPERATIONS DURING THE REPORTING PERIOD** *(Cont'd)*

- (2) During the reporting period, the Company conducted studies in different projects, and gained more understanding in the market as well as the operation capabilities of its projects. On 1st January 2004, Guiyang Xiaohe Sewage Water Treatment Plant officially commenced its operation. Economic and social efficiency was satisfactory. On the bases of Guizhou Capital Water, the Company actively expanded the sewage water treatment market in the peripheral area of Guiyang. On 18th May 2004, the Company entered into "Framework Agreement for the Cooperation in the Construction and Operation of Sewage Water Treatment Plant Facilities and Utility Water Plant Facilities in Chibi" with Chibi Municipal Government, which symbolised the Company's move into supply of utility water, and further expanded the scope of operation and geographical region for its operation. In 2004, the Company further optimised its organisation structure. A branch on its water operation was established, which was an important strategic move for capitalising on the Company's advantages in sewage water treatment, and establishing the professional services of "Capital Environmental". This water operation branch is engaged in the operation and management of two existing sewage water treatment plants and the operation of Xianyanglu and Beicang Sewage Water Treatment Plants that commenced operation during the year. The establishment of this branch carried further strategic implications such that through the provision of operation and management services as well as technology consultation services and installation and commissioning services for sewage water treatment plants, new profit centers will be identified, and the Company will expand into other markets for the operation of sewage water treatment business in other regions. In addition, it is contemplated by the Company to establish branches for project construction and design and consultation as well as a new training centre.
- (3) During the reporting period, the research and development centre as the base for the Company's research and development activities officially commenced operation. After development for the year, the research and development centre has more than 20 staff, whilst 30% of them have qualifications of university graduate or above. The principal mission of this research and development centre is to provide technological proposals for the construction and operation of the Company's sewage water treatment plants. Efforts are also devoted to develop patent products with proprietary intellectual property rights. During the reporting period, the applications for patents with respect to the research results of three projects were approved.
- (4) During the reporting period, the Company successfully issued RMB1,200,000,000 of A Shares Convertible Bonds, which was listed on SSE on 19th July 2004 (short form: Tianjin Convertible Bonds; code: 110874).
- (5) During the reporting period, the Company further enhanced its investors' relationship management. Upon the issue of A Shares Convertible Bonds, the Company conducted online road shows, investors' conferences, seminars on analysis of investment value in the PRC. In October 2004, an investors' conference and a seminar on analysis of investment value were conducted by the Company at Guiyang. Selecting Xiaohe Sewage Water Treatment Plant of Guizhou Capital Water as an example, a win-win cooperation model was explained to the capital market. The investors at large gained further understanding about the Company.

## 2. OPERATIONS OF THE GROUP

### (1) Scope of the principal businesses of the Group and its operating conditions

#### 1. Description on the operating conditions of the Group's principal businesses

The principal businesses of the Company are construction, design, management, operation, technological consultation of sewage water treatment plant and their related infrastructure facilities and auxiliary services; the construction, design, toll collection, repair and maintenance, management, technological consultation of toll roads and auxiliary services in relation to the operation of the Southeastern Half Ring Road of the Middle Ring of Tianjin; and the development and operation of environmental protection technology and products.

##### a. Operations of sewage water processing and construction of sewage water treatment plants

During the reporting period, the Company provided sewage water treatment services in Tianjin region through Jizhuangzi Sewage Water Treatment Plant and Dongjiao Sewage Water Treatment Plant. Income for sewage water processing in Tianjin region is derived from the "Sewage Water Processing Agreement" entered into between the Company and Tianjin Sewage Company. During the reporting period, two sewage water treatment plants processed 227,000,000 cubic meters of sewage water in total, representing an increase of 9,000,000 cubic meters or 4.1% as compared to 218,000,000 cubic meters last year. During the reporting period, Jizhuangzi Sewage Water Treatment Plant processed 94,800,000 cubic meters of sewage water, representing an increase of 4.2% as compared to that of last year, whereas Dongjiao Sewage Water Treatment Plant processed 1,319,100,000 cubic meters of sewage water, representing an increase of 3.7% as compared to that last year. The increase in volume of sewage water processed was mainly attributable to the increase in water supply from the upstream.

During the reporting period, income from sewage water treatment business in Tianjin region was RMB437,770,000, representing an increase of 4% as compared to that of last year. The increase in income from sewage water treatment business did not have any material effect to the profit for the reporting period.

Xiaohe Sewage Water Treatment Plant under Guizhou Capital Water entered into "Sewage Water Processing Agreement" with Guiyang Municipal and Urban Administration Bureau, by which Guizhou Capital Water received sewage water treatment fees for processing sewage water. During the reporting period, Xiaohe Sewage Water Treatment Plant processed 26,460,000 cubic meters of sewage water in total, and received RMB22,226,000 as income from sewage water treatment.

## **2. OPERATIONS OF THE GROUP** *(Cont'd)*

### **(1) Scope of the principal businesses of the Group and its operating condition** *(Cont'd)*

#### 1. Description on the operating conditions of the Group's principal businesses *(Cont'd)*

##### a. Operations of sewage water processing and construction of sewage water treatment plants *(Cont'd)*

Income from construction of sewage water treatment plants has been based on the "Sewage Water Plants Fee Agreement" entered into between the Company and Tianjin Sewage Company on 24th September 2001. During the reporting period, water transmission had commenced and is now in the stage of commissioning and trial operation for the expansion project of Jizhuangzi Sewage Water Treatment Plant and Xianyanglu Sewage Water Treatment Plant under construction at the end of 2004. The civil engineering work for the principal structures and buildings at Beicang Sewage Water Treatment Plant was fundamentally completed. It is endeavoured by the Company to complete the equipment commissioning and trial operation for the two newly constructed sewage water treatment plants during the first half of 2005. Sewage water treatment fees can be collected upon reaching the water treatment standard.

As a result of the shortage in supply of electricity in Northern PRC, the power supply authorities delayed in the provision of electricity, as well as the delay in the schedule for equipment purchase with respect to the equipment leased on daily basis, the progress for the expansion project of Jizhuangzi Sewage Water Treatment Plant and Xianyanglu Sewage Water Treatment Plant under construction were affected as a whole. During the first quarter in 2005, the existing plant of Jizhuangzi Sewage Water Treatment Plant (with a processing capability of 260,000 cubic metres per day) suspended certain operations for implementing improvement works. During the first and second quarter of 2005, the volume of sewage water treated by the Company will be affected to a certain extent. The soil processing facility annexed to Xianyanglu Sewage Water Treatment Plant will also commence its equipment installation during the first quarter of 2005. It is expected that the two projects under construction will be completed by August 2005.

During the reporting period, construction of sewage water treatment plants completed which construction fee amounted to approximately RMB440,000,000. In accordance with the progress of the construction project, the Company recognised a construction fee of RMB225,000,000.

## 2. OPERATIONS OF THE GROUP *(Cont'd)*

### (1) Scope of the principal businesses of the Group and its operating condition *(Cont'd)*

#### 1. Description on the operating conditions of the Group's principal businesses *(Cont'd)*

##### b. Operations of toll business

Pursuant to the "Toll Fee Collection Subcontracting Agreement" with Tianjin City Motor Vehicles Toll Collection Office whereby the Company agreed to engage Tianjin City Motor Vehicles Toll Collection Office to collect tolls on its behalf and to handle the operation, management, repair and maintenance of the toll stations. Between 1st January 2004 and 31st December 2004, the Company's toll business realised an income of RMB67,374,000. Since the change of toll collection arrangement to subcontracting toll collection on 1st July 2004, the income was basically stable, without major changes.

#### 2. Analysis of the income and profit contribution by business segment

| Segments   | Income from<br>the relevant<br>business<br><i>RMB'000</i> | Proportion<br>to total income<br>from principal<br>business<br>% | Profit<br>contribution<br><i>RMB'000</i> | Proportion to<br>total profit<br>contribution<br>% |
|--|---|--|--|--|
| Operations of sewage<br>water processing and<br>construction of sewage<br>water treatment plants | 685,200   | 90.74  | 514,135                                  | 90.97  |
| Operation of toll business   | 67,374  | 8.92   | 50,518                                   | 8.94   |
| Sales of construction<br>materials   | 2,574   | 0.34   | 526                                      | 0.09   |
| Including:   |   |  |  |  |
| Connected transactions   | 662,912   | 87.79  | 507,018                                  | 89.71  |
| Total  | 755,148   | —  | 565,179                                  | —  |

*Note:* Connected transactions as to the sales of products to the controlling shareholder of the Company (the "Controlling Shareholder") and its subsidiaries by the Company during the reporting period amounted to nil.

## 2. OPERATIONS OF THE GROUP *(Cont'd)*

### (1) Scope of the income and project contribution of the Group and its operating condition *(Cont'd)*

#### 3. Analysis of the income and profit contribution by geographical segments

| Geographical Segments                 | Income from the relevant business<br>RMB'000 | Proportion to total income<br>(%) | Profit contribution<br>RMB'000 | Proportion to total profit contribution<br>(%) |
|---------------------------------------|--|-----------------------------------|--------------------------------|--|
| Tianjin                               | 732,922                                      | 97.06                             | 558,062                        | 98.74  |
| Guizhou                               | 22,226                                       | 2.94                              | 7,117                          | 1.26   |
| Including:                            |  |                                   |                                |  |
| Connected transactions                | 662,912                                      | 87.79                             | 507,018                        | 89.71  |
| Total                                 | 755,148                                      | —                                 | 565,179                        | —  |
| Inter-company transactions eliminated | 755,148                                      | —                                 | 565,179                        | —  |

#### 4. Description of production, operation and market share of principal products

During the reporting period, the Company is mainly engaged in the provision of construction and operation services for sewage water treatment facilities. Its principal assets and undertakings included four sewage water treatment plants in Tianjin region (including those in operation and under construction). The Company will re-position itself from a region Tianjin player to a national player by gradually expanding its markets to other regions in the PRC.

## 2. OPERATIONS OF THE GROUP (Cont'd)

### (2) Operations and results of the major companies in which the Company has controlling interests and management participation

#### 1. Operations and results of the companies in which the Company has controlling interests

| Name of Company   | Major products or services  | Registered capital<br>RMB'000 | Scale of assets<br>RMB'000 | Net Profit<br>RMB'000 |
|---|---|-------------------------------|----------------------------|-----------------------|
| Tianjin Water Recycling Company Limited<br>(天津中水有限責任公司)       | Production and sales of recycled water, development and construction of facilities for re-used water; manufacture, installation, commissioning and operation of equipment for recycled water  | 20,000                        | 158,859                    | -392                  |
| Guizhou Capital Water Co., Ltd<br>(貴州創業水務有限公司)                | Development, construction, operation and management of urban sewage water treatment plants, drinking water treatment plants and solid waste treatment facilities; research, development and marketing of environmental conservation technology; consultancy services of water treatment facilities and environmental conservation project | 100,000                       | 159,038                    | 1,795                 |
| Tianjin Capital New Materials Company Limited<br>(天津創業建材有限公司) | Manufacture and sales of construction materials, new compound material products, polymer material products; technical consultation on new piping materials  | 37,500                        | 51,978                     | -2,906                |

## 2. OPERATIONS OF THE GROUP *(Cont'd)*

### (2) Operations and results of the major companies in which the Company has controlling interests and management participation *(Cont'd)*

#### 1. Operations and results of the companies in which the Company has controlling interests *(Cont'd)*

"Planning on the Utilisation of Re-cycled Water in Central Cities" issued by Tianjin Municipal Government during the reporting period provided political foundation for the utilisation of re-cycled water in cities, and as a result of which the Company has adopted proactive measures in respect of the development of re-cycled water market.

In 2004, operation of Xiaohe Sewage Water Plant (小河污水處理廠) under Guizhou Capital Water entered into normal cycles, and the quality and quantity of water have attained the required standards. We are currently negotiating with Guiyang Government of the PRC on the construction and operation of the second phase construction work of Xiaohe Sewage Water Plant by Guizhou Capital Water.

In 2004, Tianjin Capital New Materials Company Limited ("Capital Materials Company") has basically completed investments in the infrastructural work and fixed assets, and has commenced trial production in May 2004. Due to some unfavorable factors such as the increase in the price of glass steel raw materials during the reporting period, no profit has yet been realised. In 2005, more efforts will be put on product selection and development and market expansion.

#### 2. Operations and results of the major companies in which the Company invested

As at the end of the reporting period, the Company invested RMB2,000,000 in Tianjin Beifang Rencaigang Company Limited (天津北方人才港股份有限公司) ("Beifang"), representing 6.1% of Beifang's registered capital. The principal activities of Beifang comprise the provisions of senior executive insurance services, senior executive personnel services (employment agent, financial guarantee consultation service, personal creditworthiness assessment); enterprise talent assistance project; development and operation of technological project achievements and real estate development and operation. During the reporting period, Beifang actively explored the sources of talented personnel, established and strengthened the personnel market in Tianjin city, and devoted its efforts to attract more senior personnel, expertise and technicians for Tianjin and the areas surrounding the Bohai district. During the reporting period, Beifang recorded a profit of RMB910,000.

As at the end of the reporting period, the Company invested RMB2,000,000 in Tianjin Baotong Light Mass Materials Company Limited (天津市寶通輕集料有限責任公司) ("Baotong"), representing 20% of Baotong's registered capital. The principal activities of Baotong are the production and sales of high resistance and light mass materials. In 2004, Baotong recorded an income of RMB2,280,000 in its key operations, but recorded a loss in its operation result.



## 2. OPERATIONS OF THE GROUP *(Cont'd)*

### (3) Major customers and suppliers of the Company

|   | <i>RMB'000</i> |                                   |     |
|---|----------------|-----------------------------------|-----|
| Total purchase to the largest supplier      | 26,786         | Proportion to the total purchases | 63% |
| Total purchases from the top five suppliers | 35,209         | Proportion to the total purchases | 82% |
| Total sales to the largest customer         | 662,913        | Proportion to the total sales     | 88% |
| Total sales to the top five customers       | 685,839        | Proportion to the total sales     | 90% |

### (4) Problems and difficulties occurred during the course of operation and solutions thereof

During the reporting period, as the price of electricity continued to surge, the operation expenses of our sewage water treatment plants were affected to a certain extent. The Company was devoted to control costs through centralised management, centralised purchase and increase in income sources to minimise the impact to the lowest level.

## 3. INVESTMENTS OF THE GROUP

The Company's total investments during the reporting period was RMB309,213,000, representing a decrease of 0.25% when compared to last financial year.

### (1) Use of the proceeds

In 2004, the Company raised a net fund of RMB1,165,392,000 by the issue of A Shares Convertible Bonds, and has utilised an aggregate amount of RMB73,446,000 during the year, with a balance of the proceeds of RMB1,091,946,000, which will be used in investing into three construction-in-progress projects.

### 3. INVESTMENTS OF THE GROUP (Cont'd)

#### (2) Projects committed

| Committed project name  | Construction  | Expansion   | Construction  | Total     |
|---|---|---|---|-----------|
|   | project of Xianyanglu<br>Sewage Water<br>Treatment Plant  | project of Jizhuangzi<br>Sewage Water<br>Treatment Plant<br>(Including the water<br>sewage project around<br>south-eastern rural areas)   | project of Beicang<br>Sewage Water<br>Treatment Plant   |           |
|   | RMB'000   | RMB'000   | RMB'000   | RMB'000   |
| Intended investment amount  | 620,000   | 321,000   | 149,000   | 1,090,000 |
| Any change in the actual investment amount be changed                         | No  | No  | No  |           |
| Actual investment   | 48,330  | 6,170   | 18,950  | 73,450    |
| The work progress   | The civil construction project and facility installation and adjustment were completed. Part of the structure on soil region was completed. The roads in the factory region were basically completed. Most of the pipes network was basically completed. The water can be circulated and the factory has commenced trial operation. | The civil construction of structure and buildings and equipment installation and adjustment in the new factory region were completed. The road and pipe network construction was basically completed. | The structure and buildings of the factory region were basically completed. It started to install equipment. The pipe construction outside the factory was basically completed. |           |
| Was the project carried out as scheduled                                      | No  | No  | Yes   |           |
| Reasons for delay in project schedule and the income not up to intended level | 1. The electricity distribution time of the electricity department was delayed due to the power shortage in the northern region of the PRC.<br>2. The procedures of purchasing the equipment from Japan Bank For International Cooperation resulted in delay in equipment purchase, and affected the progress of the whole project. |   |   |           |

Note: The income from the project cannot be measured because the project has not been completed or commenced operation at present.

### **3. INVESTMENTS OF THE GROUP** *(Cont'd)*

#### **(3) Major investments made out of funds other than proceeds from subscription**

1. The Eighth Meeting of the Third Board of Directors of the Company was held on 8th July 2004. The resolution relating to the increase in the registered capital of Capital Materials Company was approved. Capital Materials Company intended to increase its registered capital to RMB40,000,000. Upon the approval of the Board of Directors, the Company intended to increase its capital in Capital Materials Company by contributing additional RMB17,500,000 in cash, and amounted to RMB26,500,000 in aggregate after the increase, representing 66.25% of the registered capital of Capital Materials Company after the increase. The Company became the controlling shareholder of Capital Materials Company. On 28th October 2004, the Company held the Tenth Meeting of the Third Board. During the meeting, the proposal of amendment relating to the alteration to the capital increase agreement in respect of Tianjin Capital New Materials Company Limited was considered and approved. It was resolved that the Company's additional contribution of RMB17.5 million to the registered capital remained unchanged even when Senyuan Technology was not able to fulfill its obligations to make additional capital contribution. Upon completion of the capital increase, the registered capital of Capital Materials Company will be increased to RMB37.5 million. The Company had contributed, in aggregate, RMB 26.5 million, representing 70.67% of the registered capital. (Please also refer to the related announcement made by the Company in Shanghai Securities News, Hong Kong Wen Wei Po and The Standard on 9th July 2004 and 29th October 2004.)
2. The Eighth Meeting of the Third Board of Directors of the Company was held on 8th July 2004. The resolution relating to the change in shareholding of Guizhou Capital Water was approved. Upon the approval of the Board of Directors, the Company agreed with Longli Group Company Limited ("Longli Group") that Longli Group shall transfer 25% of its 30% shareholding in Guizhou Capital Water to the Company and the remaining 5% of its shareholding to Guizhou Jinxiu Cultural Science and Technology Company Limited. (Please also refer to the related announcement made by the Company in Shanghai Securities News, Hong Kong Wen Wei Po and The Standard on 9th July 2004.)

#### **(4) Conclusion**

Possessed with more sewage water treatment plant coming into operation in the PRC, together with robust economic growth and the increase in the living standards, the Directors are confident that the operating income of the Company will continue to surge.

#### 4. FINANCIAL CONDITION OF THE GROUP, OPERATING RESULT AND CASH FLOW ANALYSIS

| Items  | As at<br>the end of<br>the period<br><i>RMB'000</i> | As at the<br>beginning of<br>the period<br><i>RMB'000</i> | Change<br><i>RMB'000</i> | Change<br>% |
|--|---|---|--------------------------|-------------|
| Total assets                                 | 4,657,758   | 3,186,946   | 1,470,812                | 46.15       |
| Profit from principal businesses             | 565,179   | 466,037   | 99,142                   | 21.27       |
| Net profit                                   | 323,197   | 276,892   | 46,305                   | 16.72       |
| Net increase in cash and<br>cash equivalents | 918,667   | 450,074   | 468,593                  | 104.11      |
| Shareholders' equity                         | 2,235,763   | 2,018,966   | 216,797                  | 10.74       |

- (1) The change equity in total assets was attributable to the issuance of A Shares Convertible Bonds.
- (2) The change in profit from principal businesses was attributable to increase of construction income of sewage treatment plant.
- (3) The change in net profit was attributable to increase of construction income of sewage water treatment plant.
- (4) The change in net increase in cash and cash equivalents was attributable to the issuance of A Shares Convertible Bonds.
- (5) The change in Shareholders' equity was attributable to the Company's profits for the reporting period.

#### 5 ANALYSIS OF FINANCIAL POSITION

The financial conditions of the Company can be analysed in detail as follows:

- (1) As at 31st December 2004, the liability to asset ratio (Total liabilities ÷ Total assets) was 51.64%. The amount of the liabilities was reasonable and the ratio represented a reasonable, stable and healthy financial condition.
- (2) As at 31st December 2004, the total assets of the Group amounted to RMB4,657,758,000, representing an increase by 46.15% as compared with the total assets of RMB 3,186,946,000 last year. The increase was mainly due to new construction projects.
- (3) As at 31st December 2004, the long-term liabilities of the Group amounted to RMB1,896,719,000, representing an increase by RMB1,175,067,000 as compared with the long-term liabilities of RMB721,652,000 last year. The increase was mainly attributable to the loans borrowed for the new construction projects.

## 5 ANALYSIS OF FINANCIAL POSITION *(Cont'd)*

- (4) As at 31st December 2004, the Shareholders' equity of the Group amounted to RMB2,235,763,000 representing an increase by 10.74% as compared with the Shareholders' equity of RMB2,018,966,000 last year. The increase was mainly attributable to the Company's profits for the year.
- (5) Total profit before taxation of the Group for the year was RMB482,811,000, representing an increase by 16.92% as compared with the total profits of RMB412,938,000 last year. The increase was mainly due to the increase of profits from the construction of sewage water treatment plants.
- (6) Net profit for the year was RMB323,197,000, representing an increase by 16.72% as compared with the net profit of RMB276,892,000 last year. The increase was mainly due to the increase of profit from the construction of sewage water treatment plants.
- (7) The cash flows derived from operating activities of the Group per share for the year was RMB0.11, representing a decrease by RMB0.10 as compared with RMB0.21 last year. The decrease was mainly due to the decrease of revenue from operations of the construction of sewage water treatment plants and toll fares.
- (8) As at 31st December 2004, the short-term loans comprised the unsecured loan of RMB 100,000,000 obtained by the Company from Shanghai Pudong Development Bank Tianjin Branch bearing an interest rate at 5.31% per annum.
- (9) As at 31st December 2004, the long-term loans comprised : (1) a long-term loan of RMB555,000,000 obtained from the State Development Bank, of which RMB500,000,000 was transferred to the Company along with the acquisition of the three Sewage Plant Construction Projects from Tianjin Sewage Company in 2002. The interest rate of this loan varies according to the interest rate of long-term loan as promulgated by the People's Bank of China. The prevailing interest rate is 6.12%(at the end of 2003:6.76%) per annum and the loan is repayable during the period from 2004 to 2011 by instalments; (2) a long-term loan of RMB50,000,000 obtained from China Everbright Bank bearing an interest rate of 5.76% (at the end of 2003:5.76%).
- (10) The gearing ratio of the Company (the total liabilities to the sum of total liabilities and the shareholder's equity) increased from 36.61% as at 31st December 2003 to 51.64% as at 31st December 2004. It was mainly attributable to the issue of A Share Convertible Bonds.
- (11) As at 31st December 2004, the income tax paid by the subsidiary of the Company, Guizhou Capital Water Co. Ltd. ("Guizhou Capital Water") is RMB884,527 (income tax rate: 33%). There were no other holding or subsidiary company of the Company paid the income tax as at 31st December 2004.
- (12) The ageing of account payable of the Company is within one year.
- (13) As at 31st December 2004, total assets less current liabilities of the Company was RMB4,149,063,000.
- (14) Main receivables and payables items of the Group are denominated in RMB. Therefore, there is no material effect on the Group resulting from the fluctuations in foreign exchange rates.

## 6. OPERATING AND DEVELOPMENT PLANS IN THE COMING YEAR

- (1) To ensure the completion of sewage water treatment projects

In 2005, the Company will capture the opportunities arising from the completion in the expansion work of Jizhuangzi Sewage Water Treatment Plant and the commissioning of Xianyanglu Sewage Water Treatment Plant, and ensure that these sewage water treatment plants will commence normal operation as soon as practicable. During the first half of the year, the Company upgraded the existing Jizhuangzi Sewage Water Treatment Plant, so as to ensure that the plant as a whole will operate in an efficient manner. The phases of construction for Beicang Sewage Water Treatment Plant has been reasonably arranged, so as to maintain normal operation during the year.

- (2) To improve the operation and management of sewage water treatment plants

Following the completion of sewage water treatment projects successively in 2005, Jizhuangzi Sewage Water Treatment Plant (the newly constructed Xianyanglu Sewage Water Treatment Plant and Beicang Sewage Water Treatment Plant) will commence operation. The holding company for the Company's water operations will consistently apply and achieve the objective of minimising the operating costs of sewage water treatment plants. The operation and management activities of the sewage water treatment plants will further improve, so as to support the continuous, stable and rapid development of the Company.

- (3) To devote more efforts to the development of sewage water treatment projects

On the basis of preliminary studies made for the development projects in 2004, the Company will devote more efforts to the development of sewage water treatment projects nationwide. The Company use its best endeavour to complete the negotiation of the contract for its sewage water treatment projects. On the basis of existing sewage water treatment projects, more efforts will be devoted to the development on water projects in the peripheral medium to small cities. At the same time, the Company will focus to develop new markets in central and southern part of China. The Company will actively participate in the tender and seek to be awarded for major national sewage water treatment projects.

- (4) To further adjust its structure and expand its profit centers

Faced with the continuous development in the market, the Company will further leverage on the advantages over technology and project construction, and further establish special companies for project management as well as design and consultation. At the same time, more efforts will be devoted in training, so as to achieve the strategy for the sustainable development of the Company.

- (5) To implement new salary and performance appraisal system

The Company will implement new salary and performance appraisal system, so as to form motivation mechanism, and enhance the motivation of its staff. At the same time, cooperation between different departments will be strengthened. Initiative of the staff will be improved. The Company will fully capitalise on its existing resources and create maximum efficiency at minimum costs.

## **6. OPERATING AND DEVELOPMENT PLANS IN THE COMING YEAR** *(Cont'd)*

- (6) To consolidate the establishment of an internal control system

In 2005, the Company will strengthen budgetary management. A budget limit warning system will be established. Warnings will be issued upon expenditures exceeding plans or budget limits. At the same time, the Company will conduct further reform in office administration, and introduce policies relating to the control of costs and fees. Researches will also be conducted to integrate resources for the Company's websites, the office automation system and operation and control system as well as the simultaneous sewage water treatment system.

- (7) As at 31st December 2004, the Company has no future plan for material investment.

## **7. REVIEW OF BOARD ACTIVITIES**

- (1) **The Board meetings and resolutions passed during the reporting period**

The Board convened nine board meetings in 2004. All Directors seriously executed their duties in accordance with the articles of association of the Company (the "Articles of Association") and the Rules Governing the Procedures for Operating the Board Meeting:

1. The Third Meeting of the Third Board of the Company was convened on 12th February 2004 at which the following resolutions were considered and approved:
  - a. the 2003 annual report of the Company and its summary which the Company intended to announce in the PRC and overseas;
  - b. the 2003 financial statements of the Company as respectively audited by domestic and international auditors of the Company;
  - c. the 2003 board working report of the Company;
  - d. the 2003 final financial report and 2004 financial budget of the Company;
  - e. the 2003 profit appropriation plan of the Company;
  - f. the proposal of the audit committee of the Company regarding the re-appointment of PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd., the PRC and PricewaterhouseCoopers Certified Public Accountants, Hong Kong as the Company's auditors in the PRC and overseas;
  - g. the 2004 operating and development plan of the Company;
  - h. the resolution regarding the adjustment of the Company's department deployments;
  - i. the proposal regarding the extension of the validity period of all the terms of the Company's A Shares Convertible Bonds for one year;

## **7. REVIEW OF BOARD ACTIVITIES** *(Cont'd)*

### **(1) The Board of Directors' meetings and resolutions during the reporting period** *(Cont'd)*

1. The Third Meeting of the Third Board of the Company was convened on 12th February 2004 at which the following resolutions were considered and approved: *(Cont'd)*
  - j. the proposal regarding the application by the Board in the Shareholders' general meeting for the authorisation to allot and issue new Shares (H Shares);
  - k. the proposal regarding the convening of the 2003 annual general meeting (being the 12th Shareholders' general meeting of the Company), and agreed the issue of the notice for the meeting;
  - l. the resolution regarding the change of the Company's registered office.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 13th February 2004.

2. The Fourth Meeting of the Third Board of the Company was convened on 25th March 2004 at which the resolution regarding the appointment of Mr. Chan Yuk Hiu as the full-time qualified accountant of the Company was considered and approved.

The announcement for the resolution of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 26th March 2004.

3. The Fifth Meeting of the Third Board of the Company was convened on 13th April 2004 at which the following resolutions were considered and approved:
  - a. the amendments to the terms of the A Shares Convertible Bonds;
  - b. the submission to the Shareholders' general meeting to authorise the Board to handle the matters relating with the issue of A Shares Convertible Bonds;
  - c. the proposal regarding the convening of the 2004 Extraordinary General Meeting and the convening of H Shares Class Meeting, Domestic Shares Class Meeting for the amendments to the issuing terms of the A Shares Convertible Bonds, and agreed for the issue of notice of such meeting.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 14th April 2004.



## **7. REVIEW OF BOARD ACTIVITIES** *(Cont'd)*

### **(1) The Board of Directors' meetings and resolutions during the reporting period** *(Cont'd)*

4. The Sixth Meeting of the Third Board of the Company was convened on 29th April 2004 at which the following resolutions were considered and approved:
  - a. the 2004 first quarterly report of the Company, and agreed to be announced in the PRC and overseas;
  - b. the confirmation of the cap amount for the waiver of the Company's continuing connected transactions;
  - c. the application for working capital loans;
  - d. the proposal on the convening of the 2004 Second Extraordinary General Meeting, and agreed the issue of the notice of such general meeting.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 30th April 2004.

5. The Seventh Meeting of the Third Board of the Company was convened on 13th May 2004 at which the "Proposal regarding the amendment to the resolutions of the Company's Extraordinary General Meeting and H Shares and Domestic Shares Class Meetings on 30th May 2004" was considered and approved.

The announcement for the resolution of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 14th May 2004.

6. The Eighth Meeting of the Third Board of the Company was convened on 8th July 2004 at which the following resolutions were considered and approved:
  - a. the capital increment to Tianjin Capital New Materials Company Limited;
  - b. the changes in the shareholding in Guizhou Capital Water Co., Ltd.;
  - c. the application for the listing of the Company's 1,200 million A Shares Convertible Bonds.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 9th July 2004.

## **7. REVIEW OF BOARD ACTIVITIES** *(Cont'd)*

### **(1) The Board of Directors' meetings and resolutions during the reporting period** *(Cont'd)*

7. The Ninth Meeting of the Third Board of the Company was convened on 19th August 2004 at which the following resolutions were considered and approved:
- a. the 2004 half-yearly report of the Company and its summary which the Company intended to be announced in the PRC and overseas;
  - b. the adjustments on the Company's department deployment;
  - c. the establishment of a water operation company by the Company;
  - d. the increase in the amount for the purchase of the Company's office building;
  - e. the proposed establishment of Tianjin Capital Environmental Protection (Hong Kong) Company Limited.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 20th August 2004.

8. The Tenth Meeting of the Third Board of the Company was convened on 28th October 2004 at which the following resolutions were considered and approved:
- a. the 2004 third quarterly report of the Company and its summary which the Company intended to announce in the PRC and overseas;
  - b. the capital increment agreement of Tianjin Capital New Materials Company Limited.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 29th October 2004.

9. The Eleventh Meeting of the Third Board of the Company was convened on 16th December 2004, at which the resolutions regarding the resignation of Mr. Chan Yuk Hiu from his office as the full-time qualified accountant of the Company, and the appointment of Ms. To Wai Kum as the full-time qualified accountant of the Company were considered and approved.

The announcement for the resolutions of this Board meeting was published on Shanghai Securities, Hong Kong Wen Wei Po and The Standard on 17th December 2004.

## **7. REVIEW OF BOARD ACTIVITIES** (Cont'd)

### **(2) The Board of Directors' execution of resolutions of the Shareholders' meetings**

During the reporting period, the Board of Directors has strictly complied with the resolutions and mandates granted in the Shareholders' meetings, the Company Law, Securities Law and the Articles of Association to duly execute all the resolutions passed at the Shareholders' meetings. According to the resolutions, the performance by the Board of Directors in 2004 was as follows:

1. The proposal relating to the amendment to the plan of A Shares Convertible Bonds and the extension of the validity period on the Proposal to Issue A Shares Convertible Bonds by the Company was passed in the 2004 Annual General Meeting of the Company. The Board of Directors has devoted efforts in this aspect in 2004, and has successfully issued 1,200 million A Shares Convertible Bonds in July 2004.
2. The proposal in respect of the profit appropriation plan for 2003 was considered and passed at the 2003 Annual General Meeting of the Company. The profit appropriation plan has been implemented. The registration date, ex-dividend date and dividend payment date were 19th May 2004, 20th May 2004 and 28th May 2004.
3. The resolution regarding the approval of the cap amount for the waiver of the Company's continuing connected transactions was considered and passed in the 2004 Second Extraordinary General Meeting of the Company. Pursuant to the resolution of the general meeting, the Board of Directors made serious review on the continuing connected transactions of the Company during the reporting period, and found the transactions comply with the requirements under the waiver document. The independent non-executive Directors and auditors of the Company also issued their opinions in this respect.
4. As to other business transacted in the annual general meeting of the Company, the Board of Directors had implemented such matters in accordance with the resolutions of the Shareholders' general meetings.

## **8. PROPOSAL ON PROFIT APPROPRIATION AND NOT TO INCREASE SHARE CAPITAL BY TRANSFERRING FROM CAPITAL RESERVE FUND**

As audited by PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd., the PRC auditors of the Company and PricewaterhouseCoopers, Certified Public Accountants, Hong Kong auditors of the Company respectively, the consolidated net profit of the Company amounted to RMB323,200,000 in 2004. Taking into account of transferring 10% thereof in the sum of RMB32,320,000 to the statutory common reserve and 5% thereof in the sum of RMB16,160,000 to the statutory provident fund in accordance with the relevant requirements of the Company Law of the PRC and the Articles of Association as well as the retained profit RMB493,800,000 at the beginning of the year and the distribution in 2004 of cash dividend RMB106,400,000 for 2003, the actual profit distributable to Shareholders amounted to RMB662,125,000 for this financial year. Based on the total capital of 1,330,000,000 Shares in issue as at 31st December 2004, it is intended to make a payment of RMB1.00 (including tax) in cash per ten Shares in accordance with the profit appropriation policy for 2004. The appropriation proposal shall be submitted to the Shareholders' general meeting for approval.

No transfer from the capital reserve fund to share capital was made for 2004.

## 9. EXPLANATION OF CERTIFIED PUBLIC ACCOUNTANTS IN RESPECT OF FUNDS USED BY THE CONTROLLING SHAREHOLDERS AND OTHER CONNECTED PARTIES OF THE COMPANY

PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd., the PRC auditors of the Company stated in specific details about the flow of funds with the Controlling Shareholder and other related parties.

In accordance with the requirements as set out in the "Notice Concerning the Regulation on the Flow of Funds between Listed Companies and their related Parties and the Provision of Guarantees by Listed Companies to External Parties" (Zheng Jian Fa [2003] Document No.56 ) issued by the CSRC and the State Asset Management Commission under the State Council, the statement on the application of funds by the Controlling Shareholder and other related parties for the year ended 31st December 2004 was prepared as follows:

### Funds used and repayments by the connected parties of the Company

| Application of fund   | Name of the related parties | Relationship with the Company             | Amount incurred for this year<br><i>RMB'000</i> | Accounting items        | Balance as at the end of the year<br><i>RMB'000</i> | Remarks  |
|-----------------------|-----------------------------|---|---|-------------------------|---|--|
| Operational fund flow | Tianjin Sewage Company      | State-owned company controlled by Tianjin | 437,768   | Accounts receivable     | 133,541   | Income receivable form sewage water treatment fees                                 |
|                       |                             | Municipal Engineering Bureau              | 225,144   | Accounts receivable     | 238,484   | Income receivable from sewage water treatment plant construction projects          |
|                       |                             |   | 22,514  | Advances from customers | (52,685)  | Set off part of 10% prepayment of management fee from sewage construction projects |
|                       |                             |   |   | Net balance             | <u>319,340</u>                                      |  |

## **10. EXPLANATION AND INDEPENDENT OPINIONS OF INDEPENDENT NON-EXECUTIVE DIRECTORS IN RESPECT OF GUARANTEES GRANTED BY THE COMPANY TO EXTERNAL PARTIES**

Pursuant to the principle as implied in the "Notice Concerning the Regulation on the Flow of Funds between Listed Companies and their related Parties and the Provision of Guarantees by Listed Companies to External Parties" (Zheng Jian Fa [2003] Document No.56 ), independent non-executive Directors have conducted examination and implementation of policies towards the external guarantee provided by the Company in a serious manner on the basis of practical principles. The relevant details are as follows:

"Upon careful examination of independent non-executive Directors, they confirmed that the Company has not provided any guarantee to the Controlling Shareholder and other connected parties of the Company as at the end of the reporting period."

Pursuant to the requirements as set out in the document above, the Company held its extraordinary general meeting on 20th December 2003 and approved the amendments to the Articles of Association and the "Rules Governing the Procedures for Operating the Meeting of the Board of Directors", so as to add the relevant provisions on approval procedures for provision of external guarantee and credit information of guaranteed parties.

## **11. AUDIT STATUS**

The accounts of the Company for 2004 prepared in accordance with the PRC Accounting Regulations and prepared in accordance with the Accounting Principles Generally Accepted in Hong Kong have been audited by PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd., the PRC auditors of the Company and PricewaterhouseCoopers Certified Public Accountants, Hong Kong auditors of the Company respectively. The PRC certified public accountants, Zhou Zhonghiu and Lin Zhijian have issued an auditors' report (PWC Zhong Tian Shen Zi (2005) No.[1507]) with unqualified opinion.

## **12. ANY OTHER BUSINESS**

The designated newspapers for the disclosure of the information by the Company are Shanghai Securities, Hong Kong Wen Wei Po and The Standard. There is no change relating to the designated newspapers for the disclosure of information.

**Ma Baiyu**

*Chairman*

Tianjin, the PRC

14th April 2005