

## INDUSTRY OVERVIEW

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## OVERVIEW OF THE PRC ECONOMY

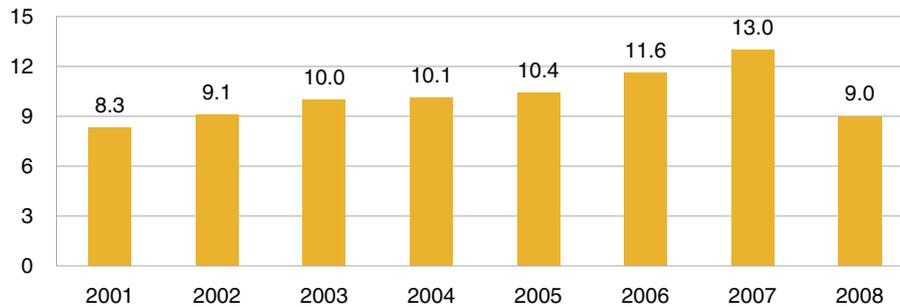
China has experienced significant economic growth between 2001 and 2008 with real GDP increasing at a compound annual growth rate (“**CAGR**”) of 10.4%, making China one of the fastest growing economies in the world. In 2008, the global financial crisis negatively impacted the PRC’s economy. However, the economy began to show signs of recovery and growth in early 2009 in part due to the strong stimulus support from the PRC Government. Real GDP increased by 9.0% in 2008 with GDP reaching approximately RMB30.1 trillion. According to a press release quoting the National Bureau of Statistics, in the first half of 2009, China’s GDP grew 7.1%, partially helped by the massive government spending.

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The table below sets forth the annual real GDP growth in the PRC from 2001 to 2008.

### PRC's Real GDP Growth Rate

(%)



Sources: Euromonitor International from International Monetary Fund, International Financial Statistics and World Economic Outlook Database/United Nations/National Statistics, April 2009

As the rates of urbanization and industrialization accelerate, China has been paying increasing attention to environmental protection in recent years. The Ministry of Environmental Protection of the PRC expressed that China will raise RMB1 trillion from various channels for the three years between 2009 and 2011 for environmental projects. Compared with the RMB47.7 billion investment in the period of the 7<sup>th</sup> Five-Year Plan, the investment in environmental protection during the 11<sup>th</sup> Five-Year Plan is estimated to be approximately RMB1.4 trillion. The investment in environmental protection is set to increase to approximately RMB3.1 trillion in the 12<sup>th</sup> Five-Year Plan, according to the Ministry of Environmental Protection.

<u>Periods</u>	<b>Investment in Environmental Protection</b> (RMB Bn)	<b>% of GDP</b> (%)	<b>Investment Amount in Sewage Treatment</b> (RMB Bn)
“6th Five-Year Plan” (1981 – 1985) .....	15.0	0.5%	N/A
“7th Five-Year Plan” (1986 – 1990) .....	47.7	0.7%	N/A
“8th Five-Year Plan” (1991 – 1995) .....	130.7	0.9%	N/A
“9th Five-Year Plan” (1996 – 2000) .....	344.8	1.0%	35.3
“10th Five-Year Plan” (2001 – 2005) .....	839.3	1.3%	47.1
“11th Five-Year Plan” (2006 – 2010) .....	1,375.0	1.5%	114.0

Sources: Ernst & Young Report, quoting from the Ministry of Environmental Protection and Ernst & Young data. With respect to the figures for investment amount in sewage treatment, note that MEP did not release any sewage investment statistics before 1995, and the 2009 and 2010 figures were estimated by Ernst & Young December 2009.

## OVERVIEW OF THE PRC WATER INDUSTRY

### Overview

According to China Water Industry Development Bulletin, the PRC water market is one of the largest in the world, with gross annual consumption of 583 billion tonnes of fresh water in 2008. Although China's land area consists of 9.6 million square kilometers, the third largest in the world, the

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country is not rich in fresh water reserves. According to the National Bureau of Statistics, China had a total water reserve of 2,712 billion tonnes in 2008. As the population grows and the economy continues to expand, China faces a water scarcity problem. Its per capita water resources was only 2,048 tonnes in 2008, which was less than one quarter of the world average of about 9,000 tonnes per capita, ranking China the 109<sup>th</sup> in the world in terms of per capita water resources. More than 400 cities in China suffer water shortages, and over 100 cities have experienced severe water shortages, with an average shortfall of 16 million tonnes per day in total according to the China Information Industry Association. Geographical disparity worsens the situation since approximately only 20% of water resources are available in Northern China, according to the Ministry of Land and Resources.

Due to the rapid pace of China's industrialization and urbanization, much of the country's wastewater is currently released into rivers and the sea without any treatment. Shanghai, for example, is surrounded by rivers but still has one of the lowest water resources per capita in the country, partly due to its large population and water pollution in upstream areas. According to the State Environmental Protection Administration (which has been reformed as the Ministry of Environmental Protection since March 15, 2008), 62% of all surface water in the PRC was classified as non potable in 2008.

### **Water Consumption in the PRC**

According to China Water Industry Development Bulletin, China's fresh water consumption grew at a CAGR of 1.8% from 532 billion tonnes in 2003 to 583 billion tonnes in 2008. Historically, fresh water consumption in China has been characterized by a high level of agricultural use, representing 65% of the total water consumption according to the Ernst & Young Report. Despite water scarcity and heavy agricultural consumption, residential use and industrial use have displayed steady growth, especially in recent years due to China's rapid economic growth and urbanization. From 2003 to 2008, the CAGR of water demand from industrial and commercial activities were 2.9% and 6.0%, respectively, according to China Water Industry Development Bulletin and the National Bureau of Statistics data, obtained in December 2009 by Ernst & Young.

The growth rate of water consumption in industrial and commercial sectors is expected to remain higher than that of the other sectors based on the historical trends from China Water Industry Development Bulletin. However, according to Ernst & Young's forecast, the growth rate is expected to drop to a more sustainable level due to expected tariff hikes. According to the same forecast, residential water demand is estimated to grow at a CAGR of 2.4% from 2009 to 2020, while industrial and commercial water demand is expected to grow at a CAGR of 2.5% and 5.0%, respectively, for the same period.

Per capita water consumption has grown from 413 tonnes in 2003 to 439 tonnes in 2008, representing a 5-year CAGR of 1.2% according to the Ministry of Water Resources. It is expected that the growth rate will become more stable or drop in the next decade due to the projected tariff hikes, the government's efforts to control water wastage and improved consciousness of water saving among the public. According to the forecast of the Ministry of Water Resources, China's water demand will grow at a CAGR of 1.0% to 2.0% in the next decade from 2009. This would mean that total water demand was estimated to range from 588 billion tonnes to 595 billion tonnes in 2009, and further increase to between 656 billion tonnes to 740 billion tonnes in 2020.

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The table below sets forth the water consumption from different sectors in China.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>CAGR</u>
<b>Residential</b>							
Total Consumption (Bn Tonnes) .....	44.2	44.4	47.4	47.2	48.1	49.7	2.4%
YoY Growth (%) .....		0.5%	6.8%	(0.4)%	1.9%	3.3%	
Proportion (%) .....	8.3%	8.0%	8.5%	8.3%	8.3%	8.5%	
<b>Industrial</b>							
Total Consumption (Bn Tonnes) .....	120.3	125.9	130.6	133.5	139.0	139.0	2.9%
YoY Growth (%) .....		4.7%	3.7%	2.2%	4.1%	0.0%	
Proportion (%) .....	22.6%	22.7%	23.4%	23.4%	24.0%	23.9%	
<b>Commercial</b>							
Total Consumption (Bn Tonnes) .....	8.0	8.9	9.4	9.5	10.4	10.7	6.0%
YoY Growth (%) .....		11.3%	5.6%	1.1%	9.5%	2.9%	
Proportion (%) .....	1.5%	1.6%	1.7%	1.7%	1.8%	1.8%	
<b>Agriculture</b>							
Total Consumption (Bn Tonnes) .....	351.7	367.3	362.2	372.0	371.1	373.2	1.2%
YoY Growth (%) .....		4.4%	(1.4)%	2.7%	(0.2)%	0.6%	
Proportion (%) .....	66.1%	66.2%	65.0%	65.1%	64.1%	64.0%	
<b>Others</b>							
Total Consumption (Bn Tonnes) .....	8.0	8.3	7.8	9.4	10.3	10.2	5.0%
YoY Growth (%) .....		3.8%	(6.0)%	20.5%	9.6%	(1.0)%	
Proportion (%) .....	1.5%	1.5%	1.4%	1.6%	1.8%	1.8%	
<b>Total use (Bn Tonnes) .....</b>	<b><u>532.1</u></b>	<b><u>554.8</u></b>	<b><u>557.3</u></b>	<b><u>571.6</u></b>	<b><u>578.9</u></b>	<b><u>582.8</u></b>	<b><u>1.8%</u></b>
<b>Per capita use (Tonnes) .....</b>	<b><u>413.0</u></b>	<b><u>427.0</u></b>	<b><u>428.0</u></b>	<b><u>435.0</u></b>	<b><u>438.0</u></b>	<b><u>438.9</u></b>	<b><u>1.2%</u></b>

Sources: Ernst & Young Report, quoting from China Water Industry Development Bulletin and the Ministry of Water Resources data, December 2009.

Water demand growth in China is primarily driven by three factors — population growth, urbanization, and development of industrial and commercial activities.

### *Population Growth*

China's population has grown steadily in the past 50 years notwithstanding that China implemented the "one child policy" in 1979. In 2008, total population grew 0.5% compared to the previous year according to the National Bureau of Statistics. However, even with such moderate growth rate, China's population is expected to reach 1.48 billion by 2020.

### *Urbanization*

Accelerated urbanization has resulted in mass migration of rural population to cities and towns. Generally, water demand on a per capita basis in urban areas is higher than that in rural areas, according to the Ernst & Young Report. In addition, urbanization also imposes a higher demand for sewage treatment capacity due to the concentration of industrial, residential and commercial activities in cities.

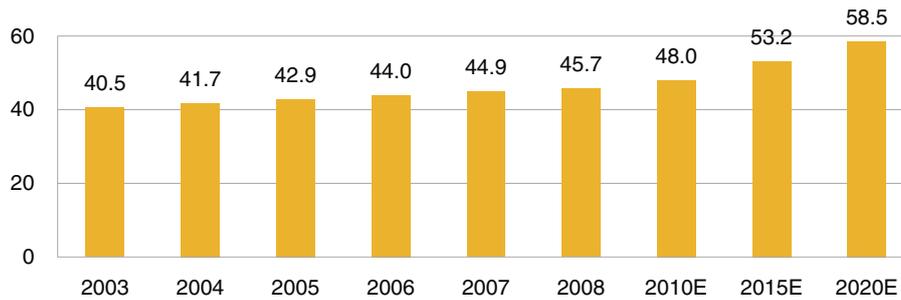
From 2003 to 2008, the urbanization rate in China has grown at a CAGR of 2.5%, reaching 45.7% in 2008, according to the National Bureau of Statistics. The government is expected to continue

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to develop the rural areas with various stimulus measures and it is expected that China will reach approximately 59% urbanization rate by 2020, according to the Ernst & Young report. The table below sets forth the historical and forecasted urbanization rates in China.

### Urbanization Rate

(%)



Sources: Ernst & Young Report, quoting from the National Bureau of Statistics for the 2003-2008 urbanization rates and Ernst & Young estimates for the 2010E, 2015E and 2020E estimated urbanization rates, December 2009.

### Industrialization

Industrialization is another major factor contributing to the increasing water consumption. The industrialization rate is generally evaluated by the increase of the percentage of the industrial output value in relation to the aggregate GDP value.

In 2008, according to the data collected by Ernst & Young, the industrial sector accounted for approximately 49% of GDP and the commercial and agricultural sectors accounted for approximately 51%. Although the data suggested the non-industrial sector is expected to account for a larger share of GDP in the future, industrial activities are expected to continue to grow. Rising affluence and the pace of infrastructure investment is expected to result in continued high output from industries with high water demand. Continuous development of water-intensive industries such as steel production or chemical manufacturing is expected to drive up industrial water demands. The table below sets forth the share of GDP contribution from different sectors in China.

Year	Real GDP Growth Rate (%)	Share of GDP from		
		Industrial Sector (%)	Commercial Sector (%)	Agricultural Sector (%)
2003	10.0	52.9	32.3	14.8
2004	10.1	53.0	31.8	15.2
2005	10.4	47.3	40.3	12.5
2006	11.6	48.7	39.5	11.8
2007	13.0	49.2	39.1	11.7
2008	9.0	48.6	40.1	11.3

Sources: Real GDP Growth Rate: Euromonitor International from International Monetary Fund, World Economic Outlook Database/United Nations/National Statistics, April 2009; GDP Composition: Ernst and Young Report, quoting from the National Bureau of Statistics data, December 2009.

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### Water Resources

The availability of water resources is affected by climate such as droughts, floods, and other environmental conditions. China had a total water reserve of 2,712 billion tonnes in 2008, according to the National Bureau of Statistics. However, according to information collected by Ernst & Young, per capita water resources was only 2,042 tonnes in the same year, less than one quarter of the global average.

From 2003 to 2008, the annual total volume of water resources in China remained relatively stable ranging from 2,682 billion tonnes in 2003 to 2,712 billion tonnes in 2008.

<u>Year</u>	<u>Total Water Resources</u> (Tonnes Bn)	<u>Water Resource per Capita</u> (Tonnes)
2003 .....	2,682	2,076
2004 .....	2,649	2,038
2005 .....	2,743	2,097
2006 .....	2,550	1,941
2007 .....	2,469	1,869
2008 .....	2,712	2,042

*Sources: Ernst & Young Report, quoting from the National Bureau of Statistics data, December 2009*

According to the National Bureau of Statistics, in 2007, thirteen provinces or provincial level cities in China experienced water deficiencies with per capita water resources below 1,000 tonnes while eight of those provinces or provincial level cities had severe water shortages with per capita water resources below 500 tonnes. Among the 600 major cities in China, more than 400 cities suffer from water shortages and over 100 cities have experienced severe water shortages with daily deficiencies amounting to 16 million tonnes in total.

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The water scarcity is aggravated by the imbalance of water resources in China, as most water resources are located in the southern part of China. According to the Ministry of Land and Resources, the region to the south of the Yangtze River occupies 36.5% of China's total acreage, but holds 81% of all its water resources. The table below sets forth the total and per capita water resources by province in 2007.

<u>Province</u>	<u>Total Water Resources in 2007</u> (Tonnes Bn)	<u>Water Resource per Capita in 2007</u> (Tonnes)
Tibet .....	416	149,001
Guangdong .....	222	2,396
Guangxi .....	188	4,011
Sichuan .....	187	2,278
Hunan .....	177	2,795
Yunnan .....	171	3,832
Jiangxi .....	163	3,769
Fujian .....	162	4,578
Xinjiang .....	95	4,695
Zhejiang .....	90	1,829
Guizhou .....	82	2,176
Heilongjiang .....	73	1,905
Hubei .....	64	1,122
Anhui .....	58	949
Qinghai .....	57	10,431
Inner Mongolia .....	41	1,720
Jiangsu .....	40	538
Chongqing .....	38	1,357
Jilin .....	35	1,300
Henan .....	32	343
Shaanxi .....	28	739
Liaoning .....	26	616
Hainan .....	23	2,735
Shandong .....	20	215
Gansu .....	19	710
Hebei .....	11	156
Shanxi .....	9	263
Shanghai .....	3	154
Beijing .....	2	142
Ningxia .....	1	177
Tianjin .....	1	95

*Sources: Ernst & Young Report, quoting from the National Bureau of Statistics data, December 2009*

China's typical continental monsoon weather has caused imbalanced water distribution between different seasons. Regional climate characteristics such as precipitation in water abundant provinces and drought in water deficient provinces also contribute to the water imbalance problem. The PRC Government has started a number of construction projects to move water resources from the south to the north of the country. In addition, wastewater and pollution are prevalent in China, further aggravating the water shortage problem.

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### Water Supply

Historically, annual water supply as provided by water supply facilities has been about 20% of total water resources according to information collected by Ernst & Young. Over the past six decades, China has managed to increase its water supply by nearly five times. Water supply capacity has increased from a daily of 282.0 million tonnes in 1949 to a daily of 1.6 billion tonnes in 2006, according to China Water Industry Development Bulletin. The increase in supply is mainly due to the expansion of water treatment and supply facilities in cities and towns. Water consumption in China increased from 532.0 billion tonnes to 583.0 billion tonnes, representing a CAGR of 1.8% from 2003 to 2008, based on data collected by Ernst & Young. Assuming no major change in water supply conditions, water supply in China is estimated to grow from 583.0 billion tonnes in 2008 to 704.0 billion tonnes in 2020 according to Ernst & Young's forecasts. The table below sets forth historical as well as forecasted water supply in China.

<u>Year</u>	<u>Water Supply</u> (Tonnes Bn)	<u>YoY Growth</u> (%)
2003 .....	532	(3.1)
2004 .....	554	4.1
2005 .....	557	0.5
2006 .....	571	2.5
2007 .....	578	1.2
2008 .....	583	0.9
2009E .....	597	2.4
2010E .....	606	1.5
2011E .....	616	1.7
2012E .....	626	1.6
2015E .....	655	4.6
2020E .....	704	N/A
CAGR ('03-'08) .....		1.8%
CAGR ('08-'20) .....		1.5%

*Sources: Ernst & Young Report, quoting from China Water Industry Development Bulletin for the 2003-2008 water supply volumes, Ernst & Young estimates for the 2009E-2012E, 2015E and 2020E supply volumes (based on average growth rate forecasted by the Ministry of Water Resources), December 2009*

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### WATER AND WASTEWATER TREATMENT INFRASTRUCTURE IN THE PRC

#### Background

The water industry in China is a service mainly run by the government, with limited fees levied for water treatment and the consumption of resources. As a result of this system, significant amounts of water are being squandered and polluted. The amount of sewage discharged has increased significantly in the five years between 2003 and 2008 and it is expected to continue to grow to 2020 due to population growth, urbanization, and industrialization. The table below sets forth the amount of sewage discharged in China for the years 2003-2008 and estimates for 2009, 2010 and 2020.

	<u>Total Sewage Discharge</u> (Tonnes Bn)	<u>YoY Growth</u> (%)	<u>Industrial Sewage Discharge</u> (Tonnes Bn)	<u>YoY Growth</u> (%)	<u>Non-Industrial Sewage Discharge</u> (Tonnes Bn)	<u>YoY Growth</u> (%)
2003 .....	46.0	4.8	21.2	2.9	24.7	6.5
2004 .....	48.2	4.8	22.1	3.8	26.1	5.7
2005 .....	52.4	8.7	24.3	10.0	28.1	7.7
2006 .....	53.6	2.3	24.0	(1.2)	29.6	5.3
2007 .....	55.6	3.7	24.6	2.5	31.0	4.7
2008 .....	57.1	2.7	24.1	(2.0)	33.0	6.5
2009E .....	59.6	3.0	N/A	N/A	N/A	N/A
2010E .....	62.3	3.2	N/A	N/A	N/A	N/A
2020E .....	95.9	N/A	N/A	N/A	N/A	N/A
CAGR ('03-'08) .....		4.4%		2.6%		6.0%
CAGR ('09-'20) .....		4.4%		N/A		N/A

*Sources: Ernst & Young Report, quoting from the Ministry of Environmental Protection data for 2003-2008 discharge volumes and 2003-2008 CAGR and Ernst & Young estimates (based on historical growth rate) for 2009E, 2010E and 2014E discharge volumes, December 2009*

In 2000, with the implementation of the 10<sup>th</sup> Five-Year Plan, the PRC Government started to encourage private investment in the sewage treatment sector. Following China's accession into the World Trade Organization, the water market was liberalized with a series of legislative reforms (the modified Water Law in 2002 and the Opinions on Accelerating the Marketization of Municipal Public Utilities Industry in 2002) in order to attract capital from domestic and foreign private enterprises. According to the Ernst & Young Report, China has budgeted RMB470 billion in the 11<sup>th</sup> Five-Year Plan for sewage treatment and RMB310 billion for water supply facilities. The National Eleventh Five-Year Plan for Environmental Protection issued by the State Council provided that all cities in China shall have sewage treatment facilities, and the urban sewage treatment rate shall be no less than 70% by 2010.

According to the Ernst & Young Report, under the recent economic stimulus plan, the PRC's infrastructure spending is expected to increase and approximately RMB210 billion or 5.3% of the RMB4 trillion stimulus package is expected to be spent on environmental protection projects.

#### Wastewater Treatment in the PRC

Sewage treatment is the process of removing contaminants from industrial, municipal and commercial wastewater through physical, chemical, and biological processes that remove

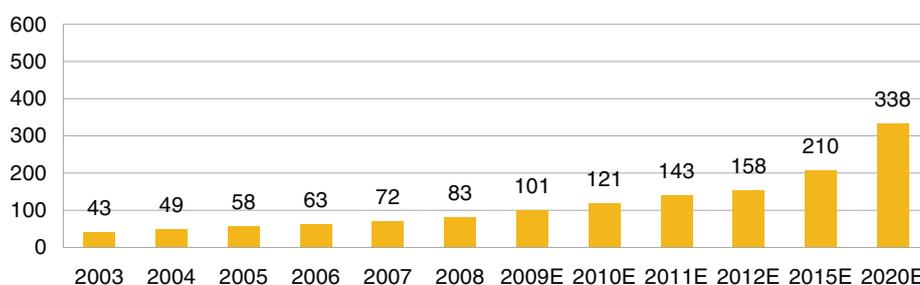
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contaminants. The objective is to make the water suitable for discharge to the environment without causing excessive pollution or for the water to be reused.

According to the data from the Ministry of Construction collected by Ernst & Young, by October 2009, China had 1,817 sewage treatment plants in total with a total daily capacity of 99.5 million tonnes, with total daily capacity expected to exceed 100 million tonnes by the end of 2009. In addition, the Ernst & Young Report provided that there were 1,986 sewage treatment projects that were under construction in October 2009 with a total expected daily capacity of 55.3 million tonnes per day. The chart below sets forth the historical and forecasted daily sewage treatment capacity in China.

### Daily Wastewater Treatment Capacity in China

(Tonnes Mn)



Sources: Ernst & Young Report, quoting from the Ministry of Construction and the Ministry of Environmental Protection data for 2003-2008 capacity volumes and Ernst & Young estimates for 2009E-2012E, 2015E and 2020E capacity volumes, December 2009

The sewage treatment rate has increased significantly for the past five years in China. In 2008, China's residential sewage treatment rate was 57% while total urban sewage treatment (including both industrial and residential) rate was 65.3%, according to the Ernst & Young Report. Based on a review of information from the Ministry of Construction and ISI News, the Ernst & Young Report estimated that the annual sewage treatment rate may continue to grow and reach the government's goal of 70% in 2010 and 90% in 2020.

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In recent years, China has strengthened its environmental legislation and made progress in reducing environmental deterioration. The Ministry of Water Resources, the Ministry of Environmental Protection and the NDRC have issued circulars and guidelines on preventing environment degradation and encouraging water and wastewater treatment investment. The government's investment in sewage treatment has increased from RMB8.7 billion in 2003 to RMB19.4 billion in 2008, representing a CAGR of 17.4% according to the Ernst & Young Report. The table below sets forth the historical and projected urban sewage and urban residential sewage treatment rate as well as annual investment by the government in this sector.

<u>Year</u>	<u>Urban Sewage Treatment Rate</u>	<u>Urban Residential Sewage Treatment Rate</u>	<u>Capital Investment in Sewage Treatment</u>
	(%)	(%)	(Bn RMB)
2003 .....	42.1	25.8	8.7
2004 .....	43.6	32.3	10.5
2005 .....	48.4	37.4	13.4
2006 .....	56.0	43.8	15.1
2007 .....	59.0	49.1	19.6
2008 .....	65.3	57.4	19.4
2009E .....	N/A	60.8	30.0
2010E .....	N/A	66.3	30.0
2020E .....	N/A	90.0	49.2
CAGR ('03-'08) .....	9.2%	17.3%	17.4%
CAGR ('09-'20) .....	N/A	6.0%	4.6%

*Sources: Ernst & Young Report, quoting from the Ministry of Environmental Protection data for 2003-2008 treatment rates and Ernst & Young estimates for 2009E, 2010E and 2020E treatment rates (based on historical growth rate and government announcement of planned investment in the sewage treatment sector), December 2009*

### Regional Characteristics

According to the 11<sup>th</sup> Five-Year Plan, the PRC Government has set an urban sewage treatment rate target of 70% by year 2010. While most of the tier one and tier two cities have already reached this target, cities including Changsha, Wenzhou and Ganzhou need to improve their sewage treatment capacity by a large margin in order to reach the 70% target treatment rate in 2010 according to the Ernst & Young Report.

Based on the information obtained by Ernst & Young as of December 2009, the current sewage treatment rate for first tier cities was about 77% on average and was expected to increase to 86% by 2010. For second tier cities, the average was about 78% and was expected to increase to 91% by 2010. For the third tier cities, the treatment rate averages 65% and was expected to increase to 82% by 2010 based on limited samples taken by Ernst & Young.

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The table below sets forth the urban sewage treatment rates for selected cities in China based on the information obtained by Ernst & Young as of December 2009. As at the Latest Practicable Date, our BOT portfolio consisted of eleven projects in the cities of Anyang, Xi'an, Chongzuo, Hancheng, Jiangyan, Yulin, Shangluo and Yantai. Please refer to the section headed "Business" in this Listing Document for further details of our BOT projects. Current and target urban sewage treatment rates for Chongzuo, Hancheng, Jiangyan, Yulin and Shangluo are not available.

City	Urban Sewage Treatment Rate (based on information obtained by Ernst & Young as of December 2009)	Target Urban Sewage Treatment Rate by 2010
	(%)	(%)
Beijing	90	90
Guangzhou	74	85
Shanghai	73	80
Shenzhen	72	90
Tianjin	76	85
Chongqing	65	90
Tsingdao	70	85
Hangzhou	80	80
Xiamen	80	100
Nanjing	85	85
Wuhan	80	90
Shenyang	75	100
Xi'an	85	95
Taiyuan	80	100
Changsha	48	80
Zhengzhou	90	90
Ningbo	70	70
Yichang	86	86
Wenzhou	55	70
Jinan	80	85
Ganzhou	10	70
Jilin	83	96
Xiangfan	75	85
Jingzhou	80	80
Jingmen	57	70
Anyang	60	80
Yantai	80	90

*Sources: Ernst & Young Report, quoting data from China Water, local municipal bulletin, and Ernst & Young estimates for cities, except Anyang and Yantai, the data for which was based on local government estimates, December 2009.*

For cities that already met the 70% sewage treatment target, there are still market opportunities for private players in the following areas:

- Industrial wastewater treatment;
- Upgrades of the existing treatment facilities because of improved water quality standards and dated facilities and installations;
- Privatization of state-owned facilities; and
- Other business models such as O&M.

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### REGULATORY FRAMEWORK OF THE WATER SECTOR IN THE PRC

#### Overview

China's water market is heavily regulated by the government. Business lines in the water industry include urban water supply, rural water supply, water resources management and sewage management. The water sector is regulated by several ministries and government agencies such as the Ministry of Water Resources, the Ministry of Housing and Urban-Rural Development (previously known as the Ministry of Construction), the Ministry of Environmental Protection and the NDRC.

China's Water Law was promulgated on January 21, 1988 and came into force in July 1988. It was consequently amended in August 2002 and came into force as amended in October 2002. It was further amended and came into force as further amended in August 2009. Some laws and regulations in relation to the water sector were introduced earlier than the Water Law. The following table sets forth the key laws and regulations of the water sector currently in force.

Name of the law or regulations	Issuing agency	Effective date	Content
Notice on strengthening water supply, water saving and preventing water pollution in urban areas	State Council	November 2000	<ul style="list-style-type: none"> <li>● Measures to reduce water pollution and waste</li> <li>● Water quality requirements in key cities</li> <li>● Targets for sewage treatment rate</li> <li>● Water tariff reform and charging of sewage treatment fee</li> </ul>
Water Law of the PRC	Standing Committee of the National People's Congress	July 1988, amended in August 2002, effective October 2002 and further amended in August 2009	<ul style="list-style-type: none"> <li>● Water resources ownership</li> <li>● Water resources utilization rules</li> <li>● Development of water transportation infrastructure</li> <li>● Water supply supervision hierarchy</li> <li>● Water tariff and water drawing permit</li> <li>● Penalties for violations and dispute resolution</li> </ul>
Notice of the National Development and Planning Commission, Ministry of Construction and State Environmental Protection Bureau Issuing Opinion about Advancing Industrialization of Urban Sewage and Garbage Treatment	Ministry of Construction, State Environmental Protection Bureau, State Development and Planning Commission	September 2002	<ul style="list-style-type: none"> <li>● Collection of sewage treatment fee and garbage treatment fee</li> <li>● Industrialization of waste and sewage treatment projects</li> <li>● Transition of government's role</li> </ul>

## INDUSTRY OVERVIEW

Name of the law or regulations	Issuing agency	Effective date	Content
Opinions on Speeding up the Marketization of Municipal Public Utilities Industry	Ministry of Construction	December 2002	<ul style="list-style-type: none"> <li>● Guidelines on opening up public utility market including water, gas, heat, sewage disposal and garbage disposal through public bidding</li> <li>● The franchise system shall be applicable to the existing and newly-established enterprises which engage in the operation of the municipal public utility projects, as well as projects under construction and new projects</li> </ul>
Notice of General Office of State Council on Promoting Water Tariff Reform Encouraging Water-saving and Water Resources Protection	General Office of State Council	April 2004	<ul style="list-style-type: none"> <li>● Goals and principles of water tariff reform</li> <li>● Impose water resources fee on broader area</li> <li>● Improve the collection of sewage treatment fee and water resources fee and supervision of sewage discharge</li> <li>● Extend the reform of the water supply system</li> </ul>
Regulations on the Administration of Water Drawing Permit and Levy of Water Resources Fee	State Council	April 2006	<ul style="list-style-type: none"> <li>● Regulations on Water Drawing Permit licensing process</li> <li>● Administration of levy and use of water resource fee</li> </ul>
Regulations on Water Drawing Permit	Ministry of Water Resources	April 2008	<ul style="list-style-type: none"> <li>● The system of issuing Water Drawing Permit including application and approval process, and supervision bodies etc.</li> </ul>

*Sources: Ernst & Young Report, December 2009*

In addition to the central government's laws and regulations, local governments, including municipal and provincial governments, can set specific implementation measures that are in line with the central government's rules. For example, the central government issued guidelines on water tariffs, but the actual tariff was set by the local governments taking local conditions into consideration.

### Tariff

China's water tariffs are regulated by the government and do not reflect the country's water scarcity and the actual cost of operating water supplies. According to the Progress Report on Price Reform in Energy and Resources Product (《近期能源資源產品價格改革進展》) issued by the NDRC on August 3, 2009, as referenced in the Ernst & Young Report, the average water tariff for residential and industrial users in 36 major cities (including water resources tariff, tap water tariff, and sewage treatment tariff) in the PRC was RMB2.35 per tonne and RMB3.19 per tonne, respectively by the end of 2008, and the average sewage treatment tariff for residential and industrial users was RMB0.70 per tonne and RMB1.00 per tonne, respectively.

## INDUSTRY OVERVIEW

China's current water tariff is much lower than most other developed countries. According to the 2009 Water Tariff Survey done by Global Intelligence Government, the average combined water and wastewater tariff in the 266 major cities was US\$1.89 per tonne, making China's current water tariff only 20% of the world's average. The following table sets forth the average water tariff for major countries in the world.

<u>Country</u>	<u>Tap Water Tariff</u> (US\$ per Tonne)	<u>Wastewater Tariff</u> (US\$ per Tonne)	<u>Combined Water and Wastewater Tariff</u> (US\$ per Tonne)
Denmark .....	8.83	0.00	8.83
Germany .....	3.12	1.75	4.87
France .....	3.58	0.66	4.24
United Kingdom .....	2.03	2.20	4.23
Australia .....	1.80	1.73	3.53
Czech Republic .....	1.61	1.58	3.18
Canada .....	1.41	1.05	2.46
United States .....	1.03	1.42	2.45
Poland .....	1.10	1.26	2.36
Spain .....	1.22	1.11	2.33
Japan .....	1.19	0.95	2.14
Portugal .....	1.31	0.55	1.85
Turkey .....	1.28	0.77	2.05
Italy .....	0.59	0.56	1.15
South Korea .....	0.49	0.16	0.65
Russia .....	0.35	0.24	0.59
Mexico .....	0.48	0.09	0.58
China .....	0.27	0.12	0.39
India .....	0.08	0.00	0.09

Sources: Ernst & Young Report, quoting from Global Water Intelligence data and Ernst & Young Analysis, December 2009

From 2003 to 2008, 36 major cities in China witnessed a CAGR of 6% in water tariff rate, according to data collected by the Ernst & Young Report. At the end of 2008, the combined tap water and wastewater tariff reached RMB2.37 per tonne, while the average wastewater treatment tariff reached RMB0.69 per tonne for the 36 major cities in China as determined by population. The table below sets forth the historic average water tariff for the major 36 cities within China.

<u>Year</u>	<u>Tap Water Tariff</u> (RMB per Tonne)	<u>Wastewater Tariff</u> (RMB per Tonne)	<u>Combined Tap Water and Wastewater Tariff</u> (RMB per Tonne)
2003 .....	1.36	0.44	1.80
2004 .....	1.40	0.50	1.90
2005 .....	1.55	0.57	2.12
2006 .....	1.63	0.60	2.23
2007 .....	1.69	0.65	2.34
2008 .....	1.68	0.69	2.37
CAGR ('03-'08) .....	4.3%	9.4%	5.7%

Sources: Ernst & Young Report, quoting from China Price Info Network data, December 2009

## INDUSTRY OVERVIEW

The tariff increases are due to the following factors:

- The government has been supportive in the implementation of tariff increases due to continued environmental deterioration and increasing water scarcity;
- Economic reform seeking to change the water sector from a pure social benefit system to a more commercialized sector in order to attract participation from the private sector; and
- Water supply and sewage treatment operators have been pushing policy makers to increase water tariffs based on the argument that improved profitability can lead to capacity expansion.

## INDUSTRY OVERVIEW

In July 2009, the NDRC and the Ministry of Housing and Urban-Rural Development jointly issued the Notice of NDRC and the Ministry of Housing and Urban-Rural Development on Management of Urban Water Tariff (《國家發改委、住房和城鄉建設部關於做好城市供水價格管理工作有關問題的通知》), in which the central government raised certain requirements on the adjustment of water tariffs including, among other things, urging the local governments to strictly follow the adjustment procedures and improve the pricing method. Since then, major cities in China have witnessed a new round of water tariff increases. The following table sets forth average water tariffs of major cities in China as of December 2009. As at the Latest Practicable Date, our BOT portfolio consisted of eleven projects in the cities of Anyang, Xi'an, Chongzuo, Hancheng, Jiangyan, Yulin, Shangluo and Yantai. Please refer to the section headed "Business" in this Listing Document for further details of our BOT projects.

City	Residential Tariff			Industrial Tariff		
	Tap Water	Wastewater	Combined	Tap Water	Wastewater	Combined
	(RMB per Tonne)					
Beijing	2.80	0.90	3.70	4.10	1.50	5.60
Guangzhou	1.32	0.90	2.22	1.83	1.40	3.23
Shanghai	1.33	1.08	2.41	2.00	1.80	3.80
Shenzhen	1.90	0.90	2.80	2.25	1.05	3.30
Tianjin	3.08	0.82	3.90	5.50	1.20	6.70
Chongqing	2.10	0.70	2.80	2.35	1.00	3.35
Tsingdao	1.80	0.70	2.50	2.20	0.80	3.00
Hangzhou	1.35	0.50	1.85	1.75	1.80	3.55
Xiamen	1.80	1.00	2.80	1.80	1.20	3.00
Nanjing	1.50	1.22	2.72	1.69	1.41	3.10
Wuhan	1.10	0.80	1.90	1.65	0.80	2.45
Shenyang	1.80	0.60	2.40	2.20	1.00	3.20
Xi'an	2.25	0.65	2.90	2.55	0.90	3.45
Taiyuan	2.40	0.50	2.90	2.70	0.80	3.50
Changsha	1.21	0.65	1.86	1.38	0.80	2.18
Zhengzhou	1.60	0.65	2.25	2.00	0.80	2.80
Ningbo	2.10	0.65	2.75	3.50	1.80	5.30
Yichang	1.12	0.80	1.92	1.45	0.80	2.25
Wenzhou	1.60	0.50	2.10	2.15	1.60	3.75
Jinan	2.25	0.70	2.95	3.00	0.80	3.80
Ganzhou	1.15	0.15	1.30	1.20	0.30	1.50
Jilin	1.00	0.40	1.40	1.80	0.80	2.60
Xiangfan	1.00	1.00	1.50	1.15	0.80	1.95
Wuhan	1.10	0.80	1.90	1.65	0.80	2.45
Jingzhou	1.07	0.80	1.87	1.12	0.80	1.92
Jingmen	1.38	0.25	2.63	1.40	0.30	1.70
Anyang	1.60	0.65	2.25	2.05	0.80	2.85
Chongzuo	1.00	0.80	1.80	1.20	0.80	2.00
Hancheng	1.15	0.30	1.45	1.65	0.30	1.95
Jiangyan	1.10	1.10	2.20	1.50	1.10	2.60
Yulin	1.28	0.70	1.90	1.35	0.86	2.21
Shangluo	2.05	0.40	2.45	2.50	0.40	2.90
Yantai	2.20	0.70	2.90	2.60	0.80	3.40

Sources: Ernst & Young Report, quoting from China Water and local pricing administration data, December 2009

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### GLOBAL WATER AND WASTEWATER TREATMENT INDUSTRY OVERVIEW

The global water and wastewater treatment industry has grown significantly in recent years. Historically, economic development and population growth were the key drivers of demand for treatment infrastructure.

The sewage treatment rate has steadily increased in both developed and developing countries across the world. The sewage treatment rate in developed countries is usually over 80% while the rate is much lower in many of the developing countries according to information collected by Ernst & Young. In many developing countries, the bulk of domestic and industrial wastewater is discharged without any treatment or with only primary treatment.

Asia is a key region for sewage treatment because of its large population and relatively low treatment rate. China and India have strong demand for sewage treatment.

The Middle East region has a significant lack of water resources. The governments of the Middle Eastern countries have been increasingly concerned about wastewater treatment and water recycling in recent years. Desalination of sea water is also considered to be a solution to solve the water shortage problem in the Middle East. The government of Saudi Arabia estimated that the wastewater sector would require more than US\$20 billion in investment over the next two decades, according to the Saudi Arabia 2010 Budget Report, as referenced in the Ernst & Young Report. In 2008, the Saudi Arabia government approved a privatization program covering wastewater treatment plants.

### REPORT COMMISSIONED FROM ERNST & YOUNG

We commissioned Ernst & Young (China) Advisory Limited (“**Ernst & Young**”), an independent advisory firm with relevant industry experience, to conduct an analysis of, and to report on, the PRC and global water and wastewater treatment markets. The report commissioned has been prepared by E&Y independent of our influence. The estimated fee we paid to Ernst & Young was US\$50,000 plus out-of-pocket expenses and taxes which we consider as reflecting market rates. Ernst & Young is a professional services firm providing a broad array of services relating to audit and risk-related services, tax and transactions. Its commercial advisory services include: commercial due diligence, market penetration and growth strategy, competitive analysis, market assessment, sourcing and distribution strategy and business plan review. Ernst & Young’s clients in the water sector within the PRC include other leading water and wastewater enterprises.

The Ernst & Young report we commissioned includes information related to the PRC and global water and wastewater treatment markets, such as an overview of the markets, as well as PRC specific information including government regulations and initiatives with respect to wastewater treatment, statistics relating to water supply, water consumption, wastewater treatment and water tariff and future estimates and trends. Ernst & Young’s independent research was undertaken through both primary and secondary research obtained from various public and private sources, as well as our management with respect to our market position. Secondary research involved reviewing company reports, independent research reports, data based on Ernst & Young’s own research database and data

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from government publications and industry sources. Primary research involved interviewing leading industry participants, government officials, and our executives. Forecast data is based on historical growth rates as well as government announcements of planned investment in the water and wastewater treatment sector. The information from the Ernst & Young Report reflects estimates of market conditions based on samples, and is prepared primarily as a market research tool. Please refer to “Risk Factors — Investors should not place under reliance on industry and market information and statistics derived from the Ernst & Young report or official government publications contained in the Listing Document”.