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CAPITAL ENVIRONMENT HOLDINGS LIMITED

首創環境控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 03989)

FURTHER ANNOUNCEMENT CONTINUING CONNECTED TRANSACTION COOPERATION FRAMEWORK AGREEMENT AND CONNECTED TRANSACTION CAPITAL INCREASE AGREEMENT

Reference is made to the announcements of Capital Environment Holdings Limited (the “**Company**”) dated 11 March 2024 and 28 March 2024 (the “**Announcements**”) in relation to the cooperation framework agreement and capital increase agreement. Unless the context otherwise requires, terms defined in the Announcements shall have the same meanings in this announcement when used herein.

The Company would like to provide the following information in relation to the key quantitative inputs and assumptions and the computation process as to how the appraised value of Capital Environmental Sanitation was arrived.

In respect of the valuation in the Valuation Report, it is also assumed the following:

1. the projected gross profit margin is approximately 18%, which was prepared based on the existing project contracts of Capital Environmental Sanitation, as well as factors that may have an impact to the revenue of those existing project contracts, including, among others, (i) the current operational status and future business plans of Capital Environmental Sanitation; and (ii) the market demand, competition, and industry policy of the market that Capital Environmental Sanitation is currently operating in.

The following revenue and gross profit margin of the existing project contracts of Capital Environmental Sanitation were considered for the purpose of the valuation:

| Project name | April 2023⁽¹⁾ – 2029 and beyond |
|---|---|
| Gross Annual Revenue of the Existing Projects | Approximately RMB115 million – RMB128 million |
| Gross Profit Margin of Garbage disposal (Project A) ⁽²⁾ | 17% – 26% |
| Gross Profit Margin of Garbage disposal (Project B) ⁽²⁾ | 2% – 7% |
| Gross Profit Margin of Garbage disposal (Project C) ⁽²⁾ | 47% – 48% |
| Gross Profit Margin of Garbage disposal (Project D) ⁽²⁾ | 23% |
| Gross Profit Margin of Garbage disposal (Project E) ⁽³⁾ | 8% |
| Gross Profit Margin of Garbage disposal revenue (Project F) ⁽²⁾ | 19% – 26% |
| Gross Profit Margin of Garbage disposal revenue (Project G) ⁽²⁾ | 23% – 24% |
| Gross Profit Margin of Garbage disposal revenue (Project H) ⁽⁴⁾ | 23% |
| Gross Profit Margin of Garbage disposal revenue (Project I) ⁽²⁾ | 17% – 18% |

Notes:

- (1) The projected figures for the existing project contracts from April to December 2023 were based on the actual monthly operational data.
- (2) The projected figures were determined based on the forecast income of each existing project contract minus a certain amount of expected deductions based on the actual operating conditions of each existing project contract.
- (3) The projected figures were calculated based on the existing contract's tax-exclusive amount of RMB56,600.
- (4) The forecast period ended on 31 August 2023 based on actual operating data.

2. save to the projected figures for operating cost, which primarily comprises of labour costs, direct materials, utilities, maintenance costs, depreciation and other production costs, the valuation adopting the income approach does not take into account of potential growth. When determining the projected cost, only the growth of labour cost is estimated with reference to i) the current salary policy of Capital Environmental Sanitation; and ii) a certain growth ratio.

3. the discount rate to the valuation of Capital Environmental Sanitation is approximately 9.26% based on the calculation of the weighted average cost of capital with the following formulas used for such calculation:

$$r = r_d \times w_d + r_e \times w_e$$

W_d : Debt ratio of the subject company

$$w_d = D / (E+D)$$

W_e : Equity ratio of the subject company

$$w_e = E / (E+D)$$

r_d : Interest-bearing debt interest rate after income taxes

r_e : Expected return on equity calculated based on the capital asset pricing model (CAPM)

$$r_e = r_f + \beta_e \times (r_m - r_f) + \varepsilon$$

r_f : risk-free rate of return

r_m : expected rate of return of the market

ε : characteristic risk adjustment coefficient of the subject company

β_e : The expected market risk coefficient of the equity capital of the subject company

$$\beta_e = \beta_u \times (1 + (1-t) \times D/E)$$

β_u : Expected unlevered market risk coefficients for comparable companies

t : applicable income tax rate

Calculating the debt ratio (W_d) and equity ratio (W_e)

Based on the estimated interest-paying debts and equity of Capital Environmental Sanitation, the debt ratio and equity ratio of Capital Environmental Sanitation are calculated as follows:

$$w_d = 2,798.91 / (3,501.38 + 2,798.91) = 0.4443$$

$$w_e = 3,501.38 / (3,501.38 + 2,798.91) = 0.5557$$

Determining Interest-bearing debt interest rate after income taxes (r_d)

The interest-bearing interest rate of Capital Environmental Sanitation is determined to be 6.5% based on the interest rates of the existing loan balances of Capital Environmental Sanitation. Accordingly, the interest-bearing debt interest rate after income tax (r_d) in this valuation is calculated to be 4.88% (6.5% x (1-25%)).

Determining the risk-free rate of return (r_f)

The risk-free rate of return reflects the basic value that can be earned when the principal is free of default risk and the expected income is guaranteed. The 2.85% yield on 10-year treasury bond is selected as the risk-free rate of return (r_f) in the valuation.

Determining the market risk premium ($r_m - r_f$)

The market risk premium represents the additional return that investors expect to earn for taking on the risk of investing in the overall market compared to a risk-free investment. The market risk premium is typically calculated using historical data on market risk premiums. In this valuation, the long-term average return rate of the Shanghai Composite Index is used to determine the market expected return rate (r_m), which aligns with the market guide on asset valuation in the PRC. After conducting a comprehensive analysis of the arithmetic mean, geometric mean, and harmonic mean of the Shanghai Composite Index, the Independent Valuer has determined the market expected return rate to be 9.7%. Accordingly, the market risk premium ($r_m - r_f$) in this valuation is determined to be 6.85% (9.7% - 2.85%).

Determining the unlevered market risk coefficients (β_u) and the market risk coefficient of equity (β_e)

$$\beta_e = \beta_u \times (1 + (1-t) \times D/E)$$

In light of the business characteristics, company size, profitability, growth prospects, industry competitiveness, and development stage of Capital Environmental Sanitation and based on the closeness or similarity between the business of comparable companies in the public facility management industry and Capital Environmental Sanitation, the Independent Valuer obtained an average β_u of 0.7222 based on the market prices of 30 comparable companies in the Shanghai and Shenzhen Stock Exchange for a period of 250 weeks prior to the date of valuation through the iFinD software. Afterwards, the β_e is calculated by taking into account of the target capital structure of Capital Environmental Sanitation on the date of valuation (D/E = 0.7994). The formula of calculation is as follows:

$$\beta_e = 0.7222 \times (1 + (1-0.25) \times 0.7994) = 1.1552$$

Determining the applicable tax rate (t)

The applicable income tax rate (t) is determined based on the forecasted annual statutory income tax rate of Capital Environmental Sanitation, i.e. 25%.

Determining the characteristic risk adjustment coefficient (ε)

Characteristic risk adjustment coefficient denotes the unsystematic risk which is the risk adjusted rate of return required due to the factors specific to the appraised entity. When compared with comparable listed companies and taking into account of factors as a whole such as Capital Environmental Sanitation's company size, development stage, core competitiveness, reliance on major customers and key suppliers, financing capabilities and financing costs, and the robustness of profit forecasts, the characteristic risk adjustment coefficient (ε) is determined as 2% in this valuation.

Determining the expected return on equity (r_e)

In light of the above, the expected return on equity (r_e) is calculated as follows:

$$r_e = 0.0285 + 1.1552 \times 0.0686 + 0.02 = 0.1277$$

Accordingly, the discount rate (r) is calculated as 9.26%, i.e. $0.0488 \times 0.4443 + 0.1277 \times 0.5557$

4. the market share of Capital Environmental Sanitation remains unchanged;
5. the projected increase for the expenses for the staff, management team and outsourced workers of Capital Environmental Sanitation is approximately 1.5%; and
6. the appraised value of Capital Environmental Sanitation is approximately RMB35,013,800 under the income approach, representing an increase of approximately 5.37% from the book value of the entire shareholders' equity of Capital Environmental Sanitation, that is, RMB33,229,400 as at the date of the valuation. In arriving the appraised value, the following additional factors were considered:
 - (i) the shifting of the operation of Capital Environmental Sanitation from "labour-intensive" to "mechanised, intelligent, and integrated", which further enhances its competitive advantage in the industry, following its efforts to drive its technological transformation and the introduction of a self-developed "integrated environmental sanitation management platform". Such a platform enables the use of intelligent applications for GPS tracking of sanitation vehicles, video surveillance of landfill sites, and centralised command and dispatch; and
 - (ii) the market environment, industry position, business qualifications, management level, human resources, customer relationships, and other factors of Capital Environmental Sanitation that are directly and closely related to its profitability and operational cash flow.

As a result of the foregoing, the appraised value is higher than the book value of the entire shareholders' equity of Capital Environmental Sanitation.

Such valuation has been reported to the Group in accordance with the requirements of the Interim Measures for the Evaluation and Management of State-owned Assets of Enterprises in Beijing by the Beijing State-owned Assets Supervision and Administration Commission (Document No. Jing Guo Zi Fa [2008] No. 5) (北京市國資委《北京市企業國有資產評估管理暫行辦法》(京國資發[2008]5號)). Since the Capital Increase relates to 49% of its enlarged registered capital of Capital Environmental Sanitation, the consideration for the Capital Increase, namely, RMB33,640,700 represents 49% of the valuation of the enlarged registered capital of Capital Environmental Sanitation, that is, approximately RMB35,013,800 divided by 51%, then minus RMB35,013,800.

By order of the Board of
Capital Environment Holdings Limited
Li Fujing
Chairman

Hong Kong, 13 June 2024

As at the date of this announcement, the Board comprises two executive directors, namely Mr. Li Fujing and Mr. Li Qingsong; one non-executive director, namely Ms. Hao Chunmei; and four independent non-executive directors, namely Mr. Pao Ping Wing, Mr. Cheng Kai Tai, Allen, Dr. Chan Yee Wah and Dr. Cao Fuguo.