

## Becoming a proxy to China railway segment

## China Logistics

### Proactive (8089 HK, HK\$8.83)

### Not Rated

**Move into railway logistic services.** Proactive, which used to offer value-added telecommunications and computer telephony solutions, is moving to become a pure railway freight services provider. On March 2007, the company signed an agreement to acquire 61.3% in Onway Logistic Ltd. for HK\$681.5m, which will be settled by the issuance of 95.0m shares at HK\$7.11 each and HK\$6.0m in cash. China Railway Hong Kong, which is held 51.0% by Guangdong China Railway Television Media Company Ltd. and 49.0% by Pacific Telecom and Network Ltd., will hold 38.75% in Onway Logistic.

**Railway freight business through Onway Logistics.** Onway Logistic will take 80.0% in a JV, China Railway Television Freight Logistics and Transportation Ltd. (CRTFLT), formed by Guangdong China Railway Television Media Company Ltd. (16.0% stake) and Beijing Run Tong Transportation Consulting Company Ltd. (4.0% stake) to provide railway freight services in China. Effectively, Proactive will hold 49.0% in CRTFLT.

**Background of the JV partners.** Guangdong China Railway Television Media Company Ltd. is a wholly owned subsidiary and window company of the Ministry of Railways (MOR). Beijing Run Tong Transportation Consulting Company Ltd. is wholly owned by MOR.

**Business model.** MOR will grant trackage rights to CRTFLT for 50 years. The company will offer rail freight transportation services for raw materials and resources such as coal and iron ore from Shaanxi Province and Inner Mongolia to major coastal cities, and western regions of China. Coal mines, power plants, steel smelters will be its potential customers.

**Revenue model.** CRTFLT will purchase 300 trains over 15-18 months. Each 55-wagon train will be able to travel at a maximum speed of 90.0 km/hour. Each wagon has the loading capacity of 70.0 tons. Assuming the average rate per single trip of RMB0.095/ton/km, utilization rate of 91.4% and average distance per route of 946.0 km, we estimate that each train can generate RMB316,243.5 in revenue per one-way trip. Assuming the loading utilization rate of the returning train of 45.7% and return freight rate of RMB0.067 per ton/km, each train can generate RMB427,760.0 per round trip.

**Profit sharing scheme.** The group plans to kick off the business in 3Q FY12/07F, starting with 30 trains. CRTFL will distribute 35.0-50.0% of its revenue to MOR as a railway network usage fee and reimbursement of operation costs. Besides, since Proactive has only 49.0% in CRTFLT, 51.0% of the profit from CRTFLT will be distributed to MOR.

**Further fund raising.** Proactive will serve as CRTFLT's fund raising platform, in our view. CRTFLT plans to spend US\$700.0m on trains ordered from China Northern Locomotive & Rolling Stock Industry (Group) Corporation (NLRIG), with an initial batch of 30. The group raised US\$50.0m from a placement of 55.0m shares at HK\$7.11 each in March 2007. It will raise US\$200.0m through equity financing, with the remainder coming from bank loans.

**Benefits from tight supply.** According to estimates, China needs at least 280,000 wagons per day to cope with its expanding domestic trade activities, while currently there are only fewer than 140,000 wagons per day available. Besides, 70,000 wagons are set to retire this year and 270,000 wagons between 2008 and 2009, which will boost demand for railway freight services.