

BABCOCK & BROWN ENVIRONMENTAL INVESTMENTS

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ASX Release

26 February 2008

LODGES SUPPLEMENTARY TARGET'S STATEMENT

Babcock & Brown Environmental Investments Limited (ASX: BEI) announced today that it served on Babcock & Brown Environmental Investments Holdings Pty Ltd (a subsidiary of Babcock & Brown (ASX: BNB)) (the Bidder) and lodged with ASIC a Supplementary Target's Statement.

A copy of the Supplementary Target's Statement is attached and is available on the BEI website www.bbeil.com.au.

ENDS

If Shareholders have any questions in relation to the Offer, they should contact Link Market Services on 1800 206 847 or +61 2 8280 7219.

SUPPLEMENTARY TARGET'S STATEMENT

BABCOCK & BROWN ENVIRONMENTAL INVESTMENTS LIMITED
ABN 77 074 226 065

1. INTRODUCTION

This document is a supplementary target's statement under section 644 of the *Corporations Act 2001* (Cth). It is the first supplementary target's statement ("**Supplementary Target's Statement**") issued by Babcock & Brown Environmental Investments Limited ABN 77 074 226 065 ("**BEI**") in relation to the off-market takeover bid by Babcock & Brown Environmental Investments Holdings Pty Ltd ACN 128 887 267 (the "**Bidder**"). The Supplementary Target's Statement supplements, and should be read together with, the Target's Statement dated 21 December 2007 issued by BEI.

This Supplementary Target's Statement is given in response to the replacement Bidder's Statement issued by the Bidder dated 21 December 2007, as supplemented by the second supplementary bidder's statement dated 21 February 2008.

You should read this Supplementary Target's Statement in its entirety.

This Supplementary Target's Statement is dated 26 February 2008. A copy of this Supplementary Target's Statement was lodged with ASIC and sent to the ASX and the Bidder on 26 February 2008. Neither ASIC nor the ASX nor any of their officers takes any responsibility for its contents.

2. BEI FINANCIAL REPORT FOR THE HALF YEAR ENDED 31 DECEMBER 2007

On 22 February 2008 BEI announced a net loss after tax of \$55.5 million for the six months to 31 December 2007, as recorded in its financial report for that period ("**Financial Report**"). The result was impacted by a significant write-down in relation to BEI's investment in and loan to Natural Fuels Australia as foreshadowed in BEI's Target's Statement dated 21 December 2007 and other write-downs in respect of Denco and Southern Oil particularised below.

After taking account of the above adjustments and the loss incurred for the six months period, the Financial Report records that the net assets of BEI Group total \$70.6 million or \$0.527 per Share as at 31 December 2007.

Note 2 to the Financial Report also records that the BEI Group has a deficiency in net current assets of \$30,292,211 at 31 December 2007 and that the ability of the BEI Group to continue as a going concern is dependent on the ongoing support of its major shareholder and BEI's ability to become profitable. The Babcock & Brown Group currently intends to support BEI and its controlled entities for a period of at least 12 months from 22 February 2008, or until such time as BEI resumes profitability and is financially self sufficient.

Denco

Note 8(ii) to the Financial Report records an impairment loss of \$6,867,346 recognised on goodwill for continuing operations. The impaired goodwill related to the purchase of the Denco business in the 2006 financial year. The discount rate applied to cash flow

projections is 13% (2006: 11%). The increased rate is due to the current state of the commodity markets affecting the ethanol industry.

Southern Oil

Note 8(i) to the Financial Report records an impairment loss of \$460,000, representing the write-down of the intangible assets in the logistics and collection business within the Southern Oil group to the recoverable amount. This cash generating unit is intended to operate at a “breakeven” cash level. The recoverable amount estimation was based on a value in use calculation and was determined at the cash generating unit level.

Natural Fuels Australia

Natural Fuels Australia is accounted for as an associate, using the equity method of accounting as BEI has significant influence. Due to the terms of the agreement with the joint shareholder, BEI does not exhibit control.

Note 6 to the Financial Report records a \$30,531,809 impairment loss, representing the write-down of the property and plant in Natural Fuels Australia to the recoverable amount. The recoverable amount estimation was based on a value in use calculation and was determined at the cash generating unit level. As a result, an impairment of the receivable from Natural Fuels Australia of \$41,468,966 was recognised to reduce the carrying value to the recoverable amount.

Additionally, Note 9 to the Financial Report records a \$7,345,060 impairment loss, representing the write-down of BEI’s investment in Natural Fuels Australia to the recoverable amount. The recoverable amount estimation was based on a value in use calculation and was determined at the cash generating unit level.

The following describes each key assumption on which management has based its cash flow projections in determining the value in use of the investment in Natural Fuels Australia:

- The cash flows were discounted at a rate of 15%.
- The budget revenue and expenses were based on prior year results, plant capabilities and future projections.
- Raw materials increases – due to the adverse changes in the commodity process, particularly palm oil, it is currently uneconomical to produce biodiesel for the near future term. Values assigned to this key assumption are consistent with external sources.

3. UPDATE ON BEI OPERATIONS

Following is an update in relation to BEI’s operations for the six months to 31 December 2007:

Denco

As set out in the Target’s Statement, there are a number of issues affecting the profitability of the US ethanol industry and as a result of the unfavourable market conditions, Denco has operated over the last six months at slightly in excess of EBITDA breakeven and continues to do so.

Southern Oil

The Target’s Statement set out anticipated earnings guidance in respect of Southern Oil. Due to the unexpected ongoing market volatility, Southern Oil is currently expected to achieve a significantly lower EBITDA for the full year than previously anticipated.

Natural Fuels Australia

BEI owns 50% of Natural Fuels Australia which owns the biodiesel plant in Darwin. Ongoing work is being carried out by Lurgi (Natural Fuels Australia's technology provider) to address the issues referred to in the Target's Statement, however the installation of the centrifuge in Darwin has still not provided the solution anticipated by Lurgi. It is not known when the plant will run efficiently and at full capacity.

Discussions are continuing with Lurgi to try to resolve outstanding contractual and other issues.

The price of palm olein, the principal feedstock for the Natural Fuels Darwin's biodiesel plant in Darwin, is currently over US\$1,100 per tonne, a price at which it is currently uneconomic to produce biodiesel.

As stated in the Target's Statement, Natural Fuels Australia is currently dependent on the ongoing support of its Shareholders and will require additional funding in order to finalise commissioning and to continue as a going concern until biodiesel economics improve.

4. RECENT TRADING IN BBSNS

BBSN are listed on the ASX. The trading price and volume of BBSN for the period July 2007 to date is graphed below.



The closing price of BBSN on 25 February 2008 was \$77.00, which values the BBSN Consideration at \$0.385 per Share.

5. INDEPENDENT DIRECTORS' RECOMMENDATION AND INTENTIONS

As at 21 February 2008, the Bidder has disclosed that it has a relevant interest in 73.21% of the Shares.

As there has not been a superior proposal to the Offer and for the reasons set out in section 2 of the Target's Statement, the Independent Directors maintain their recommendation that Shareholders accept the Offer.

As recorded in section 1.3 of the Target's Statement, the Independent Directors stated that they make no recommendation as to whether Shareholders should accept the Offer for the Cash Consideration (comprising \$0.50 cash for every Share) or the BBSN Consideration (comprising one BBSN for every 200 Shares held).

In deciding whether to accept the Offer with respect to the Cash Consideration or the BBSN Consideration, Shareholders should take account of the movements in the market price of BBSNs as set out above.

Shareholders should note that the market price of BBSNs may increase or decrease and Shareholders should consult with their professional advisers if they have any queries. As stated in the Target's Statement, trading of BBSN is reasonably illiquid for large volumes.

Tax implications of accepting the Offer and electing to receive either the Cash Consideration or the BBSN Consideration are summarised in Section 9 of the Target's Statement.

In the event that the Offer is not successful, absent a material change in the businesses, BEI will need to raise capital and / or sell assets. It is the current intention of BEI's major shareholder, Babcock & Brown, to provide financial support in the short term.

6. ADDITIONAL INFORMATION

6.1 Defined Terms

Terms defined and used in this Supplementary Target's Statement have the same meaning as in the glossary section (Section 11) of the Target's Statement, unless the contrary intention appears.

6.2 No Investment Advice

The information in this Supplementary Target's Statement does not constitute financial product advice. This Supplementary Target's Statement does not take into account the individual objectives, financial situation or particular needs of each Shareholder. This Supplementary Target's Statement does not contain personal financial or taxation advice. BEI and the Independent Directors encourage you to seek your own independent financial and taxation advice before making a decision as to whether or not to accept the Offer.

6.3 Consent to inclusion of statements

Each Director has given and has not, before the date of this Supplementary Target's Statement, withdrawn their consent to be named in this Supplementary Target's Statement as a Director and to the inclusion of statements in this Supplementary Target's Statement made or authorised by him, in the form and context which the statements are included.

Each of the above persons:

- do not make, or purport to make, any statements in this Supplementary Target's Statement or any statement on which a statement in this Supplementary Target's

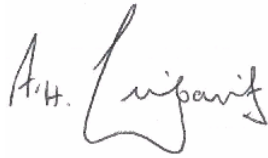
Statement is based other than those statements referred to above and as consented to by that person; and

- to the maximum extent permitted by law, expressly disclaims and takes no responsibility for any part of this Supplementary Target's Statement other than as described in this section with the person's consent.

6.4 Authorisation

Signed for and on behalf of Babcock & Brown Environmental Investments Limited following a resolution of its Directors, pursuant to section 351 of the Corporations Act.

Date: 26 February 2008

A handwritten signature in black ink, appearing to read 'A. H. Leibowitz', written in a cursive style.

Mr Tony Leibowitz
Lead Independent Director