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European Nickel PLC Positive Philippines Progress 41.5p

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European Nickel (AIM:ENK, ENickel) has announced an increase in the scale of the nickel laterite resource under JV with its partners in the Philippines, Rusina Mining and DMCI.

Previously the Acoje resource, drilled out by Rusina and DMCI, was given as a JORC-compliant (indicated and inferred) 33.15Mt @ 0.95% nickel and 0.07% cobalt down to an average depth of around 2.5m. The additional work carried out in H2 2007 brings the new estimate up to 48.8Mt @ 1.13% nickel and 0.06% cobalt. A contained metal increase from 315kt to 550kt of nickel, or 74.6% higher. The increase is mainly a result of drilling through the upper limonite zone into the deeper, higher grade, saprolite zone.

An initial resource for the 40%-owned Zambales Chromite (ZC) property has also been announced with a JORC-compliant 23.5Mt @ 1.18% nickel and 0.08% cobalt. This is based mainly on shallow historical pitting and is classified as inferred. Drilling is expected in 2008 and it is reasonable to expect a resource estimate increase based upon the results of that drilling.

The terms of the Acoje JV allow ENickel to acquire 40% interest in that resource on \$10m expenditure to produce a feasibility study into heap leaching nickel laterites from the property.

Both defined resources lie on the same geological trend. DMCI is currently operating a small-scale direct shipping nickel laterite mine from the Acoje resource.

The JV appears to be performing well with the division of labour roughly being - DCMI providing local skills and contacts and carrying out direct ship ore production, Rusina carrying out the geological exploration and resource development and ENickel bringing in the processing and production skills.

ENickel has mobilised its engineering team to progress the feasibility study by developing a test facility on the same scale as its Çaldağ test plant in Turkey.

Share Price:	41.5p
12m High:	63.5p
12m Low:	30.5p
Market Cap:	£220m fully diluted
Shares in Issue:	385m undiluted 390m diluted
Gearing:	nil (currently)
Interest Cover:	n.a.
Cash at Bank:	£55m/\$110m
EPIC Code:	ENK
SEDOL No:	3426540
Sector:	Mining
Market:	London AIM, PLUS
PR:	Bankside Communications 020 7367 8888

Nominated Advisor and Broker:

Canaccord Adams

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Previous Research Note: "Ahead in Albania", 47.5p, 14th December 2007.

Analyst: Ian Falconer

Detail of Developments

The two resources (Acoje and Zambales Chromite (ZC)) are around 15km from each other on the island of Luzon in the Philippines. At present the ZC resource is only estimated for the limonite layer. At Acoje this layer extends to around 3m in depth with an underlying nickel-enriched saprolite.

The resource estimate for Acoje has risen from a JORC-compliant 33.15Mt @ 0.95% nickel and 0.07% cobalt (in indicated and inferred categories) to 48.8Mt @ 1.13% nickel and 0.06% cobalt. In terms of contained metal this is a rise from 315,000t to 551,000t of nickel and from 23,205t to 29,280t of cobalt.

The initial ZC resource estimate inferred as a JORC-compliant 23.5Mt @ 1.18% nickel and 0.08% cobalt. This infers contained metal of 277,300t of nickel and 18,800t of cobalt.

Total metals inventory under the Philippines JV is therefore 828,300t of nickel and 48,080t of cobalt (in all categories and reported under JORC).

The 2007 drilling on the Acoje property raised resources by 74.6% by drilling into the saprolite layer. If a similar increase in resources were to be found on the ZC property the estimate would rise from 23.5Mt to around 41Mt bringing the total contained nickel across the two properties to over 1Mt. Given the geographic proximity of the two deposits and similarity in underlying geology we feel that this is a reasonable speculation, but it is subject to the results of the scheduled 2008 drill program.

Mine/Processing Plant Development

The terms of the JV allow for ENickel to acquire a 40% interest in the nickel laterite resources on the Acoje property in return for spending US\$10m and producing a Feasibility Study which definitively tests the viability of recovering nickel by acid heap leaching. The Feasibility Study into producing a refined mixed nickel/cobalt hydroxide product (MHP) by acid heap leaching, as defined under a technical agreement with BHP Billiton, is expected to cost at least US\$10m and so satisfy both criteria

The heap leach pads and trial processing facility are expected to be on a similar scale to those already built at Çaldağ in Turkey, with three 8,000t heaps irrigated using acid sourced from local producers. Column leach tests suggest that acid consumption may be lower than that at Çaldağ, so we will not predict at this point whether an on-site acid production facility should be expected in any full scale facility.

The Zambales Chromite property is 40% owned by ENickel (40% Rusina Mining, 20% DCMI). Any later full scale processing plant is expected to take laterite from both resources, and so benefit from economies of scale and the mine scheduling flexibility inherent in multi-site operation. This is especially important in the Philippines where typhoons can cause severe local disruption.

We believe that site selection for the test facility is advanced and that pre-construction site preparation could start as early as April, subject to environmental permitting. ENickel is operating the trial and would continue to operate the mines and processing plant to full scale production if the feasibility study is positive (and subject to funding and permitting considerations).

Rusina/DCMI Ferro-nickel Smelter Plans

Prior to ENickel engaging in the JV with Rusina, DCMI announced its intention to test the feasibility of constructing and operating a ferro-nickel smelter within the Philippines with Rusina taking a 40% free-carried interest and DCMI operating the study with a 60% interest. The intention was/is to provide high-grade feed from the Acoje resource to produce a ferro-nickel product. The process resulting in a saleable product with robust pricing is very sensitive to feed grade and the market for the product is expected to shrink in the long term as it is energy intensive and dirty to use. In effect this would be a DOS (Direct Ore Shipping) operation with an internal customer, vertically integrating one step towards the end-user.

We are not aware of DCMI's current opinion regarding advancing this smelter project, but it is reasonable to assume that a long-term solution that results in a preferred product and benefits from cobalt credits (e.g. acid heap leaching producing MHP) would be seen well by all concerned. However this is a matter of company strategy so we would not rule out DCMI pursuing the smelter option and it remains in Rusina's medium-term strategy. Under ENickel's agreement with Rusina up to 10Mt can be extracted from the Acoje deposit for shipment as DOS or to the DCMI/Rusina ferro-nickel smelter.

Valuation

The total estimated resource available for processing currently stands at 72.4Mt at an average grade of 1.15% nickel and 0.06% cobalt, or contained nickel of around 830,000t. Cobalt recoveries and payability are significantly lower than those of the nickel in a mixed hydroxide product, so for now we will leave potential credits for this increasingly valuable metal aside. At the current LME 27-month buyer price of \$26,925/t, 40% of 830,000t of nickel are worth approximately US\$8.9bn. Of course that doesn't reflect mining cost, recovery rates or payability from any end-buyer.

If we use the same rule-of-thumb rationale as we recently used to reach a tentative valuation for ENickel's Albanian asset (Devolli) we reach a value, to ENickel, of between \$890m (£445m) and \$89m (£45m). However the shallow nature of the resources, their status of being permitted (some being mined) and the resource's continuing ease of definition reduce the risks that this asset will not be developed to full production.

We will assume that 80% of the resource can be converted to mineable reserves giving a value between \$712m (£356m) and \$71m (£36m). If we place a 30% completion risk on the project this comes down to between \$498m (£249m) and \$50m (£25m). If we take the mid-range value of £149.5m, this equates to 38.3p per share on current issue.

Combined with our previous values for Çaldağ (89.8p) and Devolli (19.2p) we estimate the total sum of parts valuation for ENickel to be 147.3p per share, with appropriate cautions on the dilutive effects of equity-derived funding to develop Acoje and/or Devolli to production.

As a comparison, the detailed studies and agreements relating to ENickel's Caldag Mine and product provide for 70% of ore present to be placed for leaching, 72% of the contained nickel and 80% of contained cobalt to be recoverable with 75% nickel payability and 35% cobalt payability. Indicative mining costs of \$10/t have been given by other workers, we feel that these are appropriate, but do not include processing costs. We will wait until the test plant has produced an indicative processing cost before producing a valuation based upon a Discounted Cash Flow.

Discussion

In the 7 months from its announcement, the ENickel/Rusina Mining/DCMI JV has advanced quickly from an initial resource based mainly upon historical pitting and shallow drilling to a large JORC-compliant nickel/cobalt resource in two separate locations. Mining is proceeding to supply unrefined iron-rich nickel laterites direct to customers. This is otherwise known as Direct Ore Shipping (DOS). This operation is not expected to significantly affect the amount of laterite available under the JV for processing to MHP by acid heap leaching as a previous agreement between Rusina and DCMI limits mining to 5Mt of laterite or 5 years (whichever comes first). This agreement is renewable, but does indicate the scale of the DOS operations that can be expected while the heap leach feasibility study progresses. It should be noted that the DOS operation will be high-grading i.e. selectively extracting the highest grade material as the DOS customers are very sensitive to ore grade. This has in the past resulted in individual shipments being rejected by the customer. Obviously this is not the case for a Mixed Hydroxide Product, where process control can guarantee the grade of the finished product and is a major reason for investing the time and effort to refine the laterite to that product.

The DOS mining does have some beneficial side-effects. It leads to a greater knowledge of grade continuity and the deposit's geology as a whole, as well as providing ENickel's JV partners with a separate on-going income. This provides a degree of stability to the partnership and allows supplier and customer relationships to mature.

While the JV agreement provides for up to a 40% ownership of the Filipino resource its value to ENickel is likely to be equal to that of the 100% owned Çaldağ Mine due to the larger size, lower operating costs and higher grade. ENickel's experienced team are now well versed in the pitfalls of the heap leach technique and the Rusina Mining/DMCI partnership have all the necessary "on the ground" relationships to pursue the project on an aggressive timescale. Given the favourable development regime and permitted status of the resource we expect development of the resource to continue rapidly towards production.

Two mines (Çaldağ and Acoje/ZC) producing roughly equal amounts of attributable nickel using the low-cost heap leach technique should propel ENickel into the ranks of the world class nickel producers. At present the closest analogue for ENickel when Çaldağ reaches production and if Acoje/ZC reaches production is the Australian laterite miner Minara Resources (ASX:MRE), currently capitalised at A\$2.7bn (£1.2bn) and ranked 5th in terms of nickel production. Minera's current annual production is around 30,000t of nickel in

briquette form. ENickel's stated aim is to achieve 50,000t of annual contained nickel production as MHP within 5 years.

We expect Çaldağ to start production approximately 15 months from completion of construction (still being delayed by the lack of a forestry permit for the area to be used as leach pads and plant). It is conceivable that the Filipino assets may be approaching financing or even construction by the time full production is reached in Turkey (hoped to be mid-2009). Of course this is subject to all the boxes being ticked in the intervening time.

The Philippines

The two recent attacks on mining operations by communist paramilitaries have been restricted to the islands south of Manila. These have been disruptive and damaging rather than deadly and the group responsible, the Maoist NPA, is well known for extracting "revolutionary taxes" from local businesses. As with all operations in the Philippines, community relations will remain an important cornerstone to operations. The JV partners have a well known and established Philippines-listed company, in DMCI, as an active partner and given ENickel's previous exemplary record on establishing good local relationships we would hope that this operation is not the focus of offensive action by this group. Given the distance from the current area of disruptive action and Luzon's history of relative stability we do not believe this project to be at significant risk at this time.

Conclusions

We feel that Çaldağ remains the most certain of the three projects to reach production, Acoje the next most likely with Devolli predominantly present as risk diversification. This is reflected in our valuations.

There is significant upside in the Acoje/ZC project and we expect to see a revised resource estimate for the ZC resource in H2 2008. The market for direct ship nickel laterite is not seen as a sustainable one in the long-term. Its allied processing step to ferro-nickel is both dirty and energy intensive, so we opine that it is in the best interest of all partners in this JV to pursue the added-value Mixed Hydroxide Product that the heap leach processing technique gives.

We would expect timescales for the pilot plant construction and test leaching to be compressed slightly when compared to those experienced at Çaldağ due to the experience gained on that project and the large treasury that ENickel currently have.

While mining operations have recently been the focus of violent attention in the Philippines recently, the experience of other UK-listed miners shows that social licence can be maintained and operations de-risked from that perspective. In most other aspects (mining code, taxation, prospectivity, etc) the Philippines is an excellent place to look for mineral deposits.

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