

Expansion into copper rich Chile**China Resources****China Elegance (476 HK, HK\$3.00)****Not Rated**

Repositioning as a copper producer. Listed on the Hong Kong Stock Exchange in 1996, China Elegance (CE) is engaged in the manufacturing and trading of consumer products. In 2002, it diversified into metal and mineral resources trading, exploration and exploitation by investing into an iron ore exploration and production business. Since then, it has been repositioning itself as a nonferrous metal refiner trader, smelter and producer by divesting non-metal assets. It disposed of its 60.0% stake in consumer product manufacturer Unicon Spirit for HK\$3.4m in 2006 and its 10.2% interest in an Australia-listed software provider, QMASTOR, for HK\$7.3m in July 2007. In August and October of this year, the group announced plans to invest in two copper-related projects in Chile. To better reflect its business nature, the company has proposed to be renamed Sinocop Resources (Holdings) Ltd.

Alliance with the strongest. The group will work with Tong Guan, a wholly owned subsidiary of Tongling Nonferrous Metals Group Holding Co. Ltd. (TNMG) to develop a copper ore-processing project in La Plata, Chile. Established in 1952 and listed on the Shenzhen Stock Exchange in November 1996, TNMG is principally engaged in copper mining, mineral processing, smelting, refining and copper product processing. With six mines, five smelters and five copper processing enterprises, it is the largest copper smelter in China and the eight largest in the world. It produced 544,800.0 tons of cathode copper in 2006 and sales revenue reached RMB33.7b. Its copper cathode under the brand name “Jintun” and “CopperCrown” have been registered with the London Metals Exchange (LME). The group will be able to tap into TNMG’s copper smelting expertise as well as its sales channels and capital.

Strong shareholder. Shougang Holding (HK) Ltd., a subsidiary of China Shougang International Trade and Engineering Corporation (CSITEC), currently owns about 10.4% interests in the group. CSITEC is a wholly-owned subsidiary of Shougang Group, one of China’s largest steel producers and major conglomerates. CSITEC has interests in four Hong Kong-listed companies, Shougang Concord Grand (730 HK, HK\$0.78, NR), Shougang Concord Technology (521 HK, HK\$0.95, NR), Shougang Concord Century (103 HK, HK\$1.17, NR) and Shougang Concord International Enterprise (697 HK, HK\$4.03, NR). Via its subsidiary Shougang Hierro Peru S.A, CSITEC owns and operates a 670.0 km² iron mine in Peru with 1.7b tones of iron reserves. Other than financial support, we expect CSITEC to share its expertise in the Latin America mining industry. One of CE’s directors, Mr. Li Shaofeng, is the deputy-managing director of Shougang Holding (Hong Kong) and managing director of Shougang Concord Century Holdings, which is engaged in the processing and trade of copper and brass products.

Management profile. Mr. Cheung Ngan - chairman and director, joined in 1998 and became the controlling shareholder in January 2004. He possesses substantial experience in trading of metal ore and management of ferroalloy plants. He managed silicone mine exploration and production in Fujian, China.

Mr. Chan Chungchun - deputy chairman and director, joined in 1995. He has substantial experience in corporate finance and financial advisory and in the manufacturing sector in Hong Kong and China.

Mr. Li Shaofeng - director, joined in 2007. He is the deputy-managing director of Shougang Holding (Hong Kong) and managing director of Shougang Concord Century Holdings. He was managing director of Shougang Concord Grand between 2002 and 2004 and has extensive experience in the management of metal enterprises.

Copper JV in Chile. On 29 October, the company announced its Chile-based copper ore-processing joint venture (JV) with Tong Guan, a wholly owned subsidiary of Tongling Nonferrous Metals Group (TNMG) and Catania Copper (Chile) Limited (CCCL), which is 90.0% owned by the company’s chairman and deputy chairman. The company will invest US\$30.0m (for a 60% stake) and Tong Guan US\$10.0m (for a 20.0% stake). CCCL will inject the total issued share capital of copper processor Verde into the JV for a 20.0% stake. Upon the

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completion of the transaction, the JV will own 100.0% of Verde, its major vehicle for copper ore processing in La Plata area in Chile.

Verde. Verde is principally engaged in the processing of copper ore in Chile and owns equipment, water use rights, land use rights, office premises and ancillary facilities in the La Plata area. It has an exclusive supply agreement with CAH Reserve S.A., an ore supplier in La Plata.

Secured supply. CAH Reserve S.A. is 45.0%-owned by an independent third party and 55.0% by the company's chairman and deputy chairman. Under the agreement, CAH Reserve will supply Verde with copper ore from its mining concessions in La Plata. The selling price per ton is based on the extraction cost of copper ore per ton plus US\$8.0 and shall not exceed the comparable market price in Chile. If no comparable market price is available, the price must not be less favorable to the third party. Thus the agreement ensures Verde's stable ore supply at the market price. Verde will provide CAH Reserve with an estimate of the amount it requires for the next financial year (1 April - 31 March) with at least 6 months advance notice. Should the estimate for any financial year from 1 April 2010 fall below 16.4m tons, CAH Reserve can sell the difference to any third party. CAH Reserve extracts ore from La Plata Copper Mines, located at Tierra Amarrilla, 50.0km from Copiapo, close to the Freeport McMoran's Candelaria copper mine, BHP Billiton's Escondida copper mine and Codelco's Chuquicamata copper mine. In 2006, the annual production volume of the mines was 187,000.0 tons, 1.2m tons and 187,000.0 tons, respectively.

Hydrometallurgical plant. Verde will build a hydrometallurgical processing plant with an annual capacity of up to 1.8m tons of copper ore by 4Q 2008. The plant will crush and heap leach oxide ore and extract copper, which will then be crystallized to produce copper sulphate with copper content of 65.0%.

Partner's commitment. Under the JV agreement, Tong Guan will build either by itself, with other parties or through Verde, another floatation plant with an annual processing capacity of up to 14.6m tons. Under the preliminary business plan, Verde will acquire the sulphide ore from CAH Reserve and supply it to Tong Guan's floatation plant for further processing. In return, Verde will pay the plant a processing fee calculated based on the production cost plus a profit margin between 10.0% and 15.0%. The end product, copper concentrate, will have copper content of 25.0%. Tong Guan will purchase 50.0% of the output produced by the floatation plant from Verde at a price based on the prevailing long-term contractual market price. Tong Guan will also have the right of first refusal to acquire the remaining 50.0% of the output produced by the floatation plant from Verde. Separately, under the JV agreement, Tong Guan will assist in seconding and recruiting part of the management team and technical experts for the JV.

Risk factors. Since CAH Reserve will supply copper ore to Verde exclusively, the JV's hydrometallurgical processing plant and Tong Guan's floatation plant will have a stable supply of ore. The JV's sales of copper concentrate will also be secured, as Tong Guan will underwrite at least 50.0% of the floatation plant's output. With its 60.0% stake in the JV, the company will be able to consolidate the JV's financial results into its own account. However, there are some execution risks: 1) Verde's JV's hydrometallurgical processing plant will not come on stream until 4Q08; 2) the construction timetable, construction costs and shareholding structure of Tong Guan's floatation plant are yet to be determined. As the chairmen indirectly own 55.0% of CAH Reserve, deals with Verde (60%-owned by the company) will constitute connected transactions. Without taking into account the purchase of sulphide ore for Tong Guan's floatation plant, annual transactions between Verde and CAH Reserve are capped at US\$3.0m in FY3/08F, US\$16.5m in FY3/09F and US\$33.0m in FY3/10F, based on the projected annual purchase quantity of 1.8m tons.

Acquisition of Maipo mine. On 29 August, the company announced plans to acquire 60.0% in TCA (Chile) from its chairman and deputy chairman for HK\$4.68b, to be satisfied by an issue and allotment of 1.3b consideration shares at HK\$3.6 each to the vendors. Upon the completion of the transaction, the company shall hold 60.0%, chairman and deputy chairman collectively 20.0% and Loyal Nation, 20.0% in TCA. CE's chairman and deputy chairman will have an effective 55% stake in TCA.

Table 1: Timetable of the acquisitions

Sep 07 to Oct 07	Appoint technical adviser to design the drilling program
Nov-07	Commence the infrastructure and preparation work for drilling
Nov 07 to Oct 08	Carry out the topography review, drilling and assay.
Nov 08 to Jan 09	Appoint independent valuer to perform the valuation of TCA
Feb-09	Technical adviser report and valuation report ready

Source: The company

Obtaining 18 mining concessions. Incorporated in Chile, TCA holds one duly incorporated mining concession and is engaged in the exploration, exploitation and processing of mineral resources. It has filed applications for another 17 mining exploitation concessions, including five duly incorporated mining exploration concessions, to the Ordinary Court of Justice in Chile. It has also completed the registration of the petition for the 17 mining concessions in the Discovery Registry in Chile and published the rights in the Mining Official Gazette. Once awarded, the company will hold 18 concessions.

Rich in resources. The 18 mining concessions are in Maipo copper mines located in San Gabriel of the San Jose administrative region, 60.0-75.0km south east of Santiago. Covering 47.0 km², Maipo Copper Mine is divided into three mining areas, Perico, North Maipo and South Maipo. According to a geological study by the North China Geological Exploration Bureau (NCGEB) between May 2000 and July 2001, North and South Maipo copper mines are situated on the central-north mineral vein, located in the southern part of Chile. They share the same mineral structure with Anglo America's La Disputada copper mine and Codelco's Ei Teniente copper mine. As of the end of fiscal year 2006, Anglo America's La Disputada copper mine produced 295,000.0 tons of copper and Codelco's Ei Teniente 420,000.0. NCGEB identified three large anomalous and 16 mineral veins with Cu contents of 0.28-2.29%. Chilean geologists estimate that the Perico mining area has copper reserves of 300,000 tons with the average Cu content exceeding 1.0%.

Launch in 2010. According to the company's business plan and acquisition timetable, Maipo copper mines will not come on stream until 2010. The JV, which will control TCA, will set up a hydrometallurgical processing plant to process the ore extracted from the mines into copper concentrate.

Preliminary earnings forecasts. We quantify the group's business plan under the following major assumptions: 1) LME copper price at US\$7,000.0/ton. 2) total number of share capital at 1,368.3m at end-FY3/09F and 2,668.3m at end-FY3/10F; 3) Verde's hydrometallurgical processing plant and Tong Guan's floatation plant to be come on stream in FY3/09F; and 4) TCA's hydrometallurgical processing plant to start operation in FY3/10F.

Table 2: Preliminary revenue model of China Elegance

Year ended March 31 (HK\$m)	2009F	2010F	2011F	2012F
Turnover	2,922.0	5,673.1	8,424.3	9,714.4
Cost of good sold	(1,353.7)	(2,810.6)	(3,877.5)	(4,267.6)
Transportation cost	(86.2)	(170.4)	(254.6)	(295.7)
Gross profit	1,482.1	2,692.1	4,292.2	5,151.1
Taxation	(252.0)	(524.0)	(796.0)	(942.0)
After tax profit	1,230.2	2,168.2	3,496.2	4,209.1
Minority interests	(492.1)	(1,023.3)	(1,554.5)	(1,839.7)
Net profit	738.1	1,144.9	1,941.7	2,369.5
Free cash flow	457.6	(3,069.5)	2,388.2	2,903.6
EPS (HK\$)	0.539	0.429	0.727	0.888

Source: SBI E2-Capital

Table 3: Preliminary revenue model of Tong Guan's floatation plant

Year ended March 31 (HK\$m)	2009F	2010F	2011F	2012F
Turnover	2,580.3	3,870.4	5,160.5	5,160.5
Cost of good sold	(1,224.4)	(1,836.6)	(2,448.8)	(2,448.8)
Transportation cost	(82.2)	(123.3)	(164.4)	(164.4)
Gross profit	1,273.6	1,910.5	2,547.3	2,547.3
Taxation	(216.5)	(324.8)	(433.0)	(433.0)
After tax profit	1,057.1	1,585.7	2,114.2	2,114.2
Minority interests	(422.8)	(634.3)	(845.7)	(845.7)
Net profit	634.3	951.4	1,268.5	1,268.5
Free cash flow	379.0	691.9	921.2	921.2
Assumption:				
LME copper price (US\$/ton)	7,000.0	7,000.0	7,000.0	7,000.0
ASP (US\$/ton)	1,569.1	1,569.1	1,569.1	1,569.1
Daily ores processing volume (ton)	20,000	30,000	40,000	40,000
Production volume (m tons)	0.21	0.32	0.42	0.42
Production cost per ton	744.6	744.6	744.6	744.6
Ore processing capacity (tons)	40,000	40,000	40,000	40,000
Operating days	312	312	312	312

Source: SBI E2-Capital

Table 4: Preliminary revenue model of Verde's hydrometallurgical processing plant

Year ended March 31 (HK\$m)	2009F	2010F	2011F	2012F
Turnover	341.7	512.6	683.5	683.5
Cost of good sold	(129.3)	(194.0)	(258.6)	(258.6)
Transportation cost	(4.0)	(5.9)	(7.9)	(7.9)
Gross profit	208.5	312.7	417.0	417.0
Taxation	(35.4)	(53.2)	(70.9)	(70.9)
After tax profit	173.0	259.6	346.1	346.1
Minority interests	(69.2)	(103.8)	(138.4)	(138.4)
Net profit	103.8	155.7	207.6	207.6
Free cash flow	78.6	141.1	203.7	203.7
Assumption:				
LME copper price (US\$/ton)	7,000.0	7,000.0	7,000.0	7,000.0
ASP (US\$/ton)	4,322.5	4,322.5	4,322.5	4,322.5
Daily ores processing volume (ton)	2,500	3,750	5,000	5,000
Production volume (m tons)	0.01	0.02	0.02	0.02
Production cost per ton	1,635.5	1,635.5	1,635.5	1,635.5
Ore processing capacity (tons)	5,000	5,000	5,000	5,000
Operating days	312	312	312	312

Source: SBI E2-Capital

Table 5: Preliminary revenue model of TCA's flotation plant

Year ended March 31 (HK\$m)	2010F	2011F	2012F	2013F
Turnover	1,290.1	2,580.3	3,870.4	5,160.5
Cost of good sold	(390.0)	(780.1)	(1,170.1)	(1,560.2)
Transportation cost	(41.1)	(82.2)	(123.3)	(164.4)
Gross profit	859.0	1,718.0	2,577.0	3,435.9
Taxation	(146.0)	(292.1)	(438.1)	(584.1)
After tax profit	713.0	1,425.9	2,138.9	2,851.8
Minority interests	(285.2)	(570.4)	(855.5)	(1,140.7)
Net profit	427.8	855.5	1,283.3	1,711.1
Free cash flow	(3,902.6)	1,263.3	1,778.7	2,294.1
Assumption:				
LME copper price (US\$/ton)	7,000	7,000	7,000	7,000
ASP (US\$/ton)	1,569	1,569	1,569	1,569
Daily ores processing volume (ton)	10,000	20,000	30,000	40,000
Production volume (m tons)	0.11	0.21	0.32	0.42
Production cost per ton	474.4	474.4	474.4	474.4
Ore processing capacity (tons)	40,000	40,000	40,000	40,000
Operating days	312	312	312	312

Source: SBI E2-Capital

Fund raising. In July 2006, CE placed 150.0m new shares at HK\$0.055 each, raising HK\$8.04m. In July 2007, it issued and allotted convertible bonds with a face value of HK\$70.0m and conversion price of HK\$0.40 each via SBI-E2 Capital. Shougang Holding (HK) Ltd. took 125.0m shares. In the same month, the group issued and allotted convertible bonds with a face value of HK\$160.0m and conversion price of HK\$1.0 to Credit Suisse and Deutsche Bank, evenly. Currently, CE has 1,208.3m shares outstanding. If all the outstanding CBs are exercised, the group's share capital will increase to 1,368.3m shares. Upon the issue of the consideration shares for the acquisition of the Maipo copper project, the group's outstanding shares shall increase to 2,668.3m.

Valuation. Hong Kong and China-listed copper miner and smelters are trading at a one-year forward P/E of 40.6x and two-year forward P/E of 35.8x. Based on our preliminary EPS forecasts, CE is trading at P/E of 5.6x.

Table 6: Peer group comparison

Company name	Ticker	Year End	Currency	Price	Market Cap (US\$m)	P/E (x)	
						1-yr forward	2-yr forward
Jiangxi Copper	358 HK	Dec	HKD	26.9	19,483.4	16.4	17.3
EPI Holdings	689 HK	Dec	HKD	0.6	298.8	11.7	4.9
Anhui Jingcheng Copper	002171 CH	Dec	CNY	33.1	602.0	68.9	47.1
Tongling Nonferrous Metals Group	000630 CH	Dec	CNY	33.4	5,782.3	41.0	36.1
Yunnan Copper Industry	000878 CH	Dec	CNY	78.8	13,263.2	47.7	34.3
Western Mining	601168 CH	Dec	CNY	48.6	15,519.9	64.1	60.4
<i>Average</i>						40.6	35.8

Source: Bloomberg

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as Placing Agent for China Elegance (convertible bonds with a face value of HK\$70.0m) in July 2007.