

**Appendix 4E: Preliminary Final Report**
**Name of entity**

Magnesium International Limited

ABN 23 003 669 163

**1 Reporting period**

Report for the financial year ended 30 June 2006

**2 Results for announcement to the market**

2.1 Revenue from ordinary activities	up 93.3% to	<b>\$A'000</b> 29
2.2 Net loss from ordinary activities after tax attributable to members	up 250.6% to	(14,798)
2.3 Net loss for the period attributable to members	up 250.6% to	(14,798)
2.4 Dividends	<i>Amount per security</i>	<i>Franked amount per security</i>
Final dividend	Nil ¢	Nil ¢
Previous corresponding period	Nil ¢	Nil ¢
2.5 Record date for determining entitlements to the dividend	Not applicable	
2.6 Brief explanation of any of the figures reported above necessary to enable the figures to be understood:	The attached Annual Report contains full details of the company's financial results for the year ended 30 June 2006	

This information is provided in accordance with Listing Rule 4.3A

**MAGNESIUM** INTERNATIONAL

L I M I T E D  
A.B.N 23 003 669 163

# ANNUAL REPORT

## 2006

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## CHAIRMAN AND MANAGING DIRECTOR'S REPORT

Dear Fellow Shareholder,

I present the 2006 Annual Report of Magnesium International Limited (MIL).

### OVERVIEW

The past year has been one of major challenge and ultimately disappointment for our Company. The unexpected increase in projected Capital Costs of our Sokhna primary magnesium project being developed by our then 50% owned Egyptian Magnesium Company S.A.E. ("EMAG") and a downturn in magnesium alloy pricing combined to lead to a significant downwards re-rating of our share price.

Your Directors then set about reformulating the EMAG project and developed a plan that involved:

1. having MIL move to 100% ownership of EMAG from the previous 50% ownership position; and
2. re-estimating the project Capital Cost to avoid the excessive European content in the December 2005 estimates.

We have increased our interest in EMAG to 100% by acquiring the 50% EMAG interest held by our former partner, Amiral. This resulted in a simpler structure for the project with Amiral effectively swapping its direct investment in EMAG to an investment in Magnesium International.

We have been successful in reducing the estimated Direct Costs of construction of Stage 1 of the proposed plant including owner's capital cost from over US\$400 million to around US\$290 million – which results in a Total Capital Cost of US\$380 million. This is in line with our estimates from early 2005.

This has been achieved by:

- i. increasing the local Egyptian and regional content;
- ii. using value engineering and, in particular, re-designing the "wet end" of the plant;
- iii. re-tendering and reshaping vendor bid packages; and
- iv. shifting the proposed construction contractual arrangements from Fixed Price Engineering Procurement and Construction ("EPC") to an Engineering, Procurement and Construction Management ("EPCM") arrangement with underlying fixed price sub contract packages.

During the year magnesium metal has been one of the very few commodities where the price has actually reduced. This is as a result mainly of slower short term demand growth and of Chinese surplus supply. In the medium term Clark & Marron, an independent market expert, has forecast prices to recover as market demand grows and the Chinese producers face mounting cost pressures. However, in the short term, the lower price is a disadvantage in the promotion of the EMAG project.

We recognised that our available funds would be insufficient for MIL to take EMAG to Financial Close and developed a plan to raise additional equity in order to do this. This equity was to enable MIL to complete further engineering and estimating work which had the objective of further reducing the projected construction costs.

Unfortunately, we did not get the support from investors we had been expecting and have had to reduce the rate of cash burn. This has the consequent effect of further delaying when EMAG may achieve Financial Close.

In the absence of MIL being able to fund the program in its own right we have begun actively seeking Strategic Partners for either MIL and/or EMAG. This was something we had always intended but believed that the further MIL took EMAG towards Financial Close the better the outcome for shareholders.

We are making progress towards bringing in a Strategic Partner. We have several candidates who are going through their evaluation of our project. We are hopeful that this will produce a satisfactory outcome for shareholders.

## **VISION**

In the circumstances it is clearly appropriate to review MIL's vision or raison d'être. For some years MIL's vision has been to use the Dow Electrolytic Magnesium process technology as the platform for entry into the rapidly growing market for magnesium alloys. The events of the past year do not alter our commitment to realising that vision but the strategies to achieve it are now dependent on our ability to attract the Strategic Partner with the capital and other resources to bring EMAG into being. Our aim is to maximize the share of the upside that we can retain for our shareholders on the introduction of the Strategic Partner.

The reasons why we believe the magnesium industry is attractive for MIL and its potential Strategic Partners notwithstanding the recent poor pricing trends are:

1. It is a growth industry – historical growth in primary magnesium alloy demand has been around 10% and this is forecast to continue. This provides room for a new industry entrant with the right cost structure;
2. The demand drivers are very strong – the pressure is on automotive manufacturers to reduce fuel consumption and emissions. One way of doing this without sacrificing vehicle performance is to reduce vehicle weight. Increased use of magnesium alloys is one enabler to meet this objective. Magnesium alloys are now priced at their most attractive levels relative to many competing materials which could lead to an acceleration in demand growth;
3. The magnesium technologies have improved significantly in recent years which will allow for increased adoption. Development of new alloys; improved metal processing and improved coating technologies are all assisting magnesium alloys to become more competitive in a broader range of automotive components. As an example, BMW are now using a magnesium alloy engine block which uses a magnesium alloy that was not commercially available 5 years ago;
4. The Dow process technology allows EMAG to be very cost competitive – the projected cash operating costs at Sokhna are below US60 cents/lb alloy which allows an attractive operating cost margin below Chinese competitors to provide the returns on the capital invested. The other advantage is that the Dow process is electrolytic and provides economies of scale that the Chinese producers with the Pidgeon process based plants cannot achieve. This should enable EMAG, once established, to capture much of the growth in magnesium alloy as the marginal cost of increased production is even lower.

## **EMAG STATUS**

EMAG has made considerable progress over the past year – although not as fast as we would have preferred.

We remain of the view that Egypt is the right place. The drivers for Egypt as the location include:

1. Egyptian power prices are at competitive levels internationally and are expected to remain so for a long time. Egyptian power generation is based on low cost natural gas that would otherwise be shut-in or sold into LNG plants;
2. Construction costs and capabilities in Egypt are very competitive internationally. For much of the EMAG plant that can be fabricated in Egypt the costs are significantly lower than in Europe;
3. The infrastructure for the supply of power, gas and process water is available.

Most of the necessary inputs and contractual arrangements are well advanced, although not complete.

### **Magnesite Supply**

During the year further work on the Sul Hamed magnesite deposit in Southern Egypt has been undertaken with its owners, El Nasr Mining Company (“ENMC”), an Egyptian Government owned company. This has indicated the deposit should have the potential, with further exploration, to have magnesite of the necessary quality to provide the feedstock for at least Stage 1 of the EMAG plant. There is potential for further extensions to the known deposit.

Commercial discussions are underway with ENMC on the supply of magnesite terms. Alternative supply is being investigated from Turkey.

### **Power**

During the year we finalized a long term contract for the supply of power with the Egyptian Electricity Transmission Company.

### **Gas**

We have finalised the engineering details of the gas supply arrangements and are in the process of finalising the commercial arrangements. The gas price is set by the Egyptian Government so there is no price risk involved.

### **Site**

We have an offer of the long term lease terms on the site within the Sokhna port area. However, these terms are unacceptable and we are investigating alternative sites in the immediate vicinity. There are several sites that meet our requirements and this is unlikely to result in any project delay.

### **Environmental**

During the year EMAG was granted the necessary environmental approvals for the plant. A further and separate approval is required for the residue disposal and discussions are underway with the relevant authorities. The residues are benign and inert insolubles from the initial acid leach of magnesite.

## **MAGNESIUM ALLOY MARKETS**

Magnesium alloy markets have been depressed through the past year. This has primarily been the result of a surge in supply from Chinese producers. The consequence has been that the prices in Europe are determined by the delivered cash costs of the Chinese producers. This has reduced typical alloy prices to around US\$1.05/lb delivered duty paid in Europe. However, Chinese cash costs are increasing, initially driven by higher Ferrosilicon prices (Chinese producers typically use 1.1 tonnes of Ferrosilicon per tonne of magnesium produced).

On a longer term basis we expect the alloy prices to recover as Chinese costs of production increase. Higher Ferrosilicon, coal and transport costs are already beginning to impact on Chinese production costs.

## **MAGSHEET**

Magsheet is trialling the production of thin magnesium alloy sheet using a proprietary twin toll cast technology which is under option from CSIRO. This technology offers the prospect of a quantum shift downwards in the costs of producing thin magnesium sheet and Magsheet is working with several potential customers on achieving a production ready status.

Magsheet has made progress through the year but not at the rate we were expecting. We have now installed a new larger furnace at Clayton which is currently (end August) being commissioned.

The Magsheet strategy is to supply an intermediate 3 mm thick coil which is then rolled to 0.5 – 1.0 mm thickness for various applications.

Once the new furnace has been commissioned we have several potential customers who require coils for final trialling into thin sheet before placing orders.

The Magsheet operation will be reviewed once we have the feedback from the potential customers on their trialling activity.

## **FUNDING**

At Year End MIL had cash, net of trade and other payables, of A\$3 million. We have reduced the cash burn rate to ensure we have time to allow the introduction of a Strategic Partner into EMAG.

## **FINANCIAL ACCOUNTS**

The financial accounts set out in this Annual Report reflect the disappointing year. As a consequence of the current status of the EMAG project exploration assets and mining lease values have been written back.

## **OUTLOOK**

We are working towards achieving some recovery in MIL's value. We see this as coming from the introduction of a Strategic Partner into MIL and/or EMAG and the possible successful development of the Magsheet technology.

We have a small and dedicated team who are committed to delivering the best outcome possible. We are indebted to them for their efforts.

A handwritten signature in black ink, appearing to read 'Pat Elliott', with a horizontal line underneath.

**Pat Elliott**  
**Chairman and Managing Director**

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES**

**A.B.N 23 003 669 163**

**FINANCIAL REPORT**

**FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006**

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
TENEMENT SCHEDULE AS AT 30 JUNE 2006**

		Area Hectares	Expiry Date	MIL Interest Held %
<b>SOUTH AUSTRALIA</b>				
<b>MINING LEASES</b>				
<b>Myrtle Springs</b>	ML5000	18.0	30.03.2022	100%
<b>Myrtle Springs</b>	ML5001	14.3	30.03.2022	100%
<b>Myrtle Springs</b>	ML6092	519.7	30.06.2010	100%
<b>MISCELLANEOUS PURPOSE LEASES</b>				
<b>Myrtle Springs</b>	MPL 18	16.0	30.03.2022	100%
<b>Myrtle Springs</b>	MPL 27	5.4	30.09.2008	100%
<b>NORTHERN TERRITORY</b>				
<b>Huandot</b>	ML 23292	125.1	25.05 2031	100%

**All Tenement Leases are registered in the name of Magnesium Developments Limited, a controlled entity of Magnesium International Limited.**

## **MAGNESIUM INTERNATIONAL LIMITED AND CONTROLLED ENTITIES DIRECTORS' REPORT**

Your Directors present their report on the company and its controlled entities together with the financial report for the year ended 30 June 2006.

### **Principal Activities**

The principal activities of the economic entity during the course of the financial year consisted of the continuing proposed development of its magnesium smelter project at Port Sokhna, Egypt and the evaluation and progressing of other magnesium based opportunities.

### **Review of Operations**

During the year the key operational activities of the economic entity were as follows:

- Continuing to progress the finalisation of EPC costs and evaluation, project design and processes of the smelter. EPC and EPCM work was continued by Egyptian Magnesium Company SAE ("EMAG"), as an in-house exercise.
- Negotiation of electricity, gas and EPA agreements with the relevant authorities in Egypt.
- A special free zone company, EMAG, was incorporated to facilitate development of the smelter. Magnesium International Limited ("MIL") and Amiral Magnesium Overseas, Ltd were both equal shareholders.
- In June 2006 MIL acquired the remaining 50% interest in EMAG from Amiral Magnesium Overseas, Limited, in return for the issue of 2,500,000 shares in MIL. For 11 months of the year EMAG was accounted for as a joint venture, with MIL accounting for 50% of its results; for one month EMAG was accounted for as a 100% owned subsidiary.
- The commercialisation of the MagSheet twin roll casting technology with the CSIRO continued in 2006.
- MIL evaluated alternatives to fund EMAG through to Financial Close, focusing on an interim equity raising in June/July 2006. There was insufficient interest to enable MIL to complete the equity raising, in part due to equity market conditions. MIL announced on 28 July 2006 that steps were being taken to minimise cash outflows. These actions include the winding down of the Sydney office, Egyptian operations being focussed on the maintenance of project relationships and pursuing outstanding required contracts and MagSheet activities and expenditures being contained. These steps should provide the Company with the financial resources to pursue the search for a strategic partner into 2007.

Further details can be found in the Chairman and Managing Director's Report at pages 3 to 6.

### **Results of Operations**

The consolidated Income Statement shows a net loss from ordinary activities for the financial year of \$14,798,000 compared with \$4,221,000 in 2005. This result includes non-cash accounting charges for impairment of \$3,309,000 against carrying values of exploration and evaluation expenditures, an impairment of \$1,180,000 against the goodwill component of the remaining 50% of EMAG which MIL acquired on 1 June 2006 and an impairment charge against the EMAG investment of \$1,038,000. Without these one-off transactions the loss would have been \$9,271,000.

Net cash outflows from operating and investing activities, were \$7,108,000 compared to \$6,929,000 in 2005.

These are the consolidated entity's first financial statements prepared in accordance with Australian equivalents to IFRS (AIFRS). The effect on transition to IFRS was to decrease net assets by \$40,011,000 to \$7,869,000, primarily due to the application of AASB 6 to Exploration and evaluation expenditure capitalised under previous GAAP (AASB 1022 *Accounting for the Extractive Industries*). This expenditure did not meet the narrower definitions of exploration and evaluation expenditure of AASB 6 *Exploration and Evaluation of Mineral Resources*.

# MAGNESIUM INTERNATIONAL LIMITED AND CONTROLLED ENTITIES DIRECTORS' REPORT

## Results of Operations (continued)

The expenditure then fell under AASB 138 *Intangible Assets* and has been subject to impairment testing at transition. The effect in the consolidated entity is to reduce *Exploration and evaluation expenditure* by \$40,010,584 and to increase retained losses at 1 July 2004 by \$40,010,584.

The effect on transition to IFRS on the income statement for 30 June 2005 was to increase the net loss for the year by \$71,000 in respect of share compensation services.

## Significant Changes in State of Affairs

During the year MIL acquired the remaining 50% of EMAG shares which it did not own from Amiral Magnesium Overseas, Ltd. In settlement of this transaction 2,500,000 shares in MIL were issued to Amiral Magnesium Overseas, Ltd.

There were no other significant changes in the state of affairs of the economic entity.

## Subsequent Events

There has not been any other matter or circumstance which has arisen since the end of the financial year that has significantly affected, or may significantly affect, the operation of the economic entity, the result of those operations, or the state of affairs of the economic entity in future financial years, other than as disclosed elsewhere in the financial report.

## Future Developments

The likely developments in the operations of the economic entity in future financial years and the expected results of those operations are uncertain. Accordingly, this information has not been provided in this report.

## Environmental Regulation

The economic entity's operations are subject to normal environmental regulations under Australian and overseas legislation in relation to its mining exploration and other activities. The Directors believe that the economic entity has adequate systems in place for the management of its environmental requirements and are not aware of any significant breaches of those environmental requirements during the period covered by this report.

## Dividends

No dividends have been declared or paid since the start of the financial period and the directors do not recommend the payment of a final dividend for the year ended 30 June 2006 (2005: \$nil).

## **Directors**

The names of the Directors of the company during or since the end of the financial year are:

### **Patrick Elliott – BCom, MBA, CPA**

#### **Chairman and Managing Director**

Mr Elliott, aged 54, has over 30 years experience in investment, financial and industrial management, having previously been with Consolidated Goldfields Australia Limited, Morgan Grenfell Australia Limited and Natcorp Investments Limited. Mr Elliott is also a Director of Argonaut Resources NL, Australia Oriental Minerals NL and Crossland Uranium Mines Limited. Mr Elliott has been a Director since 1991 and became Managing Director on 31 January 2006 and Chairman in March 2006.

### **James Beecher – BCom, MBA, FCPA, FAICD**

#### **Company Secretary and Executive Director**

Mr Beecher, aged 52, was appointed Company Secretary in July 2004 and a Director in September 2005. Mr Beecher has over 25 years experience in senior finance, accounting and secretarial positions in resources, financial services and services companies.

### **Malcolm Richmond – BSc (Hons), BCom, FAIMM, ATSE**

#### **Non-Executive Director**

Professor Richmond, aged 61, is visiting Professor of Business and Professor of Engineering at the University of Western Australia, Adviser Technology Commercialisation at Curtin University and a former member of the Senate at Murdoch University. Professor Richmond has been a director of numerous listed companies over the past 10 years. Professor Richmond, a metallurgist by profession, was with the CRA / Rio Tinto Group for 26 years. He worked for CRA/Rio Tinto in a number of positions including: Vice President Strategy and Acquisitions; Managing Director Research and Technology and Managing Director Development, Hamersley Iron Pty Limited. Professor Richmond has been a Director since 2001.

### **Ossama Al-Sharif**

#### **Non-Executive Director**

Captain Ossama Al-Sharif, aged 52, is President and Chief Executive Officer of the Amiral Group. He has significant experience in establishing and growing start-up ventures, having built up a maritime and logistics conglomerate in Egypt in the past decade. In 1992, Capt. Al-Sharif teamed up with the global shipping line APL, a leading global logistics and container transportation company, and established a strong local presence in both Jordan and Egypt. In 1997 he developed the first private container handling company in Egypt, transforming the Adabyia military port into a commercial port on the Red Sea with regular service liners. In 1999, Capt. Al-Sharif founded the Sokhna Port Development Co, the concession holder for Sokhna Port in Egypt, and developed it into a world-class port and logistics centre. Captain Al-Sharif has been a Director of Magnesium International since February 2005.

### **Peter Sydney-Smith – MA, CA**

#### **Executive Director to July 2006, Non-Executive Director**

Mr Sydney-Smith, aged 53, joined the Group as finance director in October 2005. Prior to this he was Finance Director of Vedanta plc (2003 – 2005) a London listed metals and mining group with operations in India and Zambia. He is currently finance director of Nikanor plc. He was previously Finance Director at BPB plc, an international building materials group (1992 – 2002). Mr Sydney-Smith was an executive director until July 2006, when he became a non-executive director. Mr Sydney-Smith is a chartered accountant and a member of the Institute of Chartered Accountants of England and Wales.

**David Karpin – AM, BCom (Hons), MBA, Hon LLD, FCPA, FAICD, FAIM, ACIS, MACS  
Ex Chairperson and Non-Executive Director**

Mr Karpin was a Director of MIL from 2002 until his resignation in March 2006.

**Gordon Galt – BCom, B Eng Mining (Hons), MAICD, MAIMM  
Ex Managing Director**

Mr Galt was Managing Director of MIL from 2002 until his resignation in January 2006.

**Andy Hogendijk – AAUQ, FCPA, FAICD  
Ex Non-Executive Director**

Mr Hogendijk was a Director of MIL from 2001 until his resignation in March 2006.

**Directors Meetings**

The following table sets out the number of Directors' meetings (including meetings of committees of Directors) held during the financial year and the number of meetings attended by each Director (while they were a Director or committee member).

	Board of Directors		Audit Committee		Remuneration & Nominations Committee	
	Held	Attended	Held	Attended	Held	Attended
PJD Elliott	11	11	2	2	1	1
JD Beecher	9	9	-	-	-	-
MR Richmond	11	11	-	-	1	1
OFR Al-Sharif	11	10	-	-	-	-
PE Sydney-Smith	7	7	-	-	-	-
GT Galt	7	7	-	-	-	-
AJ Hogendijk	8	8	2	2	-	-
DS Karpin	8	8	2	-	1	1

**Interests in shares or options – key management personnel**

The relevant interest of each key management person in the shares and options issued by the companies within the consolidated entity, as notified by the Directors to the Australian Stock Exchange in accordance with S205G(1) of the Corporations Act, 2001, at the date of this report is as follows :

	Ordinary shares	Unlisted Options	Listed Options
<b>Directors:</b>			
PJD Elliott	206,998	510,000	4,168
JD Beecher	29,167	100,000	2,084
MR Richmond	-	150,000	-
OFR Al-Sharif	4,800,000	-	1,150,000
PE Sydney-Smith	-	-	-
<b>Officers:</b>			
P Baily	-	150,000	-
P Cameron	-	150,000	-
MG Moran	-	500,000	-
<b>Total key management personnel</b>	<b>5,036,165</b>	<b>1,560,000</b>	<b>1,156,252</b>

### Unlisted share options

Unlisted share options granted by Magnesium International Limited to key management personnel during the financial year ended 30 June 2006 were as follows:

Magnesium International Limited	Number of options	Exercise price	Expiry date
<b>Directors</b>			
GT Galt	150,000	\$2.00	31 October 2012
JD Beecher	100,000	\$1.16	30 June 2011
<b>Officers</b>			
M Moran	500,000	(i)	30 June 2011
P Cameron	150,000	(i)	30 June 2011
<b>Total key management personnel</b>	<b>900,000</b>		

No options have been issued since the end of the financial year.

### Unlisted options over ordinary shares at the date of this report

<u>Shares</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
150,000	\$3.00	1 August 2007
480,000	\$8.95	30 November 2006
500,000	\$4.95	1 December 2006
150,000	\$4.95	31 March 2007
500,000	\$2.00	18 May 2007
190,200	\$1.20	31 May 2010
600,000	See (i)	30 June 2011
300,000	See (i)	30 June 2011
100,000	\$1.20	30 June 2011
150,000	\$2.00	31 October 2012
100,000	\$1.16	30 June 2011
500,000	See (i)	30 June 2011
150,000	See (i)	30 June 2011
<u>3,870,200</u>		

### Shares issued on exercise of options

No ordinary shares of Magnesium International Limited were issued and paid for during or since the end of the year as a result of the exercise of unlisted options.

### Listed options over ordinary shares at the date of this report

<u>Shares</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
5,833,750	\$1.80	1 March 2007

### Auditor's Independence Declaration

The auditor's independence declaration in relation to the audit for the financial year is provided on page 21 of this report as required under Section 307C of the Corporations Act.

<sup>i</sup> The terms of the unlisted options are described in Note 15 to the Financial Statements.

## Non-audit Services

During the year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The Board has considered the non-audit services provided during the year by the auditor and is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporation Act 2001 for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Board to ensure they do not impact the integrity and objectivity of the auditor.
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in Professional Statement F1 *Professional independence*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services provided during the year are set out below:

	Consolidated	
	2006	2005
	\$	\$
<b>Statutory audit</b>		
Auditors of the Company		
- Audit and review of financial reports	54,450	55,054
<b>Services other than statutory audit</b>		
<b>Other services</b>		
- Advisory Services	3,675	-
- Taxation compliance and tax consolidation advice	43,507	85,189
- AIM listing services	-	41,818
	47,182	127,007
<b>TOTAL</b>	<b>101,632</b>	<b>182,061</b>

## Remuneration Report

The parent entity's policy for determining the nature and amount of emoluments of board members and senior executives of the company is as follows:

The remuneration structure for executive officers and Directors, including executive Directors, seeks to emphasise payment for results through providing individual reward arrangements, for example the use of share options as disclosed in the Directors Report.

The objective of the individual reward arrangements is to both reinforce the short and long term goals of the company and to provide a common interest between management and shareholders.

All directors are now employed on a consultancy basis in order to preserve the Company's cash.

## Employment contracts

Details of contracts between executives, Magnesium International Limited and certain controlled entities are as follows:

Name	Contract	Duration	Notice	Termination
PE Sydney-Smith	Yes	Open	6 months	12 months

Mr Sydney-Smith stepped down as Executive Finance Director, on 12 July 2006 and will continue with the company as a non-executive director. Termination payments due to Mr Sydney-Smith total \$59,857, representing July salary and accrued statutory entitlements.

### **Key management personnel remuneration**

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company and the Consolidated entity. Key management personnel include directors and the five most highly remunerated directors and executives (as required by S300A of the Corporations Act) for the Company and the Consolidated entity.

The directors of the Company during or since the end of the financial year are:

<b>Name</b>	<b>Position</b>
PJD Elliott	Chairman and Managing Director (previously non-executive director, appointed Managing Director on 31 January 2006 and Chairman on 30 March 2006).
JD Beecher	Executive Director (appointed 19 September 2005)
MR Richmond	Non-Executive Director
OFR Al-Sharif	Non-Executive Director
PE Sydney-Smith	Executive Director (appointed 21 October 2005). Non-Executive Director from 12 July 2006.
GT Galt	Managing Director (resigned 31 January 2006)
AJ Hogendijk	Non-Executive Director (resigned 14 March 2006)
DS Karpin	Chairman (resigned 30 March 2006)

## Key management personnel remuneration (Company and consolidated)

Key management personnel		Short-Term			Post Employment	Share based payments	FBT	Total
		Salary and Fees \$	Consulting Fees \$	Other benefits \$	Super-annuation \$	Options (i), (ii), (iii) \$		
P Baily (iv)	2006	-	32,261	-	-	-	-	32,261
	2005	-	126,719	-	-	-	-	126,719
JD Beecher (v)	2006	-	186,946	-	-	84,230	-	271,176
	2005	-	225,403	-	-	-	-	225,403
P Cameron (vi)	2006	18,000	-	1,432	-	-	-	19,432
	2005	-	-	-	-	-	-	-
PJD Elliott	2006	30,000	269,000	-	-	-	-	299,000
	2005	40,000	30,000	-	-	-	-	70,000
MG Moran (vi)	2006	27,000	-	9,279	-	-	-	36,279
	2005	-	-	-	-	-	-	-
MR Richmond	2006	40,000	8,000	-	3,600	-	-	51,600
	2005	40,000	-	-	7,875	-	-	47,875
OFR Al-Sharif	2006	40,000	-	-	-	-	-	40,000
	2005	13,556	-	-	-	-	-	13,556
PE Sydney-Smith (vii)	2006	347,644	-	-	43,353	-	-	390,997
	2005	-	-	-	-	-	-	-
<b>Former key management personnel</b>								
R Eaglesham (viii)	2006	-	-	-	-	-	-	-
	2005	-	246,109	-	-	-	-	246,109
GT Galt (x)	2006	87,686	-	-	7,892	88,212	-	183,790
	2005	344,478	-	-	45,000	-	35,773	425,251
AJ Hogendijk (ix)	2006	30,000	15,000	-	2,700	-	-	47,700
	2005	40,000	3,863	-	13,125	-	-	56,988
DS Karpin (ix)	2006	78,288	78,287	-	-	-	-	156,575
	2005	100,000	115,000	-	-	-	-	215,000
<b>Compensation: key management personnel</b>	2006	698,618	589,494	10,711	57,545	172,442	-	1,528,810
	2005	578,034	747,094	-	66,000	-	35,773	1,426,901

- (i) The value of options as a percentage of remuneration in 2006 was 31% and 48% for Messrs JD Beecher and GT Galt respectively.
- (ii) No short-term or long-term incentives were paid in 2005 or 2006.
- (iii) Options vesting in the year ended 30 June 2006 were valued using the Black Scholes option pricing model. No option expense arose for the financial year ended 30 June 2005 as the options issued to key management personnel, as described in sub-note 2 of Note 15 to the Financial Statements, do not vest until after the date of Financial Close. Upon vesting these options will also be valued using the Black Scholes option pricing model.
- (iv) P Baily also provided consulting services to EMAG. Payments were \$200,410 in 2006 (2005:\$73,293).
- (v) JD Beecher was appointed a director on 19 September 2005. Mr Beecher also provided consulting services to EMAG. Payments in 2006 were \$103,666 (2005: \$8,000).

- (vi) Salaries, expatriate allowances and consulting fees paid subsequent to the 100% acquisition of EMAG by MIL on 1 June 2006 are included above. Remuneration of \$226,265 was paid to P Cameron and \$247,001 was paid to M Moran by the EMAG joint venture prior to 1 June 2006.
- (vii) PE Sydney-Smith was appointed a director on 21 October 2005.
- (viii) R Eaglesham also provided consulting services to EMAG. Payments were \$111,920 in 2006 (2005:\$96,497).
- (ix) DS Karpin and AJ Hogendijk resigned as directors on 30 March and 12 March 2006 respectively.
- (x) GT Galt was seconded to EMAG in March 2005. EMAG were responsible for his remuneration arrangements from July 2005 to April 2006, when he left the company. \$481,788 was paid by EMAG in respect of these arrangements in the year ended 30 June 2006 (2005: \$187,797). Outstanding employee entitlements accrued prior to March 2005 were settled by MIL in 2006.

## **INDEMNIFICATION OF OFFICERS AND AUDITORS**

### **Indemnification**

The parent entity has indemnified or agreed to indemnify each Director and all officers of the company or of any related body corporate against a liability incurred when such an officer acts in accordance with section 199A of the Corporations Act 2001.

The parent entity has not indemnified or agreed to indemnify the auditor of the company or of any related body corporate against a liability incurred by the auditor.

### **Insurance Policies**

Since the end of the previous financial year the ultimate parent entity has paid premiums in respect of Directors' and officers' liability and legal expenses insurance contracts. Such insurance contracts insure against certain liabilities (subject to specific exclusions) persons who are or have been Directors or officers of the economic entity.

Directors have not included details of the nature of the liabilities covered, or the amount of the premium paid, as such disclosure is prohibited under the terms of the contract.

### **Rounding of Amounts**

The Company is of a kind referred to in ASIC Class Order 98/100 and, accordingly, amounts in the financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise indicated.

Dated at Sydney Australia this 29th day of August 2006.

Signed in accordance with a resolution of the directors.



PJD Elliott  
Director

## **MAGNESIUM INTERNATIONAL LIMITED AND CONTROLLED ENTITIES CORPORATE GOVERNANCE**

*The Board of Directors has implemented the Best Practice Recommendations of the ASX Corporate Governance Council to the extent appropriate for the size and nature of its business.*

*The responses of the Board to the Best Practice Recommendations are outlined below, with comments where appropriate*

### **Principle 1: Lay solid foundations for management and oversight**

The Company has a Board (3 non-executive Directors, 1 executive director plus the Managing Director) with the Managing Director managing activities; roles and functions are flexible in order to meet specific requirements.

The Company has adopted a Board Charter, which sets out the Board and management's responsibilities:

The Board is responsible for identifying obligations and expectations, both regulatory and ethical, of shareholders, regulators, creditors and others.

The Board is responsible to ensure that these expectations and obligations are met to the extent the Company's resources allow. This may include meeting promised milestones and financial estimates.

The responsibility for the operation and administration of the Company has been delegated to the Managing Director.

He is assisted by a number of consultants, contractors and employees in the areas of engineering, financial, management, accounting, modelling and company secretarial matters.

Apart from the statements on responsibilities the Company has not in detail formalised the functions reserved to the Board and those delegated to management.

### **Principle 2: Structure the board to add value**

The Company does not currently comply with the recommendations in Section 2.1 that a majority of Directors should be independent.

One of the non-executive directors, OFR Al-Sharif, is the President and CEO of the Amiral Group which provides services to the Egyptian Magnesium Company (EMAG). He is a substantial shareholder of the Company. The board believes that Mr Al-Sharif is able to contribute to strategic issues at board level on an independent basis.

PJD Elliott has been a Director of the Company since 1991, a period of time, which in the words of the ASX Best Practice recommendations, "could be perceived to materially interfere" with his "ability to act in the best interests of the company". Mr Elliott was appointed Managing Director, and then Chairman early in 2006; this was done in order to utilise his knowledge and experience in order to progress the EMAG project.

The Board does not believe that Mr Elliott's period of tenure as a Director compromises his independence.

Each Director of the Company has the right to seek independent professional advice at the expense of the Company. Prior approval of the Chairman is required, but this will not be unreasonably withheld.

### **Principle 3: Promote ethical and responsible decision-making**

The Company has established a policy concerning trading in its securities by Directors, management, staff and significant consultants which restricts trading to defined time periods.

The Company does not have a formal code of conduct, again reflecting the Company's small size and the close interaction of the small number of individuals throughout the organisation.

### **Principle 4: Safeguard integrity in financial reporting**

The Chief Executive Officer and the personnel responsible for producing the financial results have declared in writing to the board that the financial records of the Company for the financial year have been properly maintained, the Company's financial reports for the year ended June 2006 comply with accounting standards and present a true and fair view of the Company's financial condition and operational results.

The Audit Committee, which has a formal charter approved by the Board, now comprises the board as a whole.

The Company's auditor, KPMG was appointed in 1989 and a new engagement partner was appointed in June 2006. The previous engagement partner completed the Company's review for the period ended 31 December 2005.

### **Principle 5: Make timely and balanced disclosure**

The Company, its Directors and staff are aware of continuous disclosure requirements and operate in an environment where strong emphasis is placed on full and appropriate disclosure. The Company does not have formal written policies regarding disclosure, but uses strong informal systems underpinned by experienced individuals.

### **Principle 6: Respect the rights of shareholders**

The Company does not have a communications strategy to promote effective communication with shareholders, as it believes this is excessive for small companies. The Company communicates regularly with shareholders via its website and timely announcements to the ASX, AIM and Deutsche Börse including use of Corporate File interviews.

For many years the Company has requested the external auditor to attend general meetings and this has been supported by the Company's audit partners at KPMG.

### **Principle 7: Recognise and manage risk**

The Company is a small, non-operating company and does not believe that there is significant need for formal policies on risk oversight and management. However there is in place a formal policy on risk oversight and management of the magnesium smelter project.

Risk management arrangements are the responsibility of the Board of Directors and senior management collectively.

**Principle 8: Encourage enhanced performance**

The Company has a Remuneration and Nominations Committee, which meets as and when required, to review performance matters.

There has been no formal performance evaluation of the board during the past financial year.

The Directors work closely with management and have full access to all the Company's files and records.

**Principle 9: Remunerate fairly and responsibly**

The Board Remuneration and Nominations Committee determines remuneration levels on an individual basis. Directors believe that the size of the Company makes individual salary negotiation more appropriate than formal remuneration policies.

The Committee seeks independent external advice and market comparisons as necessary.

In accordance with Corporations Act requirements, the Company discloses the fees or salaries paid to all Directors, and executive officers of the company.

The Company has an Employee Share Option Plan, which was introduced in 2001, following approval from shareholders.

**Principal 10: Recognise the legitimate interests of stakeholders**

The Company does not have a Code of Conduct to guide compliance with legal and other obligations. This reflects the Company's size and lack of operational activity, which makes legal compliance a less onerous task than with larger companies.

The Board of Directors continues to review the situation to determine the most appropriate and effective operational procedures.

AUDITOR'S INDEPENDENCE DECLARATION  
UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

**To the Directors of Magnesium International Limited**

In relation to the independent review for the financial year ended 30 June 2006, to the best of my knowledge and belief there have been:

- (i) No contraventions of the auditor independence requirements as set out in the Corporations Act 2001,
- (ii) No contraventions of any applicable code of professional conduct in relation to the audit.



KPMG



Mark Epper  
Partner  
Sydney  
29<sup>th</sup> August 2006

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
INCOME STATEMENTS  
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006**

	Note	Economic Entity		Parent Entity	
		2006	2005	2006	2005
		\$'000	\$'000	\$'000	\$'000
Revenue		29	15	1	15
Consultants expenses		(1,322)	(1,700)	(1,260)	(1,700)
Corporate expense		(711)	(1,006)	(703)	(1,006)
Employment expense	4	(1,227)	(1,099)	(1,029)	(1,099)
Occupancy expenses		(179)	(131)	(175)	(131)
Impairment of loans and investments	11	(1,038)	-	(7,869)	-
Impairment of exploration and evaluation expenditure	13	(3,309)	-	-	-
Goodwill impairment	22	(1,180)	-	-	-
Research (MagSheet) expenses		(1,677)	-	-	-
Other operating expenses		(549)	(601)	(597)	(598)
<b>Operating loss before financing costs</b>		<b>(11,163)</b>	<b>(4,522)</b>	<b>(11,632)</b>	<b>(4,519)</b>
Financial income	6	347	301	347	301
Financial expenses	6	(4)	-	(4)	-
<b>Net financing costs</b>		<b>343</b>	<b>301</b>	<b>343</b>	<b>301</b>
<b>Loss before Tax</b>		<b>(10,820)</b>	<b>(4,221)</b>	<b>(11,289)</b>	<b>(4,218)</b>
Share of losses, EMAG joint venture		(3,978)	-	-	-
Income tax expense	7	-	-	-	-
<b>Net Loss for the year</b>		<b>(14,798)</b>	<b>(4,221)</b>	<b>(11,289)</b>	<b>(4,218)</b>
Basic and diluted loss, cents per share	8	(38.7)	(14.1)		

The Income Statements are to be read in conjunction with the notes set out on pages 26 to 55.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
STATEMENTS OF CHANGES IN EQUITY  
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006**

<b>Economic Entity</b>	<b>Note</b>	<b>Share Capital</b>	<b>Currency translation Reserve</b>	<b>Share compensation expense</b>	<b>Retained losses</b>	<b>Total</b>
<b>Equity</b>		<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Balance at 1 July 2004		76,290	-	-	(68,421)	7,869
Net loss for the year		-	-	-	(4,221)	(4,221)
Share compensation expense	15	-	-	71	-	71
Shares issued		13,937	-	-	-	13,937
<b>Balance at 30 June 2005</b>		<b>90,227</b>	<b>-</b>	<b>71</b>	<b>(72,642)</b>	<b>17,656</b>
Balance at 1 July 2005		90,227	-	71	(72,642)	17,656
Net loss for the year		-	-	-	(14,798)	(14,798)
Share compensation expense	15	-	-	172	-	172
Shares issued on acquisition	22	975	-	-	-	975
Currency translation reserve	16	-	71	-	-	71
<b>Balance at 30 June 2006</b>		<b>91,202</b>	<b>71</b>	<b>243</b>	<b>(87,440)</b>	<b>4,076</b>

  

<b>Parent Entity</b>	<b>Note</b>	<b>Share Capital</b>	<b>Currency translation Reserve</b>	<b>Share compensation expense</b>	<b>Retained losses</b>	<b>Total</b>
<b>Equity</b>		<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Balance at 1 July 2004		76,290	-	-	(72,206)	4,084
Net loss for the year		-	-	-	(4,218)	(4,218)
Share compensation expense	15	-	-	71	-	71
Shares issued		13,937	-	-	-	13,937
<b>Balance at 30 June 2005</b>		<b>90,227</b>	<b>-</b>	<b>71</b>	<b>(76,424)</b>	<b>13,874</b>
Balance at 1 July 2005		90,227	-	71	(76,424)	13,874
Net loss for the year		-	-	-	(11,289)	(11,289)
Share compensation expense	15	-	-	172	-	172
Shares issued on acquisition		975	-	-	-	975
<b>Balance at 30 June 2006</b>		<b>91,202</b>	<b>-</b>	<b>243</b>	<b>(87,713)</b>	<b>3,732</b>

The Statements of Changes in Equity are to be read in conjunction with the notes set out on page 26 to 55.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
BALANCE SHEETS  
AS AT 30 JUNE 2006**

	Note	Economic Entity		Parent Entity	
		2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000
<b>CURRENT ASSETS</b>					
Cash and cash equivalents	9	4,024	11,132	3,910	11,132
Trade and other receivables	10	348	2,337	167	2,042
<b>TOTAL CURRENT ASSETS</b>		<b>4,372</b>	<b>13,469</b>	<b>4,077</b>	<b>13,174</b>
<b>NON-CURRENT ASSETS</b>					
Inter company receivables	10	-	-	-	295
Investment in joint ventures	11	-	1,293	-	1,293
Property, plant and equipment	12	741	524	34	61
Exploration and evaluation expenditure	13	-	3,309	-	-
<b>TOTAL NON-CURRENT ASSETS</b>		<b>741</b>	<b>5,126</b>	<b>34</b>	<b>1,649</b>
<b>TOTAL ASSETS</b>		<b>5,113</b>	<b>18,595</b>	<b>4,111</b>	<b>14,823</b>
<b>CURRENT LIABILITIES</b>					
Trade and other payables	14	962	836	364	846
Employee benefits	15	75	103	15	103
<b>TOTAL CURRENT LIABILITIES</b>		<b>1,037</b>	<b>939</b>	<b>379</b>	<b>949</b>
<b>TOTAL LIABILITIES</b>		<b>1,037</b>	<b>939</b>	<b>379</b>	<b>949</b>
<b>NET ASSETS</b>		<b>4,076</b>	<b>17,656</b>	<b>3,732</b>	<b>13,874</b>
<b>EQUITY</b>					
Issued capital	16	91,202	90,227	91,202	90,227
Share compensation expense		243	71	243	71
Currency translation reserve		71	-	-	-
Retained losses	16	(87,440)	(72,642)	(87,713)	(76,424)
<b>TOTAL EQUITY</b>		<b>4,076</b>	<b>17,656</b>	<b>3,732</b>	<b>13,874</b>

The Balance Sheets are to be read in conjunction with the notes set out on pages 26 to 55.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
STATEMENT OF CASH FLOWS  
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006**

	Note	Economic Entity		Parent Entity	
		2006	2005	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		\$'000	\$'000	\$'000	\$'000
Cash paid to suppliers and employees		(6,639)	(5,930)	(4,969)	(5,661)
Sundry receipts		19	15	1	15
<b>Net cash used in operating activities</b>	<b>23</b>	<b>(6,620)</b>	<b>(5,915)</b>	<b>(4,968)</b>	<b>(5,646)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Interest received		347	301	347	301
Acquisition of property, plant and equipment		(249)	(22)	(3)	(22)
Investment in joint venture entity		(649)	(1,293)	(649)	(1,293)
Acquisition of subsidiary, net of cash cost	<b>22</b>	63	-	-	-
<b>Net cash used in investing activities</b>		<b>(488)</b>	<b>(1,014)</b>	<b>(305)</b>	<b>(1,014)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Proceeds from the issue of share capital		-	14,612	-	14,612
Payment of transaction costs		-	(675)	-	(675)
Advances to controlled entities		-	-	(1,949)	(268)
<b>Net cash provided by (used in) financing activities</b>		<b>-</b>	<b>13,937</b>	<b>(1,949)</b>	<b>13,669</b>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>		<b>(7,108)</b>	<b>7,008</b>	<b>(7,222)</b>	<b>7,009</b>
Cash and cash equivalents at 1 July		11,132	4,124	11,132	4,123
<b>Cash and cash equivalents at 30 June</b>		<b>4,024</b>	<b>11,132</b>	<b>3,910</b>	<b>11,132</b>

The statements of cash flows are to be read in conjunction with the notes set out on pages 26 to 55.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2006**

## **Significant Accounting Policies**

### **1. Significant accounting policies**

Magnesium International Limited is a listed public company, incorporated and domiciled in Australia. The consolidated financial report of the company for the year ended 30 June 2006 comprises the company and its subsidiaries ("the consolidated entity"), and the consolidated entity's interest in jointly controlled entities.

The consolidated financial report was authorised for issue by the directors on 29th August, 2006.

#### **(a) Statement of compliance**

The consolidated financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. International Financial Reporting Standards ("IFRSs") form the basis of Australian Accounting Standards ("AASB's") adopted by the AASB, and for the purpose of this report are described as Australian equivalents to IFRS (AIFRS) to distinguish from previous Australian GAAP. The financial reports of the consolidated entity and the company also comply with IFRS's and interpretations adopted by the International Accounting Standards Board.

This is the consolidated entity's first consolidated financial report prepared in accordance with AIFRS and AASB 1 *First Time Adoption of AIFRS* has been applied. An explanation of how the transition to AIFRS has affected the reported financial position, financial performance and cash flows of the consolidated entity and the company is provided in note 26.

This report should also be read in conjunction with public announcements made by Magnesium International Limited during the year in accordance with the continuous disclosure obligations arising under the Corporations Act 2001.

#### **(b) Going concern**

The financial report has been prepared on a going concern basis which presumes the realisation of assets and extinguishment of liabilities in the normal course of business for the foreseeable future. The directors have taken steps to minimise cash outflows including the winding down of the Sydney office, focussing the Egyptian operations on maintaining project relationships and pursuing outstanding required contracts and containing MagSheet commitments. Certain properties may also be marketed for sale. These steps will provide the consolidated entity with the financial resources to pursue the search for a strategic partner into 2007.

#### **(c) Basis of preparation**

The financial report is presented in Australian dollars and is prepared on the historical cost basis.

The company has elected to early adopt the following accounting standards and amendments:

- AASB 2004-3 *Amendments to Australian Accounting Standards* (December 2004) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 101 *Presentation of Financial Statements*, ASB 124 *Related Party Disclosures*.
- AASB 2005-7 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 134 *Interim Financial Reporting*.
- AASB 2005-8 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004).

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**Significant Accounting Policies (continued)**

**(c ) Basis of preparation (continued)**

- AASB 2005-11 *Amendments to Australian Accounting Standards* (September 2005) amending AASB 101 *Presentation of Financial Statements*, AASB 112 *Income Taxes*, AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 133 *Earnings per Share*.

The company has elected not to early adopt the following issued accounting standards and amendments:

- AASB 7 *Financial Instruments: Disclosure* (August 2005) replacing the presentation requirements of financial instruments in AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007.
- AASB 2005-9 *Amendments to Australian Accounting Standards* (September 2005) requires that liabilities arising from the issue of financial guarantee contracts are recognised in the balance sheet. AASB 2005-9 is applicable for annual reporting periods beginning on or after 1 January 2006.
- AASB 2005-10 *Amendments to Australian Accounting Standards* (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings per share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance contracts*, arising from the release of AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007.

The consolidated entity plans to adopt AASB 7, AASB 2005-9 and AASB 2005-10 in the 2007 financial year.

The initial application of AASB 7, AASB 2005-10 and AASB 2005-09 is not expected to have an impact on the financial results of the Company and the consolidated entity.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

The preparation of a consolidated financial report in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. These accounting policies have been consistently applied by each entity in the consolidated entity.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of Australian Accounting Standards that have significant effect on the financial report and estimates with a significant risk of material adjustment in the next year are discussed in note 2.

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report and in preparing an opening AIFRS balance sheet at 1 July 2004 for the purposes of the transition to Australian Accounting Standards - AIFRS.

The accounting policies have been applied consistently by the entities in the consolidated entity.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**Significant Accounting Policies (continued)**

**(d) Basis of consolidation**

**(i) Subsidiaries** are entities controlled by the company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in subsidiaries are carried at their cost of acquisition in the company's financial statements.

**(ii) Joint ventures** are those entities over whose activities the consolidated entity has joint control, established by contractual agreement.

In the consolidated financial statements, investments in jointly controlled entities are accounted for using equity accounting principles. Investments in joint venture entities are carried at the lower of the equity accounted amount and recoverable amount.

The consolidated entity's share of the jointly controlled entity's net profit or loss is recognised in the consolidated income statement from the date joint control commenced until the date joint control ceases. Other movements in reserves are recognised directly in the consolidated reserves. In the Company's financial statements, investments in joint venture entities are carried at cost.

**(iii) Transactions eliminated on consolidation**

Intra group balances and transactions, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

**(e) Foreign currency**

**(i) Foreign currency transactions**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at balance sheet date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognized in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

**(ii) Financial statements of foreign operations**

The assets and liabilities of foreign operations are translated to Australian dollars at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Australian dollars at rates approximating the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on retranslation are recognised directly in a separate component of equity.

**(iii) Net investment in foreign operations**

Exchange differences arising from the translation of the net investment in foreign operations are transferred to the foreign currency translation reserve, a separate component of equity. They are released into the income statement upon disposal

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**Significant Accounting Policies (continued)**

**(f) Property, plant and equipment**

**(i) Owned assets**

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy 1k). Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

**(ii) Subsequent costs**

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

**(iii) Depreciation**

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives in the current and comparative periods are as follows:

➤ Buildings	40 years
➤ Plant and equipment	2 ½ to 8 years
➤ Fixtures and fittings	2 ½ to 8 years

The residual value, the useful life and the depreciation method applied to an asset is reassessed at least annually.

**(g) Intangible assets**

**(i) Goodwill**

**Business combinations**

All business combinations are accounted for by applying the purchase method. Goodwill represents the difference between the cost of an acquisition and the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated impairment losses. Goodwill is allocated to cash generating units and is no longer amortised but is tested annually for impairment (see accounting policy 1k).

Negative goodwill arising on an acquisition is recognised directly in profit or loss.

**(ii) Research and development**

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the consolidated entity has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy 1k).

**(iii) Subsequent expenditure**

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**Significant Accounting Policies (continued)**

**(h) Exploration and evaluation assets**

Exploration and evaluation costs, including the costs of acquiring licences, are capitalised as exploration and evaluation assets on an area of interest basis. Costs incurred before the consolidated entity has obtained the legal rights to explore an area are recognised in the income statement.

Exploration and evaluation assets are only recognised if the rights of the area of interest are current and either:

- (1) the expenditures are expected to be recouped through successful development and exploitation of the area of interest; or
- (2) activities in the area of interest have not at the reporting date, reached a state which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves and active and significant operations in, or in relation to, the area of interest are continuing.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount (see impairment, accounting policy 1k). For the purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units to which the exploration activity relates. The cash-generating unit shall not be larger than the area of interest.

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, exploration and evaluation assets attributable to that area of interest are first tested for impairment and then reclassified from intangible assets to mining property and development assets within property, plant and equipment.

**(i) Trade and other receivables**

Trade and other receivables are stated at their cost less impairment losses (see accounting policy 1k).

**(j) Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the consolidated entity's cash management are included as a component of cash and cash equivalents for the purposes of the statement of cash flows.

**(k) Impairment**

The carrying amounts of the consolidated entity's assets, other than deferred tax assets (see accounting policy 1q), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

Recoverable amounts are estimated at each balance sheet date for intangible assets that are not yet available for use and for assets that have an indefinite useful life.

An impairment loss is recognised where the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the Income statement.

**(i) Calculation of recoverable amount**

The recoverable amount of assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

## Notes to the Consolidated Financial Statements (continued)

For the year ended 30 June 2006

### Significant Accounting Policies (continued)

#### (k) Impairment (continued)

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Impairment losses in respect of goodwill are not reversed.

#### (l) Employee benefits

##### (i) Share-based payment transactions

The share option program allows consolidated entity executives to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. Fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using the Black Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

##### (ii) Employee benefits

Liabilities for employee entitlements for wages, salaries and annual leave that are expected to be settled within twelve months of the reporting date represent present obligations resulting from employees' services up to reporting date, calculated on undiscounted amounts based on current wage and salary rates, including related on-costs. Obligations for contributions to employee superannuation plans are recognized as an expense in the income statement as incurred.

Non-accumulating non-monetary benefits, such as medical care, housing or cars, are expensed based on the net marginal cost to the consolidated entity as the benefits are taken by the employees.

#### (m) Provisions

Provisions are recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

#### (n) Trade and other payables

Trade and other payables are stated at cost.

#### (o) Revenue

##### (i) Goods sold and services rendered

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due, there is a risk of return of goods or there is continuing management involvement with the goods.

##### (ii) Government grants

A Government grant is recognised in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the consolidated entity will comply with the conditions attaching to it. Grants that compensate the consolidated entity for expenses incurred are recognised as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**  
**Significant Accounting Policies (continued)**

**(p) Expenses**

**Net financing costs**

Interest income and expense are recognised in the income statement as they accrue, using the effective interest method.

**Operating lease payments**

Payments made in operating leases are recognised in the income statement on a straight line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense and are spread over the term of the lease.

**(q) Tax**

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items realised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**Tax consolidation**

**Head Entity**

The Company is the head entity in a tax-consolidated group comprising the Company and all of its Australian wholly owned subsidiaries. The implementation date of the tax consolidation system for the tax-consolidated group was 1 July 2003.

The members of the tax-consolidated group have not entered into tax funding arrangements or a tax sharing agreement dealing with the allocation of income tax liabilities should the head entity default on its obligations. Tax funding or sharing agreements are not considered to be currently relevant to the operations of the tax-consolidated group given the tax losses available to the group.

**(r) Segment reporting**

A segment is a distinguishable component of the consolidated entity that is engaged either in providing products or services, or in providing products or services within a particular economic environment.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**(s) Goods and services tax**

Revenue, expenses and assets are recognized net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances the GST is recognized as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from the ATO is included as a current asset in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from the ATO are classified as operating cash flows.

**2. Accounting estimates and judgements**

Management discussed with the Board the development, selection and disclosure of the consolidated entity's critical accounting policies and estimates and the application of these policies and estimates.

**Key sources of estimation uncertainty**

Note 1b of the significant accounting policies indicates that, given the steps taken by the directors to minimise cash outflows, the consolidated entity is a going concern.

**Critical accounting judgements in applying the consolidated entity accounting policies**

The first time adoption of AIFRSs has involved critical accounting judgements in applying the consolidated entity's accounting policies. On transition to IFRS, the consolidated entity determined that \$40,011,000 of the exploration, evaluation and development expenditure capitalised under previous GAAP (AASB 1022 *Accounting for the Extractive Industries*) did not meet the narrower definitions of exploration and evaluation expenditure of AASB 6 *Exploration and Evaluation of Mineral Resources*. The expenditure then falls under AASB 138 *Intangible Assets* and was subject to impairment testing at transition, resulting in a write down to retained earnings of \$40,011,000.

**3. Segment reporting**

The company operates in one segment only, being the global magnesium industry.

**4. Employment expenses**

	Consolidated		The Company	
	2006	2005	2006	2005
	\$'000	\$'000	\$'000	\$'000
Wages and salaries	837	795	639	795
Directors fees	218	233	218	233
Equity-settled transactions	172	71	172	71
<b>Total employment expenses</b>	<b>1,227</b>	<b>1,099</b>	<b>1,029</b>	<b>1,099</b>

Employment expenses exclude consulting fees of \$1,322,000 for 2006 (2005: \$1,700,000). The consulting fees paid to key management personnel are disclosed in Note 24.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**5. Auditors remuneration**

	Consolidated		The Company	
	2006	2005	2006	2005
<b>Statutory audit</b>				
<i>Auditors of the Company</i>	\$	\$	\$	\$
Audit and review of financial reports	54,450	55,054	54,450	55,054
	<b>54,450</b>	<b>55,054</b>	<b>54,450</b>	<b>55,054</b>
<b>Services other than statutory audit</b>				
Advisory services	3,675	-	3,675	-
Taxation services	43,507	85,189	43,507	85,189
AIM listing services	-	41,818	-	41,818
	<b>47,182</b>	<b>127,007</b>	<b>47,182</b>	<b>127,007</b>
<b>Auditors remuneration</b>	<b>101,632</b>	<b>182,061</b>	<b>101,632</b>	<b>182,061</b>

**6. Net financing costs**

	Consolidated		The Company	
	2006	2005	2006	2005
<b>Financial income</b>	\$'000	\$'000	\$'000	\$'000
Interest income	347	301	347	301
Interest expense	(4)	-	(4)	-
<b>Net financing costs</b>	<b>343</b>	<b>301</b>	<b>343</b>	<b>301</b>

**7. Income tax expense**

No income tax expense or current tax receivable or payable arose in the current or previous year as the consolidated entity and the company made losses.

	Consolidated		The Company	
	2006	2005	2006	2005
<b>Reconciliation between tax expense and pre tax loss</b>	\$'000	\$'000	\$'000	\$'000
Loss before tax	<b>(10,820)</b>	<b>(4,221)</b>	<b>(11,289)</b>	<b>(4,218)</b>
<b>Income tax benefit @ 30%</b>	<b>(3,246)</b>	<b>(1,245)</b>	<b>(3,387)</b>	<b>(1,245)</b>
Future income tax benefit not recognised	3,246	1,245	3,387	1,245
<b>Income tax expense on pre-tax losses</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Deferred tax assets have not been recognised in respect of the following items:

	Consolidated		The Company	
	2006	2005	2006	2005
	\$'000	\$'000	\$'000	\$'000
Tax losses	<b>25,848</b>	<b>24,612</b>	<b>7,229</b>	<b>5,994</b>

Deductible tax losses do not expire under current income tax legislation.

The claimability of deferred tax assets against future profits is subject to the parent entity passing either of the continuity of ownership or continuity of business tests under current income tax legislation requirements.

Deferred tax assets have not been recognised in respect of these items because it is not considered probable that future taxable profits will be available against which the consolidated entity can utilise the benefits therefrom.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**8. Earnings per share**

**Basic loss per share**

The calculation of the basic and diluted loss per share at 30 June 2006 was based on the loss attributable to ordinary shareholders of \$14,798,000 (2005: \$4,221,000) and a weighted average number of ordinary shares outstanding during the year ended 30 June 2006 of 38,245,649 (2005: 29,919,595), calculated as follows:

	<b>Consolidated</b>	
	<b>2006</b>	<b>2005</b>
	'000	'000
<b>Loss attributable to ordinary shareholders</b>	<b>14,798</b>	<b>4,221</b>
<b>Weighted average number of ordinary shares</b>		
Issued shares at 1 July	38,040	23,506
Conversion of B class shares	-	2,458
Effect of shares issued 10 February 2005	-	158
Effect of shares issued 1 March 2005	-	418
Effect of shares issued 14 March 2005	-	3,380
Effect of shares issued 1 June 2006	205	-
<b>Weighted average number at 30 June</b>	<b>38,245</b>	<b>29,920</b>
<b>Basic and diluted loss per share, cents</b>	<b>(38.7)</b>	<b>(14.1)</b>

**9. Cash and cash equivalents**

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	\$'000	\$'000	\$'000	\$'000
Bank balances	2,124	2,669	2,010	2,669
Call deposits	1,900	8,463	1,900	8,463
<b>Cash and cash equivalents in the statement of cash flows</b>	<b>4,024</b>	<b>11,132</b>	<b>3,910</b>	<b>11,132</b>

**10. Trade and other receivables**

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	\$'000	\$'000	\$'000	\$'000
<b>Current</b>				
Trade Receivables	4	-	4	-
Other receivables and prepayments	344	2,337	163	2,042
	<b>348</b>	<b>2,337</b>	<b>167</b>	<b>2,042</b>
<b>Non-current</b>				
Loans to controlled entities	-	-	-	295

Other receivables in 2005 included an advance of \$1,852,000 to the EMAG joint venture.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**11. Other Investments**

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
<b>Non-current</b>				
Investment in joint venture entity	-	1,293	-	1,293

For the eleven months to 1 June 2006, MIL accounted for its 50% investment in EMAG as a joint venture and recorded \$3,978,185 as its share of losses for the period. During the 11 months to 1 June 2006 the consolidated entity recorded an impairment of \$1,038,000 against its investment and loans to EMAG; the company recorded an impairment of \$5,825,321 against its investment and loans to EMAG and an impairment of \$2,043,000 against its loan to MagSheet Pty Limited. Loan balances with EMAG were \$nil at 30 June 2006. The funds advanced to EMAG were used for expenditure on the smelter project. It is the Company's policy to expense these project expenditures as incurred.

**12. Property, plant & equipment**

	<b>Consolidated</b>				<b>The Company</b>			
	<b>Land</b>	<b>Buildings</b>	<b>Plant &amp; Equip-ment</b>	<b>Total</b>	<b>Land</b>	<b>Buildings</b>	<b>Plant &amp; Equip-ment</b>	<b>Total</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
<b>Cost</b>								
Balance at 1 July 2004	371	100	275	746	-	-	275	275
Additions	-	-	22	22	-	-	22	22
Balance at 30 June 2005	371	100	297	768	-	-	297	297
Balance at 1 July 2005	371	100	297	768	-	-	297	297
Additions	-	-	248	248	-	-	3	3
Disposals	-	-	(37)	(37)	-	-	(37)	(37)
Foreign exchange movements	-	-	2	2	-	-	-	-
Balance at 30 June 2006	371	100	510	981	-	-	263	263

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**  
**12 Property, plant and equipment (continued)**

	Consolidated				The Company			
	Land	Buildings	Plant & Equip-ment	Total	Land	Buildings	Plant & Equip-ment	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Depreciation and impairment losses</b>								
Balance at 1 July 2004	-	(5)	(210)	(215)	-	-	(210)	(210)
Depreciation charge for the year	-	(3)	(26)	(29)	-	-	(26)	(26)
Balance at 30 June 2005	-	(8)	(236)	(244)	-	-	(236)	(236)
Balance at 1 July 2005	-	(8)	(236)	(244)	-	-	(236)	(236)
Depreciation charge for the year	-	(2)	(31)	(33)	-	-	(30)	(30)
Disposals	-	-	37	37	-	-	37	37
Balance at 30 June 2006	-	(10)	(230)	(240)	-	-	(229)	(229)
<b>Carrying amounts</b>								
At 1 July 2004	371	95	65	531	-	-	65	65
At 30 June 2005	371	92	61	524	-	-	61	61
At 1 July 2005	371	92	61	524	-	-	61	61
At 30 June 2006	371	90	280	741	-	-	34	34

**13. Exploration and evaluation expenditure**

	Consolidated		The Company	
	2006	2005	2006	2005
	\$'000	\$'000	\$'000	\$'000
Expenditure carried forward in respect of areas of interest at beginning of year	-	3,309	-	-

The \$3,309,000 of exploration and evaluation expenditure related to the cost of acquiring mining licenses and exploitation of the Myrtle Springs mining leases. Recoverability of the carrying amounts of exploration and evaluation assets was dependent on the successful development and commercial exploitation or sale of the respective area of interest. At 30 June 2006 the expenditure was impaired as its recoverability is uncertain.

**14. Trade and other payables**

Trade payables	962	836	354	836
Amounts due to controlled entities	-	-	10	10
	<b>962</b>	<b>836</b>	<b>364</b>	<b>846</b>

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**15. Employee benefits**

**a) Annual leave**

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Liability for current annual leave	<b>75</b>	<b>103</b>	<b>15</b>	<b>103</b>

Employee benefits expense is recognised in the “employment costs” line in the Income Statement.

**b) Share based payments**

The Employee Share Option Plan (ESOP) was approved by shareholders at a meeting held on 28 November 2001. The ESOP is a standard type plan which limits the number of options that can be issued to not more than 5% of the total number of shares on issue. It provides that:

- Directors can issue options to employees, consultants, contractors or agents at an option price of nil and an exercise price determined by the Directors,
- options vest, unless otherwise determined, over 3 years, 25% on the 1<sup>st</sup> anniversary of the issue date, 25% on the 2<sup>nd</sup> anniversary and 50% on the 3<sup>rd</sup> anniversary. The Directors may impose performance conditions,
- options are exercisable within 5 years of vesting,
- options lapse 30 days after termination of employment or of the contract/consultancy agreement, and
- loans may be made in connection with the shares issued pursuant to the exercise of options to employees. The loan may be at no interest or a less than commercial rate and the amount repayable of the loan may be limited to the proceeds of the sale of the shares acquired with the loan.

Details of employee options issued under the plan during the year ended 30 June 2006 are shown in note 24.

No options were exercised under the Employee Share Option Plan in the year ended 30 June 2006.

The recognition and measurement principles in AASB 2 have not been applied to options granted before 7 November 2002, in accordance with the transitional provisions in AASB 1.

The terms and conditions of share option grants are as follows, whereby all options are settled by physical delivery of shares:

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**15. Employee Benefits (continued)**

**Summary of options on issue**

Grant Date	Number of options	Exercise Price	Vesting conditions	Expiry Date
30/11/2001	480,000	\$8.95	On issue	30/11/2006
1/12/2001	500,000	\$4.95	On issue	1/12/2006
30/03/2002	150,000	\$4.95	On issue	31/3/2007
29/11/2002	150,000	\$3.00, Sub-Note 1	Financial Close	01/08/2007
01/09/2004	600,000	Sub-Notes 2, 5	Financial Close	30/6/2011
01/09/2004	300,000	Sub-Notes 3, 5	Financial Close	30/6/2011
19/05/2004	500,000	\$2.00	On issue	18/05/2007
31/03/2005	100,000	\$1.20	Financial Close	30/6/2011
31/05/2005	190,200	\$1.20	On issue	31/5/2010
19/09/2005	650,000	Sub-Notes 4, 5	Financial Close	30/6/2011
31/10/2005	150,000	\$2.00	On issue	31/10/2012
31/10/2005	<u>100,000</u>	\$1.16	On issue	30/6/2011
	<b><u>3,870,200</u></b>			

**Sub-Note 1**

Mr Galt's options were approved by shareholders at a meeting held on 29 November 2002. The 675,000 options were issued in five tranches:

Tranche 1: 150,000 options at an exercise price of \$3.00 per option exercisable by 1 August 2007.

Tranches 2 to 5: These options have all lapsed.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**15. Employee Benefits (continued)**

**Sub-Note 2: Directors Options**

1,350,000 options in three tranches were issued following approval by shareholders at the Annual General Meeting on 27 August 2004. The then Managing Director received 750,000 options, which have all lapsed, and the then four Directors (Messrs Karpin, Elliott, Hogendijk and Richmond) each received 150,000 options. Details of the tranches which are still current are as follows:

- Tranche 1: 200,000 options (50,000 options for each of Karpin, Elliott, Hogendijk and Richmond) at 20% above the average market price of the ordinary shares of the Company subsequent to the date of approval by shareholders of the option grant. The exercise price for these options is \$1.38. The options are exercisable at any date from the date of Financial Close (described in Sub-Note 4) up until 30 June 2011.
- Tranche 2: 200,000 options (50,000 options for each of Karpin, Elliott, Hogendijk and Richmond) at the average market price of the Company's ordinary shares for the 5 trading days subsequent to Financial Close (described in Sub-Note 4). The options are exercisable at any date from the date of Mechanical Completion up until 30 June 2011.
- Tranche 3: 200,000 options (50,000 options for each of Karpin, Elliott, Hogendijk and Richmond) at 20% above the average market price of the Company's ordinary shares for the 5 trading days subsequent to Financial Close (described in Sub-Note 4). The options are exercisable at any date from the date of Commissioning up until 30 June 2011.

**Sub-Note 3 Employee Options**

300,000 options were issued pursuant to the company's Employee Share Option Plan in three Tranches. The details of the three Tranches are as follows:

- Tranche 1: 100,000 options at 20% above the average market price of the Company's ordinary shares for the first 5 trading days in July 2004. The exercise price for these options is \$1.46. The options are exercisable at any time from the date of Financial Close (described in Sub-Note 4) up until 30 June 2011
- Tranche 2: 100,000 options at the average market price of the Company's ordinary shares for the 5 trading days subsequent to Financial Close (described in Sub-Note 4). The options are exercisable at any date from the date of Mechanical Completion up until 30 June 2011.
- Tranche 3: 100,000 options at 20% above the Tranche 2 price of the Company's ordinary shares. The options are exercisable at any date from the date of Commissioning up until 30 June 2011.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**15. Employee Benefits (continued)**

**Sub-Note 4: Employee Options**

650,000 options were issued pursuant to the company's Employee Share Option Plan in three Tranches. The details of the three Tranches are as follows:

- Tranche 1: 250,000 options at the average market price for the five trading days prior to joining the Company. The exercise prices for these options are \$1.50 (200,000) and \$1.34 (50,000). The options are exercisable at any time from the date of Financial Close (described in Sub-Note 4) up until 30 June 2011
- Tranche 2: 200,000 options at the average market price of the Company's ordinary shares; 50,000 for the 5 trading days subsequent to and 150,000 for the 5 trading days before Financial Close (described in Sub-Note 4). The options vest at Mechanical Completion.
- Tranche 3: 200,000 options at the average market price, plus 20%, of the Company's ordinary shares; 50,000 for the 5 trading days subsequent to and 150,000 for the 5 trading days before Financial Close (described in Sub-Note 4). The options are exercisable at any date from the date of Commissioning Completion.

**Sub-Note 5: Financial Close**

Financial Close is defined for the purposes of these options as the date upon which the Board resolves that commitments for equity and debt funding suitable and sufficient for the Company's magnesium smelter project have been accepted.

**15 (c). Summary of Options**

The number and weighted average exercise prices of share options are as follows:

	Weighted average	Number of options '000	Weighted average	Number of options '000
		2006		2005
Outstanding at the beginning of the year	\$3.38	3,974	\$5.24	2,935
Forfeited during the year	\$2.86	(1,004)	\$6.27	(993)
Exercised during the year	-	-	\$1.50	(408)
Granted during the year	\$1.52	900	\$1.44	2,440
<b>Outstanding at the end of the year</b>	<b>\$3.09</b>	<b>3,870</b>	<b>\$3.38</b>	<b>3,974</b>
<b>Options exercisable</b>		<b>2,070</b>		<b>2,324</b>

The options outstanding at 30 June 2006 have exercise prices in the range from \$1.16 to \$8.95 and a weighted average contractual life of 5.5 years.

No share options were exercised during the year.

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**15. Employee Benefits (continued)**

**Fair value of share options and assumptions**  
**For the financial year ended 30 June 2006**

	<b>2006</b>	<b>2005</b>
Fair value at measurement date	\$0.69	\$0.34
Share price	\$1.65	\$1.12
Exercise price	\$1.16 to \$2.00	\$1.20
Expected volatility	30.8 %	26.3 %
Option life	6 years	5 years
Expected dividends	Nil %	Nil %
Risk-free interest rate	4.55 %	4.55 %

Share based payment expense in the period to 30 June 2006 was \$172,442 (2005: \$71,000). This cost excludes 1,800,000 options granted where it is not possible to ascribe a share price to future periods when certain options are exercisable, or the options do not vest until Financial Close.

**16. Capital and reserves**

**Share Capital**

	<b>The Company</b>	
	<b>Fully Paid Ordinary Shares '000</b>	
	<b>2006</b>	<b>2005</b>
On issue at 1 July	38,040	23,506
B class shares converted into ordinary shares	-	2,458
Issued for cash	-	12,076
Shares issued on acquisition (see note 24)	2,500	-
<b>On issue at 30 June</b>	<b>40,540</b>	<b>38,040</b>

**Currency translation reserve**

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity.

**Share compensation expense**

Share compensation expense represents the cost of expensing share options. Share compensation expense for 2006 was \$172,442 (2005: \$71,000).

**Dividends**

No dividends were paid or proposed in 2006 (2005 \$: nil).

**17. Financial instruments**

Exposure to credit, interest rate and currency risks arises in the normal course of the consolidated entity's business. Derivative financial instruments or hedging contracts are not used.

At balance sheet date there were concentrations of credit risk as cash and cash equivalents were deposited with only two, AA/A rated, financial institutions. This concentration of credit risk is monitored on an ongoing basis.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**17. Financial instruments (continued)**

**Effective interest rates**

Consolidated	Effective interest rate	2006		Effective interest rate	2005	
		Total	6 months or less		Total	6 months or less
	%	\$'000	\$'000	%	\$'000	\$'000
Cash & Cash Equivalents	5.6%	4,024	4,024	5.7%	11,132	11,132
	5.6%	4,024	4,024	5.7%	11,132	11,132

The effective interest rates for the cash and cash equivalents of the Company were 5.6% (2005: 5.7%).

**Foreign currency risk**

The consolidated entity is exposed to foreign currency risk on sales, purchases and cash balances that are denominated in a currency other than the AUD. The currencies giving rise to this risk are USD and Euros. Foreign currency balances are held to facilitate currency transfers by the consolidated entity between Australia and Egypt.

**Fair values**

Consolidated	Note	2006		2005	
		Carrying amount	Fair value	Carrying amount	Fair value
		\$'000	\$'000	%	\$'000
Trade and other receivables	10	348	348	2,337	2,337
Cash & Cash Equivalents	9	4,024	4,024	11,132	11,132
Trade and other payables	14	(962)	(962)	(836)	(836)
		3,410	3,410	12,633	12,633
Unrecognised (losses)/ gains			-		-

All Company financial instruments are stated at fair value.

**Estimation of fair values**

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

**Trade and other receivables / payables**

Where the remaining life is less than one year, the notional amount is deemed to reflect the fair value. All other receivables / payables are discounted to determine the fair value.

**18. Operating leases**

	Consolidated		The Company	
	2006	2005	2006	2005
	\$'000	\$'000	\$'000	\$'000
Less than one year	215	144	209	144
Between one and five years	-	288	-	288
More than five years	-	-	-	-
	215	432	209	432

During the year ended 30 June 2006, \$178,661 was recognised as an expense in the income statement in respect of operating leases (2005: \$131,008).

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**19. Capital and other commitments**

Non-cancellable operating lease rentals are payable as follows:

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Capital expenditure commitments</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Within one year	86	-	-	-
One year or later and no later than five years	-	-	-	-
Later than five years	-	-	-	-
	<u>86</u>	<u>-</u>	<u>-</u>	<u>-</u>

**Key management personnel (excluding directors)**

*Commitments under non-cancellable employment contracts payable:*

Within one year	708	-	-	-
One year or later and no later than five years	-	-	-	-
	<u>708</u>	<u>-</u>	<u>-</u>	<u>-</u>

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**20. Contingencies**

The directors are of the opinion that provisions are not required in respect of these matters, as it is not probable that a future sacrifice of economic benefits will be required or the amount is not capable of reliable measurement.

Contingent liabilities not considered remote

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
<b><i>Litigation</i></b>				
MAN Ferrostaal AG ("MFS") has advanced a claim against EMAG for Euro 314,286 in unpaid fees under an EPC Quoting Services Contract between them dated 23 March 2005. MFS claims that it has delivered various services to EMAG under that contract and is entitled to payment. EMAG disputes that MFS has provided those services in accordance with its contractual obligations. MFS and EMAG are in correspondence concerning the dispute. The Contract amount was Euro 2,000,000, of which Euro 1,471,430 has been paid by EMAG.	523	-	-	-
<b><i>Retirement benefits</i></b>				
A number of the Company's former Directors have agreed that retirement benefits amounting to \$182,001 will only become payable upon Financial Close of the Dow technology development project.	182	182	182	182
<b><i>Success fees</i></b>				
A number of the Company's advisors, consultants and other parties have entered into Success Fee arrangements, whereby amounts become payable upon Financial Close of the Dow technology development project. The fees payable vary depending on the amount of capital raised.	-	-	-	-
<b><i>Dow Chemicals</i></b>				
Under an agreement with The Dow Chemical Company ("Dow") a controlled entity has purchased an exclusive licence to Dow's technology for the manufacture of magnesium. The purchase gives full access to Dow's technology for the manufacture of magnesium and to Dow's magnesium database and patents. A technology fee of US\$4.9 million is payable by 30 days after Financial Close.	6,530	7,600	6,530	-
<b><i>Commonwealth Scientific and Industrial Research Organisation (CSIRO) Options</i></b>				
MagSheet Pty Limited has into an Option Agreement with the CSIRO, which will give a worldwide exclusive licence to their magnesium alloy sheet metal technology. The exercise price is \$9.6 million if exercised by November 2007 or \$12.5 million if exercised by November 2008.	9,600	9,600	9,600	9,600
	<b>16,835</b>	<b>17,382</b>	<b>16,312</b>	<b>9,782</b>

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**21. Consolidated entities**

Parent entity:	Incorporated	Ownership interest	
		2006	2005
Magnesium International Limited	Australia		
<b>Significant subsidiaries:</b>			
Egyptian Magnesium Company S.A.E.	Egypt	100	50
MagSheet Pty Ltd	Australia	100	100
SAMAG Limited	Australia	100	100
Magnesium Developments Ltd	Australia	100	100

**22. Acquisitions of subsidiaries**

On 1 June 2006, the consolidated entity acquired the remaining 50% of shares in the Egyptian Magnesium Company S.A.E; this was satisfied by the issue of 2,500,000 shares in MIL. The share price used to value the acquisition transaction was \$0.39, this being the closing price of MIL shares on 31 May 2006. In the one month to 30 June 2006 the subsidiary contributed a net loss of \$310,000 to the consolidated net loss for the year. If the acquisition had occurred on 1 July 2005, the consolidated entity net loss would have increased by \$3,978,000 to \$18,776,000.

The acquisition had the following effect on the consolidated entity's assets and liabilities:

**Acquiree's net assets at the acquisition date**

	Recognised / fair values
	\$'000
Cash at Bank	63
Property, plant and equipment	18
Trade and other payables	<u>(286)</u>
Net identifiable assets and liabilities	(205)
Goodwill on acquisition	<u>1,180</u>
Consideration, settled by the issue of shares	<u>975</u>

Goodwill arising on acquisition of \$1,180,000 has been impaired due to the early stage of the smelter project.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**23. Reconciliation of cash flows from operating activities**

	Consolidated		The Company	
	2006	2005	2006	2005
	\$000	\$000	\$000	\$000
<b>Cash flows from operating activities</b>				
<b>Operating Loss for the period</b>	(11,163)	(4,522)	(11,632)	(4,519)
Joint venture losses	(3,978)	-	-	-
<b>Adjustments for:</b>				
Depreciation and amortisation	33	29	31	26
Impairment of loans and investments (non cash)	1,741	-	4,862	-
Exploration and evaluation impairment	3,309	-	-	-
Goodwill impairment	1,180	-	-	-
Share compensation expense	171	72	171	72
<b>Operating cash flow before changes in working capital and provisions</b>	<b>(9,408)</b>	<b>(4,421)</b>	<b>(6,568)</b>	<b>(4,421)</b>
Decrease/(increase) in trade and other receivables	1,989	(2,077)	2,170	(1,807)
Increase/(decrease) in trade and other payables	126	552	(482)	551
Increase/(decrease) in provisions and employee entitlements	(28)	31	(88)	31
<b>Net cash used in operating activities</b>	<b>(6,620)</b>	<b>(5,915)</b>	<b>(4,968)</b>	<b>(5,646)</b>

**24. Related party disclosures**

The parent entity's policy for determining the nature and amount of emoluments of board members and senior executives of the company is as follows:

The remuneration structure for executive officers and Directors, including executive Directors, seeks to emphasise payment for results through providing individual reward arrangements, for example the use of share options as disclosed in the Directors Report.

The objective of the individual reward arrangements is to both reinforce the short and long term goals of the company and to provide a common interest between management and shareholders.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**24. Related party disclosures (continued)**

**Employment contracts**

Details of contracts between executives, Magnesium International Limited and certain controlled entities are as follows:

<b>Name</b>	<b>Contract</b>	<b>Duration</b>	<b>Notice</b>	<b>Termination</b>
PE Sydney-Smith	Yes	Open	6 months	12 months

Mr Sydney-Smith stepped down as Executive Finance Director, on 12 July 2006 and will continue with the company as a non-executive director. Termination payments due to Mr Sydney-Smith total \$59,857, representing July salary and accrued statutory entitlements.

**Key management personnel remuneration**

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company and other executives. Key management personnel include the five most highly remunerated S300A directors and executives for the company and the consolidated entity.

The directors of the Company during or since the end of the financial year are:

<b>Name</b>	<b>Position</b>
PJD Elliott	Chairman and Managing Director (previously non-executive director, appointed Managing Director on 31 January 2006 and Chairman on 30 March 2006).
JD Beecher	Executive Director (Appointed 19 September 2005)
MR Richmond	Non-Executive Director
OFR Al-Sharif	Non-Executive Director
PE Sydney-Smith	Executive Director (appointed 21 October 2005). Non-Executive Director from 12 July 2006.
GT Galt	Managing Director (resigned 31 January 2006)
AJ Hogendijk	Non-Executive Director (resigned 14 March 2006)
DS Karpin	Chairman (resigned 30 March 2006)

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**24. Related party disclosures (continued)**

**Key management personnel remuneration (Company and consolidated)**

<b>Key management personnel</b>		Short-Term			Post Employment	Share based payments	FBT	Total
		Salary and Fees	Consulting Fees	Other benefits	Super-annuation	Options (i), (ii), (iii)		
		\$	\$	\$	\$	\$	\$	
P Baily (iv)	2006	-	32,261	-	-	-	-	32,261
	2005	-	126,719	-	-	-	-	126,719
JD Beecher (v)	2006	-	186,946	-	-	84,230	-	271,176
	2006	-	225,403	-	-	-	-	225,403
P Cameron (vi)	2006	18,000	-	1,432	-	-	-	19,432
	2005	-	-	-	-	-	-	-
PJD Elliott	2006	30,000	269,000	-	-	-	-	299,000
	2005	40,000	30,000	-	-	-	-	70,000
MG Moran (vi)	2006	27,000	-	9,279	-	-	-	36,279
	2005	-	-	-	-	-	-	-
MR Richmond	2006	40,000	8,000	-	3,600	-	-	51,600
	2005	40,000	-	-	7,875	-	-	47,875
OFR Al-Sharif	2006	40,000	-	-	-	-	-	40,000
	2005	13,556	-	-	-	-	-	13,556
PE Sydney-Smith (vii)	2006	347,644	-	-	43,353	-	-	390,997
	2005	-	-	-	-	-	-	-
<b>Former key management personnel</b>								
R Eaglesham (viii)	2006	-	-	-	-	-	-	-
	2005	-	246,109	-	-	-	-	246,109
GT Galt (x)	2006	87,686	-	-	7,892	88,212	-	183,790
	2005	344,478	-	-	45,000	-	35,773	425,251
AJ Hogendijk (ix)	2006	30,000	15,000	-	2,700	-	-	47,700
	2005	40,000	3,863	-	13,125	-	-	56,988
DS Karpin (ix)	2006	78,288	78,287	-	-	-	-	156,575
	2005	100,000	115,000	-	-	-	-	215,000
<b>Compensation: Key management personnel</b>	2006	698,618	589,494	10,711	57,545	172,442	-	1,528,810
	2005	578,034	747,094	-	66,000	-	35,773	1,426,901

- (i) The value of options as a percentage of remuneration in 2006 was 31.7% and 48% for Messrs JD Beecher and GT Galt respectively.
- (ii) No short-term or long-term incentives were paid in 2005 or 2006.

## Notes to the Consolidated Financial Statements (continued)

For the year ended 30 June 2006

### 24. Related party disclosures (continued)

- (iii) Options vesting in the year ended 30 June 2006 were valued using the Black Scholes option pricing model. No option expense arose for the financial year ended 30 June 2005 as the options issued, as described in sub-note 2 of Note 16 to the Financial Statements, do not vest until after the date of Financial Close. Upon vesting these options will also be valued using the Black Scholes option pricing model.
- (iv) P Baily also provided consulting services to EMAG. Payments were \$200,410 in 2006 (2005:\$73,293).
- (v) JD Beecher was appointed a director on 19 September 2005. Mr Beecher also provided consulting services to EMAG. Payments in 2006 were \$103,666 (2005: \$8,000).
- (vi) Salaries, expatriate allowances and consulting fees paid subsequent to the 100% acquisition of EMAG by MIL on 1 June 2006 are included above. Remuneration of \$226,265 was paid to P Cameron and \$247,001 was paid to M Moran by the EMAG joint venture prior to 1 June 2006.
- (vii) PE Sydney-Smith was appointed a director on 21 October 2005.
- (viii) R Eaglesham also provided consulting services to EMAG. Payments were \$111,920 in 2006 (2005:\$96,497).
- (ix) DS Karpin and AJ Hogendijk resigned as directors on 30 March and 12 March 2006 respectively.
- (x) GT Galt was seconded to EMAG in March 2005. EMAG were responsible for his remuneration arrangements from July 2005 to April 2006, when he left the company. \$481,788 was paid by EMAG in respect of these arrangements in the year ended 30 June 2006 (2005: \$187,797). Outstanding employee entitlements accrued prior to March 2005 were settled by MIL in 2006.

### Interests in shares or options – key management personnel

The relevant interest of each Director in the shares and options issued by the companies within the consolidated entity, as notified by the Directors to the Australian Stock Exchange in accordance with S205G(1) of the Corporations Act, 2001, at the date of this report is as follows :

<b>Directors:</b>	<b>Ordinary shares</b>	<b>Unlisted Options</b>	<b>Listed Options</b>
PJD Elliott	206,998	510,000	4,168
JD Beecher	29,167	100,000	2,084
MR Richmond	-	150,000	-
OFR Al-Sharif	4,800,000	-	1,150,000
PE Sydney-Smith	-	-	-
<b>Officers:</b>			
P Baily	-	150,000	-
P Cameron	-	150,000	-
MG Moran	-	500,000	-
<b>Total key management personnel</b>	<b>5,036,165</b>	<b>1,560,000</b>	<b>1,156,252</b>

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**24. Related party disclosures (continued)**

**Unlisted share options**

Unlisted share options granted by Magnesium International Limited to directors and key management personnel during the financial year ended 30 June 2006 were as follows:

Magnesium International Limited	Number of options	Exercise price	Expiry date
<b>Directors</b>			
GT Galt	150,000	\$2.00	31 October 2012
JD Beecher	100,000	\$1.16	30 June 2011
<b>Officers</b>			
M Moran	500,000	(ii)	30 June 2011
P Cameron	150,000	(i)	30 June 2011
<b>Total key management personnel</b>	<b>900,000</b>		

No options have been issued since the end of the financial year.

**Unlisted options over ordinary shares at the date of this report**

<u>Shares</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
150,000	\$3.00	1 August 2007
480,000	\$8.95	30 November 2006
500,000	\$4.95	1 December 2006
150,000	\$4.95	31 March 2007
500,000	\$2.00	18 May 2007
190,200	\$1.20	31 May 2010
600,000	See (i)	30 June 2011
300,000	See (i)	30 June 2011
100,000	\$1.20	30 June 2011
150,000	\$2.00	31 October 2012
100,000	\$1.16	30 June 2011
500,000	See (i)	30 June 2011
150,000	See (i)	30 June 2011
<b>3,870,200</b>		

**Other related party transactions**

Loans are made by the company to wholly owned subsidiaries for working capital and operating expense purposes. During the year ended 30 June 2006, such loans to subsidiaries totalled \$1,949,000 (2005: \$268,000). These loans have been subsequently written off by the company.

**25. Subsequent events**

There has not been any other matter or circumstance which has arisen since the end of the financial year that has significantly affected, or may significantly affect, the operation of the economic entity, the result of those operations, or the state of affairs of the economic entity in future financial years, other than as disclosed elsewhere in the financial report.

<sup>ii</sup> The terms of the unlisted options are described in Note 15 to the Financial Statements.

## Notes to the Consolidated Financial Statements (continued) For the year ended 30 June 2006

### 26. Explanation of transition to AIFRSs

As stated in significant accounting policies note 1 (a) these are the consolidated entity's first consolidated financial statements prepared in accordance with AIFRSs.

The policies set out in the significant accounting policies section of this report have been applied in preparing the financial statements for the year ended 30 June 2006, the comparative information presented in these financial statements for the year ended 30 June 2005 and in the preparation of an opening AIFRS balance sheet at 1 July 2004 (the consolidated entity's date of transition).

In preparing its opening AIFRS balance sheet, the consolidated entity has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (previous GAAP). An explanation of how the transition from previous GAAP to AIFRSs has affected the consolidated entity's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

#### Notes to the reconciliation of equity

- a The consolidated entity has applied AASB 6 to exploration, evaluation and development expenditure capitalised under previous GAAP (AASB 1022 *Accounting for the Extractive Industries*). This expenditure did not meet the narrower definitions of exploration and evaluation expenditure of AASB 6 *Exploration and Evaluation of Mineral Resources*. The expenditure then falls under AASB 138 *Intangible Assets* and has been subject to impairment testing at transition, resulting in a remaining balance of \$3,309,000 in exploration and evaluation expenditure which relates to the cost of acquiring mining licenses and exploitation of the reserves.

The effect in the consolidated entity is to reduce Exploration and evaluation expenditure by \$40,010,584 and to increase retained losses at 1 July 2004 by \$40,010,584. It has also resulted in impairments in the Company at 1 July 2004 and 30 June 2005 to investments in subsidiaries of \$19,536,000 and inter-company receivables of \$24,058,000.

- b The consolidated entity applied AASB 2 to share-based payment arrangements at 1 July 2005 except for equity-settled share-based payment arrangements granted before 7 November 2002. Under previous GAAP the consolidated entity did not account for equity-settled share-based payments. Such payments are now recognised at fair value in accordance with AASB 2. The consolidated entity granted equity-settled share-based payments in 2005 and 2006.

The effect in the consolidated entity of accounting for equity-settled share-based payment transactions at fair value is to increase *Employment expenses* by \$70,698 for the year ended 30 June 2005. Equity-settled share-based payment transactions are carried in *Equity* as *Share compensation Reserve*. The adoption of AASB 2 is equity-neutral for equity-settled transactions. The transaction expense recognised does not include the cost of all options as it is not possible to ascribe a share price to future periods in which certain options become exercisable.

- c The above changes had no impact on deferred tax liabilities or the tax charge in the income statement.

**Notes to the Consolidated Financial Statements (continued)**  
**For the year ended 30 June 2006**

**26. Explanation of transition to AIFRSs (continued)**

d The effect of the above adjustments on retained earnings is as follows:

\$'000	Note	Consolidated		The Company	
		1 July 2004	30 June 2005	1 July 2004	30 June 2005
Exploration, evaluation and development	a	(40,011)	(40,011)	-	-
Investments in subsidiaries	a	-	-	(19,536)	(19,536)
Intercompany receivables	a	-	-	(24,058)	(24,058)
Reserve for own shares	b	-	(71)	-	(71)
<b>Total adjustment to retained earnings</b>		<b>(40,011)</b>	<b>(40,082)</b>	<b>(43,594)</b>	<b>(43,665)</b>

**Explanation of material adjustments to the cash flow statement for 2005**

There were no material differences between the cash flow statements presented under AIFRSs and the cash flow statement presented under previous GAAP.

**e Notes to the reconciliation of profit**

Interest income has been reclassified from revenue to financial income under AIFRS.

## 26. Explanation of transition to AIFRSs (continued)

### Reconciliation of equity

	Note	Consolidated					The Company						
		Previous GAAP	Effect of transition to AIFRSs 1 July 2004	AIFRSs	Previous GAAP	Effect of transition to AIFRSs 30 June 2005	AIFRSs	Previous GAAP	Effect of transition to AIFRSs 1 July 2004	AIFRSs	Previous GAAP	Effect of transition to AIFRSs 30 June 2005	AIFRSs
<b>\$'000</b>													
<b>Current Assets</b>													
Cash and cash equivalents		4,124	-	4,124	11,132	-	11,132	4,123	-	4,123	11,132	-	11,132
Trade and other receivables		261	-	261	2,337	-	2,337	234	-	234	2,042	-	2,042
<b>Total Current Assets</b>		<b>4,385</b>	<b>-</b>	<b>4,385</b>	<b>13,469</b>	<b>-</b>	<b>13,469</b>	<b>4,357</b>	<b>-</b>	<b>4,357</b>	<b>13,174</b>	<b>-</b>	<b>13,174</b>
<b>Non-Current Assets</b>													
Property, plant and equipment		531	-	531	524	-	524	65	-	65	61	-	61
Exploration and evaluation expenditure	a	43,320	(40,011)	3,309	43,320	(40,011)	3,309				20,829	(19,536)	1,293
Investments	a				1,293		1,293	19,536	(19,536)		20,829	(19,536)	1,293
Inter company receivables	a							24,086	(24,058)	28	24,353	(24,058)	295
<b>Total Non-Current Assets</b>		<b>43,851</b>	<b>(40,011)</b>	<b>3,840</b>	<b>45,137</b>	<b>(40,011)</b>	<b>5,126</b>	<b>43,687</b>	<b>(43,594)</b>	<b>93</b>	<b>45,243</b>	<b>(43,594)</b>	<b>1,649</b>
<b>Total Assets</b>		<b>48,236</b>	<b>(40,011)</b>	<b>8,225</b>	<b>58,606</b>	<b>(40,011)</b>	<b>18,595</b>	<b>48,044</b>	<b>(43,594)</b>	<b>4,450</b>	<b>58,417</b>	<b>(43,594)</b>	<b>14,823</b>
<b>Current Liabilities</b>													
Trade and other payables		284	-	284	836	-	836	294	-	294	846	-	846
Employee benefits		72		72	103		103	72		72	103		103
<b>Total Current Liabilities</b>		<b>356</b>		<b>356</b>	<b>939</b>		<b>939</b>	<b>366</b>		<b>366</b>	<b>949</b>		<b>949</b>
<b>Total Liabilities</b>		<b>356</b>		<b>356</b>	<b>939</b>		<b>939</b>	<b>366</b>		<b>366</b>	<b>949</b>		<b>949</b>
<b>Net Assets</b>		<b>47,880</b>	<b>(40,011)</b>	<b>7,869</b>	<b>57,667</b>	<b>(40,011)</b>	<b>17,656</b>	<b>47,678</b>	<b>(43,594)</b>	<b>4,084</b>	<b>57,468</b>	<b>(43,594)</b>	<b>13,874</b>
<b>Shareholders' Equity</b>													
Issued capital		76,290	-	76,290	90,227	-	90,227	76,290	-	76,290	90,227	-	90,227
Share compensation expense	b	-	-	-	-	71	71	-	-	-	-	71	71
Retained losses		(28,410)	(40,011)	(68,421)	(32,560)	(40,082)	(72,642)	(28,612)	(43,594)	(72,206)	(32,759)	(43,665)	(76,424)
<b>Total Equity</b>		<b>47,880</b>	<b>(40,011)</b>	<b>7,869</b>	<b>57,667</b>	<b>(40,011)</b>	<b>17,656</b>	<b>47,678</b>	<b>(43,594)</b>	<b>4,084</b>	<b>57,468</b>	<b>(43,594)</b>	<b>13,874</b>

## 26. Explanation of transition to AIFRSs (continued)

### Reconciliation of profit for the year ended June 30 2005

\$'000	Note	Consolidated			The Company		
		Previous GAAP	Effect of transition to AIFRSs	AIFRSs	Previous GAAP	Effect of transition to AIFRSs	AIFRSs
<b>Revenue</b>	<b>e</b>	316	(301)	15	316	(301)	15
<b>Expenses</b>							
Consultants Expenses		(1,700)	-	(1,700)	(1,700)	-	(1,700)
Administrative expenses		(1,006)	-	(1,006)	(1,006)	-	(1,006)
Employment Expenses	<b>b</b>	(1,028)	(71)	(1,099)	(1,028)	(71)	(1,099)
Occupancy Expenses		(131)	-	(131)	(131)	-	(131)
Other operating expenses		(601)	-	(601)	(598)	-	(598)
<b>Operating loss before financing costs</b>		<b>(4,150)</b>	<b>(372)</b>	<b>(4,522)</b>	<b>(4,147)</b>	<b>(372)</b>	<b>(4,519)</b>
Financial income	<b>e</b>		301	301	-	301	301
<b>Loss before tax</b>		<b>(4,150)</b>	<b>(71)</b>	<b>(4,221)</b>	<b>(4,147)</b>	<b>(71)</b>	<b>(4,218)</b>
Income tax expense		-	-	-	-	-	-
<b>Net Loss for the year</b>		<b>(4,150)</b>	<b>(71)</b>	<b>(4,221)</b>	<b>(4,147)</b>	<b>(71)</b>	<b>(4,218)</b>
Basic and diluted loss (cents) per share		(13.9)	(0.2)	(14.1)			

## DIRECTORS' DECLARATION

In the opinion of the directors of Magnesium International Limited:

- 1 The financial statements and notes, set out on pages 22 to 55, are in accordance with the Corporations Act 2001, including:
  - (a) Giving a true and fair view of the financial position of the Company and the consolidated entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
  - (b) Complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- 2 There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- 3 The directors have been given the declarations by the Managing Director and the Chief Financial Officer for the financial year ended 30<sup>th</sup> June 2006 required by Section 295A of the Corporations Act 2001.

Dated at Sydney, Australia, on the 29th day of August 2006.

Signed in accordance with a resolution of the directors

A handwritten signature in black ink, appearing to read 'PJD Elliott', with a horizontal line underneath it.

PJD Elliott  
Managing Director

## **INDEPENDENT AUDIT REPORT TO THE MEMBERS OF MAGNESIUM INTERNATIONAL LIMITED**

### **Scope**

#### ***The financial report and Directors' responsibility***

The financial report comprises the income statements, balance sheets, statements of changes in equity, statements of cash flows, accompanying notes to the financial statements (Notes 1 to 26), and the Directors' declaration for both Magnesium International Limited (the "Company") and its Controlled Entities (the "Consolidated Entity"), for the year ended 30 June 2006. The Consolidated Entity comprises both the company and the entities it controlled during that year.

The Directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding the AIFRS adjustments required under the Australian Accounting Standard AASB 1 First time Adoption of Australian Equivalents to International Reporting Standards.

#### ***Audit approach***

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, Australian Accounting Standards, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position, of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the Directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

**INDEPENDENT AUDIT REPORT  
TO THE MEMBERS OF MAGNESIUM INTERNATIONAL LIMITED (CONTINUED)**

**Audit opinion**

In our opinion, the financial report of Magnesium International Limited is in accordance with:

- a) the Corporations Act 2001, including:
  - i. giving a true and fair view of the Company's and consolidated Entity's financial position as at 30 June 2006 and of their performance for the financial year ended on that date; and
  - ii. complying with Australian Accounting Standards, and the Corporations Regulations 2001; and
- b) other mandatory financial reporting requirements in Australia.

**Going Concern**

Without qualification to the statement above, attention is drawn to the following matter. As a result of the matters described in Note 1(b) to the financial statements, there is significant uncertainty whether the consolidated entity will be able to continue as a going concern and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report.



KPMG



Sydney, 29th August 2006

**MAGNESIUM INTERNATIONAL LIMITED AND CONTROLLED ENTITIES**  
**ADDITIONAL INFORMATION**  
**for Listed Public Companies**

Additional information required by the Australian Stock Exchange Listing Rules and not disclosed elsewhere in this report:

**1. Shareholding – Ordinary shares**

(i) Distribution schedule of ordinary shareholdings as at 23rd August 2006.

1 – 1,000	2,059
1,001 – 5000	1,715
5,001 – 10,000	398
10,001 – 100,000	314
100,001 and over	31

Total number of holders	<u><u>4,517</u></u>
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(ii) Number of shareholders with less than a marketable parcel	<u><u>3,376</u></u>
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(iii) 20 Largest Shareholders – Ordinary Shares

	Number of Ordinary Shares Held	% Held
1. ANZ Nominees Limited	6,360,075	15.69%
2. Citicorp Nominees Pty Limited	4,093,411	10.10%
3. Amiral Magnesium Overseas, Limited	2,500,000	6.17%
4. Ossama Fathi Rabah Al-Sharif	2,300,000	5.67%
5. JP Morgan Nominees Australia Limited	1,715,107	4.23%
6. National Nominees Limited	1,330,557	3.28%
7. Pacific Gold Resources Ltd	476,449	1.18%
8. Bestfield Company	466,400	1.15%
9. Ms Ee-Lynn Lai	324,989	0.80%
10. Westpac Custodian Nominees Limited	318,945	0.79%
11. Ucan Nominees Pty Ltd	302,130	0.75%
12. Fulur Pty Ltd	291,293	0.72%
13. Fiske Nominees Limited	274,114	0.68%
14. Ipseity Pty Ltd	258,443	0.64%
15. Glenpace Pty Limited	233,500	0.58%
16. Mrs Tea Hua Cameron	226,500	0.56%
17. Mr PJD Elliott	206,998	0.51%
18. Invesko Pty Limited	200,000	0.49%
19. Jamarie Pty Limited	200,000	0.49%
20. Pershing Keen Nominees Limited	200,000	0.49%
<b>Percentage held by 20 largest shareholders</b>	<u><u>22,278,911</u></u>	<u><u>54.96%</u></u>

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES**  
**Additional Information for Listed Public Companies**

**2. Shareholding – Listed Options**

(i) Distribution schedule of ordinary shareholdings as at 23<sup>rd</sup> August 2006.

1 – 1,000	178
1,001 – 5000	223
5,001 – 10,000	14
10,001 – 100,000	17
100,001 and over	9
Total number of holders	<u>441</u>

(ii) Number of shareholders with less than a marketable parcel 437

(iii) 20 Largest Option holders

	Number of Options Held	% Held
1. ANZ Nominees Limited	1,196,500	20.51%
2. Ossama Fathi Rabah Al-Sharif	1,150,000	19.71%
3. HSBC Custody Nominees (Australia) Limited	650,000	11.14%
4. Citicorp Nominees Pty Limited	558,216	9.57%
5. Dr Fereudin Mahboubi	372,437	6.38%
6. Magdalena Finance Corp	260,000	4.46%
7. Magdalena & Stephen Mayer	166,952	2.86%
8. Mr Nicholas Baradakis	140,000	2.40%
9. KBC Peel Hunt Limited	107,500	1.84%
10. Mr Paul Vincent Dwyer	100,000	1.71%
11. Mr Daniel Yee	75,000	1.29%
12. Mr Sander Schaake	60,000	1.03%
13. Ucan Nominees Pty Ltd	47,500	0.81%
14. Rangemen Pty Limited	40,300	0.69%
15. Forbar Custodians Limited	40,000	0.69%
16. Fiske Nominees Pty Limited	25,000	0.43%
17. Latitude Investments Pty Limited	25,000	0.43%
18. Fitel Nominees Limited	22,500	0.39%
19. Porchester Capital Investment Limited	22,500	0.39%
20. Mr WR & Mrs IA Wright	22,500	0.39%
<b>Percentage held by 20 largest option holders</b>	<u><b>5,081,905</b></u>	<u><b>87.11%</b></u>

(v) Voting Rights

Article 37 of the parent entity's Constitution stipulates the voting rights of members as follows:  
Subject to any rights or restrictions attached to any class of shares and to these Articles:

- a) at a meeting of Members or class of Members each Member entitled to vote may vote in person or by proxy or attorney;
- b) on a show of hands every person present who is a Member or a representative of a Member shall have (1) vote ; and
- c) on a poll, every Member present in person or by proxy or by or attorney or representative shall have in respect of:
  - I. each fully paid share held by him in the parent company, one (1) vote; and
  - II. each contributing share held by him in the parent entity, voting rights pro rata to the amount paid up on each share.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES**  
**Additional Information for Listed Public Companies**

1. The address of the principal office in Australia is:

Level 6, 210 George Street, Sydney NSW 2000. Telephone (02) 9252 1505

2. Registers of securities are held at:

Computershare Registry Services Pty Limited  
Level 5, 115 Grenfell Street  
ADELAIDE SA 5000  
Phone: (08) 8236 2300      Facsimile: (08) 8236 2305

Computershare Investor Services PLC  
PO Box 82, The Pavilions, Bridgwater Road  
BRISTOL BS99 7NH  
United Kingdom  
Phone: +44 (0) 870 702 0000 Facsimile: +44 (0) 870 703 6114

3. Stock Exchange Listings

The parent entity's shares are quoted on the Australian Stock Exchange, the Alternative Investment Market (AIM) on the London Stock Exchange and the Regulated Unofficial Market on the Frankfurt Stock Exchange.

The Home Exchange is Sydney, Australia.

4. Restricted Securities- there are no restricted securities.
5. Unquoted Securities - 3,870,200 Unlisted Options are on issue.

**MAGNESIUM INTERNATIONAL LIMITED  
AND CONTROLLED ENTITIES  
ABN 23 003 669 163**

**CORPORATE DIRECTORY**

<b>DIRECTORS</b>	Patrick Elliott (Chairman and Managing Director) James Beecher Malcolm Richmond Ossama Al-Sharif Peter Sydney-Smith
<b>SECRETARY</b>	James Beecher
<b>REGISTERED OFFICE</b>	Level 6 210 George Street SYDNEY NSW 2000 Phone: (02) 9252 1505 Facsimile: (02) 9252 1507
<b>HEAD OFFICE</b>	Level 6 210 George Street SYDNEY NSW 2000 Phone: (02) 9252 1505 Facsimile: (02) 9252 1507
<b>AUDITORS</b>	KPMG 10 Shelley Street SYDNEY NSW 2000
<b>SHARE REGISTRAR</b>	Computershare Registry Service Pty Limited Level 5 115 Grenfell Street ADELAIDE SA 5000 Phone: (08) 8236 2300 Facsimile: (08) 8236 2305
<b>BANKERS</b>	Westpac Banking Corporation Westpac Plaza Branch 273 George Street SYDNEY NSW 2001
<b>WEBSITE</b>	<a href="http://www.mgil.com.au">www.mgil.com.au</a>
<b>ASX CODE</b>	MGK
<b>AIM CODE</b>	MGK
<b>DAX CODE</b>	MIC