

**MAGNESIUM INTERNATIONAL**

L I M I T E D

28 July 2006

**I FUNDING UPDATE****II QUARTERLY REPORT – PERIOD TO 30 JUNE 2006****I Funding Update**

Further to the 12 July 2006 announcement the Directors of Magnesium International Limited (“MIL”) report that discussions with a party interested in providing interim equity finance have concluded and that party has advised that at this time they will not be making an offer to provide finance for the period to financial close. Accordingly the company will pursue other opportunities to introduce a strategic partner. This may take time.

Steps are being implemented to reduce the cash spend to minimize cash outflows from the A\$3m net cash balance at 30 June 2006. These include the winddown of the Sydney office, Egyptian operations focussed on maintaining project relationships and pursuing outstanding required contracts and Magsheet activity continued until the results of current initiatives are known. These steps should provide the Company with the financial resources to pursue a search for a strategic partner into 2007.

**II Quarterly Update**

As already reported MIL's operations are being curtailed following the failure to attract sufficient investors to fund the company through to financial close. The key actions to preserve the Company's cash resources include:

- a. All directors to be employed on a consultancy basis
- b. Reductions in the Sydney and Cairo offices with staff supporting the search for a strategic partner; other costs will be reduced
- c. Magsheet will be monitored with contained expenditure commitments until the results of current initiatives are known and a strategic partner/buyer will be sought
- d. The “Egypt/Indian” construction concept will be pursued with potential partners but the employment of consultants has been delayed
- e. Certain properties in Australia will be marketed

The Directors also report progress in other areas:

**1. EMAG Ownership Restructuring**

This has now been completed and EMAG is now owned 100% by MIL following MIL shareholder approval by way of General Meeting held on 17 May 2006. An Independent Expert's Report was prepared by PKF Corporate Finance Advisory Services (NSW) Pty Ltd (“PKF”) and was sent to shareholders as announced on 13 April 2006

The final processing of the share transfers under Egyptian Law is currently in progress.

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## **2. Capital Cost Estimate and Plant Capacity**

The initial re-estimate of Capital Cost was completed in June 2006. This reduced the Phase 1 estimate for direct cost (including owner's capital cost) to some \$290 million, in line with the July 2005 Feasibility Study. The level of local Egyptian content has risen to some 40% and there was additional benefit from improved design and value engineering. In addition to the direct cost estimate would be costs for Engineering, Procurement and Construction Management and contingency of some 30%. This results in a total estimated construction cost of \$377 million. The program going forward is aimed at reducing this further.

The Company has undertaken a thorough review of the plant's construction capacity and layout resulting in the number of cells being increased by 10% to 144. This results in a more efficient use of capital through reduced bottlenecking in the cell house. The ancillary circuits in the leach, drying, acid recovery and cast house areas have sufficient capacity to accommodate the extra units. Together with other changes in operating parameters, this should increase pure magnesium output from 88,000 tonnes per annum to 100,000 tonnes per annum and of high quality metal alloys (HQMA) from 96,000 tonnes per annum to 108,000 tonnes per annum. This increase in capacity is estimated to incur limited additional capital cost, so improving the proposed plant's capital efficiency. The plant layout and design should also permit future expansion with the doubling of 108,000 tonnes per annum capacity to 216,000 tonnes per annum

## **3. Ore Supply**

MIL's existing mining tenements in South Australia contain adequate, proven to JORC standards, magnesite feedstock for the EMAG smelter. However, these are higher cost compared to alternative magnesite sources available in Egypt or within the region.

During the quarter evaluation work focussed principally on the Sul Hamed area in the far south-eastern region of Egypt. The area is approximately 40 kilometres from the Red Sea and some 900 km south of Sokhna port. Open cut magnesite mining is already occurring in the area at a low rate of extraction.

An Egyptian government operation, El Nasr Mining Company ("ENMC"), has the mining lease and currently extracts up to around 10,000 tonnes per year of magnesite with a grade of 42% MgO. Recent geological evaluation and exploration by ENMC has indicated the deposit should have the potential, with further exploration, to have sufficient in grade and quantity for the first phase of the Sokhna magnesium smelter which will require 200,000 tonnes per annum of +40% MgO grade. Initial tests conducted by the Central Laboratory of the Egyptian Mineral Resources Authority indicate the Sul Hamed magnesite should be a suitable feedstock for the EMAG plant but further detailed test work is necessary for design sizing purposes.

Further in-fill drilling is planned to bring Sul Hamed up to JORC standards. Additional confirmatory testwork is currently underway.

Detailed negotiations are underway with ENMC on the terms of supply. These negotiations are well advanced.

#### **4. Operating Costs**

During the quarter the operating cost estimates were further refined to include the benefit of the increase in estimated capacity. The current ex-plant cash cost is estimated to be around US\$0.56/lb for pure magnesium and US\$0.60/lb for HQMA on the basis of Egyptian magnesite, the current industrial electricity price and the latest estimates of the major input costs. Several options to reduce these costs and gain by-product credits are being investigated.

At this level of operating cost the Port Sokhna smelter would become the magnesium industry's lowest cost producer. This conclusion is drawn from the Clark & Marron and Metal Bulletin Research ("C&M/MBR") independent market study that was prepared for EMAG in March 2006.

#### **5. Environmental Approvals**

During the March quarter EMAG was granted the environmental approval for the proposed primary magnesium smelter operation. This is a major milestone for the project.

The smelter operation also requires the further separate approval of the drying pit for solid plant residues which results mainly from natural impurities found in the smelter's magnesite feedstock. Negotiations with the relevant authorities have progressed during the quarter.

#### **6. Market Study and Current Market Conditions**

Clark & Marron prepared a Market Update during the quarter.

The key results from this update and Clark & Marron's earlier work include:

- demand for magnesium diecasting alloys will continue to grow strongly over the next decade especially as the European car industry has begun to grasp the potential for using magnesium diecast components in high volume applications;
- Over the next ten years forecast demand growth of diecasting alloy consumption is 9.9% per annum;
- Prices for High Quality Magnesium Alloys ("HQMA") (EMAG's target market) are currently depressed by an overcapacity of Chinese material which is sold at prices estimated to be around delivered cash costs;
- The attractiveness of production in China is receding and mounting cost pressures, unfavourable exchange rate movements and changes to the VAT rebate system all act to raise Chinese production costs with a flow on into HQMA prices;
- Already higher ferrosilicon prices are starting to cause HQMA pricing to increase;
- The EMAG project, if it proceeds, remains the only potential new Greenfield electrolytic project sufficiently advanced to come on stream within the next five years and take advantage of the opportunity existing for low cost Rest of World (i.e non China) production.

The Clark & Marron studies highlights the attractiveness of the market that EMAG will be entering in terms of demand growth and pricing.

In the short term, the prices in the EU and USA for HQMA have fallen respectively into the range US\$1.05 – 1.15 per pound area due mainly to slower short term demand growth. The lags between the improvement in magnesium alloy's competitive position versus other materials and increased usage by auto manufacturers suggest possible strong demand growth over the next 2 – 4 years. Medium term prices as reported by C&M are forecast to recover as market demand grows and as the Chinese producers face mounting cost pressures.

## **7. Metal Sales Agreement**

During the quarter the sales and marketing agreement with Thyssen Kruppe Metallurgie expired. EMAG has held further discussions with TKM on the arrangements to extend the contract to accommodate EMAG's project timelines and TKM's requirements.

## **8. Magnesium sheet manufacturing venture (Magsheet)**

Marketing, production trialling and technical evaluation continued through the quarter. The Clayton (Melbourne) plant was used to trial various process parameters as well as produce sample coils for evaluation by potential customers in Japan and elsewhere.

The programme of providing samples and testing of the Twin Roll Cast ("TRC") magnesium alloy sheet product also continued successfully although various technical issues must be first resolved to permit successful marketing. A range of potential customers covering several applications for magnesium sheet have indicated interest in placing orders at MIL's proposed pricing, subject to finalisation of technical trials of the TRC sheet in their particular applications.

New potential target markets outside of camera, communications and computer sectors such as portable power battery plates have been identified and samples are being evaluated.

Subsequent to the end of the quarter the new furnace and metal delivery system has been installed and is currently being commissioned. This was later than forecast due mainly to supplier issues. This has delayed the technical evaluation and proof of the new equipment but the new furnace is expected to increase the Clayton plant's reliability and capacity once commercial production is underway.

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## Appendix 5B

Rule 5.3

### Mining exploration entity quarterly report

Introduced 1/7/96. Origin: Appendix 8. Amended 1/7/97, 1/7/98.

**Magnesium International Limited**

**ACN 003 669 163**

Quarter ended ("current quarter")

**30th June 2006**

<b>Consolidated statement of cash flows</b>	<b>Current quarter \$A'000</b>	<b>Year to date 9 Months \$A'000</b>
<b>Cash flows related to operating activities</b>		
1.1 Receipts from product sales and related debtors	-	-
1.2 Payments for		
(a) exploration and evaluation	-	-
(b) development	-	-
(c) production	-	-
(d) administration	(2,386)	(5,472)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	68	337
1.5 Interest and other costs of finance paid	-	-
1.6 Income taxes paid	-	-
1.7 Other	3	22
<b>Net Operating Cash Flows</b>	<b>(2,315)</b>	<b>(5,113)</b>
<b>Cash flows related to investing activities</b>		
1.8 Payment for purchases of:		
(a) prospects	-	0
(b) equity investments	-	(649)
(c) intangibles	-	(550)
1.9 Proceeds from sale of:		
(a) prospects	-	-
(b) equity investments	-	-
(c) other fixed assets	-	-
1.10 Advances to related entities (EMAG)	(200)	(2,005)
1.11 Advances repaid by related entities (EMAG)	-	1,039
1.12 Other	-	-
<b>Net investing cash flows</b>	<b>(200)</b>	<b>(2,165)</b>
<b>1.13 Total operating and investing cash flows</b>	<b>(2,515)</b>	<b>(7,278)</b>
<b>Cash flows related to financing activities</b>		
1.14 Proceeds from issues of shares, options, etc.	-	-
1.15 Proceeds from sale of forfeited shares	-	-
1.16 Proceeds from borrowings	-	-
1.17 Repayment of borrowings	-	-
1.18 Dividends paid	-	-
1.19 Other (Egyptian Magnesium Company S.A.E. Cash at bank on acquisition 1 June 2006)	113	113
<b>Net financing cash flows</b>	<b>113</b>	<b>113</b>
<b>Net increase (decrease) in cash held</b>	<b>(2,402)</b>	<b>(7,165)</b>
1.20 Cash at beginning of quarter/year to date	6,474	11,132
1.21 Exchange rate adjustments	(48)	57
<b>1.22 Cash at end of quarter</b>	<b>4,024</b>	<b>4,024</b>
<b>Payments to directors of the entity and associates of the directors</b>		
<b>Payments to related entities of the entity and associates of the related entities</b>		
1.23 Aggregate amount of payments to the parties included in item 1.2	423	
1.24 Aggregate amount of loans to the parties included in item 1.10	2,909	
1.25 Explanation necessary for an understanding of the transactions Salaries, Directors fees and consultancy fees are at normal commercial rates.		
<b>Non-cash financing and investing activities</b>		
2.1 Details of financing and investing transactions which have had a material effect on consolidated assets and liabilities but did not involve cash flows	Nil	
2.2 Details of outlays made by other entities to establish or increase their share in projects in which the reporting entity has an interest	Nil	
<b>Financing facilities available</b>	Available \$A'000	Used \$A'000
3.1 Loan facilities	Nil	Nil
3.2 Credit standby arrangements	Nil	Nil
<b>Estimated cash outflows for next quarter</b>		
4.1 Exploration and evaluation	Nil	
4.2 Development	Nil	
<b>Total</b>	<b>-</b>	

<b>Reconciliation of cash</b>		Current quarter \$A'000	Previous quarter \$A'000
Reconciliation of cash at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts is as follows			
5.1 Cash on hand and at bank		2,124	2,474
Deposits at call		-	-
Bank overdraft		-	-
Other - bank bills		1,900	4,000
<b>Total: cash at end of quarter (item 1.22)</b>		<b>4,024</b>	<b>6,474</b>

#### Changes in interests in mining tenements

	Tenement reference	Nature of interest	Interest at start of quarter	Interest at end of quarter
6.1 Interests in mining tenements relinquished, lapsed or reduced		<b>No changes</b>		
6.2 Interests in mining tenements acquired or increased	ML 23292	100%	None	100%

#### Issued and quoted securities at end of current quarter

	Total number	Number quoted	Issue price per security	Amount paid up
7.1 Preference securities	<b>None</b>	<b>None</b>		
7.2 Changes during quarter	<b>None</b>	<b>None</b>		
7.3 Ordinary securities	30/06/2006	38,040,170	38,040,170	\$90,227,474
7.4 Changes during quarter				
(a) Increases through issues		2,500,000		\$975,000
(b) Decreases through returns of capital, buy-backs				
<b>Ordinary shares at end of quarter</b>		<b>40,540,170</b>	<b>38,040,170</b>	<b>\$91,202,474</b>
7.5 Convertible debt securities				
7.6 Changes during quarter				
(a) Increases through issues				
(b) Decreases through securities matured, converted				
<b>Convertible Debt Securities at end of quarter</b>		<b>None</b>	<b>None</b>	<b>Nil</b>

#### 7.7A Listed options

Description	Conversion factor	Total Number	Number Quoted	Exercise price	Expiry Date
1 March 2007 options	30/06/2006	5,833,570	5,833,570	\$1.80	1/03/2007
Issued during Quarter		Nil	Nil		
Expired during quarter		Nil	Nil		
<b>Listed Options at end of quarter</b>		<b>5,833,570</b>	<b>5,833,570</b>		
7.7B Unlisted options					
30 November 2006 Options	1 share for 1 option	480,000	-	\$8.95	30/11/2006
1 December 2006 Options	1 share for 1 option	500,000	-	\$4.95	1/12/2006
31 March 2007 Options	1 share for 1 option	150,000	-	\$4.95	31/03/2007
18 May 2007 Options	1 share for 1 option	500,000	-	\$2.00	18/05/2007
Managing Director's Options	1 share for 1 option	150,000	-	\$3.00	1/08/2007
Directors Options	1 share for 1 option	450,000	-	\$1.38	30/06/2011
31 May 2010 Options	1 share for 1 option	190,200	-	\$1.20	31/05/2010
30 June 2011 Options	1 share for 1 option	1,950,000	-	Various	30/06/2011
30 June 2011 Options	1 share for 1 option	100,000	-	\$1.16	30/06/2011
31 October 2012 Options	1 share for 1 option	150,000	-	\$2.00	31/10/2012
7.8 Issued during quarter	30/06/2006	4,620,200	-		
		None			
7.9 Expired during quarter	Lapsed	(750,000)		Various	30/06/2011
7.10 Exercised during quarter		None	0		
<b>Unlisted Options at end of quarter</b>		<b>3,870,200</b>	<b>Nil</b>		

7.11 Debentures		<b>None</b>	<b>None</b>
7.12 Unsecured notes		<b>None</b>	<b>None</b>

#### Compliance statement

1 This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Law or other standards acceptable to ASX.

2 This statement does give a true and fair view of the matters disclosed.

Signature:

Date: 28 July 2006

Company Secretary

Print name:

James Beecher