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Magnesium International Ltd
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Magnesium International Limited (MIL) said in an ASX announcement on 10 March 2006 that Directors are confident that the increase in capital costs reported in December 2005 from the incomplete MAN Ferrostaal EPC pricing exercise will be substantially, if not completely, reversed. Can you outline MIL's revised plans to progress the project?

MD Pat Elliott

The first step has been to re-arrange the ownership of EMAG. This has been agreed with our local partners, Amiral, and is subject to shareholders' approval.

The second step is to re-work the capital cost estimate so we are sure that the project economics are attractive. The MAN Ferrostaal work on capital costs, which remains incomplete, was primarily based around fabricating the plant in Germany and constructing it in Egypt. We are now revising this to achieve the maximum amount of fabrication work done in Egypt where costs are very low by world standards.

My view is that we have an economic project, and the objective of the current engineering work is to improve our confidence levels that this is the case and be able to prove that to investors.

Unfortunately, the impact of this additional work is to delay likely Financial Close into 2007.

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Can you reiterate how you might reduce the anticipated total construction cost?

MD Pat Elliott

We are reducing the capital cost estimates by:

1. increasing the amount of the fabrication work undertaken in Egypt and other lower cost Middle East and Asian sources compared to the EU;
2. scrutinising the scope and design of the plant very thoroughly in a “value engineering” exercise. We are not changing any of the critical parts of the process, but we’re making sure we take out all sections that might be considered optional extras. That includes any equipment which were designed to handle the second module of production. We’re now focusing on building a plant that is purely designed for module one (43,000 tonnes a year) with all incremental module two requirements coming at the time of module two;
3. re-tendering and restructuring a number of vendor bid packages so that competitive bidding is maximised;
4. shortening the construction schedule; and,
5. reviewing the construction contract structure and possibly moving to a fixed price EPCM arrangement.

Over the last few years the number of Lump Sum Turn Key EPC providers in the engineering construction industry has reduced. However, specialist subcontractors continue to work under fixed price contracts and the project financing banks are more prepared to finance projects in that situation. The principal contractor is still appointed to manage the subcontractors. Clearly it is a slightly higher risk approach for the principal but it means avoiding paying the EPC contractor a big margin because it is no longer taking all the risk. This approach may impact on the financing structure and cost but it does significantly reduce overall costs. The key to achieving this is making sure we have a very strong owner’s team.

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You are similarly looking to reduce operating costs. Can you explain the program there?

MD Pat Elliott

We’ve initiated a program to review all operating cost inputs and to pursue cost reduction and by-product revenue opportunities in parallel with the engineering and capital costing activities. We recently agreed contract terms for power and gas supply and these were in line with expectations.

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MIL recently announced that the Egyptian Magnesium Company S.A.E. (EMAG) will move from being a 50% owned associate of MIL to a 100% fully controlled subsidiary. Can you explain the mechanics of the transaction?

MD Pat Elliott

The transaction is effectively a share swap. The Amiral Group will swap its 50% shareholding in EMAG for 2.5 million shares in MIL. That will take Amiral's and its associates' interests in MIL to nearly 12%.

We think it's an attractive deal for MIL shareholders because we're getting ownership of the other 50% of EMAG, but shares on issue will only increase by 6.6%. EMAG's major asset is of course 100% of the proposed 88,000tpa magnesium plant at Port Sokhna, Egypt.

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How did you determine that the consideration for MIL's additional 50% shareholding in EMAG would be 2.5 million shares?

MD Pat Elliott

The consideration for buying back the 50% in EMAG related directly to the amount of capital Amiral had invested and was also tied back to the price for the share placement to Amiral approved by shareholders in late February 2005. That placement was done at \$1.20 a share and raised \$12 million. The effective MIL price Amiral is paying on converting its EMAG shareholding into MIL is around \$1.14 based on their cash investment into EMAG. When compared to the \$1.20 placement price in February 2005 which included a 1 for 2 free option and the current MIL market price the price is attractive to the other MIL shareholders.

In addition, to these ownership changes we have entered into further agreements with Amiral:

1. a service agreement with Amiral that safeguards EMAG's rights to construct the smelter at Port Sokhna, and
2. a brokerage agreement that provides for Amiral to assist in placing part of EMAG's equity requirements.

These agreements provide both EMAG and Amiral with strong focus to get the project to fruition.

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Can you outline the management structure of MIL moving forward?

MD Pat Elliott

I have been appointed Managing Director and two of the key people that report to me are Mike Moran, our Project Director, based in Cairo and Peter Sydney-Smith, our Finance Director based in London. Mike has full responsibility for the engineering team and Peter is responsible for financing the project. Both Peter and Mike are recent appointees who have significantly strengthened our management team. I will remain as MD until financial close and we'll then probably appoint a longer term MD. We think that financial close will be in around twelve months.

We've recently announced changes to the board and we're also seeking additional Non-Executive Directors with Egyptian and regional project expertise.

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Following this restructure what is MIL's current funding strategy?

MD Pat Elliott

At 31 December 2005, MIL had \$7.5 million in cash and that's sufficient to carry us through until late this year, but as we've already announced, we'll need to raise additional capital to take us through to the revised financial close. We've already spoken to a large number of existing and potential new investors who have indicated their interest in participating in any raisings. We're working on securing a pricing structure for that equity which does not merely reflect the current share price.

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MIL recently stated that initial commercial orders have been taken for MagSheet's magnesium alloy sheet produced in the Melbourne plant, with product due for supply early in 2006. Can you explain the potential financial significance of MagSheet for MIL? Are you still confident that its technology offers substantial operating cost savings against competitors' products?

MD Pat Elliott

The CSIRO technology MagSheet is using is leading edge and well ahead of the pack. The feedback from industry experts and people who have tested and assessed our product has been very positive. That view has been confirmed by work conducted by the leading industry consultants, Clark & Marron. In the aluminium industry Twin Roll Cast (TRC) technology is well established, but it has not yet been successfully applied with magnesium alloys until the CSIRO has been able to develop it.

This breakthrough is significant because TRC can reduce operating costs by between 40% and 60%, depending on the application, compared with the current commercial technologies used in rolling magnesium sheet.

We're well advanced in negotiating commercial contracts with a couple of Japanese groups and if we finalise those it will be a big step towards establishing MagSheet as a standalone business. Financially, this would be very significant to MIL.

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World metal prices were generally strong through 2005 but magnesium has been weak. Can you give a general update on magnesium alloy markets?

MD Pat Elliott

Last year magnesium alloy prices moved up to around US\$1.60/lb but this year eased back to US\$1.20-1.30/lb. We view this as a short period of weakness. The market analysis undertaken by Metal Bulletin Research/Clark & Marron has longer term pricing at over US\$1.45/lb. Current weakness is due to a short term slowdown in US demand growth due to reduced SUV sales and supply growth as a major US recycler came back on stream after a fire.

Our long term pricing view is based on the ability of car manufacturers to switch between aluminium and magnesium in a number of motor vehicle component applications. Magnesium has a specific gravity ratio of around 1.55 times that of aluminium. i.e a user can pay 1.55 times the price for magnesium and get the same volume of metal as aluminium. So, once aluminium moves above, say US\$1.00/lb, then it is viable for car manufacturers to switch to magnesium alloys if the magnesium alloy price is below US\$1.55/lb. This ignores the other benefits of using magnesium alloys: longer tool life, lower machining costs and better strength and rigidity.

Our feasibility study used the Metal Bulletin Research/Clark & Marron forecast price of over US\$1.45/lb for magnesium alloy, which will prove to be well achievable for large tonnages if the price of aluminium remains around current levels of US\$1.10/lb. There is a lead time of at least two to three years for car manufacturers to switch, but that suits us because that is around the timeframe for us to get into production. We expect to find good demand at over US\$1.45/lb when EMAG commences production in 2009/10.

Demand for magnesium alloy has been growing by about 9-10% a year for around 10 years and that has been over a period when oil prices have been typically around US\$20-30/barrel. Despite the intention of various governments to lower vehicle fuel emissions, there hasn't been a real economic driver for car manufacturers to improve fuel consumption until now. With oil prices at US\$60/barrel and petrol pump prices much higher consumers are now reacting and car manufacturers will have to take notice. One of the ways they can get better fuel efficiency is to make the car lighter by using more materials like magnesium alloys, but that will only happen if companies like EMAG come into being because most of the existing projects have very limited growth paths. The competitive position of magnesium alloys has been significantly improved in recent months setting the scene for an acceleration in demand growth.

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The last quarterly report referred to the TKM offtake agreement being extended to June 2006. This seems a short period. Can you explain your intentions in this area?

MD Pat Elliott

The agreement originates back to the South Australian project and it is our intention to enter a fresh agreement once we have advanced the construction contract. Our first objective with TKM is to use their industrial material experience to market and distribute our product into the High Quality Magnesium Alloy sector. Hence the 15 year exclusive agreement. We are also keen to use the TKM market knowledge to lead us into higher priced higher specification alloys rather than be primarily a producer of standard grade alloys. We also wish to progress the discussions in respect of short and long term contractual arrangements with end users and the monthly offtake for non contract customers in the context of TKM's requirements on maximum uncommitted stock levels.

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In your December 2005 quarterly report, you stated that Metal Bulletin Research / Clark & Marron believe that EMAG is the most likely Greenfield magnesium smelter project capable of being developed outside China in the next five years. How competitive is the Chinese technology?

MD Pat Elliott

The Chinese technology uses a batch process which produces pure magnesium which has to undergo a number of additional steps before it can become magnesium alloy with comparable quality and consistency of quality. Many Chinese producers do not have the necessary expertise to take these steps and a lot of Chinese metal is therefore reprocessed in Europe and at other locations. Wherever the upgrading occurs, it all involves significant extra cost and the Chinese producers still do not provide the technical support required by most high quality magnesium alloy customers for their particular applications.

Chinese production costs are increasing at a significantly greater rate than those of Western producers. For instance, one tonne of magnesium produced in China typically requires around 22 tonnes of coal. There is pressure from the Chinese government for several industries to become more environmentally responsible and that will add to their production costs. Our view is that Chinese costs will rise at a much faster rate than Egyptian or Western World costs in a lot of areas and that their competitive position will weaken. When you factor all these issues, there's no doubt that we'll be very competitive with the Chinese.

Another aspect of the Chinese process route is that it offers almost no economies of scale. The electrolytic Dow process that EMAG is using provides significant scale economies especially once the second module is developed taking EMAG's planned capacity to 88,000 tonnes per annum. EMAG's operating costs will be at the bottom end of the world cash operating cost curve placing EMAG in an excellent position to capture ongoing market growth in the longer term.

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In summary, how confident are you of MIL's project going ahead in the timeframe currently envisaged?

MD Pat Elliott

The market conditions are right for new magnesium alloy projects and I'm confident that we can get our capital cost numbers into the range where the investment returns will attract debt and equity providers to finance the project.

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Thank you Pat.

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