

**MAGNESIUM** INTERNATIONAL

L I M I T E D

31 January 2006

**QUARTERLY REPORT – QUARTER ENDED 31 DECEMBER 2005****1. Highlights**

Magnesium International Limited (“MIL”) has this past quarter and the period following the December 2005 announcement that the Port Sokhna magnesium smelter project would be delayed due to higher construction costs, actively initiated steps to secure the project’s future. These include:

- The strengthening of the management team with the recent appointments of Peter Sydney-Smith as Finance Director and Mike Moran as Project Director;
- Closure of the MAN Ferrostaal (“MFS”) work and the transfer of the project team from Germany to Egypt;
- Management changes as reported in today’s earlier announcement including the appointment of Pat Elliott as Managing Director and the resignation of Gordon Galt;
- Ongoing discussions with the Amiral group, the Port operator and investor in MIL, on the ownership structure and funding of EMAG, the current joint venture entity.

**2. Forward Programme**

Assuming final agreement is reached with Amiral, the next step will be to re-evaluate and significantly reduce the indicative cost of constructing the Port Sokhna magnesium plant by:

- Increasing the Egyptian content (involving less European fabrication);
- undertaking Value Engineering to minimise project scope;
- re-tendering a number of vendor bid packages; and
- possibly using changed construction contractual arrangements.

This programme of work is scheduled for completion by June 2006 and will include a full financial evaluation of the project’s funding requirements. This may result in an interim funding requirement to finance the expected engineering and project work through to financial close, now expected in early 2007. The Company will provide investors with regular updates on progress throughout this phase.

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The cash balance at the end of the quarter was A\$7.5 million which is sufficient to undertake the forward programme required.

## 3. Detailed Comments

### 3.1 Capital Cost Estimate and Reducing Construction Costs

We reported in December 2005 that the indicative cost to construct the first module of magnesium smelter had been materially higher than forecast in the Company's internal feasibility study. The factors contributing to this increase included:

- the high level of global demand for equipment and services for resources sector projects;
- high raw material prices, including steel and copper, both of which are major components; and
- the relatively high European content of some material aspects of the project.

MFS has ended its work to determine the price of a fixed price EPC contract to construct the first module of the magnesium smelter. This work that commenced in March 2005 was delayed by the late delivery of certain vendor bids and with some of the bids still incomplete.

EMAG has initiated an evaluation of ways to reduce the overall construction cost, including;

- further increasing the Egyptian content (and reducing European fabrication);
- undertaking a Value Engineering program to minimise project scope;
- re-tendering a number of vendor bid packages; and
- a possible change in construction contractual arrangements to a fixed price Engineering, Procurement and Construction Management ("EPCM") arrangement.

A change to fixed price EPCM offers the potential for reduced construction capital cost and a shorter time to project completion after construction starts. Under fixed price EPCM, EMAG would appoint an organisation to complete the engineering design, then procure and manage the construction and pre-commissioning of the project through a number of fixed price contracts direct with EMAG. This approach would also require a stronger in-house project management team for the duration of the project construction and mechanical completion as the overall supervision is undertaken internally rather than through a head EPC Contractor.

The EMAG project team led by project director Mike Moran, has now moved from Germany to Egypt and have commenced re-evaluating the construction cost on the basis of the alternative EPCM strategy and much reduced European content. This exercise is anticipated to take some 3-4 months, thereafter

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further work will be necessary to strengthen the in-house team and progress engineering design to a stage sufficient to enable a definitive cost estimate to be completed and for the re-tendering of the construction contracts. As a result financial close is not expected until early 2007.

The Company will assess its funding needs and develop an alternative financing strategy based on a proposed EPCM construction methodology, an increasingly accepted approach as many contractors withdraw from Fixed Price EPC ("Engineering, Procurement and Construction"). The Company will be talking to potential equity and debt investors in both Europe and the Middle East.

## 3.2 Ore Supply

MIL's existing mining tenements in South Australia contain adequate and suitable magnesite feedstock for the EMAG smelter. The logistics and costs of exporting this magnesite to Egypt have now been evaluated. Additional testing of the ore was undertaken by an independent analysis company during the past quarter and this has provided further input for the wet plant design of the smelter.

Evaluation of other magnesite supply options continued during the quarter. 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.

Initial results from widespread surface sampling of the magnesite deposits in the area were received and drilling of the most prospective areas is under way. Surface samples analysed to date suggest that good quality magnesite may exist over an extensive area.

Initial sampling of the Zurgat Naan deposit, a second Egyptian deposit being evaluated, will occur in January. Contact with Turkish suppliers was intensified and samples from one supplier have been received and are being tested.

The objective of this work is to establish a reliable and much lower cost ore supply source closer to the smelter.

## 3.3 Environmental Approvals

The EIA for the smelter within Sokhna Port was submitted to the Red Sea Ports Authority in mid September 2005. Formal feedback was received in December and the few clarifications requested have been submitted.

The smelter operation also requires the separate approval of a site for the storage of smelter solid residue which results mainly from natural impurities found in the smelter's magnesite feedstock. EMAG has selected a temporary storage area and has received in principle approval for the site from the Governorate of Suez (GOS). The site has at least fifteen years' storage volume available for the initial

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plant Module. The EIA for this solid residue site is expected to take approximately three months to complete.

## 3.4 Market Study

In July 2005, Metal Bulletin Research / Clark & Marron (“MBR/C&M”) were commissioned to undertake a study of the current status and future development of the world magnesium market for use by the Board, banks and equity providers to the EMAG project. This study is largely complete and forecasts:

- continued strong short and long term growth (+9% per year) in the market for lightweight magnesium alloys in the auto sector (EMAG’s target market) to assist the auto industry to reduce greenhouse gas emissions and offset rising oil costs;
- a drop in magnesium prices in 2006 followed by improved prices over the next decade to the US\$1.40 - \$1.50/lb range (in real terms) as Chinese costs rise, export rebates eliminated and there are further revaluations of the Chinese currency;
- continuation of the marked slowdown in the rate of production increase in China, as has already occurred in 2005; and
- development of new electrolytic capacity in low cost locations outside China

MBR/ C&M believe that EMAG is the most likely greenfield magnesium smelter project capable of being developed outside China in the next five years and that, based on current estimates, EMAG will operate in the lowest quartile of the ex works cash cost curve and have the added advantages of low distribution costs and a low tax regime.

## 3.5 Metal Sales Agreement

The Metal Sales Agreement between MIL and ThyssenKrupp Metallurgie (TKM) was extended to 30 June 2006. Negotiations also occurred to finalise a direct agreement with EMAG, during which TKM has flagged a requirement to insert a maximum uncommitted stock level clause into the agreement, however this would not apply to sales covered by short or long term contractual arrangements with end users or normal monthly offtake for non contract customers. MIL intends to have over 90% of production under such arrangements.

During the quarter EMAG has held discussions with end users to obtain letters of intent which could lead to firm contracts by the time of Financial Close. These discussions will be ongoing.

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**4. 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. The Dow research files are being reviewed and are providing valuable insights from the previous work.

The programme of providing samples and testing of the Twin Roll Cast ("TRC") magnesium alloy sheet product also continued successfully. 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. Initial commercial orders have been taken, with product due for supply early in 2006.

A new furnace and metal delivery system has been ordered and is due for installation in March 2006. This is expected to significantly increase the Clayton plant's reliability and capacity and is necessary to enable expected commercial orders to be filled.

MIL's operating subsidiary, Magnesium International (No 1) Pty Limited, has been re-named Magsheet Pty Ltd and the trademark "MagSheet" has been registered.

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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")

**31st December 2005**

<b>Consolidated statement of cash flows</b>	<b>Current quarter \$A'000</b>	<b>Year to date 6 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	(895)	(2,032)
1.3 Dividends received	-	-
1.4 Interest and other items of a similar nature received	92	186
1.5 Interest and other costs of finance paid	-	-
1.6 Income taxes paid	-	-
1.7 Other	14	16
<b>Net Operating Cash Flows</b>	<b>(789)</b>	<b>(1,830)</b>
<b>Cash flows related to investing activities</b>		
1.8 Payment for purchases of:		
(a) prospects	-	0
(b) equity investments		(649)
(c) intangibles	(275)	(550)
1.9 Proceeds from sale of:		
(a) prospects		-
(b) equity investments		-
(c) other fixed assets		-
1.10 Advances to related entities (EMAG)	(288)	(1,663)
1.11 Advances repaid by related entities (EMAG)		1,039
1.12 Other		-
<b>Net investing cash flows</b>	<b>(563)</b>	<b>(1,823)</b>
<b>1.13 Total operating and investing cash flows</b>	<b>(1,352)</b>	<b>(3,653)</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 (provide details if material)	-	-
<b>Net financing cash flows</b>	<b>-</b>	<b>-</b>
<b>Net increase (decrease) in cash held</b>		
1.20 Cash at beginning of quarter/year to date	(1,352)	(3,653)
1.21 Exchange rate adjustments	8,831	11,132
1.22 Cash at end of quarter	19	19
	<b>7,498</b>	<b>7,498</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	93	
1.24 Aggregate amount of loans to the parties included in item 1.10	2,055	
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>		
3.1 Loan facilities	Available \$A'000	Used \$A'000
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>	

**Reconciliation of cash**

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

	Current quarter \$A'000	Previous quarter \$A'000
5.1 Cash on hand and at bank	1,998	2,822
Deposits at call	-	9
Bank overdraft	-	-
Other - bank bills	5,500	6,000
<b>Total: cash at end of quarter (item 1.22)</b>	<b>7,498</b>	<b>8,831</b>

**Changes in interests in mining tenements**

- 6.1 Interests in mining tenements relinquished, lapsed or reduced  
6.2 Interests in mining tenements acquired or increased

Tenement reference	Nature of interest	Interest at start of quarter	Interest at end of quarter
	<b>No changes</b>		
	<b>No changes</b>		

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

	Total number	Number quoted	Issue price per security	Amount paid up
7.1 <b>Preference securities</b>	<b>None</b>	<b>None</b>		
7.2 Changes during quarter	<b>None</b>	<b>None</b>		
7.3 <b>Ordinary securities</b> 30/09/2005	38,040,170	38,040,170		\$90,227,474
7.4 Changes during quarter				
(a) Increases through issues				
(b) Decreases through returns of capital, buy-backs				
<b>Ordinary shares at end of quarter</b>	<b>38,040,170</b>	<b>38,040,170</b>		<b>\$90,227,474</b>
7.5 <b>Convertible debt securities</b>				
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	30/09/2005	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>		
<b>7.7B Unlisted options</b>					
30 November 2006 Options	1 share for 1 option	480,000	Nil	\$8.95	30/11/2006
1 December 2006 Options	1 share for 1 option	500,000	Nil	\$4.95	1/12/2006
31 March 2007 Options	1 share for 1 option	150,000	Nil	\$4.95	31/03/2007
18 May 2007 Options	1 share for 1 option	500,000	Nil	\$2.00	18/05/2007
Managing Director's Options	1 share for 1 option	150,000	Nil	\$3.00	1/08/2007
Directors Options	1 share for 1 option	450,000	Nil	\$1.38	30/06/2011
30 June 2011 Options	1 share for 1 option	1,950,000	Nil	Various	30/06/2011
31 May 2010 Options	1 share for 1 option	190,200	Nil	\$1.20	31/05/2010
	30/09/2005	4,370,200	Nil		
<b>7.8 Issued during quarter</b>					
30 June 2011 Options	1 share for 1 option	100,000	Nil	\$1.16	30/06/2011
31 October 2012 Options	1 share for 1 option	150,000	Nil	\$2.00	31/10/2012
<b>7.9 Expired during quarter</b>		None	Nil		
<b>7.10 Exercised during quarter</b>		None	Nil		
<b>Unlisted Options at end of quarter</b>		<b>4,620,200</b>	<b>Nil</b>		
7.11 <b>Debentures</b>		<b>None</b>	<b>None</b>		
7.12 <b>Unsecured notes</b>		<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:

Company Secretary

Date: 31 January 2006

Print name:

James Beecher