Lodge Partners Research
ABN: 25 053 432 769
AFSL: 246271

BUY- $0.27

China Magnesium Corporation Ltd (CMC)

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Company Data

ASX Code	CMC
Price	$0.27
12 month price target	$0.70
Implied return	160%
Shares on issue	131.02m
Market cap	$35.4m
12 Month price range	$0.18/$0.44
Monthly turnover	5.1m
Listed	09/11/2010
GICS Industry Group	Materials

Directors & Management

William Bass	Non-Executive Chairman
Tom Blackhurst	Managing Director &CEO
Xinping Liang	COO/Executive Director
Peter Robertson	Non-Executive Director
Garry Edwards	CFO/Company Secretary

Earnings Summary

Year end June	2011A	2012F	2013F	2014F
Lodge adj profit	(1.7)	2.5	13.1	27.1
Reported profit (pre abn)	(1.7)	2.8	14.6	30.1
EPS pre goodwill (¢)	(1.8)	2.0	9.99	20.6
EPS growth	**-30%**	**na**	**409%**	**107%**
P/E ratio	**na**	**13.7 x**	**2.7 x**	**1.3 x**
EV / EBIT	-15.3 x	9.9 x	2.4 x	1.4 x
EV / EBITDA	-17.0 x	5.7 x	2.0 x	1.2 x
CFPS (¢)	(1.7)	3.8	3.8	11.0
Price / CF	-16.2 x	7.0 x	7.2 x	2.4 x

Share Price Chart

Source: Iress Market Technology

Practical Completion of Phase 1 Expansion

CMC has been issued a certificate of Practical Completion by the Pingyao Development Reform Commission in respect of the Phase 1 expansion to 20,000 tpa at the company's magnesium production facility in northern China.

As a consequence of the practical completion within budget, the unlisted 12 million options, which were issued at the company's IPO cannot be exercised and now expire.

This is another milestone CMC has achieved in its development towards becoming one of the largest magnesium producers in the world. There will be a commissioning period over the next three months or so followed by ramp up towards production at an annual rate of 20,000 tpa. We expect this production run rate to be achieved during the second quarter of CY2012.

CMC will continue with its planned expansion in production through Phase 2 and Phase 3, at which time it will have capacity to produce 105,000 tpa. That will make it the largest producer of magnesium in the world.

CMC is also progressing with its plans to de-risk its business via vertical integration, through the purchase of a Dolomite quarry and Ferrosilicon production operation.

Conclusion

CMC continue to deliver on the milestones it has set for itself and announced to the market. It continues to de-risk its magnesium production operation, in line with our expectations.

While there is some short term weakness in the spot magnesium price, we believe our long term price forecasts, built into our modelling, will be achieved.

We continue to recommend the stock as a BUY, and believe there is significant share price upside over the next 12 months, from current levels, once

- it completes the purchase of the Ferrosilicon business,
- production ramps up to current stated (20,000 tpa) capacity, and
- Phase 2 expansion progresses towards successful completion.

CMC plans to increase capacity to produce 105,00 tpa of magnesium alloy from its plant in China by CY2014

KEY MILESTONES

2010	
9-Nov	Official Listing on ASX after raising $12 million (before costs) via IPO
15-Nov	CMC completes minimum 75% joint venture earn-in
7-Dec	Capital works start on China plant upgrade
2011	
5-Jan	CMC increases interest in JV to 90.7%
16-Feb	CMC secures land rights for expansion
10-Mar	Ground-breaking Ceremony for First Phase Expansion
17-Mar	Rationalisation of Chinese magnesium industry to benefit CMC
29-Apr	CMC commences magnesium production at upgraded existing plant
4-May	Baiyuan Dolomite Quarry acquisition (30 km from production plant)
8-Nov	Completion of equity capital raising to help fund purchase of ferrosilicon co.
29-Dec	Phase one expansion certificate for practical completion issued

China Magnesium Corporation Limited (CMC)

Mkt Cap: $35.4m **$0.27**

Valuation data

Year ending Jun	2011A	2012F	2013F	2014F	2015F
Lodge adj profit	**(1.7)**	**2.5**	**13.1**	**27.1**	**42.9**
Reported profit (pre WHT)	(1.7)	2.8	14.6	30.1	47.6
EPS_{adj} (¢)	**(1.5)**	**2.0**	**10.0**	**20.6**	**32.7**
EPS growth	**(30.2%)**	**na**	**408.7%**	**106.6%**	**58.3%**
P/E ratio	**na**	**13.7 x**	**2.7 x**	**1.3 x**	**0.8 x**
DPS (¢)	0.0	0.0	0.0	9.0	15.0
Yield	**0.0%**	**0.0%**	**0.0%**	**33.3%**	**55.6%**
Franking	0.0%	0.0%	0.0%	0.0%	0.0%
Payout ratio	0%	0%	0%	44%	46%
EV / EBIT	na	9.9 x	2.4 x	1.4 x	0.7 x
EV / EBITDA	na	5.7 x	2.0 x	1.2 x	0.6 x
NTA per share	$0.08	$0.11	$0.21	$0.37	$0.58
Pr / NTA	3.3 x	2.5 x	1.3 x	0.7 x	0.5 x

Profit and loss ($M)

Year ending Jun	2011A	2012F	2013F	2014F	2015F
Sales revenue	0.3	21.8	84.0	179.1	284.7
EBITDA	(1.8)	6.9	23.5	46.6	72.3
Dep'n and amort'n	(0.2)	(0.2)	(0.9)	(2.0)	(3.2)
EBITAg	**(2.0)**	**6.6**	**22.6**	**44.6**	**69.0**
Goodwill amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**(2.0)**	**3.9**	**19.3**	**40.9**	**65.0**
Net interest expense	0.2	(0.3)	(0.7)	(1.5)	(1.9)
Pre-tax profit	(1.8)	3.7	18.6	39.4	63.1
Tax	0.0	(0.8)	(4.1)	(9.3)	(15.5)
Effective tax rate	*0.0%*	*22.9%*	*21.9%*	*23.7%*	*24.6%*
Preference dividends	0.0	0.0	0.0	0.0	0.0
Minorities	(0.1)	0.0	0.0	0.0	0.0
Withholding tax	0.0	(0.3)	(1.5)	(3.0)	(4.8)
Lodge adj profit	**(1.7)**	**2.5**	**13.1**	**27.1**	**42.9**
Net profit (pre sig & WHT)	(1.7)	2.8	14.6	30.1	47.6
One-off items (post tax)	(0.3)	0.0	0.0	0.0	0.0
Reported net profit	(2.0)	2.5	13.1	27.1	42.9

Balance sheet ($M)

Year ending Jun	2011A	2012F	2013F	2014F	2015F
Cash	4.8	2.5	3.2	4.7	10.2
Receivables	0.2	3.2	13.1	28.8	46.1
Inventories	0.6	1.6	6.6	14.4	23.1
Other	0.5	0.5	0.5	0.5	0.5
Current assets	**6.0**	**7.9**	**23.3**	**48.3**	**79.9**
Net PPE	5.5	7.8	19.4	35.5	33.7
Investments	0.0	7.0	7.0	7.0	7.0
Goodwill	0.0	0.0	0.0	0.0	0.0
Deferred tax assets	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Non-current assets	**5.5**	**14.8**	**26.4**	**42.5**	**40.7**
Total assets	**11.4**	**22.7**	**49.8**	**90.8**	**120.6**
Debt	0.0	6.0	15.0	27.0	21.0
Provisions	0.0	0.0	0.0	0.0	0.0
Other	0.4	1.6	6.6	14.4	23.1
Total liabilities	**0.4**	**7.6**	**21.6**	**41.4**	**44.1**
Equity / reserves	12.5	13.9	13.9	13.9	13.9
Retained profits	(2.1)	0.5	13.6	34.8	61.9
Total s/h funds	**11.0**	**15.1**	**28.2**	**49.3**	**76.5**
Minorities	0.7	0.7	0.7	0.7	0.7

Cashflow ($M)

Year ending Jun	2011A	2012F	2013F	2014F	2015F
EBIT	(2.0)	3.9	19.3	40.9	65.0
Net interest paid	0.2	(0.3)	(0.7)	(1.5)	(1.9)
Dep'n and amort'n	0.2	0.2	0.9	2.0	3.2
Tax paid	0.0	(1.1)	(5.5)	(12.3)	(20.3)
Gross cash from op'ns	**(1.6)**	**2.8**	**14.0**	**29.1**	**46.1**
(Inc) / dec in wk'g cap	0.0	(2.9)	(9.9)	(15.6)	(17.4)
(Inc) / dec in provisions	(0.1)	0.0	0.0	0.0	0.0
Other	(0.2)	5.1	0.8	1.0	(1.5)
Operating cashflow	**(1.9)**	**5.0**	**4.9**	**14.5**	**27.2**
growth over pcp					
Investing cashflows					
Capital expenditure	0.0	(7.6)	(13.3)	(19.0)	0.0
Asset sales	0.0	0.0	0.0	0.0	0.0
Investments	0.0	(7.0)	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing cashflows					
Equity raised	0.0	1.4	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	(5.9)	(15.7)
Chg in loans	**0.0**	**6.0**	**9.0**	**12.0**	**(6.0)**
Other non-op flows	0.0	0.0	0.0	0.0	0.0
Free cashflow	**(1.9)**	**(2.6)**	**(8.4)**	**(4.5)**	**27.2**

Ratio analysis

Year ending Jun	2011A	2012F	2013F	2014F	2015F
EBITDA / sales	na	34.7%	29.4%	26.6%	25.8%
EBITAg / sales	na	33.6%	28.3%	25.5%	24.6%
EBIT / sales	**na**	**19.8%**	**24.2%**	**23.4%**	**23.2%**
Return on assets	na	19.4%	41.5%	47.5%	58.9%
Return on equity	**na**	**18.7%**	**51.7%**	**61.0%**	**62.3%**
Return on funds emp.	**na**	**31.5%**	**66.0%**	**73.3%**	**81.8%**
Net debt / (cash) ($M)	(4.8)	3.5	11.8	22.3	10.8
Debt / equity	0.0%	39.8%	53.2%	54.7%	27.5%
Net debt / equity	**(43.1%)**	**23.1%**	**42.0%**	**45.2%**	**14.1%**
Interest cover	10.0 x	na	27.4 x	27.4 x	34.4 x

Attrib. Production

	2011A	2012F	2013F	2014F	2015F
MagAlloy (000t)	0.2	6.7	27.1	59.4	95.2
Production Costs A$t	**2273**	**2273**	**2273**	**2273**	**2273**

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We have divided our recommendations into three main Categories':

Buy: Expected Total Return in excess of 15% over a 1 year period.

Hold: Expected Total Return between 0% and 15% over a 1 year period.

Sell: Expected Total Return less than 0% over a 1 year period.

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