

## Booming Mg prices drive huge result

No surprise at the bottom line as NPAT come in at A\$13.8m for 1H FY22 following guidance of A\$13m provided on 25 July. Full year guidance commentary also unchanged, “2H will be less than 1H” leaving a wide range given that the supercharged 1H NPAT is 2.8x full year FY21 result. The potentially company transforming business in Qinghai may be getting closer to starting real operations with some positive news and a timeline expected within weeks. Our FY22e NPAT increases from A\$15.3m to A\$17.2m and is only A\$3.4m above 1H as we forecast a sharp slowdown in second half earnings. Our valuation is A\$0.64 per share (unchanged).

## Anodes – continued steady volume growth

The 5% increase in volume for the period is below the four-year CAGR of 11% but demonstrates continued steady growth. The high gross margin on exploding magnesium prices was a surprise given the competitive nature of the industry – we would have been less surprised with steady \$ / tonne of conversion cost. We consequently expect earnings to decline in line with the magnesium price while volumes continue to grow (albeit 2H volume guidance is flat).

## Metals – huge tailwinds but expect reversal

There was no shortage of tail winds in the first half to drive higher revenue on volumes which were more than 30% lower than pcp. Gross margin was 25% vs average 6% in the previous six half years periods. Higher Mg price allowed Magontec to harvest additional magnesium scrap while still expanding margins. With the Mg price now down 46% vs the effective price that drove the 1H result, we forecast 2H revenue and margins to be ~half of what they were in 1H (but still well ahead of historical averages). Qinghai supplier, QSLM, continues to progress towards restart with two out of the three steps proven to operational level. We forecast that Magontec will produce 16k tonnes of Mg alloy in FY24 (vs capacity of 100k tonnes).

## Valuation

The high Mg prices in the last three months of the first half should ensure that 3Q earnings remain strong, but a fire in the German recycling plant in July could impact the result. Management highlights the uncertainty in markets and broad economic indicators as the reason for providing such a broad guidance range. Longer term we still see some risk that the Mg price will fall further (it is still 60% above the four-year average prior to 2021) which would add additional pressure on earnings. The Group now has \$1.2m cash on the balance sheet and we forecast that to increase to A\$3m by 31 Dec on the back of falling Mg prices. We continue to value the business using a sum-of-the-parts methodology. Notwithstanding a variety of changes to valuation metrics, our A\$0.64 per share valuation remains unchanged. Refer to page 8 for an assessment of the risks to our valuation.



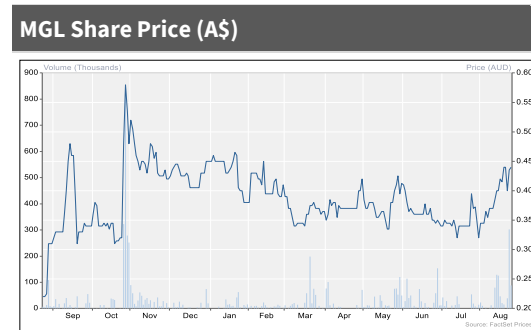
Founded in 1953, MGL's operations involve the manufacture of magnesium anodes for corrosion protection in water heaters, and manufacture and recycling of magnesium alloys that are sold into the global auto industry. The Company has manufacturing facilities in Europe and China and sales in those regions, as well as the US. Its primary alloy production facility in Qinghai, China is operating at a loss, awaiting the restart of its magnesium supplier. Once restarted, MGL will be one of the few suppliers of low-CO2 magnesium alloys.

<http://magontec.com/>

Stock	MGL.ASX
Price	A\$0.45
Market cap	A\$35m
Valuation	A\$0.64 (unchanged)

Valuation estimates (per share)	
Anodes	A\$0.39
Recycling	A\$0.13
MGL Qinghai	A\$0.12

Next steps	
3 Months:	Announcement of timing re Qinghai
2H FY22:	Restart of magnesium supply to Qinghai
6 Months:	FY22 result



Source: FactSet

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Figure 1 – Financial Summary

Year End 31 Dec		2020A	2021A	2022E	2023E	2024E	Stock information								
Core PE	x	nm	8.1x	2.2x	4.2x	4.5x	Share Price	\$						0.45	
EV/EBIT	x	129.1x	5.7x	1.3x	2.4x	1.9x	Market capitalisation	\$m							34.5
<b>EV/EBITDA</b>	<b>x</b>	<b>13.3x</b>	<b>4.1x</b>	<b>1.1x</b>	<b>1.9x</b>	<b>1.5x</b>	<b>Valuation</b>	<b>\$</b>							<b>0.64</b>
Div yield	%	0.0%	2.7%	2.9%	3.1%	3.3%	Shares on issue (Basic)	m							76.7
FCF Yield	%	11.2%	14.3%	33.2%	11.8%	24.2%	Shares on issue (diluted) (m)	m							83.3

Profit & Loss Statement							2H FY19					
	\$m	2020A	2021A	2022E	2023E	2024E	2H FY19	1H FY20	2H FY20	1H FY21	2H FY21	1H FY22
<b>Revenue</b>		<b>95.1</b>	<b>115.2</b>	<b>150.4</b>	<b>168.0</b>	<b>176.4</b>	<b>63.4</b>	<b>46.0</b>	<b>49.1</b>	<b>50.9</b>	<b>64.3</b>	<b>93.8</b>
Change pcp	%		21.1%	30.6%	11.7%	5.0%			-22.5%	10.6%	31.0%	84.4%
<b>Gross Profit</b>		<b>12.2</b>	<b>19.2</b>	<b>37.3</b>	<b>25.3</b>	<b>24.8</b>	<b>7.6</b>	<b>5.9</b>	<b>6.3</b>	<b>7.7</b>	<b>11.5</b>	<b>26.8</b>
margin	%	12.8%	16.7%	24.8%	15.0%	14.1%	12.0%	12.9%	12.8%	15.1%	17.9%	28.5%
<b>EBITDA</b>		<b>3.5</b>	<b>10.1</b>	<b>27.3</b>	<b>15.0</b>	<b>14.4</b>						
margin	%	3.7%	8.8%	18.1%	9.0%	8.2%						
Depreciation and Amort		-3.1	-2.8	-2.9	-3.1	-3.3						
EBIT		0.4	7.3	24.4	12.0	11.1						
Finance expense		-0.6	-0.5	-0.5	-0.1	-0.1						
Tax and adjustments		-0.5	-1.7	-6.7	-3.0	-2.8						
<b>NPAT (reported)</b>		<b>-0.7</b>	<b>5.0</b>	<b>17.2</b>	<b>8.9</b>	<b>8.3</b>						
Significant, discontinued et.al		-0.4	0.6	0.0	0.0	0.0						
<b>NPAT (Underlying)</b>		<b>-0.3</b>	<b>4.4</b>	<b>17.2</b>	<b>8.9</b>	<b>8.3</b>						

Performance ratios						
		2021A	2022E	2023E	2024E	
ROE (%)		12.2%	39.8%	17.5%	14.3%	
ROIC (%)		12.8%	44.4%	20.1%	18.8%	
Net debt/(Net debt + E)		16%	-8%	-14%	-30%	
Interest cover (EBITDA)		19.2x	54.5x	nm	nm	
Capex/Depreciation		31%	35%	32%	30%	
Days Working Capital		87	85	91	91	

Per Share Data						
		2020A	2021A	2022E	2023E	2024E
Ave. diluted shares outstanding	m	76	79	83	83	83
<b>Underlying EPS</b>	<b>cps</b>	<b>-0.4</b>	<b>5.6</b>	<b>20.6</b>	<b>10.7</b>	<b>9.9</b>
growth pcp	%		nm	270%	-48%	-7%
Reported EPS	cps	-0.9	6.3	20.6	10.7	9.9
growth pcp	%		nm	227%	-48%	-7%
DPS	cps	0.0	0.0	1.2	1.3	1.4
Payout (on underlying)	%	0%	0%	6%	12%	14%

Balance sheet						
	\$m	2020A	2021A	2022E	2023E	2024E
Cash & Deposits		5	5	5	8	15
Receivables		22	21	29	32	34
Inventory		22	24	26	35	37
PP&E (incl right of use assets)		19	18	16	14	12
Intangibles		3	3	3	3	3
Other Assets		3	12	3	3	3
<b>Total Assets</b>		<b>75</b>	<b>83</b>	<b>82</b>	<b>95</b>	<b>103</b>
Payables		13	18	20	25	27
Borrowings		17	12	1	1	1
Provisions / other (incl. Lease Liab.)		17	17	17	17	17
<b>Total Liabilities</b>		<b>46</b>	<b>46</b>	<b>39</b>	<b>44</b>	<b>45</b>
<b>Shareholders' Funds</b>		<b>29</b>	<b>36</b>	<b>43</b>	<b>51</b>	<b>58</b>
<b>Net Debt</b>		<b>12</b>	<b>7</b>	<b>-3</b>	<b>-6</b>	<b>-13</b>

Cashflow statement						
	\$m	2020A	2021A	2022E	2023E	2024E
EBITDA		3.5	10.1	27.3	15.0	14.4
Net interest		-0.6	-0.5	-0.5	-0.1	-0.1
Tax paid		-0.5	-1.7	-6.7	-3.0	-2.8
Working capital movements		1.4	-3.6	-7.6	-7.0	-2.2
Other		0.7	1.6	0.0	0.0	0.0
<b>Operating CF</b>		<b>4.5</b>	<b>5.8</b>	<b>12.5</b>	<b>5.1</b>	<b>9.3</b>
Capital expenditure		-0.7	-0.9	-1.0	-1.0	-1.0
Asset sales		0.0	0.0	0.0	0.0	0.0
Acquisitions		0.0	0.0	0.0	0.0	0.0
Other		-0.4	0.0	0.0	0.0	0.0
<b>Investing CF</b>		<b>-1.1</b>	<b>-0.8</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-1.0</b>
Net borrowings		-2.8	-5.3	-10.2	0.0	0.0
Dividends paid		0.0	0.0	-0.9	-1.0	-1.1
New share issues		0.0	0.0	0.0	0.0	0.0
<b>Financing CF</b>		<b>-2.8</b>	<b>-5.7</b>	<b>-11.1</b>	<b>-1.0</b>	<b>-1.1</b>
<b>Net change in cash</b>		<b>0.7</b>	<b>-0.7</b>	<b>0.4</b>	<b>3.1</b>	<b>7.3</b>

Segments						
		2021A	2022E	2023E	2024E	
<b>Revenue</b>						
Anodes		43.1	54.4	48.9	48.9	
Metals (incl. Qinghai)		72.1	96.0	119.1	127.5	
<b>Total Revenue</b>		<b>115.2</b>	<b>150.4</b>	<b>168.0</b>	<b>176.4</b>	
<b>Gross Profit</b>						
Anodes		13.6	17.7	13.7	13.7	
Metals (incl. Qinghai)		5.6	19.5	11.6	11.1	
<b>Total Gross Profit</b>		<b>19.2</b>	<b>37.3</b>	<b>25.3</b>	<b>24.8</b>	
<b>Gross Profit margin</b>						
Anodes		31.6%	32.6%	28.0%	28.0%	
Metals (incl. Qinghai)		7.8%	20.3%	9.7%	8.7%	
<b>Avg Segment margin</b>		<b>16.7%</b>	<b>24.8%</b>	<b>15.0%</b>	<b>14.1%</b>	
Other income		1.7	1.5	1.5	1.5	
Overheads		-10.9	-11.5	-11.7	-12.0	
<b>EBITDA</b>		<b>8.3</b>	<b>25.8</b>	<b>13.5</b>	<b>12.9</b>	

Share price and volume	
Volume (Thousands)	Price (AUD)
Source: FactSet Prices	

Company description	
<p>Founded in 1953, MGL's operations involve the manufacture of magnesium anodes for corrosion protection in water heaters, and manufacture and recycling of magnesium alloys that are sold predominantly into the auto industry. The Company has manufacturing facilities in Europe and China. It has sales in those regions, as well as the US. Its primary alloy production facility in Qinghai, China is operating at a loss, awaiting the restart of its magnesium supplier. Once this supply has restarted, MGL will be one of the few suppliers of low-CO2 magnesium alloys.</p>	

Note: Right of use assets = ~3% of PP&amp;E

Source: Company, MST Access

## Results boom with the magnesium prices

Magontec reported 1H22 NPAT of A\$13.8m slightly above the A\$13m which it pre-announced on 25 July. Revenue in both divisions increased more than 80%. Gross profit margins in the Metals business exploded, increasing from 6% in 1H FY21 to 25% in the current period. Margins in the Anodes business were 34% compared with 31% on the previous corresponding period and compared with the historical range of 20% to 34%.

Gross Profit and EBITDA were up 2.5x and 8.0 x respectively with underlying NPAT of A\$13.8m compared with A\$1.1m in the previous corresponding period.

Figure 2 – 1H FY22 Result summary

Dec y/e, A\$m	1H21	1H22	% pcp
<b>Revenue</b>	<b>50.9</b>	<b>93.8</b>	<b>84%</b>
Metal	32.2	60.1	87%
Anodes (CCP)	18.7	33.7	80%
<b>Gross profit</b>	<b>7.7</b>	<b>26.8</b>	<b>247%</b>
Metal	2.0	15.2	672%
Anodes (CCP)	5.7	11.5	101%
<b>Gross margin (%)</b>	<b>15.1%</b>	<b>28.5%</b>	<b>1,338bps</b>
Metal	6.1%	25.3%	1,918bps
Anodes (CCP)	30.7%	34.3%	358bps
Overheads	(5.5)	(7.1)	27%
<b>EBITDA</b>	<b>2.2</b>	<b>19.7</b>	<b>812%</b>
<b>Underlying NPAT</b>	<b>1.1</b>	<b>13.8</b>	<b>1,121%</b>
Margin (%)	2.2%	14.7%	1,249bps
<b>Diluted EPS (c)</b>	<b>1.4</b>	<b>16.6</b>	<b>1,086%</b>
DPS (c)	0.0	0.6	n.m

Source: Company, MST Access

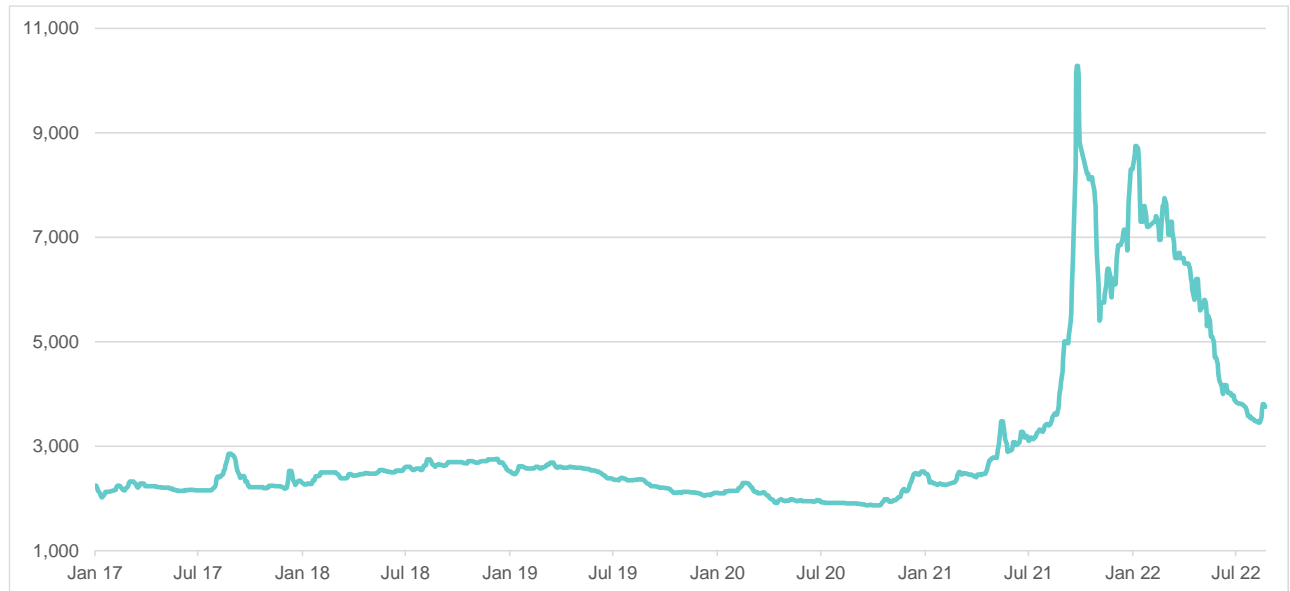
In spite of working capital consuming A\$10.5m over the six months, cash flow generation was strong enough to turn net debt of A\$7m at 31 Dec 2021 to net cash of A\$1.2m at 30 June 2022.

On the back of the strong cash and earnings result, Magontec declared a maiden dividend of 0.6 cents per share (cps).

### Magnesium price

Magontec credited the strong magnesium price as the reason for its turbo-charged earnings. The average Mg price in the current period was 2.9x the Mg price in the previous corresponding period (note that we have lagged the Mg price by three months to reflect the likely working capital effect on the realised price in period under consideration). This compares with revenue which was ~1.8x revenue in the pcp.

Figure 3 – Magnesium price – China (US\$)



Source: Company, MST Access

### Mg price outlook

The current Mg price is more than 60% below the peak price that was realised in November last year and which would have contributed to earnings and revenue in the current half. The current price is 46% below the effective average Mg price in 1H FY21.

Magontec outlined the reasons for long-term price strength in the Mg price: demand for lightweight metals in the transport industry, increasing pressure on current manufacturing processes from an environmental perspective, and the cost of new environmentally friendly manufacturing capacity.

Near term, the picture is less clear as Magnesium prices are still 60% above the average price in the three years prior to COVID. Contributing to high Mg price is the shut-down of the only major US magnesium producer, US Magnesium LLC, following equipment failure in September last year. It would appear that this facility is still not operating to normal capacity with one of US Magnesium LLC's customers (Kaiser Aluminum) declaring force majeure last month due to supply of magnesium from US Magnesium that "unexpectedly ceased" in June. Availability and price of magnesium in the US is particularly sensitive to local supply given that the US have 141% tariffs on Chinese produced magnesium. China produces ~80% of magnesium globally.

We forecast magnesium prices to remain at current levels and note the difficulty in forecasting future price trends.

## Anodes (Cathodic Corrosion Protection)

The Anodes business continues to deliver steady volume growth with a CAGR of 11% since 1H FY18 with volume growth in the current period of 5%. Magontec estimate that 80% of anodes go into hot water heaters that are replacements for failed systems with the remaining 20% into new dwellings.

We estimate that the average magnesium price in 1H FY22 increased 2.9x compared with 1H FY21. Revenue increased 80% reflecting the cost structure of anodes where ~40% of the selling price of anodes is the cost of magnesium.

We are actually surprised the margins increased with magnesium prices increasing so sharply. Given the competitive nature of the industry, we would not have been surprised had margins contracted such as Magontec maintained a more constant \$ / tonne of anodes produced.

Contributing to the strong result is fixed energy costs that its Romanian facility enjoyed due to a government cap on energy costs. In addition, 70% of energy costs at this facility come from renewable sources. Similarly, Magontec's Chinese anode facility was also able to access energy at steady prices.

In analysing the revenue of the Anodes business there does not appear to be any quantitative relationship between volumes, revenue and the underlying price of magnesium. This is due in part to the contribution to the business from electronic anodes – which is not quantified.

The Company's outlook for the business in 2H is for volumes to remain flat on lower Mg prices. The assumptions for the Anodes business for the second half can be seen in a historical context of the business.

Figure 4 – Anodes business - Historical and forecast half-years

(A\$m)	1H FY19	2H FY19	1H FY20	2H FY20	1H FY21	2H FY21	1H FY22	2H FY22e
Volume (t)	1,251	1,343	1,451	1,587	1,639	1,656	1,722	1,722
... growth (pcp)			16%	18%	13%	4%	5%	4%
Avg Mg price (lag)	-	-	-	1,924	2,365	4,498	6,901	3,755
<b>Revenue</b>	<b>13.3</b>	<b>16.4</b>	<b>15.0</b>	<b>15.8</b>	<b>18.7</b>	<b>24.4</b>	<b>33.7</b>	<b>20.7</b>
... growth (pcp)			13%	-4%	25%	55%	80%	-15%
<b>Gross Profit</b>	<b>3.4</b>	<b>5.2</b>	<b>3.0</b>	<b>3.6</b>	<b>5.7</b>	<b>7.9</b>	<b>11.5</b>	<b>6.2</b>
... margin	26%	32%	20%	23%	31%	32%	34%	30%

Source: Company, MST Access

## Metals

The metals business benefited from a range of significant and likely unrepeatable tailwinds during the period. This is most dramatically reflected in the revenue and earnings which were both up strongly on volumes which were more than 30% lower than the previous corresponding period.

Volumes were supported by the acquisition of scrap from outside of the usual sources (magnesium alloy die casters in Europe). This was possible because the higher magnesium price allowed for extra collection and processing costs from difficult-to-extract magnesium.

In the Metals business, we can find no meaningful relationships between the magnesium price, volumes, revenue, gross profit and margins.

Figure 5 – Metals business – historical and forecast revenue and gross profit

	1H FY19	2H FY19	1H FY20	2H FY20	1H FY21	2H FY21	1H FY22	2H FY22e
Revenue	50.9	49.0	30.2	33.5	32.2	39.9	60.1	35.9
... growth			-41%	-32%	7%	19%	87%	-10%
Gross Profit	2.8	2.4	2.3	1.7	2.0	3.6	15.2	4.3
... margin	6%	5%	8%	5%	6%	9%	25%	12%

Source: Company, MST Access

In the forecasts for the second half, we can see that revenue is only 60% of the first half, albeit only down 10% compared with 1H FY21. Uncertainty around the effect of falling magnesium prices has led us to more than halve gross margins compared with the previous half. Compared with 2H FY22, gross margins are still higher, and are ~ double the average margins in the five previous half year periods.

## Qinghai

Magontec's Qinghai based magnesium alloy business has continued to operate at minimal capacity aimed to maintain Magontec's presence in the Asian market. It has continued to source magnesium from areas in China resulting in high transport costs. It has operated at a small cash loss and will continue to do so until its adjacent magnesium producer restarts the supply of liquid magnesium to Magontec's cast house.

This supplier, Qinghai Salt Lake Magnesium Co Ltd (QSLM), continues to progress towards the production of magnesium. Two out of the three steps have now been proven to work successfully and Magontec regional executives expressed "... a firm sense that considerable progress has been made...". Ultimately owned by the Chinese government, QSLM's major shareholder has undergone a restructure, with new management being installed at QSLM. This management team is yet to provide a timetable for the full restart of QSLM but Magontec management expect to receive this in coming weeks. Previous expectations were that QSLM would start supplying liquid magnesium this year, but meaningful volumes are now considered to be less likely, notwithstanding the progress that has been achieved. We have not assumed full production until beyond FY25, with the benefits of QSLM being reflected in margins in the metals business being considerably higher than historical averages. Refer to our initiating coverage for further details.

## Forecasts and valuation

### Trading conditions and 2H earnings forecasts

While direct guidance is not provided, management's over-riding commentary is that, "...with markets and broad economic indicators in such uncertain territory, it is difficult to anticipate the momentum that the company will take into the second half".

The results in the first half indicate the sensitivity of the earnings to the magnesium price. Given days inventory of 90 days, the benefits of the higher magnesium prices in the last three months of 1H FY22 is likely to result in a strong start to FY23. Management commentary supports this view. However, a fire in Magontec's German recycling plant which destroyed stock and shut production for some weeks may have a significant negative impact on the earnings for the period, albeit insurance may cover some of the losses.

Following the discussions in the earlier sections of this report, we note the sharp fall in forecast earnings for the second half, albeit it remains higher than longer term averages prior to recent periods.

Figure 6 – Group half year historical and forecast revenue and gross profit

(A\$m)	1H FY19	2H FY19	1H FY20	2H FY20	1H FY21	2H FY21	1H FY22	2H FY22e
<b>Revenue</b>								
Anodes Revenue	13.3	16.4	15.0	15.8	18.7	24.4	33.7	20.7
... growth			13%	-4%	25%	55%	80%	-15%
Metals Revenue (AUDm)	50.9	49.0	30.2	33.5	32.2	39.9	60.1	35.9
... growth			-41%	-32%	7%	19%	87%	-10%
<b>TOTAL</b>	<b>64.2</b>	<b>65.4</b>	<b>45.2</b>	<b>49.3</b>	<b>50.9</b>	<b>64.3</b>	<b>93.8</b>	<b>56.6</b>
<b>Gross Profit</b>								
Anodes Gross Profit (AUDm)	3.4	5.2	3.0	3.6	5.7	7.9	11.5	6.2
... margin	26%	32%	20%	23%	31%	32%	34%	30%
Metals Gross Profit (AUDm)	2.8	2.4	2.3	1.7	2.0	3.6	15.2	4.3
... margin	6%	5%	8%	5%	6%	9%	25%	12%
<b>TOTAL</b>	<b>6.2</b>	<b>7.6</b>	<b>5.3</b>	<b>5.3</b>	<b>7.7</b>	<b>11.5</b>	<b>26.8</b>	<b>10.5</b>

Source: Company, MST Access

Notwithstanding the sharp decline that we forecast in the second half, our full year FY22 forecasts show revenue up by 23%, and earnings up by between 11% and 12%. FY23 revenue forecasts are unchanged but with a 30% increase in overheads and a 5% decline in gross profit, our NPAT forecast declines by 16%.



Figure 7 – Earnings changes

(A\$m, Dec y/e)	FY22e			FY23e		
	Previous	Current	% Chg	Previous	Current	% Chg
<b>Revenue</b>						
Anodes (CCP)	47.1	54.4	15%	50.0	48.9	-2%
Metals	74.8	96.0	28%	118.3	119.1	1%
<b>TOTAL</b>	<b>121.9</b>	<b>150.4</b>	<b>23%</b>	<b>168.3</b>	<b>168.0</b>	<b>0%</b>
<b>Gross Profit</b>						
Anodes (CCP)	19.6	17.7	-9%	14.3	13.7	-4%
Metals	13.8	19.5	41%	12.2	11.6	-5%
<b>TOTAL</b>	<b>33.4</b>	<b>37.3</b>	<b>12%</b>	<b>26.6</b>	<b>25.3</b>	<b>-5%</b>
<b>Gross Profit Margin</b>						
Anodes (CCP)	41.6%	32.6%	-897 bps	28.7%	28.0%	-68 bps
Metals	18.4%	20.3%	188 bps	10.3%	9.7%	-62 bps
<b>TOTAL</b>	<b>27.4%</b>	<b>24.8%</b>	<b>-262 bps</b>	<b>15.8%</b>	<b>15.0%</b>	<b>-75 bps</b>
Overheads	-8.9	-11.5	29%	-8.9	-11.7	32%
<b>EBITDA</b>	<b>24.5</b>	<b>27.3</b>	<b>11%</b>	<b>17.7</b>	<b>15.0</b>	<b>-15%</b>
Margin	20.1%	18.1%	-197 bps	10.5%	9.0%	-155 bps
NPAT underlying	15.3	17.2	12%	10.3	8.9	-13%
<b>Earnings per Share (A\$ cents)</b>	<b>18.6</b>	<b>20.6</b>	<b>11%</b>	<b>12.5</b>	<b>10.7</b>	<b>-14%</b>
Dividends per Share (A\$ cents)	0.0	1.2	nm	0.0	1.3	nm

Source: Company, MST Access

## Valuation

We use a sum of the parts valuation methodology for the Group. This consists of capitalising earnings from the Anodes business using an EV/EBITDA multiple derived from a list of comparable companies which is then discounted by 30%. We use the same valuation of the recycling business (part of Metals division) used in our initiating coverage report which was based on the sale of a magnesium recycling company similar to Magontec's European recycling business. We use a heavily discounted valuation estimate for Qinghai and estimate its value based on it operating at 28% capacity utilisation.

Figure 8 – Sum of the parts valuation

Business	Valuation methodology	EV (\$m)	Net Debt (\$m)	Equity val. (\$m)	per share (\$)
Anodes	EV / EBITDA multiple (disc comps)	29.0	-3.3	32.3	\$0.39
Recycling	Capacity multiple (recent txn)	11.0		11.0	\$0.13
<b>Total</b>	<b>(fully operating businesses)</b>	<b>40.0</b>	<b>-3.3</b>	<b>43.3</b>	<b>\$0.52</b>
Qinghai	EV / EBITDA at 28% capacity util.	10.0		10.0	\$0.12
<b>TOTAL</b>		<b>50.0</b>	<b>-3.3</b>	<b>53.3</b>	<b>\$0.64</b>

Source: Company, MST Access

Our valuation of the Anodes business is based on the capitalisation of the average of FY22 and FY23 earnings forecasts by the median multiple of a range of metal processing companies which we discount by a further 30%.

Figure 9 – Comparable companies

Valuation		Price (AUD)	MCAP (AUD)	EV (AUD)	EBITDA Margin		EV / EBITDA		Price / Earnings		Net Debt / EBITDA	
					2022	2023	2022	2023	2022	2023	2022	2023
SGM-AU	Sims	15.41	2,991	3,402	10.4%	7.8%	3.5x	5.5x	5.4x	10.7x	0.1x	0.0x
UMI-BE	Umicore	33.05	11,770	13,002	27.5%	25.1%	7.8x	8.2x	13.9x	15.9x	1.1x	1.4x
600459-CN	Sino-Platinum Metals	16.52	2,057	2,746	-	-	-	-	-	-	-	-
DBG-FR	Derichebourg	5.93	1,366	2,304	9.6%	9.1%	3.3x	3.4x	4.2x	4.8x	1.3x	1.0x
SCHN-US	Schnitzer Steel Inds	35.74	1,419	2,030	9.6%	8.6%	4.3x	4.8x	5.5x	6.9x	0.8x	-0.1x
7456-JP	Matsuda Sangyo Co., Ltd.	2362.00	672	823	-	-	-	-	5.5x	5.2x	-	-
ERA-FR	Eramet	103.00	4,281	6,038	34.3%	23.2%	2.2x	3.8x	2.8x	6.0x	0.2x	0.2x
RS-US	Reliance Steel & Aluminum	189.98	16,569	18,565	15.7%	13.1%	4.8x	7.0x	6.6x	9.1x	0.1x	-0.5x
AGS-DE	Allgemeine Gold- und Silbers	-	-	-	-	-	-	-	-	-	-	-
<b>Median</b>					<b>16%</b>	<b>11%</b>	<b>3.5</b>	<b>4.8</b>	<b>5.4</b>	<b>6.5</b>	<b>0.2</b>	<b>0.0</b>

Source: MST Access, FactSet

This gives a capitalisation multiple of 2.9 times to apply to MGL's FY22 earnings.

Figure 10 – Valuation of the Anodes business based on discounted comparable company EV / EBITDA multiple

EV / EBITDA valuation - Anodes	Avg FY22 / FY23	
Comparable companies - median	x	4.2
Discount for company size	%	30%
EV / EBITDA multiple for Anodes	A\$m	2.9
Avg FY22e and FY23e EBITDA	A\$m	9.9
Enterprise Value	A\$m	29.0

Source: MST Access

We have retained the original valuation methodology of the recycling business which was based on a transaction multiple of a European magnesium recycling company in 2019 (refer to [initiation coverage report](#) for further details).

Similarly, we have retained the valuation methodology for MGL's Qinghai business. Our analysis assumes that QSLM now re-starts production of magnesium in 2023, and the liquid metal starts being delivered to MGL Qinghai's cast-house in that year with 10,000 tonnes of production of magnesium. (Total capacity is 100,000 tpa).

Note that should QSLM fail to deliver molten magnesium to MGL Qinghai, then at some point in the future, we would expect QSLM may be in breach of its agreement. It is not clear what recourse MGL might have to QSLM, however, we note that QSLM owns 29% of the equity of MGL.

## Risks

Key risks to our forecasts and valuation include:

- Failure of the Qinghai cast house to receive the planned magnesium metal
  - QSLM magnesium production does not restart or does not produce the contracted level of magnesium metal
  - The problems with trucks used to deliver the metal from QSLM to MGL's cast house remain unresolved (notwithstanding that there has been more than sufficient time to fix the problem.
  - QSLM divert the magnesium to other customers to an extent that is in breach of the agreement
- MGL loses its licence to operate in the Qinghai province
- Unforeseen operational (including safety) problems at Qinghai, or indeed any of its other processing plants in China, Germany and Romania
- A dramatic deterioration of the competitive environment in one or more of its markets
- A loss of access to capital which is particularly important to fund working capital which increases in line with sharply rising magnesium prices
- We may have underestimated the extent to which demand for structural magnesium in vehicles will offset the decline in demand for magnesium used in engines and drive chains as electric vehicles replace internal combustion engines



- We may have over-estimated the long-term demand for “green” magnesium from the transport industry

## Investment thesis

MGL operates three magnesium processing businesses with processing plants based in China and Europe. The Cathodic Corrosion Protection (Anodes) segment produces anodes for residential and commercial water heaters in China and Europe which are sold to original equipment manufacturers (OEMs) in China, Europe and the US. The Metals segment has two elements: a magnesium alloy Recycling business in Europe whose customers are motor vehicle manufacturers and Tier 1 suppliers; and a magnesium alloy production business in Qinghai, China sited next to a magnesium plant (QSLM) from which it will receive molten magnesium once this plant restarts. This plant halted production in late 2019, and it is expected to restart supplying molten magnesium to MGL’s Qinghai facility in 2022.

From a valuation perspective, we consider MGL in three parts: Anodes, Recycling and Qinghai.

### Anodes and Recycling – aggregate value underpins the current share price

The Anodes business produces traditional magnesium anodes and electronic anodes that are used in water heaters to prevent corrosion. Volumes show solid stable growth over the past 5 years with MGL having high market share in what is a niche sector. This is a stand-alone business and we have therefore valued it separately on an EV/ EBITDA basis using the average multiple of comparable companies discounted by 30%.

The Recycling business does not report separately, but its high market share as an important supplier to the European and North American markets gives it strategic value. We estimate its value based on the price achieved in 2019 on a capacity based multiple for a smaller but similar business.

### Qinghai – serious upside but out of MGL’s control

MGL’s Qinghai magnesium alloy cast house was designed to be supplied molten magnesium by Qinghai Salt Lake Magnesium Co. Ltd (QSLM). The business is currently loss-making as MGL is sourcing a nominal amount of high cost magnesium to ensure at least some of its customers continued to get supplied. QSLM has announced that it will be restarting operations in 2022 with ramp up expected over subsequent months.

Qinghai is the source of substantial upside but is wholly dependent on the supply of molten magnesium from QSLM. Should MGL’s Qinghai plant achieve 75% capacity utilisation (based on product from QSLM), this would add a further A\$0.90 per share to our valuation.

We are not aware of the details of the supply and access contract between QSLM and MGL and the potential scenarios should QSLM not meet its contractual obligations to supply magnesium metal to MGL Qinghai’s alloy production facility. We note that QSLM has a 29% stake in MGL, but we are not aware of a link between that and QSLM’s agreements with MGL.

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