

November 12, 2015

INITIATING REPORT

Sector View: **OUTPERFORM**

Junior Developer Tackles the North American Magnesium Market

Exploration

Discovery

Development

Production

The investing world is brimming with bumper stickers dispensing fortune-making advice in twelve words or less. One of my favourites is this: “You don’t make money when you sell. You make money when you buy.” A good bumper sticker needs no explanation but I’ll offer one anyway – you first have to buy low before you can sell high.

The trick to investing profitably in this market is to know how to avoid the pitfalls while capturing the value. Finding a company to buy on the cheap is easy—the question is, should you? MGX Minerals (CSE.XMG) offers an excellent example of what we look for in value investing. MGX is developing a number of low-cost industrial assets in western Canada. The company’s flagship project is Driftwood Creek, a magnesium oxide (magnesia) deposit located in British Columbia. Here’s what we like:

Mineral Target

Before we bother to look at any other features of a mining company, the underlying mineral needs to make sense. Industrial minerals are attractive for the simple reason that, unlike precious metals, they tend to behave according to predictable supply / demand forces. MGX Minerals’ flagship property, Driftwood Creek, is a magnesia deposit. As a critical input to the steel industry, demand closely follows the steel and construction industries. North America is a net importer of magnesia making location a key competitive advantage.

Low op-ex / cap-ex

The days of chasing multi-million ounce discoveries thousands of feet below ground are gone – at least until the economics of extraction and commodity pricing re-align. We love low-cost projects and nothing is lower cost than a “shovel-and-bucket” quarry operation. With virtually no over-burden or tailings and minimal processing, the economics of industrial quarry operations are significantly defined by fixed operating inputs like shipping and logistics costs. Located less than 20km from rail and with ready access to Alberta’s abundant and cheap natural gas market, Driftwood Creek is ideally located to service the North American demand.

Near term cash-flow

With a minimal environmental footprint, MGX plans to scale its operations with an application for an initial mining permit of up to 220,000 tonnes (700 tpd). This is

Company data

Price (\$CAD)	\$0.54
Market cap	\$15.9m
Shares O/S	30.6m
52-week hi/low	\$0.70/0.12
Avg. daily volume	8,800
Enterprise value	\$16m
Sector	Mining
Industry	Industrials

52-week stock chart – CSE.XMG



Recent news

2015-11-04

MGX receives Driftwood Creek bulk sampling permit

2015-11-04

MGX receives final land survey approval for Driftwood

2015-10-29

MGX Minerals drills 88 m of 43.41% MgO at Driftwood

2015-10-09

MGX Minerals completes phase II drilling at Driftwood

2015-10-09

MGX Minerals begins Cranbrook mill site evaluation

See page 2 for important disclosures and disclaimers.

still relatively small and allows MGX to operate without need of a federal environmental assessment. The enormous advantage of early production is early cash-flow. For junior miners, the most significant business risk is access to capital. And at no time is this more critical than in a commodities bear market. Last month some 30 junior resource companies were de-listed from the TSX Venture exchange for failing to meet capital requirements. Mid to large caps have reserves to see them through the tough times. The juniors have been relying on a fast diminishing pool of mostly retail investors. Even those with quality assets are vulnerable to the music stopping.

Scale Potential

From an investor’s point of view, the ability to start small is only compelling if it comes with the potential to grow big. MGX’s Driftwood Creek deposit in British Columbia is expected to yield two varieties of saleable magnesia: Caustic Calcined Magnesia and Dead Burned Magnesia – the latter being the dominant product. The company intends to produce up to 100,000 tonnes annually. The current market price for mid-grade MgO is \$375-\$400 USD per tonne. While these production numbers are aspirational to be sure, they do illustrate the scale potential of MGX’s business.

Current Situation

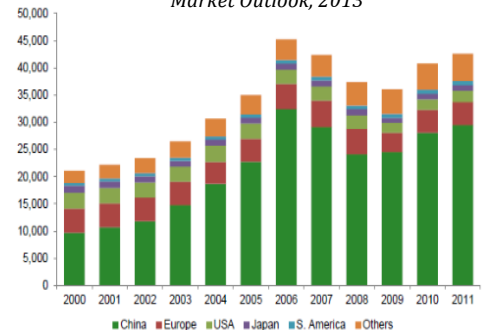
The Driftwood Creek property has a historic non NI43-101 compliant resource of 28m tonnes representing decades of potential supply. Because the company plans to take the property into production (rather than dress it up for a sale) primary efforts have been directed to advancing the Driftwood Creek project through the various hurdles necessary to reach commencement of production. In May 2015, MGX announced agreements with Eaton Corp. and Highbury Energy, providing for engineering, construction and finance assistance in building out the company’s proposed processing facility. The company is awaiting results of pilot plant testing to determine final specifications to optimize the design and construction parameters of industrial-sized kilns to process mineralized material from Driftwood Creek. If all goes as expected, we expect to see construction and assembly of the processing plant by Summer 2016 and commencement of mining operations by Fall 2016.

At a current share price of \$0.54 the company has a current market capitalization of approximately \$16 million. For an advanced-stage development company pursuing near term production, MGX Minerals presents a compelling case and we would expect the market to re-rate the company as the milestones above our achieved. A proposed financing was announced (see news release dated August 31, 2015) for the issuance of up to 1-million units (share plus warrant) at \$0.50 per unit. A portion of this proposed financing remains unallocated. Further financing will be required in order to capitalize construction of the proposed processing plant.

Disclaimers and Disclosures

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Global Refractories Production by Region
 Source: Bauxite & Alumina Global Industry & Market Outlook, 2013



Global Magnesia Supply by Product
 Source: Roskill Information Services Ltd., 2013

