



# Diatreme Resources (DRX)

## Zircon price doubled in 2011, to \$2,500/t

2011 Q1 contract supply at \$1,200/t; Q4 \$2,550/t

**Important:** Since October 2009, Intersuisse and an associate company, Phillip Capital Pty Ltd, has provided and continues to provide capital markets, corporate advisory and capital raising services for Diatreme and receives fees. Since October 2009 Intersuisse has managed five capital raisings for Diatreme and received fees. For Disclosures, refer to the back page under "Important Information".

### Recommendation

**Buy**

### Price

**7.2 c**

Intersuisse NPV based valuation

**60c**

ASX / S&P Sector

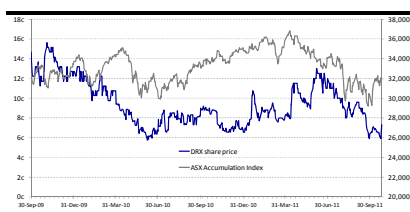
**Metals & Mining**

- **DRX's Pre-Feasibility Study for its Cyclone zircon project is nearing completion.**
- **Intersuisse expects that DRX will be able to conclude its JV negotiations with BaoTi after completing the PFS.**
- **Cyclone is a globally significant zircon resource, and zircon prices have risen strongly as supply struggles to keep up with demand.**
- **Intersuisse estimates**
  - (i) **the NPV of the Cyclone deposit, un-risked, to be \$346m (assuming \$2,500/t for zircon), and**
  - (ii) **that the payments by BaoTi to buy into the project more than cover the equity needed by DRX to develop the Cyclone project.**

### Snapshot

|                 |                                 |
|-----------------|---------------------------------|
| Last Price      | \$0.072                         |
| Market Cap.     | \$27.5 million                  |
| Shares on Issue | 354.6m FPO                      |
| Listed options  | 88.65m<br>ex 15c, 30 Sept. 2013 |
| 52 Week High    | \$0.130 (adjusted)              |
| 52 Week Low     | \$0.059 (adjusted)              |

### Price Chart



### Shareholders

|                      |        |
|----------------------|--------|
| Andrew Tsang         | 21.77% |
| Doral Industries Ltd | 6.60%  |
| Zhangxi Zeng         | 4.48%  |
| Chaohui Zhang        | 2.26%  |
| Huntley Custodians   | 1.93%  |

### Directors and Management

|               |                                |
|---------------|--------------------------------|
| Tony Fawdon   | Executive Chairman/CEO         |
| David Hall    | Executive Director, Operations |
| George White  | Non Executive Director         |
| Andrew Tsang  | Non Executive Director         |
| William Wang  | Non Executive Director         |
| Neil McIntyre | Chief Financial Officer        |

Analyst: Pieter Bruinstroop :

### Zircon prices continue to rise

Australia is the world's largest producer of zircon, which is used extensively for ceramic glazes, for kitchen tiles, dinner-ware, bathroom products and decorative ceramics; it is used extensively in Asian apartment construction.

Zircon prices have risen strongly through 2011, despite the media noise on the Chinese property market slowing, from \$1,200/t in Q1 to \$2,550/t in Q4.

### DRX concluding its pre-feasibility study

DRX will complete its PFS by December 2011 and its Definitive Feasibility Study by December 2012.

Intersuisse's base case valuation of the Cyclone project, assuming a discount rate of 10% real, after tax, and zircon price \$2,500/t (and AUD = 1.05 USD) is \$346m.

Intersuisse's base case valuation for DRX assumes that DRX sells a 50% interest in the project for 75% of the value of that interest, which provides more funds than the equity needed by DRX for its share of the cost of developing the project.

The conclusion of the joint venture agreement with BaoTi has taken longer than expected, but Intersuisse expects a result after the PFS has been agreed and published.

### Conclusions

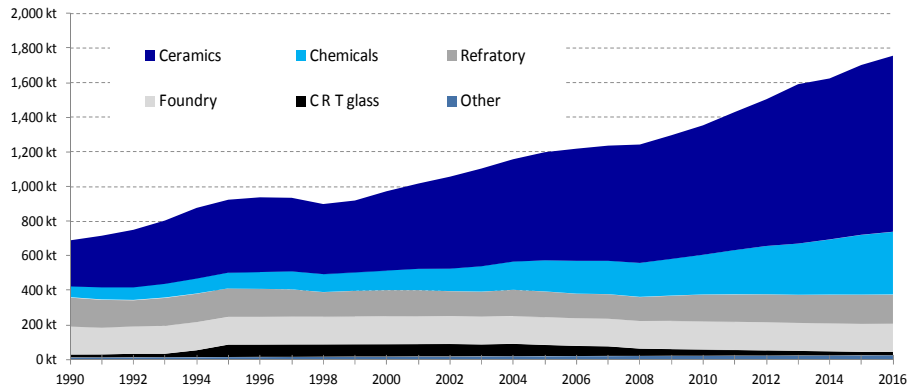
Intersuisse retains a BUY recommendation on DRX.

**For further information about Diatreme Resources contact Intersuisse Limited**  
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**Zircon Market**

Figure 1 shows that the dominant end use demand for zircon is in ceramics; for glazes for kitchen tiles, dinner-ware, bathroom products and decorative ceramics. It also shows that this end use has been growing strongly, as has chemical use, while other uses have been stagnant or in decline.

Figure 1 : Zircon demand, by end use

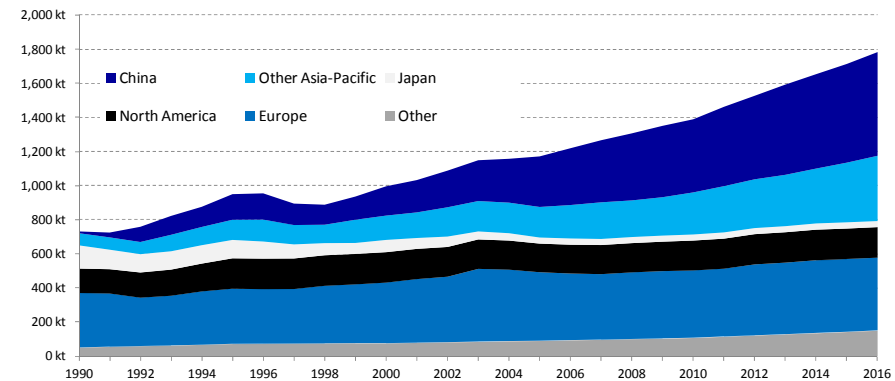


DRX is undertaking a feasibility study of the Cyclone deposit, which is primarily a zircon project.

Source : TZMI 2007, Iluka

Figure 2 shows that consumption growth is driven by China and also Asia-Pacific, other than Japan or China, while Japan, Europe and North America are stagnant or in decline.

Figure 2 : Zircon consumption growth, by region



Source : TZMI 2007, Iluka

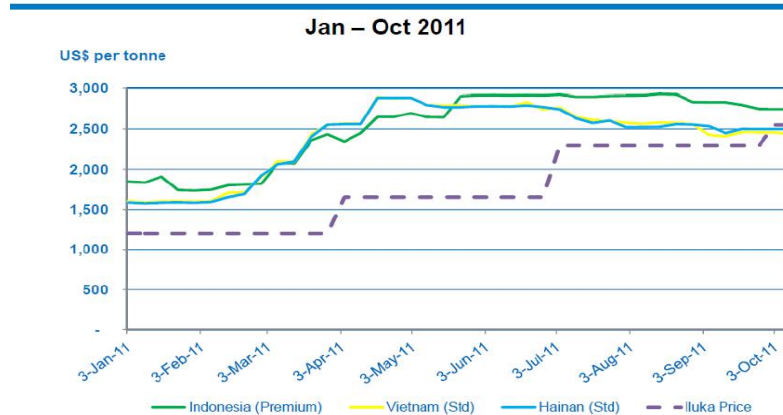
Intersuisse has been bullish on the fundamentals of the zircon market

Figure 3 shows that zircon prices have risen strongly though CY 2011.

Figure 3 : Zircon prices, though 2011

**China domestic zircon prices: recent trends**

Zircon prices have risen strongly through the year.



Source : Titanium and Zircon Mineral Institute (TZMI)

Figure 3 shows that Iluka's contract prices have doubled over the course of CY 2011, while spot prices have been over \$2,500/t since about April 2011.

Figure 4 is a list of mineral sands projects from TZMI. It suggests that there is a significant amount of product in development.

Figure 4 : Potential mineral sands projects

|   | Country      | Company              | Titaniferous | Zircon | Earliest |
|---|--------------|----------------------|--------------|--------|----------|
| <b>Projects in Development</b>                    |              |                      |              |        |          |
| KZN Sands - Fairbreeze                            | South Africa | Exxaro Resources     | 190kt        | 60kt   | 2013     |
| Moma stage 2                                      | Mozambique   | Kenmare Resources    | 250kt        | 30kt   | 2012     |
| Birzulovo   | Ukraine      | Velta LLC            | 102kt        | 0kt    | 2011     |
| Kwale   | Kenya        | Base Resources       | 246kt        | 40kt   | 2013     |
| Grande Cote                                       | Senegal      | Mineral Deposits     | 320kt        | 80kt   | 2013     |
| <b>Projects with advanced feasibility studies</b> |              |                      |              |        |          |
| Coburn Sands                                      | Australia    | Gunson Resources     | 69kt         | 40kt   | 2014     |
| Tormin  | South Africa | Mineral Commodities  | 4kt          | 32kt   | 2013     |
| Keysbrook   | Australia    | Matilda Zircon       | 59kt         | 15kt   | 2014     |
| Tamil Nadu  | India        | Tata Steel           | 294kt        | 28kt   | 2014     |
| <b>Projects under active investigation</b>        |              |                      |              |        |          |
| Donald  | Australia    | Astron               | 122kt        | 86kt   | 2013     |
| Xolobeni  | South Africa | Mineral Commodities  | 155kt        | 15kt   | 2014     |
| Athabasca Sands                                   | Canada       | Titanium Corporation | 0kt          | 55kt   | 2014     |
| Cerro Blanco                                      | Chile        | White Mountain       | 186kt        | 0kt    | 2014     |

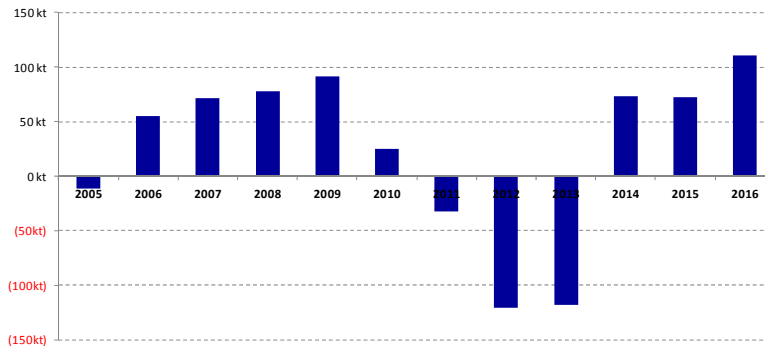
Intersuisse understands that zircon stocks have been run down, which is why prices have risen strongly through 2011.

Source : TZMI

However, our review of a similar list compiled in 2006 shows many of the same projects, with the only change being when production is expected.

Figure 5 shows that, if all of the projects proceed as expected, then the zircon market will still be in significant deficit until 2013.

Figure 5 : Historical and project market balance for zircon



While there are enough projects to bring the market back into surplus, experience has been that nearly all projects take longer than originally expected.

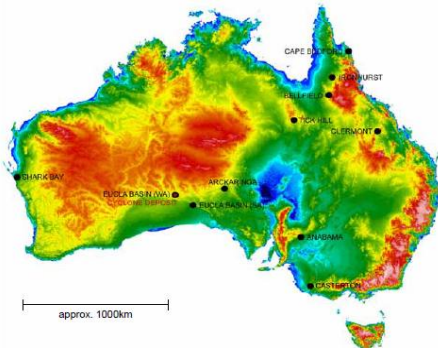
Intersuisse expects that projects will be delayed and that the zircon market will remain tight

Source : TZMI, Intersuisse

In Intersuisse's view, taking into account likely project delays, the zircon market will remain tight over the projected period.

## Diatreme Resources (DRX)

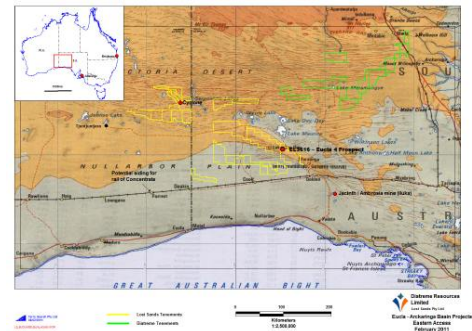
Figure 6 : Diatreme's projects



Diatreme has interests in addition to the Cyclone mineral sands project, but these are still very immature.

Source : Diatreme Resources, 2010 Annual Report

Figure 7 : DRX's Cyclone deposit



Source : DRX Quarterly report, September 2011

DRX has a range of projects, as shown in Figure 6. However, the only project that is sufficiently advanced for Intersuisse to be able to value is the Cyclone mineral sands project, which is in the Eucla Basin, on the WA side of the WA-SA border. The location is shown in Figure 7.

Diatreme has nearly 1Mt of zircon in JORC resources.

Figure 8 shows the latest reported JORC Resource statement by DRX on the Cyclone deposit. It shows that Cyclone has nearly 1Mt of contained zircon.

Figure 8 : JORC Resources, DRX's Cyclone deposit

| DRX          | Resources       | HfM          | Slimes       | Oversize     | Zircon        | Rutile        | HfTi          | Ilmenite      | Zircon        | Rutile        | HfTi          | Ilmenite      | Zircon       |
|--------------|-----------------|--------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|
| Measured     | 49.7 Mt         | 2.7 %        | 4.5 %        | 5.3 %        | 32.2 %        | 12.7 %        | 16.8 %        | 10.0 %        | 427 kt        | 169 kt        | 223 kt        | 133 kt        | 0.9 %        |
| Indicated    | 72.2 Mt         | 2.2 %        | 4.2 %        | 6.0 %        | 32.3 %        | 12.7 %        | 18.0 %        | 12.8 %        | 513 kt        | 202 kt        | 286 kt        | 203 kt        | 0.7 %        |
| Inferred     | 10.2 Mt         | 1.7 %        | 3.6 %        | 8.9 %        | 33.6 %        | 10.9 %        | 23.0 %        | 21.4 %        | 58 kt         | 19 kt         | 40 kt         | 37 kt         | 0.6 %        |
| <b>TOTAL</b> | <b>132.1 Mt</b> | <b>2.3 %</b> | <b>4.3 %</b> | <b>5.9 %</b> | <b>32.3 %</b> | <b>12.6 %</b> | <b>17.9 %</b> | <b>12.4 %</b> | <b>998 kt</b> | <b>389 kt</b> | <b>549 kt</b> | <b>373 kt</b> | <b>0.8 %</b> |

Source : Diatreme Resources, ASX announcement, 5 October 2010

### Cyclone : Development Plan

In March 2010, DRX published a Scoping Study showing the project to be economic.

In August 2010, DRX announced it had executed a Memorandum of Understanding with BaoTi,

DRX has signed an MOU with BaoTi, a Chinese company, to jointly develop the Cyclone deposit.

- BaoTi that is described as “the leading zircon and titanium fabrication company in China and presently dominates Chinese exports in zircon and titanium end user products, having an 80% market share”;
- The MOU was for BaoTi to take an equity stake in DRX and for DRX and BaoTi to jointly develop the Cyclone deposit.

The development time frame is for construction to take place through 2014, with first product in 2015.

In January 2011, DRX published an Independent Technical Review of the Cyclone project, which was updated in June 2011. Using the data in the ITR, Intersuisse has developed the cost and production data shown in Figure 9.

Figure 9 : Intersuisse's estimated production and cost data for Cyclone

|                                 | Average / Total  | 2015              | 2016              | 2017              | 2018              | 2019              | 2020              | 2021              | 2022              | 2023              | 2024              | 2025              |
|---------------------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Overburden                      | 105,963 kt       | 8,232 kt          | 10,780 kt         | 9,800 kt          | 10,780 kt         | 12,740 kt         | 10,780 kt         | 10,780 kt         | 10,780 kt         | 10,780 kt         | 8,085 kt          | 2,425 kt          |
| S / R                           | 1.1 : 1          | 1.1 : 1           | 0.8 : 1           | 1.3 : 1           | 1.8 : 1           | 1.4 : 1           | 1.2 : 1           | 1.3 : 1           | 1.0 : 1           | 0.6 : 1           | 0.6 : 1           | 0.0 : 1           |
| Cost                            | \$A 119 m        | \$A 9.4 m         | \$A 12.2 m        | \$A 11.1 m        | \$A 13.8 m        | \$A 12.2 m        | \$A 12.2 m        | \$A 12.2 m        | \$A 12.2 m        | \$A 12.2 m        | \$A 9.4 m         | \$A 2.9 m         |
| AUD/t Material                  | \$A 1.13/t       | \$A 1.14/t        | \$A 1.13/t        | \$A 1.14/t        | \$A 1.13/t        | \$A 1.08/t        | \$A 1.13/t        | \$A 1.13/t        | \$A 1.13/t        | \$A 1.13/t        | \$A 1.16/t        | \$A 1.18/t        |
| AUD/t HMC                       | \$A 73/t         | \$A 90/t          | \$A 74/t          | \$A 68/t          | \$A 74/t          | \$A 84/t          | \$A 74/t          | \$A 74/t          | \$A 74/t          | \$A 74/t          | \$A 57/t          | \$A 60/t          |
| Ore Mining                      | 98,000 kt        | 6,860 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 9,800 kt          | 2,940 kt          |
| Cost                            | \$A 142 m        | \$A 10.1 m        | \$A 14.2 m        | \$A 14.2 m        | \$A 14.2 m        | \$A 14.0 m        | \$A 14.2 m        | \$A 14.2 m        | \$A 14.2 m        | \$A 14.2 m        | \$A 14.4 m        | \$A 4.2 m         |
| AUD/t Material                  | \$A 1.45/t       | \$A 1.15/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.21/t        |
| AUD/t HMC                       | \$A 87/t         | \$A 76/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 74.85/t       |
| Wet Concentrator Plant          | 1,629 kt         | 104 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 164 kt            | 48 kt             |
| Cost                            | \$A 102 m        | \$A 7.9 m         | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 10.0 m        | \$A 3.6 m         |
| AUD/t Material                  | \$A 1.04/t       | \$A 1.15/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 1.03/t        | \$A 0.50/t        |
| AUD/t HMC                       | \$A 63/t         | \$A 76/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 61/t          | \$A 1.36/t        |
| Site Admin                      | \$A 33 m         | \$A 2.7 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 3.3 m         | \$A 1.0 m         |
| AUD/t HMC                       | \$A 20/t         | \$A 26/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 20/t          | \$A 22.04/t       |
| Trucking Cost (to rail head)    | \$A 49 m         | \$A 3.1 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 4.9 m         | \$A 1.4 m         |
| AUD/t HMC                       | \$A 30/t         | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30/t          | \$A 30.05/t       |
|                                 | 13.7c/t-km       | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        | 13.7c/t-km        |
| Rail to Port Augusta            | \$A 74 m         | \$A 4.7 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 7.4 m         | \$A 2.1 m         |
| AUD/t HMC                       | \$A 45/t         | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45/t          | \$A 45.14/t       |
|                                 | 4.1c/t-km        | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         | 4.1c/t-km         |
| Loading, Shipping and unloading | \$A 88 m         | \$A 5.6 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 8.9 m         | \$A 2.6 m         |
| AUD/t HMC                       | \$A 54/t         | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          | \$A 54/t          |
| MSP                             | \$A 36 m         | \$A 2.8 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 3.6 m         | \$A 1.3 m         |
| AUD/t HMC                       | \$A 22/t         | \$A 27/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 22/t          | \$A 26.45/t       |
| Port                            | \$A 11 m         | \$A 0.7 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 1.1 m         | \$A 0.3 m         |
| AUD/t HMC                       | \$A 7/t          | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         | \$A 7.0/t         |
| <b>TOTAL ANNUAL CASH COST</b>   | <b>\$A 655 m</b> | <b>\$A 46.9 m</b> | <b>\$A 65.6 m</b> | <b>\$A 64.6 m</b> | <b>\$A 65.6 m</b> | <b>\$A 67.0 m</b> | <b>\$A 65.6 m</b> | <b>\$A 65.6 m</b> | <b>\$A 65.6 m</b> | <b>\$A 65.6 m</b> | <b>\$A 63.0 m</b> | <b>\$A 19.5 m</b> |
| Royalty                         | \$A 93 m         | \$A 3.2 m         | \$A 5.1 m         | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 10.2 m        | \$A 2.9 m         |
| AUD/t product                   | \$A 69/t         | \$A 37.5/t        | \$A 37.6/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.3/t        | \$A 75.0/t        |

Source : DRX Independent Technical Review, June 2011, Intersuisse

Figure 10 shows Intersuisse's projected revenue for Cyclone, detailing our production and commodity price estimates.

Figure 10 : Intersuisse's estimated revenue for Cyclone

Intersuisse expects that zircon will account for about 80% of the revenue from Cyclone.

| Revenue  | TOTAL      | 2015       | 2016       | 2017       | 2018       | 2019       | 2020       | 2021       | 2022       | 2023       | 2024       | 2025       |
|----------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Zircon   |            | 42 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 66 kt      | 19 kt      |
|          |            | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t |
|          | SA 1,557 m | SA 99 m    | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 157 m   | SA 46 m    |
| Rutile   |            | 14 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 22 kt      | 6 kt       |
|          |            | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t |
|          | SA 518 m   | SA 33 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 52 m    | SA 15 m    |
| Hi-Ti    |            | 19 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 30 kt      | 9 kt       |
|          |            | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   |
|          | SA 84 m    | SA 5 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 8 m     | SA 2 m     |
| Ilmenite |            | 11 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 18 kt      | 5 kt       |
|          |            | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   |
|          | SA 25.3 m  | SA 2 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 3 m     | SA 1 m     |
| TOTAL    | SA 2,183 m | SA 139 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 220 m   | SA 64 m    |
| Zircon   | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     | 71.3 %     |
| Rutile   | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     | 23.7 %     |
| Hi-Ti    | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      | 3.8 %      |
| Ilmenite | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      | 1.2 %      |

Source : Intersuisse estimates

Figure 11 shows the net cashflows generated by the Cyclone deposit,

Figure 11 : Net cashflows, Cyclone deposit

Intersuisse expects that, with current zircon prices, the project will generate significant cashflows.

| Cyclone, 100% basis           | 2013       | 2014       | 2015       | 2016       | 2017       | 2018       | 2019       | 2020       | 2021       | 2022       | 2023       | 2024       | 2025      |
|-------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|-----------|
| Revenue                       | SA 0.0 m   | SA 0.0 m   | SA 144.1 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 228.2 m | SA 66.2 m |
| Cash Costs                    | SA 0.0 m   | SA 0.0 m   | SA 44.5 m  | SA 61.8 m  | SA 65.9 m  | SA 66.9 m  | SA 68.3 m  | SA 66.9 m  | SA 66.9 m  | SA 66.9 m  | SA 66.9 m  | SA 64.3 m  | SA 19.8 m |
| Dep'n & Amort'sn              | SA 0.0 m   | SA 0.0 m   | SA 10.6 m  | SA 16.1 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 16.6 m  | SA 6.0 m  |
| E B I T                       | SA 0.0 m   | SA 0.0 m   | SA 89.0 m  | SA 150.3 m | SA 145.8 m | SA 144.7 m | SA 143.3 m | SA 144.7 m | SA 144.7 m | SA 144.7 m | SA 144.7 m | SA 147.3 m | SA 40.4 m |
| Interest charge               | SA 0.0 m   | SA 0.0 m   | SA 6.6 m   | SA 7.8 m   | SA 6.7 m   | SA 5.5 m   | SA 4.1 m   | SA 2.7 m   | SA 1.1 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m  |
| Taxes                         | SA 0.0 m   | SA 0.0 m   | SA 23.9 m  | SA 41.3 m  | SA 40.3 m  | SA 40.4 m  | SA 40.4 m  | SA 41.2 m  | SA 41.6 m  | SA 42.0 m  | SA 42.0 m  | SA 42.7 m  | SA 11.7 m |
| N P A T                       | SA 0.0 m   | SA 0.0 m   | SA 58.5 m  | SA 101.1 m | SA 98.7 m  | SA 98.9 m  | SA 98.8 m  | SA 100.8 m | SA 102.0 m | SA 102.7 m | SA 102.8 m | SA 104.6 m | SA 28.7 m |
| B F S costs                   | SA 13.5 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m  |
| Project Cap. Ex               | SA 56.4 m  | SA 131.6 m | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m  |
| Sus. Cap. Ex                  | SA 0.0 m   | SA 0.0 m   | SA 1.0 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 1.5 m   | SA 0.4 m  |
| Net Cashflow, after tax       | (SA69.9 m) | (SA132 m)  | SA 68.0 m  | SA 115.8 m | SA 113.8 m | SA 114.0 m | SA 113.9 m | SA 116.0 m | SA 117.1 m | SA 117.9 m | SA 117.9 m | SA 119.7 m | SA 34.2 m |
| NCF, after tax, after finance | (SA69.9 m) | (SA18.8 m) | SA 58.4 m  | SA 102.0 m | SA 98.9 m  | SA 97.8 m  | SA 96.4 m  | SA 97.0 m  | SA 96.5 m  | SA 116.6 m | SA 117.9 m | SA 119.7 m | SA 34.2 m |

Source : Intersuisse estimates

Using a discount rate of 10% on net cashflows from 1 January 2011 gives an NPV of :

- \$404m, before financing costs; and
- \$346m after financing costs.

The former is not a realistic assessment as it does not take into account the cost of raising equity or re-paying the debt, while the latter is the returns to present equity holders.

## Financing

The MOU signed with BaoTi envisages that BaoTi takes equity in DRX and also that the Cyclone project gets developed as a joint venture.

DRX is currently working on a pre-feasibility study which is nearing completion.

Intersuisse expects that the results of the PFS will be the basis on which BaoTi will invest in DRX and the Cyclone project.

Intersuisse has no guidance as to the detail of this investment, but we have made some assumptions in order to get an indication of how it might look. Intersuisse has assumed :

Intersuisse has made assumptions of how BaoTi buys into the project.

We also assume that these issues are being finalised as part of the Joint Venture negotiations.

Our valuation is not very sensitive to the financing assumed.

- BaoTi buys 50% of the Cyclone project, paying 75% of the NPV of the 50% interest, which means a payment to DRX of \$130m (50% of \$346m is \$173m, and 75% of \$173m is \$130m);
- BaoTi takes a placement of 88m new shares in DRX, to acquire a total stake of 19.9%, and that this placement is done at a premium to the current share price, resulting in a payment to DRX of \$13m;
- The Cyclone project is funded by project finance for 60% of the capital costs of \$188m, which is after payment of feasibility studies and before capitalised interest.

As a result of the payments to DRX by BaoTi, DRX has sufficient funds to pay for its equity share of the project.

**Value to DRX shareholders**

Figure 12 shows the assumed commodity prices, operational outcomes and net cashflows to DRX shareholders.

Figure 12 : Net to DRX shareholders

|                      | 2010      | 2011       | 2012       | 2013       | 2014       | 2015       | 2016       | 2017       | 2018       | 2019       | 2020       | 2021       | 2022       | 2023       | 2024       | 2025       |
|----------------------|-----------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| AUD / USD            | 0.920     | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      | 1.050      |
| Zircon               | \$ 900/t  | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t |
| Rutile               | \$ 631/t  | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t | \$ 2,500/t |
| Hi-Ti                | \$ 150/t  | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   | \$ 300/t   |
| Ilmenite             | \$ 95/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   | \$ 150/t   |
| DRX share            | 100%      | 75%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        | 50%        |
| Zircon               | 0 kt      | 0 kt       | 0 kt       | 0 kt       | 0 kt       | 21 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      | 33 kt      |
| Rutile               | 0 kt      | 0 kt       | 0 kt       | 0 kt       | 0 kt       | 7 kt       | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      | 11 kt      |
| Hi-Ti                | 0 kt      | 0 kt       | 0 kt       | 0 kt       | 0 kt       | 9 kt       | 15 kt      | 15 kt      | 15 kt      | 13 kt      | 13 kt      | 13 kt      | 13 kt      | 13 kt      | 13 kt      | 13 kt      |
| Ilmenite             | 0 kt      | 0 kt       | 0 kt       | 0 kt       | 0 kt       | 6 kt       | 9 kt       | 9 kt       | 9 kt       | 10 kt      | 10 kt      | 10 kt      | 10 kt      | 10 kt      | 10 kt      | 10 kt      |
| Revenue              | SA 0.0 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 72.0 m  | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m | SA 114.1 m |
| Cash Op. Costs       | SA 0.0 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | (SA18.3 m) | (SA25.9 m) | (SA27.9 m) | (SA28.4 m) | (SA29.1 m) | (SA28.4 m) | (SA28.4 m) | (SA28.4 m) | (SA28.4 m) | (SA27.1 m) | (SA8.1 m)  |
| Corp. Costs          | (SA2.6 m) | (SA2.8 m)  | (SA3.0 m)  | (SA3.3 m)  | (SA3.7 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA3.8 m)  | (SA1.9 m)  |
| Exploration          | (SA1.4 m) | (SA1.1 m)  | (SA1.2 m)  | (SA1.3 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA1.5 m)  | (SA0.8 m)  | SA 0.0 m   |
| Dep'n & Amort'n      | (SA0.1 m) | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | (SA5.3 m)  | (SA8.1 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA8.3 m)  | (SA3.0 m)  |
| E B I T              | (SA4.0 m) | (SA3.9 m)  | (SA4.2 m)  | (SA4.7 m)  | (SA5.1 m)  | SA 43.2 m  | SA 74.9 m  | SA 72.1 m  | SA 71.4 m  | SA 71.4 m  | SA 72.1 m  | SA 72.1 m  | SA 72.1 m  | SA 72.1 m  | SA 74.2 m  | SA 20.1 m  |
| Interest charge      | (SA0.0 m) | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | (SA3.3 m)  | (SA3.9 m)  | (SA3.4 m)  | (SA2.7 m)  | (SA2.1 m)  | (SA1.3 m)  | (SA0.6 m)  | (SA0.0 m)  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   |
| Taxes                | SA 0.0 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | (SA11.6 m) | (SA20.6 m) | (SA20.1 m) | (SA20.1 m) | (SA20.1 m) | (SA20.5 m) | (SA20.8 m) | (SA20.9 m) | (SA21.5 m) | (SA5.9 m)  |            |
| N P A T              | (SA4.0 m) | (SA3.9 m)  | (SA4.2 m)  | (SA4.7 m)  | (SA5.1 m)  | SA 28.3 m  | SA 50.4 m  | SA 49.2 m  | SA 49.3 m  | SA 49.3 m  | SA 50.3 m  | SA 50.8 m  | SA 51.2 m  | SA 51.2 m  | SA 52.7 m  | SA 14.2 m  |
| e. p. s.             | (1.74)    | (1.06)     | (1.06)     | (1.14)     | (1.26)     | 6.4 c      | 11.4 c     | 11.1 c     | 11.1 c     | 11.1 c     | 11.4 c     | 11.5 c     | 11.6 c     | 11.6 c     | 11.9 c     | 3.2 c      |
| B F S costs          | SA 0.0 m  | SA 8.1 m   | SA 1.4 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   |
| Project Cap. Ex      | SA 0.0 m  | SA 0.0 m   | SA 0.0 m   | SA 28.2 m  | SA 65.8 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   |
| Sus. Cap. Ex         | SA 0.0 m  | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.0 m   | SA 0.5 m   | SA 0.7 m   | SA 0.7 m   | SA 0.7 m   | SA 0.8 m   | SA 0.7 m   | SA 0.7 m   | SA 0.7 m   | SA 0.7 m   | SA 0.7 m   | SA 0.2 m   |
| Project Net Cashflow | SA 0.0 m  | (SA8.1 m)  | (SA1.4 m)  | (SA28.2 m) | (SA9.4 m)  | SA 33.5 m  | SA 56.1 m  | SA 54.5 m  | SA 54.0 m  | SA 53.3 m  | SA 53.6 m  | SA 53.4 m  | SA 63.4 m  | SA 64.0 m  | SA 64.7 m  | SA 18.8 m  |
| Cash Balance         | SA 2.4 m  | SA 148.5 m | SA 144.2 m | SA 111.4 m | SA 96.8 m  | SA 134.3 m | SA 190.1 m | SA 238.2 m | SA 287.3 m | SA 337.0 m | SA 388.7 m | SA 461.8 m | SA 515.5 m | SA 569.3 m | SA 624.9 m | SA 629.2 m |
| Shares on issue      | 265.95 m  | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   | 442.69 m   |

Intersuisse's analysis shows that the projected cashflows for DRX have a present value that is many times the current share price, even after taking a reasonable risk weighting into account.

Source : Intersuisse estimates

In deriving a value for a DRX share, as shown in Figure 13, Intersuisse has

- risk-weighted the NPV derived project values; and
- given some value for franking credits generated by Australian taxes paid

Figure 13 : Detail of Intersuisse's value of DRX, of 60c a share

| discount rate =  | 12%   | 31-Dec-10        |                   | 24-Oct-11     |               |
|------------------|-------|------------------|-------------------|---------------|---------------|
|                  |       | 100%             | Product per share |               |               |
| Cyclone          | 60 %  | SA 159m          | SA 95m            | 21.5 c        | 24.6 c        |
| Franking credits | 36 %  | SA 70m           | SA 25m            | 5.7 c         | 6.2 c         |
| Other            | 40 %  | SA 0.0m          | SA 0.0m           | 0.0 c         | 0.0 c         |
| Corporate        | 100 % | (SA 23m)         | (SA 23m)          | (5.3c)        | (5.3c)        |
| Exploration      | 100 % | (SA 9.1m)        | SA 0.0m           | 0.0 c         | 0.0 c         |
| Cash             | 100 % | SA 9.3m          | SA 9.3m           | 2.1 c         | 2.1 c         |
| Project equity   | 100 % | SA 130m          | SA 130m           | 29.3 c        | 29.3 c        |
| Bao Ti equity    |       | SA 13.2m         | SA 12.4m          | 2.8 c         | 2.8 c         |
| <b>TOTAL</b>     |       | <b>SA 348.5m</b> | <b>SA 248.6m</b>  | <b>56.2 c</b> | <b>59.7 c</b> |
| Shares on issue  |       | 354.6m           | FPO shares        | 88.1m         | Bao Ti        |

Intersuisse believes that the current share price has a very large risk discount.

Source : Intersuisse estimates

Figure 14 shows that the value for the Cyclone project varies with the assumed zircon price.

Figure 14 : Sensitivity

| L-R price    | \$ 2,500/t | \$ 2,000/t |
|--------------|------------|------------|
| 100% Project | SA 346m    | SA 231m    |
| DRX value    | 59.7 c     | 41.0 c     |

Source : Intersuisse estimates

Figure 14 also shows that even with much lower assumed zircon (and rutile) prices, the DRX valuation is still significantly greater than the current share price

Intersuisse maintains a BUY rating on DRX.

**Conclusion**

There are still many hurdles until DRX is generating cash. The major hurdles include :

- Successful conclusion of joint venture negotiations with BaoTi; and
- Successful project delivery.

Intersuisse confirms a BUY rating on Diatreme Resources (DRX).

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