



Diatreme Resources (DRX) Independent Review : \$300m value

Nearly 1.0Mt of zircon in JORC Resources

Important: Intersuisse was the underwriter to the Diatreme Rights Issue which closed in March 2011 and received fees. 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. For Disclosures, refer to the back page under "Important Information".

Recommendation

Buy

Price

12.0 c

Intersuisse NPV based valuation

30c

ASX / S&P Sector

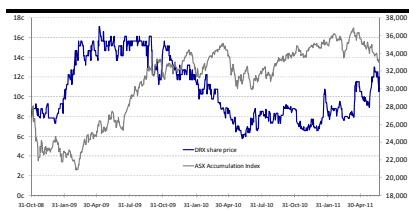
Metals & Mining

- **On 18 January, DRX published an Independent Technical Review of the Cyclone project, which gave a value for the project of \$142m - \$170m**
- **On 21 June, DRX published an update of that Review, which gave a revised value for Cyclone of \$270m to \$330m**
- **Using the most likely value, of \$300m, this gives a valuation of 51c per DRX share.**
- **Intersuisse retains a BUY recommendation.**

Snapshot

Last Price	\$0.120
Market Cap.	\$30.1 million
Shares on Issue	354.6m FPO
Listed options	88.65m
	ex 15c, 30 Sept. 2013
52 Week High	\$0.130 (adjusted)
52 Week Low	\$0.058 (*adjusted)

Price Chart



DRX has an extensive area in Eucla Basin, near Iluka's recently commissioned Jacinth-Ambrosia operations.

DRX has progressed an agreement with the Chinese company BaoTi

- BaoTi will become a substantial investor in DRX;
- Cyclone will be developed as a Joint Venture.

The projected timetable for DRX is

- Pre-Feasibility Study : end 2011
- Definitive Feasibility Study : 2012
- Financing : mid 2013
- Construction : 2013 and 2014
- Commissioning : early 2015

See www.diatreme.com.au

Analyst: Pieter Bruinstroop :

Independent Technical Review

The revised ITR has increased its assumptions for mineral sands prices, following the much larger than expected increases in prices over the course of 2011.

Zircon is the major revenue source for Cyclone and the assumed zircon price has been increased from \$1,200/t for 2014 to \$1,800/t in 2014. This compares with current prices around \$1,700/t, and it is expected that prices will be about \$500/t higher for third quarter sales.

While demand is projected to rise, supply is constrained and will take many years to respond to the presently high prices, as shown by the projections for Cyclone.

Project progress

Intersuisse that DRX has been in active negotiation with BaoTi for some time as BaoTi has satisfied its technical due diligence.

Intersuisse interprets that the revised ITR is part of these negotiations as DRX affirmed, on 26 May, the intention to execute a binding Heads of Agreement by the end June 2011.

Valuation

The independent expert valued DRX's Cyclone deposit at \$270m - \$330m. Intersuisse has not, at this time, changed its valuation of \$172m.

Intersuisse assumes that DRX will sell half the project to BaoTi, at a discount, as well as an equity stake in DRX at the current share price, but a discount to our valuation.

Intersuisse concludes that DRX will NOT need to raise any more equity to develop the project.

Intersuisse's derived risk weighted valuation is 30c per DRX share.

Independent Technical Review (ITR)

DRX published an ITR on 18 January 2011. On 21 June 2011, DRX published an updated ITR.

Intersuisse reviewed these reports and found :

DRX has published a revised Independent Technical Review, which has updated its commodity price assumptions closer to presently projected prices.

- Estimated capital cost has not changed; it has been confirmed as \$201.5m; and
- Estimated operating costs, before royalties, has not changed it has been confirmed as \$61.3m.

Commodity prices assumed

Figure 1a shows the product prices assumed in the January ITR so that this can be compared with the product prices in the June ITR, as shown in Figure 1b

Figure 1a : Product prices assumed in January 2011 ITR

Product price outlook until the first year of production [US\$]

PRODUCT	2011	2012	2013	2014
Zircon	1,050	1,100	1,150	1,200
Rutile	600	650	700	750
HiTi	320	330	340	350
Altered Ilmenite	160	170	180	190

Source : DRX ASX Announcement, 18 January 2011, at p.22

Figure 1b : Product prices assumed in June 2011 ITR

Product price outlook until the first year of production [US\$]

PRODUCT	2011	2012	2013	2014
Zircon	1,900	2,000	2,200	1,800
Rutile	900	950	950	800
HiTi	320	330	340	350
Altered Ilmenite	160	170	180	190

Source : DRX ASX Announcement, 21 June 2011, at p. 23

The ITR also assumed an AUD-USD rate of 0.800 from 2014 on.

The commodity prices assumed are still conservative given current prices and projections by other brokers.

For comparison, Figure 2 shows the commodity prices assumed by Intersuisse in our valuation of DRX

Figure 2 : Intersuisse's commodity price assumptions

	2010	2011	2012	2013	2014	2015	2016	2017	2018
AUD / USD	0.920	1.034	1.050	1.050	1.000	0.975	0.950	0.950	0.950
Zircon	\$ 900/t	\$ 1,588/t	\$ 2,200/t	\$ 2,100/t	\$ 1,775/t	\$ 1,800/t	\$ 1,800/t	\$ 1,800/t	\$ 1,800/t
Rutile	\$ 638/t	\$ 850/t	\$ 900/t	\$ 900/t	\$ 900/t	\$ 900/t	\$ 900/t	\$ 900/t	\$ 900/t
Hi-Ti	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t	\$ 200/t
Ilmenite	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t	\$ 115/t

Source : Intersuisse assumptions

For further comparison, Figure 3 shows other mineral sands prices assumed by other brokers.

Figure 3 : Other commodity price assumptions

	2010	2011	2012	2013	2014	2015
Broker A						
Zircon	\$ 906/t	\$ 1,898/t	\$ 2,738/t	\$ 2,800/t	\$ 2,500/t	\$ 2,250/t
Rutile	\$ 560/t	\$ 902/t	\$ 1,350/t	\$ 1,450/t	\$ 1,325/t	\$ 1,200/t
Syn. Rutile	\$ 598/t	\$ 733/t	\$ 1,180/t	\$ 1,280/t	\$ 1,155/t	\$ 1,030/t
Ilmenite	\$ 107/t	\$ 181/t	\$ 190/t	\$ 180/t	\$ 180/t	\$ 180/t
Broker B						
Zircon	\$ 898/t	\$ 1,795/t	\$ 2,250/t	\$ 2,150/t	\$ 1,975/t	\$ 1,800/t
Rutile	\$ 530/t	\$ 1,040/t	\$ 1,350/t	\$ 1,425/t	\$ 1,400/t	\$ 990/t
Syn. Rutile	\$ 420/t	\$ 870/t	\$ 1,134/t	\$ 1,197/t	\$ 1,176/t	\$ 839/t
Ilmenite	\$ 90/t	\$ 104/t	\$ 120/t	\$ 120/t	\$ 120/t	\$ 120/t

Source : Intersuisse

The AUD-USD rate was not included, but we understand that both brokers had much lower AUD-USD projections than those used by Intersuisse.

Other comments

Figure 4 shows the key financial data used in the ITR.

Figure 4 : Key financial data

- Capital investment including predevelopment **\$201.5 million**
- Average annual sales revenue **\$187 million**
- Average annual cash operating costs **\$69 million**
- Average annual sustaining capital cost **\$2 million**
- Average annual tax payable **\$28 million**
- Average annual net operating cashflow after tax **\$88 million**

Source : DRX ASX Announcement, 21 June 2011, at p. 23

For comparison, Figure 5 shows the derived values used in Intersuisse's valuation. It shows that Intersuisse has much lower revenue, and slightly lower costs, but much lower after tax cashflows.

Figure 5 : Intersuisse's key financial outcomes

Cyclone, 100% basis	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	\$A 0.0 m	\$A 0.0 m	\$A 100.6 m	\$A 161.8 m	\$A 161.8 m	\$A 161.8 m	\$A 161.8 m	\$A 161.8 m	\$A 161.8 m	\$A 161.8 m
Cash Costs	\$A 0.0 m	\$A 0.0 m	\$A 40.2 m	\$A 54.9 m	\$A 58.3 m	\$A 62.2 m	\$A 64.6 m	\$A 62.2 m	\$A 61.0 m	\$A 62.2 m
Dep'n & Amort'n	\$A 0.0 m	\$A 0.0 m	\$A 10.6 m	\$A 16.1 m	\$A 16.6 m	\$A 16.6 m	\$A 16.6 m	\$A 16.6 m	\$A 16.6 m	\$A 16.6 m
E B I T	\$A 0.0 m	\$A 0.0 m	\$A 49.8 m	\$A 90.8 m	\$A 86.9 m	\$A 83.1 m	\$A 80.7 m	\$A 83.0 m	\$A 84.3 m	\$A 83.0 m
Interest charge	\$A 0.0 m	\$A 0.0 m	\$A 6.6 m	\$A 7.8 m	\$A 6.7 m	\$A 5.5 m	\$A 4.1 m	\$A 2.7 m	\$A 1.1 m	\$A 0.0 m
Taxes	\$A 0.0 m	\$A 0.0 m	\$A 12.5 m	\$A 24.1 m	\$A 23.3 m	\$A 22.5 m	\$A 22.2 m	\$A 23.3 m	\$A 24.1 m	\$A 24.1 m
N P A T	\$A 0.0 m	\$A 0.0 m	\$A 30.7 m	\$A 58.9 m	\$A 57.0 m	\$A 55.1 m	\$A 54.3 m	\$A 57.0 m	\$A 59.0 m	\$A 58.9 m
B F S costs	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m
Project Cap. Ex	\$A 56.4 m	\$A 131.6 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m	\$A 0.0 m
Sus. Cap. Ex	\$A 0.0 m	\$A 0.0 m	\$A 1.0 m	\$A 1.4 m	\$A 1.4 m	\$A 1.5 m	\$A 1.5 m	\$A 1.5 m	\$A 1.5 m	\$A 1.5 m

Source : Intersuisse assumptions

Intersuisse also notes that the ITR has a full year of production in 2014, while Intersuisse assumes first product in 2015 and full production in 2016. Intersuisse believes that our assumptions are conservative and we expect that DRX will be able to do better

Using the valuation of \$300m by the ITR, gives a value of 51c per DRX share.

Valuation

Figure 6 shows how Intersuisse has derived a valuation of 51c a DRX share from the \$300m project value for Cyclone. Intersuisse has assumed

- Project finance provides 50% of the total capital funding required for the project;
 - \$101m is required in equity
- BaoTi pays 75% of the NPV for its 50% share of the project, paying \$113m ;
- BaoTi invests in DRX equity, at 12.5c a DRX share, to get 19.9% equity interest in DRX
 - Injecting \$10.5m into DRX

Figure 6 : ITR gives 51c a DRX share

Indicative value for DRX	
Cap. Ex	\$A 202 m
Debt	50%
Equity needed	\$A 101 m
BaoTi share	50%
DRX Equity	\$A 50 m
NPV	\$A 300 m
	75%
BaoTi in DRX	\$A 113 m
Shares	354.60 m
	19.9%
	84.61 m
DRX Raising	(\$A73 m)
Value per DRX share	50.7 c

Source : ITR, Intersuisse

Hence, BaoTi has injected \$123m into DRX, of which DRX needs to pay out \$50m for its equity stake in the Cyclone project, leaving \$73m in cash.

DRX will then have nearly 440m share on issue, over \$73m in cash plus \$150m in project value, giving 51c a share.

Intersuisse affirms our BUY recommendation on DRX.

Conclusion

We are not changing our base case valuation, of 30c per DRX share, at this time.

Intersuisse assumes that the revised ITR is part of the negotiation process with BaoTi.

Intersuisse expects that DRX will not require any further equity, and will have a significant amount of cash.

Intersuisse affirms our BUY recommendation on DRX.

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