

Cyclone : Resources Upgraded

Reserves to follow; DFS mid 2015;
Significant upside potential to our valuation

Recommendation

BUY, High Risk

Price

1.0c

Valuation

7.5c

- DRX announced an updated resources estimate, of 1,273kt of contained zircon, 84% of which is in the measured category, within 211Mt of Resources.
- The revised resource includes Cyclone Extended, acquired from Image Resources (IMA.ASX) in March 2015.
- The value of contained Valuable Heavy Minerals per tonne of resource is 16% higher than the previous estimate.
- DRX expect to publish the results of their DFS in Q3.
- Our valuation is higher due to the lower AUD. We see many sources of further upside to our valuation.

Snapshot

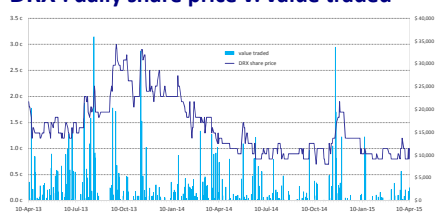
Market Cap	\$7.7m
Cash on hand (est 30 March 2014)	\$0.3m
Shares on Issue	768.1m
52 Week High	1.9c
52 Week Low	0.7c
1 month / 6 month VWAP	0.90c / 1.14c

Resource upgraded

On 9 April, DRX announced a revised resource estimate, integrating the former Image Resources' (IMA.ASX) Cyclone Extended deposit with DRX's Cyclone deposit. While the total resource volume fell by 5%, from 223Mt to 211Mt :

- There is now 156Mt in Measured, compared with 118Mt previously, with Inferred falling from 9Mt to 0;
- Contained zircon and higher grades of TiO₂ has increased, so the value per tonne of ore is now 16% higher \$22.8/t.

DRX : daily share price v. value traded



In March 2012, DRX announced the results of its Pre-Feasibility Study on the Cyclone mineral sands deposit, with a pay-back period of 2.1 years.

While DRX had announced, in August 2010, an MOU with the largest end user of zircon in China, there were 4 key assurances required, and 3 have now been delivered, with the final, environmental clearance for an access road, now in train.

DRX is now re-engaging with potential off-take partners and financiers.

A formal commitment to project construction can be expected late in 2015, with first product in early 2017.

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DFS in about 3 months; Expect higher value

The DFS has been delayed due to environmental approvals for the haul road. DRX is reviewing the capital and operating costs in the PFS and Beer & Co expect that the cap.ex of \$146m should be reduced, as should the annual op.ex of \$80m.

Product market is now positive

At the Mineral Sands conference in March, delegates were confident that the zircon market is improving while the market for titaniferous feedstocks is looking better. This affirms our commodity price expectations.

DRX has had positive discussions with potential off-takers, which will become serious after the DFS has been completed.

Beer & Co risked valuation now 7.5c/share

While the updated resource estimate is higher grade than the previous estimate, we are not changing our mining inventory at this time. We have changed our Long-Run AUD-USD rate from 0.85 to 0.75.

Beer & Co conclusions

There is significant upside potential to our valuation from higher grades, lower capital and operating cost as well as at Tick Hill and Cape Bedford.

We affirm our BUY, High Risk recommendation.

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DRX : Resource Upgraded

Upgraded Resource

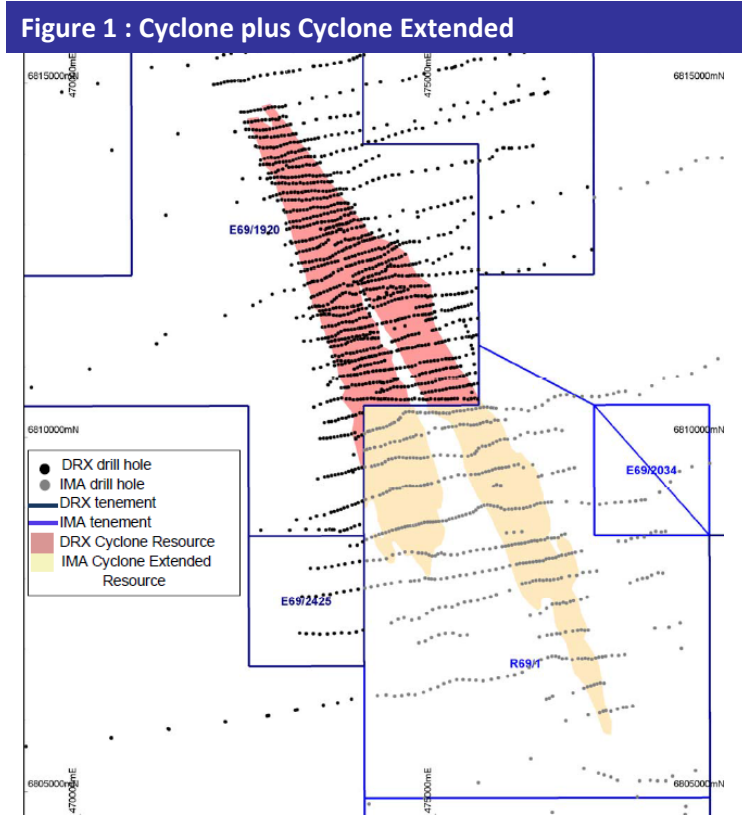
On 24 March 2015, DRX announced the completion of the acquisition of the Cyclone Extended leases, which was first announced on 11 November 2014. Figure 1 shows how Cyclone Extended integrates with Cyclone as an extension of the mineralised body.

DRX has announced a revised Resource estimate, incorporating Cyclone Extended in with Cyclone.

Compared with the previous estimate, the updated resource estimate is

- smaller in terms of overall tonnes of mineralisation, but
- larger in terms of contained valuable heavy minerals.

Most of the revised resource estimate is now in the Measured category



Source : DRX ASX announcement, 11 November 2014

Figure 2 shows the Resource estimate for Cyclone plus Cyclone Extended at the time the acquisition was announced.

Figure 2 : Previous Resource estimate, Cyclone plus Cyclone Extended

	1% cut-off	H M	slimes	over-size	Zircon	Rutile	85% - 95%	70%- 85%	<70%	SiTiOx
Measured	118 Mt	2.3 %	4.1 %	5.4 %	0.71 %	0.07 %	0.15 %	0.49 %	0.24 %	0.51 %
Indicated	96 Mt	1.9 %	5.5 %	5.4 %	0.41 %	0.01 %	0.17 %	0.10 %	0.61 %	0.05 %
Inferred	9 Mt	1.2 %	2.3 %	5.0 %	0.26 %	0.00 %	0.06 %	0.00 %	0.50 %	0.00 %
TOTAL	223 Mt	2.1 %	4.7 %	5.4 %	0.56 %	0.04 %	0.15 %	0.30 %	0.41 %	0.29 %

Source : DRX ASX announcement, 11 November 2014

On 9 April 2015, DRX announced a revised resource estimate for the combined resource, as shown in Figure 3.

The data in Figure 2 was based on addition of 2 separate resource estimates, while Figure 3 uses an integrated database with no buffers or offsets for tenement boundaries.

Comparing Figure 2 with Figure 3 shows that, in the current estimate, 74% of the resource is in the measured category, compared with 53% in the earlier estimate.

Figure 3 : Current Resource estimate, Cyclone

	1% cut-off	H M	slimes	over-size	Zircon	70% - 95%	<70%	SiTiOx
Measured	156 Mt	2.4 %	4.2 %	5.1 %	0.69 %	0.77 %	0.32 %	0.53 %
Indicated	55 Mt	1.8 %	4.1 %	4.5 %	0.36 %	0.61 %	0.37 %	0.31 %
TOTAL	211 Mt	2.2 %	4.2 %	4.9 %	0.60 %	0.73 %	0.33 %	0.47 %

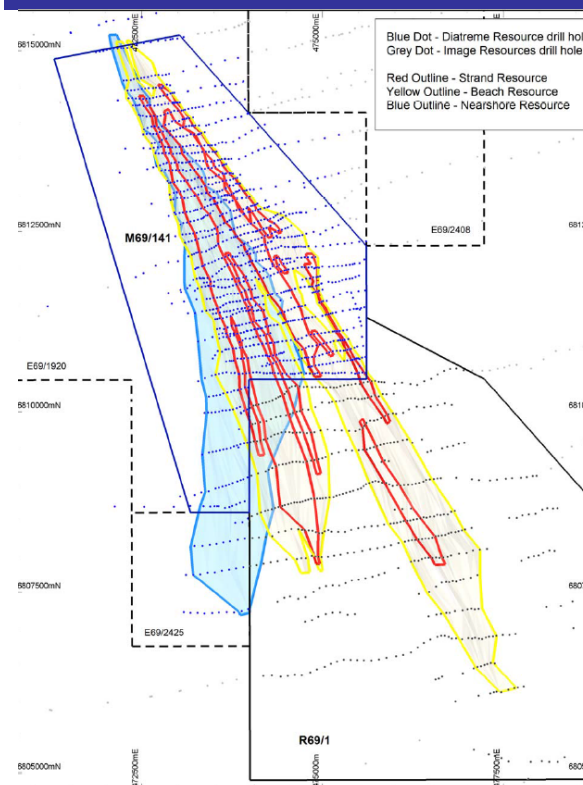
Source : DRX ASX announcement, 9 April 2015

Analysis

Figure 4 shows the outline of the resources.

Using a 1% cut-off grade, the value of contained minerals has increased by 14% - 16% per tonne of mineralisation

Figure 4 : Resource outline



Source : DRX ASX announcement, 9 April 2015

Figure 5 compares the previous and the current resource estimates. It shows :

- The total resource estimate is 5.4% smaller, at 211Mt v. 223Mt, but the current resource estimate contains more of the higher value products;
- The current resource is valued at \$A 23/t, using Beer & Co's Long-run commodity price estimates, 16% higher than the previous estimate.

Figure 5 : Comparison, previous and current resource estimates

	Measured + Indicated					TOTAL				
	Resources	Contained Minerals			Value	Resources	Contained Minerals			Value
		Zircon	Hi Ti 87	Hi Ti67	AUD /t		Zircon	Hi Ti 87	Hi Ti67	AUD /t
Previous	214 Mt	1,237 kt	1,103 kt	865 kt	\$A 20.1/t	223 Mt	1,260 kt	1,109 kt	909 kt	\$A 19.6/t
Revised	211 Mt	1,273 kt	1,539 kt	704 kt	\$A 22.8/t	211 Mt	1,273 kt	1,539 kt	704 kt	\$A 22.8/t
change	(1.4%)	2.9 %	39.5 %	(18.6%)	13.5 %	(5.4%)	1.0 %	38.8 %	(22.6%)	16.1 %

Source : DRX ASX announcements, 11 November 2014 and 9 April 2014, Beer & Co

Cyclone project- Next Steps

DFS

DRX published the results of its PFS in March 2012.

Since then, DRX has :

DFS being progressed

- Secured water supply, by locating adequate aquifers within its tenement areas, in November 2013;
- Signed a Native Title Agreement with the Traditional Owners, which was announced on 17 November 2014;
- Been awarded a Mining Licence, which was announced on 24 November 2014.

Permitting is taking longer than expected, and it is now expected to be completed during the September quarter

The updated Resource estimate was prepared as a precursor to an updated Reserves estimate.

DRX is currently reviewing the capital and operating cost estimates.

DRX is on track to publish a Definitive Feasibility Study in about July 2015.

Permitting

DRX applied for approval for a transport corridor for the mine to the rail line at Forrest. DRX has been requested for more data and to modify the proposed design to achieve more benign outcomes from potential run-off.

The process, through a Public Environmental Review, is the one factor that is not entirely within the control of DRX.

It is hoped that this will be concluded during the third quarter.

There is significant idle MSP capacity in China and DRX will seek to sell a Heavy Mineral Concentrate.

Financing

The project concept is to produce a Heavy Minerals Concentrate (HMC), grading about 98% Valuable Heavy Minerals (VHM) through a wet plant on site and for this to be separated into its various products (zircon, and various grades of titaniferous feedstocks) through one (or more) Mineral Separation Plants (MSP) in China.

An MSP is expensive to construct and its operation is highly energy intensive.

There is significant spare MSP capacity in China at present, so it makes economic sense to use this capacity rather than spend scarce capital adding to present over-capacity.

DRX has had discussions with both MSP operators and end product users on investment in the Cyclone project to assist in its capital development.

These discussions can only be finalised after DRX has published its DFS results.

DRX : Revised Valuation

Capital and Operating Costs

As part of the DFS, capital and operating costs are being reviewed.

DRX advised capital costs of \$A 146m and annual operating costs of \$A 80m in its PFS in March 2012.

These estimates are now being reviewed.

In Beer & Co's view, there is good potential for both of these costs to come down due to :

- Value engineering studies being undertaken, reviewing all costs anew;
- Lower prices for steel and oil; and
- General softness in industry conditions leading to lower prices.

Beer & Co expects that the revised costs will be lower than the current estimates

Mining Inventory

Figure 5 showed that comparing the previous resource estimate with the updated resource estimate, shows that the most recent estimate has higher grades.

Figure 6 shows the mining inventory that was used in Beer & Co's original valuation of DRX. Figure 7 shows the reserve reported by DRX in February 2012, based solely on the Cyclone deposit, which is the northern block in Figure 4.

Figure 6 : Mining Inventory for Cyclone, assumed by Beer & Co.

	H M	Zircon	Rutile	HiTi 87	HiTi 77	HiTi 67	H M Waste : Ore	Zircon	Rutile	HiTi 87	HiTi 77	HiTi 67	Waste		
Tranche 1	40 Mt	2.6 %	0.85 %	0.09 %	0.17 %	0.55 %	0.25 %	1,040 kt	1.2 : 1	340 kt	36 kt	68 kt	220 kt	100 kt	48 Mt
Tranche 2	50 Mt	2.3 %	0.75 %	0.07 %	0.14 %	0.50 %	0.20 %	1,150 kt	1.0 : 1	375 kt	35 kt	70 kt	250 kt	100 kt	51 Mt
Tranche 3	30 Mt	2.1 %	0.65 %	0.05 %	0.10 %	0.45 %	0.15 %	630 kt	1.1 : 1	195 kt	15 kt	30 kt	135 kt	45 kt	33 Mt
TOTAL	120 Mt	2.4 %	0.76 %	0.07 %	0.14 %	0.50 %	0.20 %	2,820 kt	1.10 : 1	910 kt	86 kt	168 kt	605 kt	245 kt	132 Mt

Source : Beer & Co estimates.

Figure 7 : Reserve estimate, Cyclone deposit, February 2012

	Reserves	HM	Slimes	over-size	Zircon	Rutile	Leucoxene	HiTi	Alt. Ilm	Si-TiOx	Zircon	Rutile	HiTi + Ilm.
Probable	97 Mt	2.5 %	4.0 %	5.1 %	0.79 %	0.08 %	0.17 %	0.52 %	0.26 %	0.56 %	770 kt	78 kt	922 kt

Source : DRX ASX announcement, 7 February 2012

The revised Resource estimate has higher grades than we have used in our valuation

Comparing Figure 6 with Figure 7 shows that the mining inventory assumed by Beer & Co in our analysis

- Is based heavily on the reserve estimate reported by DRX, but allows for a greater volume of material, at a lower grade, for incorporation of the Cyclone Extended deposit; and
- Explicitly assumes that higher grade material is mined in the early phase with lower grade material towards the end.

The updated resources estimate shown in Figure 4 is based on a cut-off grade of 1.0% Heavy Minerals. Figure 8 shows the Resource estimate using a cut-off grade of 1.5%.

Note that the volume is very close to the mining inventory assumed by Beer & Co in our original analysis, but the grades, especially for the better grades of titaniferous feedstocks, is higher in the updated Resources estimate.

Figure 8 : Resources estimate, expanded Cyclone deposit, 1.5% Heavy Minerals cut-off grade.

	1.5% cut-off	H M	slimes	over-size	Resource grades				Contained Minerals			
					Zircon	70% - 95%	<70%	SiTiOx	Zircon	70% - 95%	<70%	SiTiOx
Measured	102 Mt	3.1 %	3.9 %	4.4 %	0.87 %	0.96 %	0.40 %	0.67 %	891 kt	982 kt	409 kt	685 kt
Indicated	24 Mt	2.5 %	3.9 %	4.8 %	0.50 %	0.82 %	0.55 %	0.45 %	123 kt	200 kt	134 kt	110 kt
TOTAL	127 Mt	3.0 %	3.9 %	4.5 %	0.80 %	0.93 %	0.43 %	0.63 %	1,013 kt	1,182 kt	543 kt	795 kt

Source : DRX ASX announcement, 9 April 2015

Commodity Prices

Demand for both titaniferous feedstocks and zircon is leveraged to the property cycle, especially in China; the former as a basis for paint and the latter for ceramic products, such as tiles and bathroom/sanitary ware.

Mineral sands prices were weak through 2014, especially in the early part of the year, but demand and prices have improved.

With the weakness in the property cycle in China, both products have seen weak demand through 2014.

Iluka Resources (ILU.ASX) reported recently, with its annual results, that demand had improved and that ILU was re-starting its Synthetic Rutile production to respond to demand, now that it had consumed much of its zircon and titaniferous inventory.

In particular, ILU stated in the April 2015 presentation at the Mineral Sands conference :

- The end of 2014 and the start to 2015 have been encouraging;
- Demand is similar to 2013; but
- There is minimal new supply and Indonesian supply is significantly lower

Upon review, the only commodity price assumption that Beer & Co has changed has been our AUD-USD assumption, which is now 0.750, compared with 0.850 previously.

Figure 9 shows the historical prices reported by ILU, together with the projections by Beer & Co. It shows that we project a modest recovery in prices, given that prices are currently

Figure 9 : Commodity prices, historical v. projected

USD/t	Average price, 12 months to :					Beer & Co projections				
	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014	Dec. 2015	Dec. 2016	Dec. 2017	Dec. 2018	Dec. 2019
Zircon	880	1,886	2,080	1,150	1,033	1,138	1,288	1,438	1,500	1,500
Rutile	550	1,174	2,464	1,069	777	963	1,075	1,175	1,200	1,200
Syn. Rutile	450	878	1,771	1,150	750					
AUD-USD	0.920	1.032	1.036	0.968	0.903	0.750	0.750	0.750	0.750	0.750

Source : ILU ASX announcement, 19 February 2015, Beer & Co estimates

Note that Beer & Co does not project that DRX will either produce rutile nor receive any additional value for the rutile contained in the HMC which it does sell. However, we have assumed that the price DRX receives for its product are related to the rutile price :

- HiTi 87 (ie. average TiO₂ grade of 87%, compared with 94% for rutile) sells for 76% of the rutile price; and
- HiTi67 sells for 35% of the rutile price.

Figure 10 shows the production volumes, prices and resulting revenue projected by Beer & Co. Note that this production is based on the mining inventory shown in Figure 6.

Figure 10 : Projected prices, production volumes and revenue for Cyclone

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
AUD/USD	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750	0.750
Zircon USD /t	1,475	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500
HiTi 87 USD/t	912	912	912	912	912	912	912	912	912	912	912	912	912
HiTi 67 USD/t	420	420	420	420	420	420	420	420	420	420	420	420	420
Final Product Volume													
Zircon	28 kt	70 kt	70 kt	70 kt	67 kt	62 kt	62 kt	62 kt	62 kt	58 kt	54 kt	54 kt	30 kt
HiTi 87	4 kt	11 kt	12 kt	12 kt	11 kt	10 kt	10 kt	10 kt	10 kt	8 kt	7 kt	7 kt	4 kt
HiTi 67	18 kt	48 kt	50 kt	50 kt	47 kt	44 kt	44 kt	44 kt	44 kt	41 kt	38 kt	38 kt	21 kt
Revenue, AUD m	88	224	226	226	214	198	198	198	198	184	168	168	94

Source : Beer & Co estimates.

Beer & Co projects a pay-back period of less than 2 years

Financial Outcomes

Figure 11 shows the EBITDA projected by Beer & Co, based on the revenue shown in Figure 10 and the annual average operating cost estimate advised in the PFS of \$A 80m.

Figure 12 shows the financial outcomes projected by Beer & Co for the Cyclone project.

Figure 11 : Beer & Co's projected EBITDA, Cyclone

AUD m	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Revenue	88	224	226	226	214	198	198	198	198	184	168	168	94
Overburden	10	23	23	23	22	20	20	20	20	21	22	22	12
Ore Mining	7	16	16	16	16	16	16	16	16	16	16	16	9
Mine Planning	2	3	3	3	3	3	3	3	3	3	3	3	2
Wet Concentrator	6	14	14	14	14	14	14	14	14	14	14	14	8
Site Admin & Sales	3	5	5	5	5	5	5	5	5	5	5	5	4
Transport of HMC	9	24	24	24	23	21	21	21	21	20	18	18	10
Sub-Total, Operations	38	85	85	85	82	79	79	79	79	78	77	77	45
MSP Fee	22	55	56	56	53	49	49	50	50	46	42	42	24
Royalties	4	10	10	10	10	9	9	9	9	8	8	8	4
Total Cash Costs	64	150	152	152	145	137	137	137	137	133	127	127	73
E B I T D A	25	74	74	74	68	60	60	60	60	52	41	41	21

Source : Beer & Co estimates.

Figure 12 : Beer & Co's projected financial outcomes, Cyclone

AUD m	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
E B I T D A			25	74	74	74	68	60	60	60	60	52	41	41	21
Dep'n & Amort'n			(6)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(8)
Interest Expense			(6)	(6)	(5)	(3)	(2)	(0)	0	0	0	0	0	0	0
Tax Expense			(4)	(16)	(17)	(17)	(16)	(14)	(14)	(14)	(14)	(11)	(8)	(8)	(4)
N P A T			9	38	39	40	37	32	32	32	32	26	19	19	9
Project Cap. Ex	(4)	(106)	(35)	0	0	0	0	0	0	0	0	0	0	0	0
Sus. Cap. Ex	0	0	(1)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(3)	(1)	0
Net Cashflow to Equity	(4)	(60)	16	37	37	37	32	28	44	44	44	38	30	32	17

Source : Beer & Co estimates.

Valuation of DRX

On 9 January 2014, DRX announced a Heads of Agreement with Perpetual Mining Holdings Limited (PMHL), a Hong Kong based company for PMHL to take a 6% stake in the Cyclone project for \$2m. This implies a value for DRX's remaining 94% stake in Cyclone of \$31m, or more than 4x DRX's current market cap.

Our project NPV, today, is around \$A 135m

Applying a discount rate of 10% to the un-g geared, after-tax project cashflows shown in Figure 12 gives a value of \$A 127m. The NPV of the geared cashflows to equity holders is \$A 142m.

As stated earlier, DRX is seeking to bring a strategic investor into the project, such as an off-take partner or an MSP operator. We understand there is strong interest in doing so.

Beer & Co projects that DRX will raise the equity it needs to develop the Cyclone project by selling a stake in the project at a discount to NPV

As shown in Figure 13, Beer & Co assumes that DRX sells a further 40% stake in the Cyclone project at a discount to NPV. The amount raised is more than enough to fund the equity required by DRX to develop the Cyclone project.

Figure 14 shows that Beer & Co's valuation of DRX assumes a further, small equity raising later in 2015, to complete the DFS and ensure the strategic investor is secured.

Figure 13 : Financing Cyclone

Project Value	Sep. 15	\$ 139m
Project Share sold	40 %	\$ 55m
Value Received	85 %	\$ 47m
Project Capital		\$ 146m
Debt Finance	50 %	(\$73m)
Project Equity Required		\$ 73m
DRX share value received	54%	\$ 39m
further DRX equity required		(\$8m)
DRX Working Capital		\$ 4m
DRX Equity to raise		\$ 0m

Source : Beer & Co estimates.

Figure 14 : Risked valuation of DRX is 7.5c/share

discount rate =	12.0 %	31-Dec-14		13-Apr-15	
		risk :	100%	Product	per share
Cyclone	65 %	\$ 67m	\$ 43m	4.3 c	4.5 c
franking credits	40 %	\$ 25m	\$ 10m	1.0 c	1.0 c
Cape Bedford	nom	\$ 2m	\$ 2m	0.2 c	0.2 c
Tick Hill	nom	\$ 2m	\$ 2m	0.2 c	0.2 c
Corporate	100 %	(\$23m)	(\$23m)	(2.3c)	(2.3c)
Asset Sales	80 %	\$ 42m	\$ 34m	3.3 c	2.4 c
Cash	100 %	\$ 0m	\$ 0m	0.0 c	1.3 c
Cash to be raised	80 %	\$ 4m	\$ 3m	0.3 c	0.3 c
TOTAL		\$ 119m	\$ 72m	7.1 c	7.5 c
Shares on issue		726.4m	FPO shares	57.7m	options
		241m	issued 2015	48.6m	ex'd
		0m	Issued 2016		

Source : Beer & Co estimates.

Beer & Co's risked base case valuation is 7.5c/share, after allowing for a future equity raising

DRX : Conclusions

Valuation

Figure 14 shows that Beer & Co’s risked valuation is now 7.5c/share.

In our view, there is significant upside potential to our valuation, from :

While Beer & Co’s valuation is a significant multiple of the current share price, we believe there is significant further upside potential from :

- Further de-risking
- Successful project delivery;
- Higher grades in the mining inventory;
- Lower capital and operating costs.

- Progressive de-risking of the Cyclone project, as DRX announces
 - Final permit approvals received;
 - A revised estimate of Ore Reserves; and
 - The results of the DFS;
- Higher VHM grades in the Reserves than we have used in this analysis, as
 - Figure 5 showed the in-ground value of the mineralisation in the updated resources estimate is 14% - 16% higher than in the previous resources estimate
 - The value of the contained mineralisation for the resource estimate using a 1.5% cut-off grade is 24% higher than the value used in our analysis;
- There is downside potential in the capital cost estimate, due to industry slack as well as lower oil and steel prices;
- There is downside potential in the operating cost estimate, due to industry slack as well as lower oil and steel prices; and
- Developments in it other projects, especially Tick Hill and Cape Bedford.

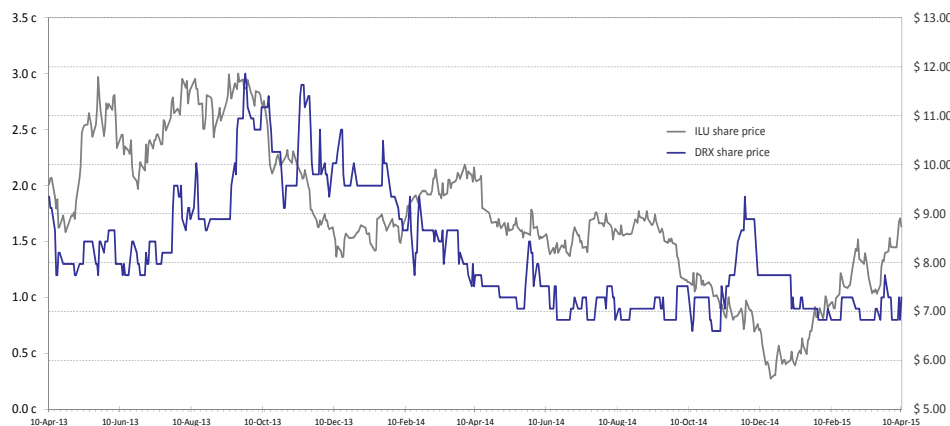
Beer & Co affirms our BUY, High Risk, rating

We expect that the biggest impact on the share price will come at the end of this year, or early 2016, when DRX announces a strategic investor.

Conclusions

The DRX share price has been effectively flat over the last 12 months, despite significant progress, as shown in Figure 15, which shows that the ILU share price has rallied with the improvements in the minerals sands markets.

Figure 15 : DRX share price v. ILU share price



Source : IRESS, Beer & Co

Beer & Co affirms our BUY, High Risk recommendation on DRX

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The analyst responsible for this research report certifies that all of the views expressed reflect his personal views about the securities and the issuer.

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