18th December 2012

ASX Code: DLE

Speculative Buy

Six month target 20 cents

Capital Structure

Sector	Materials
Share Price (A$)	0.15
Fully Paid Ordinary Shares (m)	206.4
Opt (ex 35c, exp 30/11/14) (m)	47.4
Market Cap (undil) (A$m)	30.9
Share Price Year H-L (A$)	0.25-0.08
Approx Cash (A$m)	5.4

Directors

Jie Chen	Chairman
Gang Xu	Managing Director
Tim Williams	COO & Exec Director
Anthony Ho	Company Secretary

Major Shareholders

Shandong Taishan Sun. Gp. Co. Ltd	70.3%
Gang Xu	6.7%

Analyst

GT Le Page	+61 8 9488 0800

Share Price Performance

Update

Dragon Energy Limited

Consolidation of DSO iron ore resources, JORC Resources confirms potential of Scoping Study

JORC Resources a Rocklea, Nameless...Rocklea Acquisition

- **Dragon Energy Limited** ("**Dragon**" or the Company") remains on track with our projections following on from our "Initiating Coverage" earlier this year (**RM Research**, 4//2/2012) with total resources now standing at 263.6Mt @ 52.6% Fe (58.8% CaFe3). The Rocklea resource came in at 93.59Mt @ 52.19% Fe (59.16% caFe), the majority of which lies in the Indicated category. JORC resources were further bolstered with the acquisition (July 2012) of **Murchison Metals'** Rocklea Iron Project which represents the southern extension of **Dragon's** Rocklea deposit and contains JORC Resources of 89Mt @ 53.2%Fe (59.9% caFe).
- At the Nameless Project a maiden resource (CSA Global Pty Ltd incorporating 2012 drill results) returned 81Mt @ 52.39% Fe (57.08% caFe). **RM Research** believes there is potential resource upside at both Nameless, where the deposit is open to the west, as well as the newly acquired Murchison Rocklea tenements.

Mining Studies – Infrastructure options on track

- Negotiations are continuing with various native title claimants in respect to Mining Lease applications at Rocklea and Nameless. Environmental surveys and Hydrology studies have commenced and a mine waste study was completed at Rocklea. A metallurgical drill program is also in the design phase. Studies and commercial negotiations are continuing on transport and port options.
- Marketing activities are also progressing with a view to acceptance of **Dragon** fines as a sinter feed.

Scoping Study

- Case 1 from the January 2012 Scoping Study showed a positive NPV of A$344 million, IRR of 31%, OPEX (FOB) of A$45.8/tonne and a CAPEX of A$110 million based on 2Mtpa throughput. Case 1 assumed trucking to a West Pilbara Port. At present, **Dragon's** indicated JORC Resources stand at **93.9Mt @ 52.5% Fe (59.4% caFe)**. The Study assumed an FOB iron ore price received of approximately A$120/tonne.
- **RM Research** considers one of the key drivers to Case 1 is port access which is yet to be demonstrated. We believe however that **Dragon** will direct more effort in the near term to increasing JORC Resources to allow an expanded production scenario in the range of +10Mtpa which should provide the Company with more negotiating leverage in respect to infrastructure options.

Impact

- We believe current JORC Resources are now sufficient to justify a stand-alone operation at 2-5Mtpa with a mine life of 20+ years. The Company is still targeting first production in 3Q 2014.

Action and Recommendation

- **RM Research** maintains a Speculative Buy with a six month price target of 20 cents based on peer valuations with the nearest comparable company **Flinders Mines Limited** (market capitalisation A$120 million, Enterprise Value 13 cents per tonne JORC iron ore resources) compared to **Dragon** at an EV of 9 cents. Look for resource upgrades at Rocklea/Nameless over CY 2013.

Iron ore prices have recovered from recent 31 month lows of US$88 per tonne

The Company is targeting production in 2Q 2014

INVESTMENT CASE

RESOURCE UPSIDE: **RM Research** believes that Rocklea and Nameless have further resource upside to +400Mt from the current JORC Inferred Resource of 263Mt @ 52.6% Fe. Consolidation of **Dragon** and **Murchison's** Rocklea Iron Ore Project to improve project economics with combined JORC Resources at Rocklea now standing at **182.6Mt @ 52.7% Fe (59.5% caFe)**. The permitting and application process at the Pilbara Iron Ore Project ("PIP") is well underway. Shallow resources should provide for a low strip ratio/low cost open cut operation.

MEDIUM TERM IRON ORE OUTLOOK IMPROVING: Iron ore prices have rebounded to US$122 from recent lows of US$88/tonne for 61% Fe. This compares to highs of near US$200/tonne in 2011.

NEAR TERM PRODUCTION POTENTIAL: The Company is targeting first production (subject to resolving Port access) in 3Q 2014. **RM Research** are projecting that production would commence at an annualised rate of 2-4Mtpa once a suitable port facility is available.

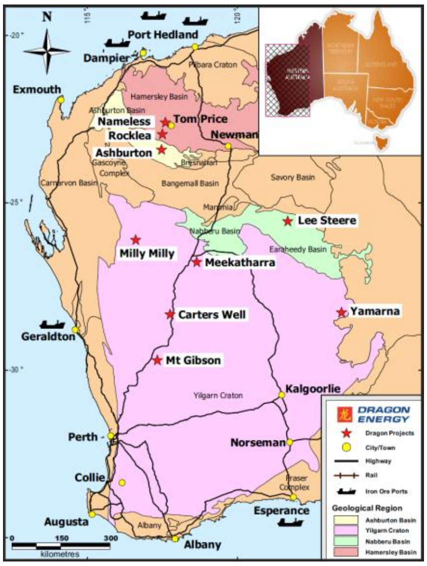
SCOPING STUDY - ATTRACTIVE FINANCIAL METRICS: Case 1 @ 2Mtpa returned an NPV of A$344 million and an Internal Rate of Return of 31%. Case 2 @ 10Mtpa returned an NPV of A$2,490 million and an Internal Rate of Return of 64% however existing JORC Resources are insufficient to support Case 2 at this stage. These metrics are competitive with industry peers and are based on FOB iron ore price of around US$120/tonne.

TIGHT SHARE REGISTER: Shandong Taishan Sunlight Group Company Limited ("**Shandong Group**") holds approximately 70% of the Shares with the top 20 holding 84%. **RM Research** believes that positive news relating to further mining studies, together with recovering sentiment towards iron ore companies are likely to be reflected in the share price of **Dragon**.

EXPERIENCED MANAGEMENT: The board of **Dragon** packs some heavy hitting mining executives including former **Shandong Group** Chairman Mr Chen with nearly 30 years operational and management experience and current MD Mr Gang Xu, a geologist with over 20 years including 9 years as a senior uranium exploration geologist with the **China National Nuclear Corporation**. COO Tim Williams (fluent Mandarin) has also had extensive experience with Chinese investment in the Australian iron ore sector.

COMPANY BACKGROUND

FIGURE 1: **Dragon Energy** Western Australian exploration portfolio (*source*: **Dragon Energy** September Quarterly Report, ASX Announcement 25/10/2012).



Dragon listed on ASX in February 2009 underpinned by privately owned Chinese cornerstone investor **Shandong Group**. This group controls 1.5 billion tonnes of coal and 100 Mt of iron ore resources in China. The **Shandong Group** is also involved in steel and power generation and is an active participant in the Chinese resources sector. The main focus of the Company is the Pilbara Iron Ore Project which comprises the Rocklea and Nameless Projects situated in the Pilbara region of Western Australia. These projects, covering around 464km^2, consist of channel iron deposits ("CID") with significant exploration upside from the current JORC Resource of 263.6Mt @ 52.6% Fe. A Scoping Study was recently completed and mining studies are currently underway with a view to commencing production in 3Q 2014. The balance of the exploration portfolio in Western Australia consists of iron, manganese, gold, base metals and uranium projects.

RESOURCES AND RESERVES

TABLE 1: JORC Resources and Reserves – Rocklea and Nameless deposits (*source*: **Dragon Energy**, September Quarterly Report 25/10/2012).

Category	50% Cut off	Mt	Fe (%)	caFe (%)	SiO_2 (%)	Al_2O_3 (%)	P (%)	LOI (%)
ROCKLEA								
Main	Indicated	78.94	52.37	59.31	8.48	3.27	0.03	11.71
Main	Inferred	9.44	51.4	58.49	8.69	3.58	0.03	12.13
North Pod	Inferred	5.22	50.97	58.11	8	4.62	0.034	12.28
Sub-Total		93.59	52.19	59.16	8.48	3.37	0.03	11.78
MURCHISON ROCKLEA								
	Indicated	15.00	53.2	60.0	7.7	4.0	0.040	11.4
	Inferred	74.00	53.2	59.9	8.3	3.4	0.030	11.2
Sub-Total		89.00	53.2	59.9	8.2	3.5	0.032	11.2
TOTALS		182.59	52.7	59.5	8.3	3.4	0.031	11.5
NAMELESS								
TOTALS	Inferred	81	52.39	57.08	7.55	5.69	0.051	8.21
TOTAL		263.59	52.60	58.76	8.07	4.10	0.04	10.49

JORC Resources were further bolstered mid-year with the acquisition of Murchison Metals' Rocklea Iron Ore Project earlier in the year

Resource estimations published mid-year at Rocklea came in ahead of expectations with a significant boost from the acquisition of the Rocklea Iron Ore Project (89Mt @ 53.2% Fe) for A$3.20 million (**Dragon**, ASX Announcement, 10/7/2012) from **Murchison Metals Ltd** (ASX: **MMX**) situated to the south of **Dragon's** tenements giving a combined 182.6Mt @ 52.7% Fe at Rocklea. The footprint at Rocklea has increased from 35 km^2 to 360 km^2 offering the Company additional iron ore exploration potential.

The maiden JORC Inferred estimate at Nameless came in around our expectations with further upside along a 2.5 kilometre palaeo-channel remaining to be drill tested. Reconnaissance exploration has returned rock chip assays up to 60.4% Fe. Applying the lower 45% Fe cut-off grade, JORC Inferred resources for Nameless came in at **159.0Mt @ 49.43% Fe (53.85% caFe).** Exploration targets remain for Nameless, which is open to the west. However, we consider there are adequate resources to commence mining so the focus is likely to switch to development.

The resources were compiled by Golder Associates using the recent drilling data from the 2011-2012 campaign.

Both Rocklea and Nameless host near surface CID style mineralisation formed in meandering river channels. As bedded iron deposits were eroded by weathering, iron particles were concentrated in river channels. These particles were rimmed with goethite deposited by iron-enriched ground water around 15-30 million years ago which fused the particles together. These deposits occur as low flat-topped mesas as well as being concealed under cover.

Their chief characteristic is their pisolitic 'texture': rounded hematitic 'pea-stones', 0.1mm to 5mm in diameter, rimmed and cemented by a goethitic matrix. The ore is brown-yellow in colour. They typically contain minor amounts of clay in discrete lenses.

EXPLORATION OVERVIEW

Pilbara Iron Ore Projects

Background

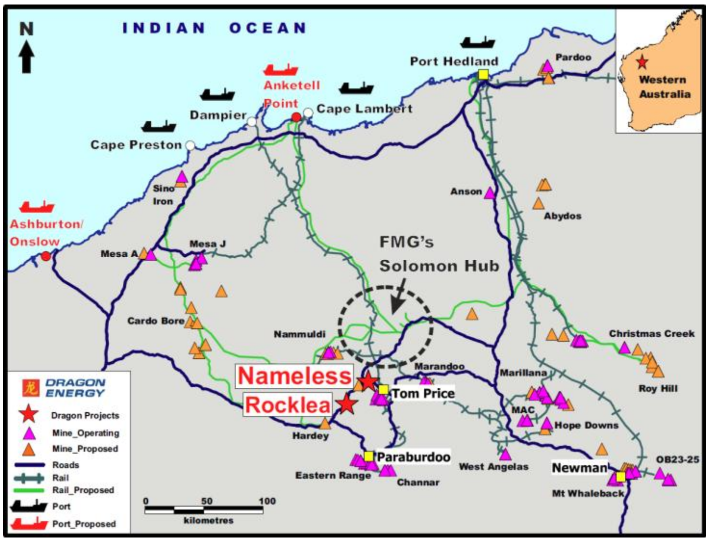


FIGURE 4: **Dragon Energy's** Pilbara Iron Ore Projects and potential infrastructure options (rail) (*source*: **Dragon Energy** ASX Announcement 4/9/2012).

The Nameless and Rocklea Projects (Figure 4) were purchased in October 2010 (in staged payments) from **AusQuest Limited** (ASX: **AQD**). More recently the Rocklea Iron Ore Project (89Mt @ 53.2 Fe) was acquired from **MMX** (as discussed earlier). These acquisitions have presented the Company with an opportunity to rapidly develop iron projects that are proximal to infrastructure and not necessarily reliant on third party rail access for the commencement of operations.

As Figure 4 set out, there are a number of port options including Anketell, Port Hedland and Cape Preston that may be suitable for the PIP. **Dragon** would also have the option of utilising third party infrastructure (e.g. **FMG**) or perhaps selling ore at the mine gate.

Rocklea Project (M47/1471, P47/1429, E47, 1153, E47/1024, E47/952)

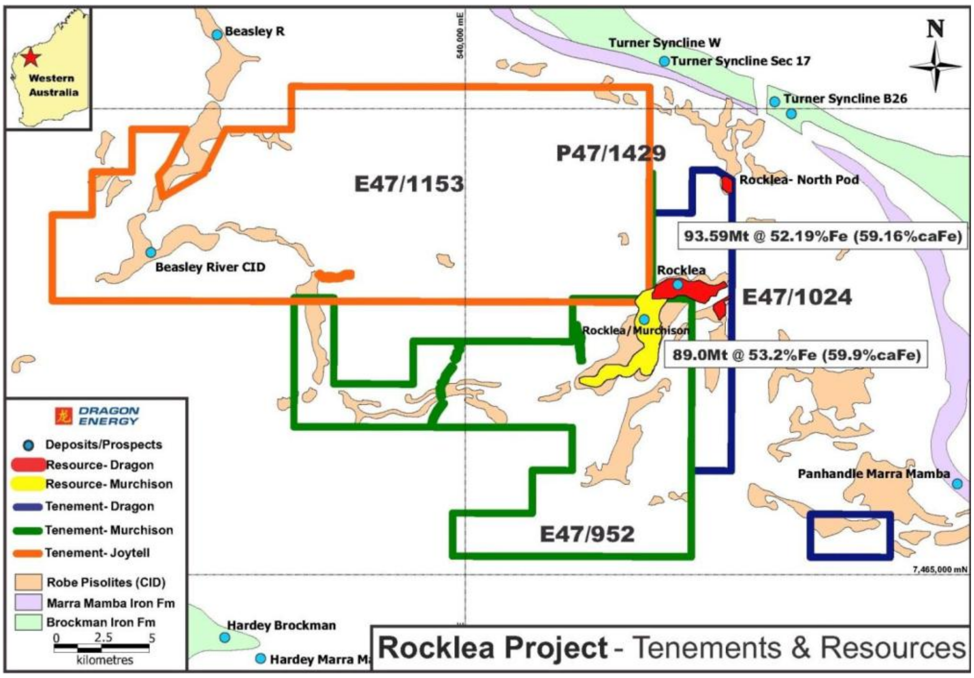


FIGURE 5: **Dragon Energy's** Rocklea Project showing JORC Resources and the adjacent Rocklea Project recently purchased from **Murchison Metals** (*source*: **Dragon Energy** ASX Announcement 4/9/2012).

Location and Access

Rocklea is situated approximately 33 kilometres southwest of Tom Price (Figure 4). The project is situated on the eastern margin of the Rocklea dome where Archaean age Fortescue Group Formations dip to the east and are overlain by Tertiary age CID and other Cainozoic deposits. Iron mineralisation consists of goethitic and hematitic detrital deposits of the Tertiary Robe Pisolites. The purchase of E47/952I and P47/1429-I from Murchison earlier this year also included iron ore rights over E47/1153I (Figure 5) adjacent to **Rio Tinto's** ("**Rio**") Beasley River Limonites Deposit which contains JORC Resources of approximately 400Mt. The acquisition brings total CID JORC Resources at Rocklea to 182.6Mt @ 52.7% Fe (59.5% CaFe).

Rocklea Iron Ore project acquisition from Murchison also came with E47/1153 I which lies adjacent to RIO's Beasley River Limonites Deposit

Previous Exploration

The presence of CID in the region was first identified by **RIO** subsidiary Hamersley Exploration Pty Ltd in the 1970's and from 2005-2009 drilling by **AQD** was successful in outlining JORC Inferred Resources of 62.7Mt @ 53.41% Fe (60.39% caFe). Further exploration upside for CID was later identified by **Dragon** with the identification of outcropping mineralisation and subsequent drilling in the north-eastern portion of the tenement was successful in expanding resources over FY 2012.

The 2012 drill program added 30Mt of JORC Resources and upgraded much of the JORC Resources to the Indicated Category

Recent Exploration Results

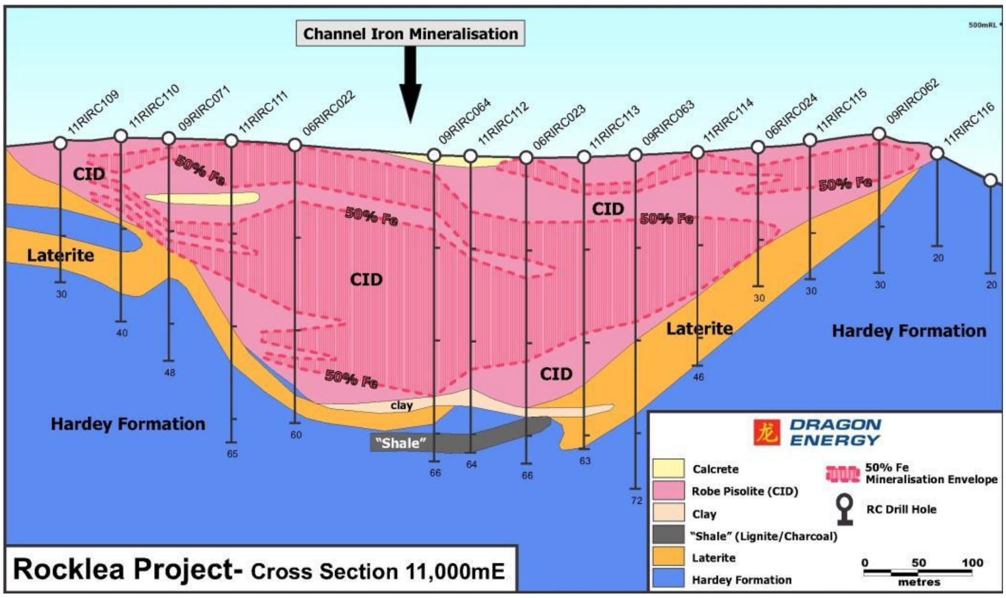


FIGURE 6: Cross section at 11,000mE at **Dragon Energy's** Rocklea Project (*source*: **Dragon Energy** ASX Announcement 4/9/2012).

A 200 hole infill and step out drilling program on a 200 metre x 50 metre grid in the NE area of the tenement was completed in 1Q 2012 and was successful in a significant increases in JORC Resources (*see* **Resources and Reserves**) and upgrading much of the Inferred Resources to the Indicated category. A representative cross section is shown in Figure 6 and highlights the excellent continuity of CID mineralisation between drill holes. The simple geometry, shallow deposit and good continuity should contribute to low strip ratios and relatively low mining costs.

Proposed Exploration

The recently acquired E47/1153 is likely to be the focus of follow up target identification and exploration in 1H 2013.

Nameless Project (M47/1452, E47/1485, E47/2456–2458)

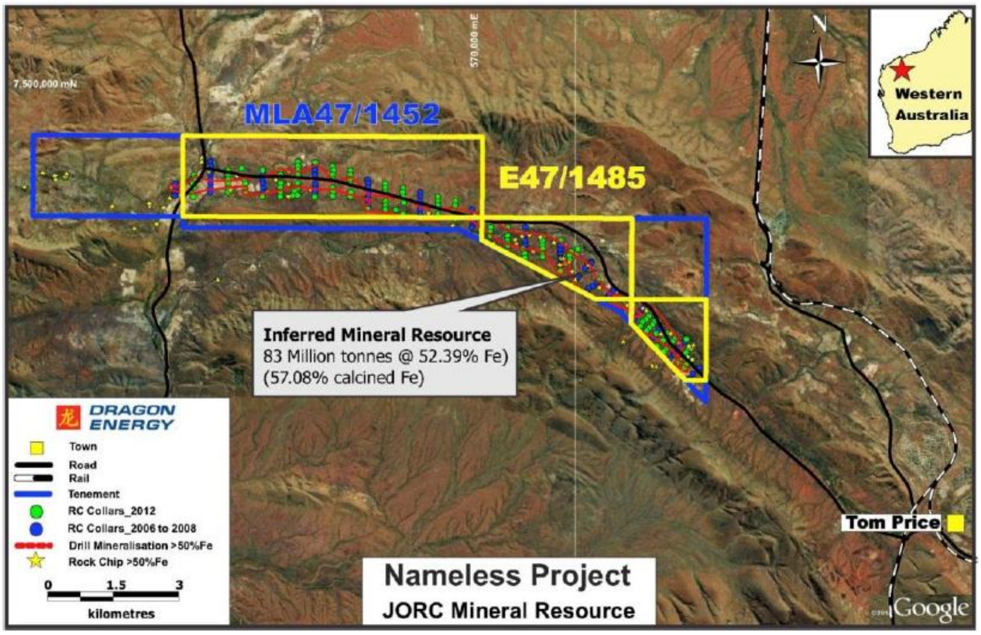


FIGURE 7: **Dragon Energy's** Nameless Project Exploration Target outline and drill targets (*source*: **Dragon Energy** ASX Announcement 27/7/2012).

The paleo channel was previously outlined by Ausquest

Location and Access

The Nameless Project (Figure 7) is located 10 kilometres north-west of Tom Price in the Pilbara Region. The project is situated along the south-dipping northern limb of the Mt Turner Syncline within the South Pilbara Basin of the Hamersley Basin. Bedrock lithologies comprise volcano-sedimentary rocks from the Fortescue and Hamersley Groups, with the Marra Mamba Iron Formation paralleling the southern boundary of the tenement. Cainozoic cover sequences include the Robe Pisolite Formation.

A further 2.50 km of palaeo-channel remains to be follow up

Previous Exploration

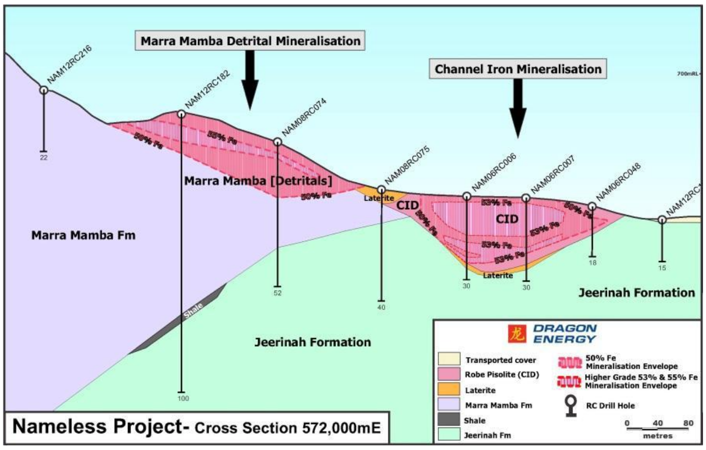


FIGURE 8: Cross section at 11,000mE at **Dragon Energy's** Nameless Project (*source*: **Dragon Energy** ASX Announcement 4/9/2012).

Reconnaissance exploration by **AQD** outlined a 15 kilometre 200-600 metre wide palaeo-channel prospective for CID. A total strike length of 12.5 kilometres was drilled on 400 metre to 1,200 metre drill traverses and was successful in outlining CID up to 24 metres in thickness. **Dragon** subsequently outlined a CID and Detrital Exploration target with a subsequent upgrade in JORC Resources based on RC drilling over 2006-2008 and 2012 announced in July 2012 (*see* **Resources and Reserves**).

The most recent drill campaign earlier in 2012 comprised 127 RC drill holes for 3,198 metres at an average drill density of 100 x 200 metres and again (Figure 8) demonstrated good continuity between drill holes and consistent CID mineralisation. As with Rocklea we are anticipating a relatively low strip, low cost open cut operation at Nameless.

Proposed Exploration

Additional exploration targets remain for Nameless with a further 2.5 kilometres of palaeo-channel to the west remaining to be drill tested. Earlier rock chip sampling returned samples up to 60.4% Fe. It is likely that further reconnaissance exploration will take place ahead of follow up drilling in CY 2013.

SCOPING STUDY

The Company announced the results of a Scoping Study by Perth based engineering firm GHD Limited on 20 January 2012 (later retracted on the same day due to a conflict with the ASIC Policy, ASX Regulations) on the PIP. Two production scenarios returned what **RM Research** consider to be compelling financial metrics. Table 2 sets out metrics for Case 1. Case 2 contemplated a 10Mtpa scenario via Anketell Port however current JORC Resources are insufficient to support an operation of this size.

TABLE 2: **Dragon Energy** Pilbara Iron Ore Project GHD Engineering Limited Scoping Study (*source*: **Dragon Energy** ASX Announcement 20/1/2012 & 4/9/2012).

FINANCIAL METRICS	Case 1
Fe Ore Price (CFR) (US$)	120/Tonne
A$/US$ Exchange Rate	1:1
CAPEX (A$m)	115.7
OPEX-FOB (A$/tonne)	45.38
***NPV (A$m)**	344.8
IRR (%)	31
Discount Rate (%)	10
PRODUCTION PROFILE	
Start Up	3Q 2013
Reserve Assumptions (Mt)	62.7
Mine Life (yrs)	33
Strip Ratio	0.7: 1 (Rocklea)
Production Rate (Mtpa)	2
Crushing/Screening	Crushing/Screening
Transport	110t Trucks/Public Road
Port	Under Evaluation
Project (Mtpa)	Rocklea (2)

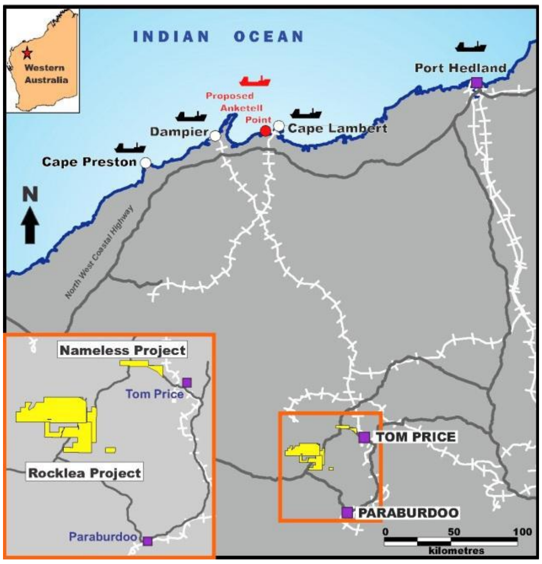
Both scenarios (Case 1 and Case 2) appear to be financially viable with relatively modest capital requirements and first production is planned for 3Q 2014. Furthermore we understand that CAPEX could be reduced by using contract mining, transportation and various other services.

Mining and Processing

Stripping ratios for Rocklea (at around 1.2:1.0) appear low overall with over 66% of the JORC resources having an even lower 0.7:1.0 strip ratio potentially allowing for relatively low mining costs. Mining costs and economics are likely to improve due to the project having substantially upgraded its resources since the Scoping Study was released in January 2012. The Rocklea ore is suitable as a DSO product with normal crushing and screening.

Transportation

FIGURE 9: CASE 1 Nameless and Rocklea road transport options (*source*: **Dragon Energy** ASX Announcement 4/9/2012).



The Study assumes sale of DSO on a CFR basis to northern China.

Case 1 (Table 2, Figure 9) was based on 110 tonne trucks using public roads through a new transhipment port on the West Pilbara Coast or North Pilbara Coast or potentially using existing multi-user port facilities.

The key with many of these iron ore projects is access to infrastructure which we understand the Company is currently addressing. We have more recently seen **BCI's** Nullagaine joint venture with **FMG** where ore is transported through the eastern rail link. **RM Research** notes that **BCI** have given away a lot of upside in the process so the financial metrics set out for Case 2 (Table 2) should be viewed with some caution.

Environmental, Approvals and Development Work

The approval and permitting process is well underway

Preliminary analysis of environmental, regulatory and other approvals are yet to throw up any road blocks. Subject to the identification and establishment of a suitable port (Case 1) production could commence (Figure 9) via road transportation as early as 3Q 2014. Environmental studies covering vertebrate, SRE, Northern Quoll and Olive Python, and Flora surveys have already been completed. A Mine Waste report has also been finalised.

Near term work will focus on seeking approvals for a suitable West Pilbara Port, environmental and heritage studies together with arranging project finance for Stage 1 (up to A$110 million). As part of this we believe that the Company will require a further A$5-10 million to complete a Feasibility Study.

A subterranean fauna survey has been initiated and a soil characterisation study is proposed to follow on from the upcoming geotechnical program. Diamond drilling is planned to collect metallurgical samples at both Rocklea and Nameless (including the recent Rocklea Iron Ore project purchased from **MMX**) and a surface water study has commenced. A LiDAR survey of the area was flown by FUGRO, for an on-going surface water study. A hydro-geological drilling programme has recently been approved by the DMP and will commence shortly.

Heritage negotiations are on-going with respective native title claimants in relation to both Rocklea and Nameless.

FIGURE 10: **Dragon Energy** planning and development (*source*: **Dragon Energy** ASX Announcement 4/9/2012).

...in the near term we anticipate more focus on growing the resource inventory

The medium term plan for Rocklea/Nameless is set out in Figure 10. **RM Research** believes that more effort will go towards the delineation of additional resources to support an expanded case scenario (Case 2 in the January 2012 Scoping Study Announcement) as JORC Resources of +200MT would provide greater bargaining power for port/rail access.

IRON ORE MARKET OUTLOOK

Iron Ore Prices Rebound

FIGURE 11: Spot iron ore prices (*source*: Bloomberg, December 2012).

Spot iron ore prices (Figure 11) have recovered from three year lows of US$87/tonne with recent prices for 62% fines CFR China recently tipping US$123/dmtu with steelmakers appearing more willing to pay a fixed price basis indicating a slight uptick in market sentiment. On the other hand crude steel output dropped to 1.93 million in early November down from 1.99 million mt/day in the corresponding period in September. Traders have recently commented that steel margins remain tight.

Spot Prices likely to trade US$115-US$125 near term

Spot prices of the seaborne iron ore trade are likely to remain range-bound (US$112-US$125/t fob, 62% fines), and should remain so in Q4. Additions to iron ore seaborne supply will continue to be required into the medium term however there is a history of poor execution. The recent cuts in Chinese steel output together with a buyers strike has lifted iron ore prices off their lows.

Chinese Domestic Output Critical

Chinese domestic output continues to be crucial to iron ore, and flexes to balance the market. Cost inflation pressures and grade depletion are structural challenges for the industry. Execution risk around new projects means high-cost Chinese domestic ore is required to balance the market for the next few years, setting a high floor to prices.

Surplus looms in 2016

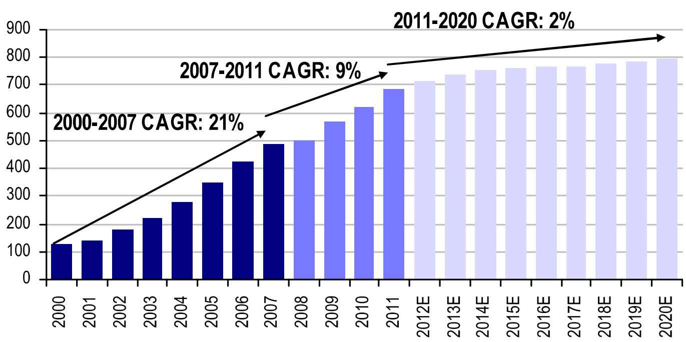
UBS base case supply model has supply increasing from 1,053Mt in CY11 to 1,510Mt in 2016 resulting in a large surplus by 2014 (Table 3). The projected surplus weighs on our price forecasts, which we see falling from US$122/t (62% fob) in CY12e to US$97/t in CY16e.

TABLE 3: UBS global/seaborne iron ore supply/demand balance. (*source*: UBS, Iron Ore, October 2012).

	2011A	2012E	2013E	2014E	2015E	2016E
Total seaborne iron ore demand (Mt)	1052	1059	1177	1226	1307	1341
Global seaborne iron ore demand growth (%)	6.0%	1.0%	11.0%	4.0%	7.0%	3.0%
Total seaborne iron ore supply (Mt)	1053	1067	1173	1335	1451	1510
Global seaborne iron ore supply growth (%)	6.0%	1.0%	10.0%	14.0%	9.0%	4.0%
Seaborne Iron Ore Balance (Mt)	1	8	-4	109	144	169
Iron Ore fines 61% FOB Price (US$/t)	164	122	122	109	97	97

Macro Themes Remain Soft

FIGURE 12: Chinese steel production growth (*source*: UBS, Iron Ore, October 2012).



Negative macro themes have continued to weigh on iron more markets on the back of a contraction in the size of China's infrastructure and property development programmes, steel production declines (Figure 12) and a sluggish US economy.

We believe that China's domestic iron ore production will fall under the current spot prices and planned capacity expansions are likely to be either postponed or cancelled.

*For other projects owned by **Dragon**...*

...landholding In excess of 1,500km²

100% owned

FIGURE 13: MMI anomalies and Regional magnetics at the Carters Well Project (*source*: Dragon Energy ASX Announcement, 23 November 2012).

Multiple commodities targeted...

...gold, iron ore, base metals and manganese

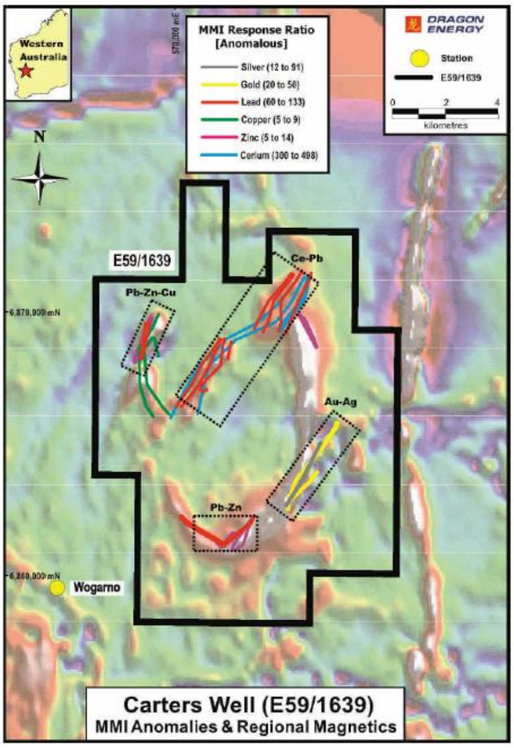
OTHER PROJECTS

Based on recent announcements, it is likely that the Company will look to accelerate exploration on the balance of the exploration portfolio which covers 24 additional projects covering approximately 1,500km^2. This will include exploration by **Dragon** in addition to the farming out of some of its properties.

- **LEE STEERE PROJECT: (DLE 100%, Wiluna Area, Western Australia, E69/22126-I, E69/2377-I) Iron Ore.** Situated approximately 200 kilometres NE of Wiluna in the Earaheedy Basin (Midwest). Previous exploration identified hematite mineralisation of BIF's and Superior-type iron within the Frere Formation. Rock chip samples returned assays up to 66.1% Fe with reconnaissance exploration identifying a prospective strike length in the Frere formation of approximately 48 kilometres. A drill program has been designed to test a stratabound manganese unit and native title access agreements are being negotiated ahead of a heritage survey. **Dragon** is then likely to apply to the DME for approvals for drilling.

- **MT GIBSON PROJECT: (DLE 100%, Mt Gibson Area, Western Australia, E59/1637-38, E59/1686-87). Gold.** Situated in the mid west region of the Yilgarn, 80 kilometres NE of Wubin. E59/1686 is strategically located south and east of the Extension Hill Hematite/Magnetite Project (hosts part of Mt Gibson Gold Operation 870,000 Au mined to date). Recent geochemical surveys on E59/1687 returned up to 2.6ppb Au in transported cover and mafic lithologies. No significant assays were returned from a recent soil survey on E59/1638.

- **CARTERS WELL PROJECT: (DLE 100%, Mt Magnet Area, Western Australia, E59/1639). Gold.** Situated 30 kilometres south of Mt Magnet near the Great Northern Highway, the project comprises four Au-Ag, Ce-Pb, Pb-Zn-Cu, Pb-Zn anomalous zoned derived from mobile metal ion ("MMI") sampling. This includes a 3km long, NE striking gold and coincident silver anomaly to the SE of the project area (Figure 13).



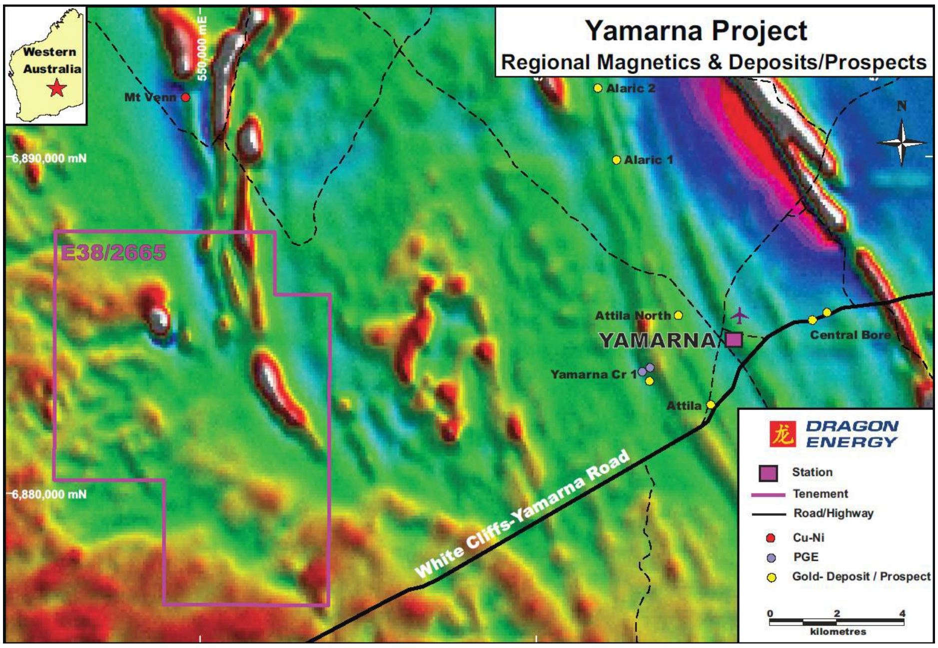
- A heritage survey was completed in the September Quarter and a 1,000 metre drilling program targeting the 3 kilometre long MMI gold/silver anomaly overlying the Coolaloo granite dome has been completed. Assays are awaited. The anomaly is believed to be associated with the hematite-magnetite-quartz shear adjacent to this granite dome.

- **ASHBURTON PROJECT: (DLE 100%, Ashburton Area, Western Australia, E08/2209-2211, E47/2417). Iron Ore, Base Metals, Gold.** The project is situated between 10 and 40 kilometres from existing rail/ infrastructure at Paraburdoo (**Rio Tinto Iron Ore**). The project is prospective for CID within braided drainages of Turee and Seven Mile Creeks (draining from the Brockman Iron Formation near Paraburdoo) of which approximately 50% is covered by Cainozoic cover. The tenements are also considered to be prospective for base metals and gold. A first pass drilling programme has been designed to test the CID potential and DME approval for drilling will be sought after a proposed heritage survey. We anticipate drilling to commence in 1H 2013.

- **MILLY MILLY PROJECT**: **(DLE 100%, Mid West Region, Western Australia, E09/1811). Iron Ore.** The Milly Milly Project covers an area of in excess of 1,500 km^2 and is prospective for magnetite mineralisation (similar to Jack Hills). The tenements are situated 196 kilometres west of Meekatharra and 58 kilometres east of Jack Hills (**Murchison Metals Limited**, ASX: **MMX**). Previous rock chip samples have returned up to 44% Fe and previous BMR magnetic surveys indicate a potential 42 kilometres of strike within the tenements. A chromite rich magnetite layer is believed to have an apparent strike length of 1.6km and may present an additional exploration target.

- **YARMANA PROJECT: (DLE 100%, Ashburton Area, Western Australia, E38/2665). Gold.** Located 120 kilometres NE of Laverton between two greenstone belts; the Cosmo-Newberry Greenstone belt to the west and the Yamarna Greenstone belt to the east (Figure 14). Gold mineralisation identified to the east is hosted by laminated quartz-mica-amphibole schist units- altered and sheared mafic volcanics and sediments. The same Greenstone succession that is also found at Mt Venn can also be identified on E38/2665.

FIGURE 14: Yarmana Project (*source*: **Dragon Energy** ASX Announcement, 4 September 2012).



- **MEEKATHARRA PROJECT**: **(DLE 100%, Ashburton Area, Western Australia, P51/2734-2744). Gold.** Located 13 kilometres SE of Meekatharra within the N-NE trending Meekatharra greenstone belt. Mineralisation is mostly associated with quartz veins within sheared and foliated mafic units. Limited exploration activities in the project area identified linear northerly trending arsenic anomalies with coincident weakly anomalous gold mineralisation to the north, and gold anomalies on lithological contacts with strongly anomalous arsenic to the south. Prospecting licenses were granted during the quarter and an 800 metre x 100 metre spaced MMI soil program was completed in the September Quarter which returned anomalies up to 68 times background for gold. A 200 metre x 100 metre MMI infill program has been completed and we anticipate drilling to commence shortly on a number of gold targets.

CORPORATE

Board changes in June 2012

There has been very little news on the corporate front since the 1 for 2 non-renounceable rights issue at 30 cents that raised A$21.4 million in January 2011. The issue was underwritten (to A$18 million) by major shareholder **Shandong Group**.

The only recent developments have been the retirement in June of this year of Mr Qingyong Guo and Mr Anthony Ho as directors of the Company. Furthermore Ms Karen Logan resigned as the Company Secretary and Mr Ho has taken on this position.

ESTIMATE OF VALUE AND PEER COMPARISON

Our peer comparison outlined below relies in part on our interpretation of the attributable market value of the iron ore and gold assets of the Company.

Iron Ore

Our iron ore peer comparison includes a selection of ASX listed peers whose primary occupation is the exploration and development of hematite resources in Western Australia. Table 5 and Figure 15 shows a graph of Enterprise Value per tonne of iron ore JORC resources (EV/T) for explorers/developers which shows a wide variation attributable to, *inter alia*:

- **Quality of Resources**-Direct shipping ores (DSO) generally having higher values than magnetite resources that require additional processing and are more capital intensive.
- **Proximity to Infrastructure**-Those “stranded resources” or resources with limited access to, for example, port and rail, will be discounted by the market.
- **Other Factors**-Low impurities such as phosphorus, silica is desirable. Coarser grained magnetites require less crushing and grinding (hence less power). Lower ore to waste ratios require less materials handling. Environmentally sensitive areas can also cause extensive delays.

TABLE 5: Table of Enterprise Value/Tonne Iron Ore JORC Resources for selected Iron Ore Explorers/Developers (*source*: **RM Research**, internal modelling, December 2012).

Company	EV/Tonne Fe equiv ($)	Resource Tonnage (Mt)	Share Price ($)	Debt	Cash ($M)	EV ($m)
Mt Gibson Iron	$4.93	95.20	$0.70	$0.0	$293.0	$470.00
BC Iron	$2.55	108.00	$3.24	$20.0	$80.0	$276.51
Fortescue Metals	$2.16	8,952.00	$4.25	$8,342.0	$2,238.0	$19,338.50
Aquila Resources	$1.30	782.00	$2.63	$0.0	$477.0	$606.56
Northern Iron	$0.93	283.00	$0.46	$119.0	$8.0	$337.81
Atlas Iron	$0.98	1,085.00	$1.52	$0.0	$313.0	$1,062.30
Sundance Resources	$0.51	2,240.00	$0.33	$200.0	$59.0	$1,157.74
Western Desert Res	$0.44	402.00	$0.72	$0.0	$111.0	$178.44
Flinders	$0.13	917.00	$0.07	$0.0	$12.3	$120.63
Dragon Energy	$0.09	263.60	$0.15	$0.0	$5.0	$25.96
Golden West	$0.05	130.00	$0.17	$0.0	$23.0	$9.66

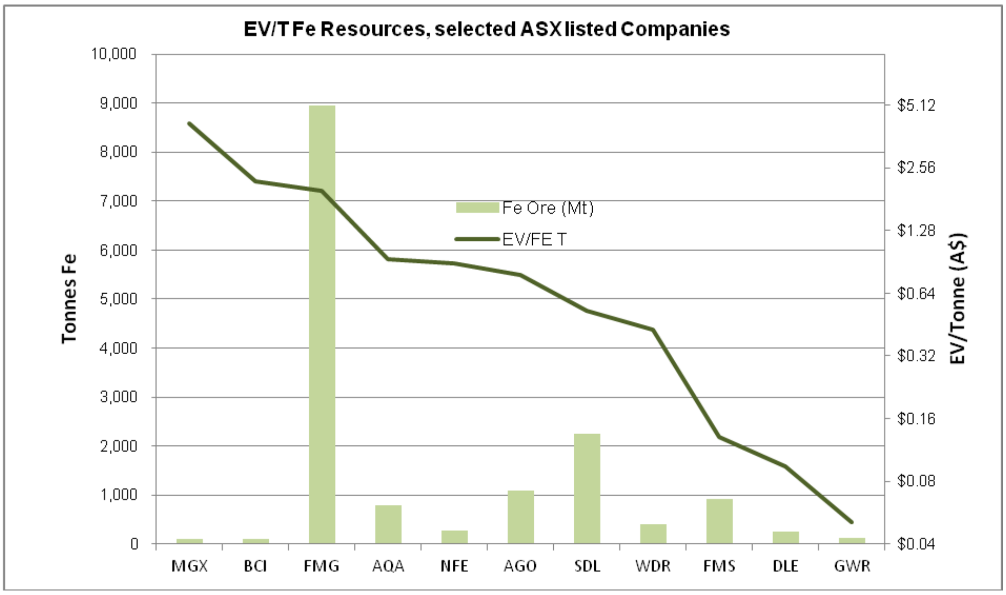
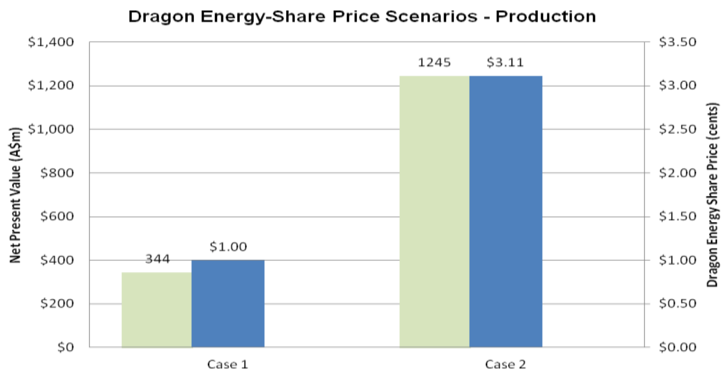


FIGURE 15: Graph of Enterprise Value/Tonne of Iron ore for selected Iron Ore explorers/developers (*source*: **RM Research** internal modelling, December 2012).

The market is looking for companies to develop a sensible business case to mine, transport and sell iron ore

The most comparable metrics in our view would be **FMS** which is trading at EV/tonne of iron ore of around 13 cents following the aborted takeover by Magnitogorsk Iron and Steel Works which had previously valued their Pilbara Iron Ore Project at an EV/tonne of around 60 cents. Given the favourable location of Nameless and Rocklea, proximity to infrastructure, together with the existing JORC resource base of just under 300Mt, **RM Research** considers EV/t in the range of 13 cents is not unreasonable for our base case scenario which would equate to around 20 cents per **Dragon** share.

FIGURE 16 Possible share price outcomes for **Dragon Energy** based on various production scenarios assuming US$120/tonne for 62% Fe (*source*: **RM Research** internal modelling, August 2012).



Looking forward to 2Q 2014, we believe Case 1 NPV's in the order of A$344 million and assuming the full A$110 million in CAPEX, a debt equity ratio of 50:50 with a A$55 million equity raising at 20 cents, a **Dragon** share price approaching A$0.50 per share is possible. Figure 16 summarises what **RM Research** considers is a possible series of share price outcomes over the next 2 years based on Net Present Value methods of valuation. We have discounted the Case 2 NPV of A$2.49 billion by 50% for the purpose of this exercise. These scenarios assume iron ore price received of US$120/tonne.

RISK ANALYSIS

Infrastructure risks remain the primary concern for iron ore explorers/developers

West Africa poses a risk for iron ore supply and may threaten competitiveness of Western Australia

- **Exploration Risk**: Infill drilling at Rocklea and Nameless may fail to convert JORC resources to reserves. Exploration on other projects in the **DLE** portfolio may fail to identify any mineralisation of economic value.
- **Traditional Owners:** Negotiations with traditional owners at Rocklea and Nameless may fail to deliver necessary site clearances for additional exploration/development. We currently view this risk as very low given the concentration of mineralisation in and around palaeo-channels.
- **Financial Position:** The Company has insufficient cash reserves (around A$5.4 million) to progress its key projects (Rocklea/Nameless) into production (refer **Scoping Study**), and the Company will need to raise additional funds to complete a Feasibility Study.
- **Infrastructure Risks:** One of the keys to iron ore development is access to adequate infrastructure to enable delivery of product to market. **RM Research** believes there are potential sites on the West Pilbara coastal region that could represent a temporary solution while options for rail access are investigated.
- **Environmental/Permitting Risks:** There may be delays in obtaining environmental and mining lease approvals. This is relevant for Rocklea and Nameless as well as the proposed port sites on the West Pilbara coast.
- **Commodity Risks:** The Company is primarily exposed to iron ore. The demand/supply scenario remains reasonable but likely to be constrained by slowing Chinese growth as steel mills have kept restocking to a minimum. The ramp up of iron ore development in West Africa poses a medium term risk to Western Australian iron ore projects.
- **Market Risks:** Further declines in equity markets may continue to put pressure on junior resource companies as investors switch out of "risk" into perceived safe haven investments such as cash, gold and counter cyclical equities. Our medium term view is that the risk premium has been eroded for many junior resource companies and we see near term upside.
- **Currency Risks:** A strengthening Australian dollar (as funds flow back into riskier currencies) may make the price of iron ore in local (Australian) currency terms less attractive. This could have negative influences on Australian iron ore explorers/developers.

DIRECTORS AND MANAGEMENT

The Shandong Group is a vertically integrated coal, iron ore, mineral processing and manufacturing company...

Jie Chen — **EXECUTIVE CHAIRMAN**

Mr Chen has nearly 30 years operational and management experience, starting his career in 1979 in a large state-owned coal mining enterprise in the PRC. Mr Chen was previously the chairman of **Shandong Group** from 2002 to 2012 under his leadership, **Shandong Group** has formed vertically integrated businesses in coal, iron ore mining, processing and manufacturing with operations in Shandong, Guizhou, Ningxia and Xinjiang. Mr Chen holds a master's degree in economics and is currently completing a doctorate degree in mine engineering. He has received multiple awards at provincial and national levels for achievements including being in the 10 excellent entrepreneurs in Shandong Province, top 20 mine managers in the PRC, and PRC's excellent entrepreneur.

Gang is a geologist with over 20 year's experience

Gang Xu, BSc, MSc, MBA, MAusIMM, MAICD — **MANAGING DIRECTOR**

Mr Xu is a geologist with over 20 years experience. He spent 9 years as a senior uranium exploration geologist with the **China National Nuclear Corporation**. Mr Xu spent a period as finance and marketing manager for **Sino Gold Limited** as it developed the first international standard mining operation in the PRC. He also has diverse experience in business research, marketing and finance. Mr Xu completed an MBA in the USA in 1997 and a master of geology in the PRC. He is a member of AusIMM and AICD.

Tim has lived and studied in China

Tim Williams, B.Comm, LLB, Dip. Lan. — **COO & EXECUTIVE DIRECTOR**

Mr Williams was most recently an associate of a corporate law firm in Adelaide, South Australia. He has spent the last five years working predominantly in the areas of resources and energy law and has advised ASX listed companies on capital raisings, international investment, exploration and mining licensing, Corporations Act and ASX Listing Rules compliance, native title negotiations and commercial contracts. Mr Williams holds Bachelor of Laws and Bachelor of Commerce degrees as well as a Diploma of Languages from the University of Adelaide. He has lived and studied in China and in recent years formed and led the resources and energy division of the Australia China Business Council in South Australia.

Anthony qualified as a Chartered Account with Deloittes in 1983

Anthony Ho, CA — **COMPANY SECRETARY**

Mr Ho is a commerce graduate of the University of Western Australia, and qualified as a Chartered Accountant in 1983 with Deloittes. He is the principal of a public practice specialising in corporate and financial services to ASX-listed companies. Prior to establishing the practice in 1991, Mr Ho spent 7 years in a senior corporate role with a major investment and resource group in Western Australia. He is a non-executive director of ASX listed **Brumby Resources Limited** and **Redisland Australia Limited**.

Mark was previously a Senior Geologist with Mt Gibson Iron

Mark Hafer, B.Sc (Hons), B.Bus (Finance), MAIG, Affiliate Finsia — **EXPLORATION MANAGER**

Mr Hafer is a geologist with more than 10 years experience. Mr Hafer has undertaken and managed greenfields to brownfields exploration programmes for gold and base metals predominantly in Australia, and in Kazakhstan. Prior to commencing with **DLE** Mark was Senior Exploration Geologist at **Mount Gibson Iron**. Previously he has also worked in the finance industry, including a Mining Commodity Analyst role.

CONCLUSION

Improving iron ore prices and infrastructure options should help investor confidence

We anticipate that the Company will seek to re-focus its resources towards exploration and development at Nameless/Rocklea with an objective of delineating +200Mt of JORC Reserves, sufficient to sustain a 10Mtpa operation. Clearly this should provide more negotiating leverage for port/rail access. The pace of exploration on the other 24 non-core tenements is also likely to pick up. While the market has failed to respond to our projected resource targets (which have subsequently been met), a breakthrough on port +/- rail options together with a recovery in sentiment towards iron ore developers should significantly improve investor confidence. **Speculative Buy**.

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Speculative Buy	We forecast strong earnings growth or value creation that may achieve a return well above that of the broader market. These companies also carry a higher than normal level of risk.
Hold	A sound well managed company that may achieve market performance or less, perhaps due to an overvalued share price, broader sector issues, or internal challenges.
Sell	Risk is high and upside low or very difficult to determine. We expect a strong underperformance relative to the market and see better opportunities elsewhere.

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