

TEMPLETON DRAGON FUND INC
Form N-CSR
March 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-08394

Templeton Dragon Fund, Inc.
(Exact name of registrant as specified in charter)

300 S.E. 2nd Street, Fort Lauderdale, FL 33301-1923
(Address of principal executive offices) (Zip code)

Craig S. Tyle, One Franklin Parkway, San Mateo, CA 94403-1906
(Name and address of agent for service)

Registrant's telephone number, including area code: (954) 527-7500

Date of fiscal year end: 12/31

Date of reporting period: 12/31/13

Item 1. Reports to Stockholders.

Contents

Annual Report	Financial Statements	12		
Templeton Dragon Fund, Inc.	Notes to Financial Statements	15	Dividend Reinvestment and Cash Purchase Plan	26
Performance Summary	Report of Independent	6	Tax Information	29
Important Notice to Shareholders	Registered Public Accounting Firm	7	Board Members and Officers	31
Financial Highlights and Statement of Investments	Annual Meeting of Shareholders	8	Shareholder Information	36
		25		

Annual Report

Templeton Dragon Fund, Inc.

Your Fund's Goal and Main Investments: Templeton Dragon Fund seeks long-term capital appreciation by investing at least 45% of its total assets in equity securities of "China companies."

Dear Shareholder:

This annual report for Templeton Dragon Fund covers the fiscal year ended December 31, 2013.

Economic and Market Overview

China's economy, as measured by gross domestic product (GDP), grew an estimated 7.7% percent year-over-year in the fourth quarter of 2013, compared

with 7.8% in the third quarter.¹ Key reasons for the moderation in growth included slower industrial production and investment growth. In contrast, domestic consumption remained a major growth driver. For calendar year 2013, China's annual GDP grew 7.7%, which matched 2012's annual growth rate and remained stronger than the government's 7.5% target.¹ Although China's economy grew slower than the past decade's double-digit annualized rate, it continued to expand faster than many developed market economies, including those of the U.S., the eurozone and Japan. China completed its leadership transition in March with the appointment of Xi Jinping as president and Li Keqiang as premier. The new government continued efforts to make China's economy more consumer driven and less reliant on exports and debt-fueled investment, while expanding trade, investment and economic relations with its global partners.

1. Source: The website of the National Bureau of Statistics of the People's Republic of China (www.stats.gov.cn).

The dollar value, number of shares or principal amount, and names of all portfolio holdings are listed in the Fund's Statement of Investments (SOI). The SOI begins on page 9.

Chinese stocks began 2013 on a positive note but experienced heightened volatility in the first half of the year, resulting largely from concerns about eurozone stability, the pace and scope of the U.S. Federal Reserve Board's (Fed's) potential tapering of its asset purchase program and the People's Bank of China's efforts to tighten liquidity to curb real estate speculation. When these fears were not realized, investor confidence rose in late June, leading to a rebound in Chinese stock prices. Financial markets grew volatile again in late August but recovered as tension surrounding Syria was defused and as the Fed announced it would delay tapering its asset purchase program. A U.S. budget impasse in late September and its resolution in October also moved the markets.

The Chinese government's announcement of social, economic and financial reforms boosted Chinese stocks in November. Despite renewed concerns about the sustainability of China's economic growth and the Fed's announcement that it would reduce its monthly bond purchases beginning in January 2014, Chinese stocks ended 2013 with gains. Greater China stocks, as measured by the MSCI Golden Dragon Index, delivered a +7.25% total return for the 12 months ended December 31, 2013.² The MSCI Hong Kong Index generated a total return of +11.09%, compared with +9.77% for the MSCI Taiwan Index and +3.96% for the MSCI China Index.²

Investment Strategy

Our investment strategy employs a fundamental, value-oriented, long-term approach. In selecting companies for investment, we will consider overall growth prospects, competitive positions in export markets, technologies, research and development, productivity, labor costs, and raw material costs and sources. Additional considerations include profit margins, returns on investment, capital resources, government regulation, management and other factors in comparison to other companies around the world that we believe are comparable.

Our approach to selecting investments emphasizes fundamental company-by-company analysis (rather than broader analyses of specific industries or sectors of the economy), to construct an action list from which we make our buy decisions. Although we will consider historical value measures, the primary factor in selecting securities for investment by the Fund will be the company's current price relative to its long-term earnings potential.

2. Source: © 2014 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. The indexes are unmanaged and include reinvested dividends. One cannot invest directly in an index, and an index is not representative of the Fund's portfolio.

Performance Overview

Templeton Dragon Fund had cumulative total returns of -3.07% in market price terms and -3.37% in net asset value terms for the 12 months under review. You can find the Fund's long-term performance data in the Performance Summary on page 6.

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown.

Manager's Discussion

During the 12 months under review, key contributors to the Fund's absolute performance included three of China's leading automobile companies: Great Wall Motor, Changan (Chongqing Changan Automobile) and Jiangling Motors.

Great Wall Motor has strong positions in China's pickup truck and sport utility vehicle markets. Changan manufactures Ford, Volvo, Mazda and Suzuki automobile brands through its joint ventures with Ford Motor, Mazda Motor and Suzuki Motor, in addition to manufacturing its own brands of minibuses and sedans. Jiangling Motors develops, manufactures and sells commercial vehicles and related components. Jiangling also collaborates with Ford in the production of its commercial vehicles in China.

China's demand for passenger and commercial vehicles has been in a strong upward trend, and all three companies, in our view, are well positioned in their respective markets to potentially benefit from the continued demand growth trend. Growing sales and strong financial results, as well as news of Ford's increased stake in Jiangling, supported these companies' share prices in 2013.

In contrast, key detractors included Dairy Farm International Holdings, a Hong Kong-based pan-Asian retailer whose core businesses consist of supermarkets, hypermarkets (department store and grocery market), health and beauty stores, convenience stores and home furnishing stores; PetroChina, China's largest integrated oil and gas company, which owns a majority of the country's proven oil and gas reserves; and Yanzhou Coal Mining, one of China's largest coal producers.

Dairy Farm International has a strong presence in Greater China and Southeast Asia. Food retailers in the region generally delivered a subdued performance in the latter part of 2013 because of food safety scandals, notably in Taiwan, and sluggish sales growth. Concerns that rising costs could compress margins further pressured Dairy Farm's share price. In the long term, however, we believe Asia's rising personal income and greater consumer demand, combined with the company's exposure to the region's high growth markets, could continue to support revenue and earnings growth.

Top 10 Holdings

12/31/13

Company	% of Total
Sector/Industry, Country	Net Assets
Dairy Farm International Holdings Ltd.	16.1 %
<i>Food & Staples Retailing, Hong Kong</i>	
Sinopec (China Petroleum and Chemical Corp.), H	9.6 %
<i>Oil, Gas & Consumable Fuels, China</i>	
CNOOC Ltd.	6.8 %
<i>Oil, Gas & Consumable Fuels, China</i>	
TSMC (Taiwan Semiconductor Manufacturing Co. Ltd.)	5.4 %
<i>Semiconductors & Semiconductor Equipment, Taiwan</i>	
PetroChina Co. Ltd., H	5.2 %
<i>Oil, Gas & Consumable Fuels, China</i>	
China Mobile Ltd.	4.2 %
<i>Wireless Telecommunication Services, China</i>	
China Construction Bank Corp., H	3.5 %
<i>Commercial Banks, China</i>	
Great Wall Motor Co. Ltd., H	2.8 %
<i>Automobiles, China</i>	
Cheung Kong Infrastructure Holdings Ltd.	2.5 %
<i>Electric Utilities, Hong Kong</i>	
Dongfeng Motor Group Co. Ltd., H	2.3 %
<i>Automobiles, China</i>	

Generally weak commodity prices, concerns about China's slower economic growth earlier in the period and worries about the government's pace of reforming gas price regulations weighed on PetroChina's shares. In our view at period-end, the company's longer term prospects remained strong. As many emerging market economies continue to grow and as China industrializes and becomes wealthier, rising energy demand could potentially benefit PetroChina. Furthermore, government reforms to bring fuel prices more in line with market prices could improve PetroChina's refining and distribution operations.

Lower coal prices and demand, as well as concerns about the potential impact of environmental legislation and shale gas development in China, negatively affected investor sentiment on the stocks of many coal companies, including Yanzhou Coal Mining. We reduced the Fund's holdings in the company during the period to raise funds for what we considered to be more attractive investment opportunities.

It is important to recognize the effect of currency movements on the Fund's performance. In general, if the value of the U.S. dollar goes up compared with a foreign currency, an investment traded in that foreign currency will go down in value because it will be worth fewer U.S.

Edgar Filing: TEMPLETON DRAGON FUND INC - Form N-CSR

dollars. This can have a negative effect on Fund performance. Conversely, when the U.S. dollar weakens in relation to a foreign currency, an investment traded in that foreign currency will increase in value, which can contribute to Fund performance. For the 12 months ended December 31, 2013, the U.S. dollar rose in value relative to most currencies. As a result, the Fund's performance was negatively affected by the portfolio's investment predominantly in securities with non-U.S. currency exposure.

In the past 12 months, our continued search for companies we considered to be attractively valued and well positioned to benefit from Greater China's positive economic and market developments led us to purchase shares of construction materials, gas utilities, apparel and luxury goods, and semiconductor companies. We also invested in machinery, marine, and paper and forest products companies. Key purchases during the period included additional investments in Anhui Conch Cement, China's largest cement producer, and Anta Sports Products, one of China's leading domestic sportswear brands, as well as a new position in ENN Energy Holdings, one of China's biggest non-state-owned piped natural gas distributors.

Conversely, we closed the Fund's position in Cambodia and undertook selective sales in Hong Kong, Taiwan and China via China H and Red Chip shares as certain stocks reached their sale targets and as we raised funds to pay

shareholder dividends.³ We also sought to position the Fund to potentially benefit from stocks we considered to be more attractively valued within our investment universe. As a result, we reduced the Fund's holdings in computers and peripherals; electric utilities; food and staples retailing; and oil, gas and consumable fuels companies. Key sales included reductions in our investments in Cheung Kong Infrastructure Holdings, one of Hong Kong's biggest infrastructure companies; Asustek Computer, a major Taiwanese manufacturer of motherboards and graphic cards for personal computers; and Yanzhou Coal Mining. Although we reduced our investment in the Fund's top holding, Dairy Farm International, to raise funds and promote diversification, we maintained a positive long-term view on the company.

Thank you for your continued participation in Templeton Dragon Fund. We look forward to serving your future investment needs.

Sincerely,

The foregoing information reflects our analysis, opinions and portfolio holdings as of December 31, 2013, the end of the reporting period. The way we implement our main investment strategies and the resulting portfolio holdings may change depending on factors such as market and economic conditions. These opinions may not be relied upon as investment advice or an offer for a particular security. The information is not a complete analysis of every aspect of any market, country, industry, security or the Fund. Statements of fact are from sources considered reliable, but the investment manager makes no representation or warranty as to their completeness or accuracy. Although historical performance is no guarantee of future results, these insights may help you understand our investment management philosophy.

3. China H denotes shares of China-incorporated, Hong Kong Stock Exchange-listed companies with most businesses in China. Red Chip denotes shares of Hong Kong Stock Exchange-listed companies with significant exposure to China.

Performance Summary as of 12/31/13

Your dividend income will vary depending on dividends or interest paid by securities in the Fund's portfolio, adjusted for operating expenses. Capital gain distributions are net profits realized from the sale of portfolio securities. Total return reflects reinvestment of the Fund's dividends and capital gain distributions, if any, and any unrealized gains or losses. Total returns do not reflect any taxes that a shareholder would pay on Fund dividends, capital gain distributions, if any, or any unrealized gains on the sale of Fund shares.

Price and Distribution Information

Symbol: TDF	Change		12/31/13		12/31/12	
Net Asset Value (NAV)	-\$	2.73	\$	28.46	\$	31.19
Market Price (NYSE)	-\$	2.56	\$	25.88	\$	28.44
Distributions (1/1/13-12/31/13)						
Dividend Income	\$	0.8018				
Short-Term Capital Gain	\$	0.0083				
Long-Term Capital Gain	\$	0.8570				
Total	\$	1.6671				

Performance¹

	1-Year		5-Year		10-Year	
Cumulative Total Return ²						
Based on change in NAV ³	-3.37 %	+	99.70 %	+	212.89 %	
Based on change in market price ⁴	-3.07 %	+	102.78 %	+	175.93 %	
Average Annual Total Return ²						
Based on change in NAV ³	-3.37 %	+	14.84 %	+	12.08 %	
Based on change in market price ⁴	-3.07 %	+	15.19 %	+	10.68 %	

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown.

Endnotes

All investments involve risks, including possible loss of principal. Special risks are associated with foreign investing, including currency volatility, economic instability and political developments of countries where the Fund invests. Emerging markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity. There are special risks associated with investments in China, Hong Kong and Taiwan, including exposure to currency fluctuations, less liquidity, expropriation, confiscatory taxation, nationalization and exchange control regulations (including currency blockage), inflation and rapid fluctuations in inflation and interest rates. In addition, investments in Taiwan could be adversely affected by its political and economic relationship with China. Because the Fund invests its assets primarily in companies in

a specific region, the Fund is subject to greater risks of adverse developments in that region and/or the surrounding regions than a fund that is more broadly diversified geographically. Political, social or economic disruptions in the region, even in countries in which the Fund is not invested, may adversely affect the value of securities held by the Fund. Also, as a nondiversified investment company investing in China companies, the Fund may invest in a relatively small number of issuers and, as a result, be subject to a greater risk of loss with respect to its portfolio securities. The Fund is actively managed but there is no guarantee that the manager's investment decisions will produce the desired results.

1. The Fund has a fee waiver associated with its investments in a Franklin Templeton money fund, contractually guaranteed through at least its current fiscal year end. Fund investment results reflect the fee waiver, to the extent applicable; without this reduction, the results would have been lower.
2. Total return calculations represent the cumulative and average annual changes in value of an investment over the periods indicated.
3. Assumes reinvestment of distributions based on net asset value.
4. Assumes reinvestment of distributions based on the dividend reinvestment and cash purchase plan.

Important Notice to Shareholders

Share Repurchase Program

The Fund's Board previously authorized the Fund to repurchase up to 10% of the Fund's outstanding shares in open-market transactions, at the discretion of management. This authorization remains in effect.

In exercising its discretion consistent with its portfolio management responsibilities, the investment manager will take into account various other factors, including, but not limited to, the level of the discount, the Fund's performance, portfolio holdings, dividend history, market conditions, cash on hand, the availability of other attractive investments and whether the sale of certain portfolio securities would be undesirable because of liquidity concerns or because the sale might subject the Fund to adverse tax consequences. Any repurchases would be made on a national securities exchange at the prevailing market price, subject to exchange requirements, federal securities laws and rules that restrict repurchases, and the terms of any outstanding leverage or borrowing of the Fund. If and when the Fund's 10% threshold is reached, no further repurchases could be completed until authorized by the Board. Until the 10% threshold is reached, Fund management will have the flexibility to commence share repurchases if and when it is determined to be appropriate in light of prevailing circumstances. The share repurchase program is intended to benefit shareholders by enabling the Fund to repurchase shares at a discount to net asset value, thereby increasing the proportionate interest of each remaining shareholder in the Fund.

In the Notes to Financial Statements section, please see note 2 (Capital Stock) for additional information regarding shares repurchased.

Annual Report | 7

Templeton Dragon Fund, Inc.

Financial Highlights

	Year Ended December 31,				
	2013	2012	2011	2010	2009
Per share operating performance (for a share outstanding throughout the year)					
Net asset value, beginning of year	\$ 31.19	\$ 27.85	\$ 33.22	\$ 28.85	\$ 18.79
Income from investment operations:					
Net investment income ^a	0.53	0.55	0.49	0.34	0.32
Net realized and unrealized gains (losses)	(1.73)	4.25	(3.62)	5.79	10.67
Total from investment operations	(1.20)	4.80	(3.13)	6.13	10.99
Repurchase of shares	0.14	0.02			
Less distributions from:					
Net investment income	(0.80)	(0.73)	(0.38)	(0.53)	(0.55)
Net realized gains	(0.87)	(0.75)	(1.86)	(1.23)	(0.38)
Total distributions	(1.67)	(1.48)	(2.24)	(1.76)	(0.93)
Net asset value, end of year	\$ 28.46	\$ 31.19	\$ 27.85	\$ 33.22	\$ 28.85
Market value, end of year ^b	\$ 25.88	\$ 28.44	\$ 25.45	\$ 30.71	\$ 27.25
Total return (based on market value per share)	(3.07)%	18.07 %	(9.44)%	19.58 %	63.60 %
Ratios to average net assets					
Expenses	1.31 %	1.31 %	1.37 %	1.47 % ^c	1.50 % ^c
Net investment income	1.74 %	1.85 %	1.57 %	1.14 %	1.34 %
Supplemental data					
Net assets, end of year (000 s)	\$ 1,027,479	\$ 1,174,229	\$ 1,054,602	\$ 1,258,237	\$ 1,092,713
Portfolio turnover rate	4.59 %	2.50 %	2.07 %	6.69 %	12.29 %

^aBased on average daily shares outstanding.

^bBased on the last sale on the New York Stock Exchange.

^cBenefit of expense reduction rounds to less than 0.01%.

Templeton Dragon Fund, Inc.

Statement of Investments, December 31, 2013

	Country	Shares	Value
Common Stocks 99.4%			
Air Freight & Logistics 0.2%			
Sinotrans Ltd., H	China	5,999,000 \$	2,266,737
Auto Components 1.3%			
Cheng Shin Rubber Industry Co. Ltd.	Taiwan	4,862,439	12,713,750
Automobiles 7.5%			
^a Chongqing Changan Automobile Co. Ltd., B	China	3,194,304	6,302,637
Dongfeng Motor Group Co. Ltd., H	China	15,368,000	23,940,813
Great Wall Motor Co. Ltd., H	China	5,180,345	28,526,018
Guangzhou Automobile Group Co. Ltd., H	China	3,313,084	3,618,849
Jiangling Motors Corp. Ltd., B	China	3,959,628	14,757,297
			77,145,614
Beverages 0.3%			
Yantai Changyu Pioneer Wine Co. Ltd., B	China	825,075	2,745,161
Commercial Banks 9.1%			
Bank of China Ltd., H	China	51,200,600	23,572,078
BOC Hong Kong (Holdings) Ltd.	Hong Kong	5,202,500	16,672,206
China Construction Bank Corp., H	China	47,622,272	35,926,969
Industrial and Commercial Bank of China Ltd., H	China	25,873,155	17,483,778
			93,655,031
Commercial Services & Supplies 0.0%†			
^{a,b} Integrated Waste Solutions Group Holdings Ltd.	China	5,424,078	95,130
Computers &			