

29 September 2011

## MCB Finance Group

Year End	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E ** (x)	Yield (%)
12/09	14.3	(0.6)	(6.1)	0.0	N/A	N/A
12/10	11.1	0.5	1.3	0.0	32.1	N/A
12/11e	16.4	3.4	15.3	0.0	2.8	N/A
12/12e	19.7	4.5	21.1	0.0	2.0	N/A

Note: \*PBT and EPS are on a pro-forma company basis. \*\* Converted at €1.15/£.

### Investment summary: H1 11 carpe diem

Having survived the credit crunch and remained profitable throughout in all countries except Latvia, MCB Finance Group's (MCB) loan offering in the Fenno-Baltic region delivered material growth in H111, critically with no lead indications of credit deterioration. Market uncertainty remains high, but as investors gain confidence in the increasing estimates, the low valuation will become more apparent. Delivery on our raised numbers will be enough. The delisting now is unlikely to conclude but the associated share price weakness has created a significant valuation discount.

### Growth story confirmed

The MCB story is about "seizing the day" and leveraging lending when economic conditions are favourable and controlling risk when they are not. H111 saw improving economic conditions in all its countries with higher GDP growth and reducing unemployment. Independent forecasts from the IMF expect these trends to continue and, unlike much of the world, their Fenno-Baltic estimates have been raised since April. MCB grew principal lent by 59%, accelerating on the trend reported in May.

### Risk remains under control

With an average loan life of under six months, lending has effectively churned more than once in H111. Credit reported in the period has remained stable and there are no lead indications of problems ahead. The underlying provision rate was 23% of revenue, somewhat below our expected long-term run rate. Further recoveries are likely, but we do not expect them to be at the level reported in H111.

### Valuation: Significant upside

Given macro-uncertainties, we have been highly conservative in estimates (we have more than doubled 2011 EPS estimates since March) and in our valuation. Some investors may consider us overly conservative. Our approach indicates a fair value of in excess of £1, which is c 6x 2012e EPS and 1.25x 2012e NAV. The closest peer (IPF) trades on a c 25% premium to this level. We note that on the multiples on a recent deal in Finland, MCB would be valued well in excess of £20m. The shares weakened on the announcement of a possible delisting, creating a large discount.

Price 37.5p  
Market Cap £6m

#### Share price graph



#### Share details

Code MCRB  
Listing AIM  
Sector Financials  
Shares in issue (post buyback) 16.69m

#### Price

52 week High 95p Low 10p

#### Balance Sheet as at 30 June 2011

Gross Debt/Equity (%) 97  
NAV per share (c) 52  
Cash (€m) 2.1

#### Business

MCB Finance Group is a leading online provider of short- and medium-term loans to customers in Finland, Estonia, Latvia and Lithuania using the Credit24 brand.

#### Valuation

	2010	2011e	2012e
P/E relative	263%	21%	18%
P/CF	60.2	N/A	N/A
EV/Sales	0.7	0.6	0.6
ROE	2.5%	28%	29%

#### Geography based on revenues

UK	Europe	US	Other
0%	100%	0%	0%

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## Update with interim results

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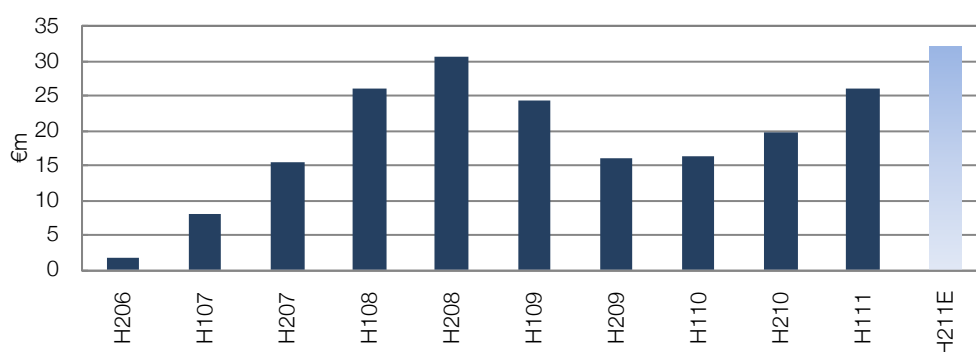
The growth story in improving economic conditions has accelerated through H111 and management confidence after the crisis allowing re-accelerated lending. With its May trading statement, MCB advised that at the four-month stage, its credit issued had increased by 45% on 2010. This has now accelerated further to 59% with over a quarter of the increase being generated by a return to lending in Latvia (H111 credit issued €2.0m vs €0.4m in H110). Elsewhere Finland was up 34%, Estonia 37% and Lithuania nearly doubled. Critically there has been no sign of underlying credit deterioration and H111 benefitted from recoveries in prior years.

### Credit issued: Continued growth

As can be seen in Exhibit 1, credit issued has continued its multi-period growth from the lows in H209. We recommend investors note the steady increase period on period, which we believe reflects a sensible approach to growth. As noted below, with an average duration of under six months, the book has a rapid turnover. We expect further growth in H211, although we have decelerated the growth rate to 23% in 2012 to reflecting current macro uncertainties. We believe this is conservative relative to the most recent macroeconomic forecasts for the region.

**Exhibit 1: Principal lent**

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Source: MCB Finance

### Credit quality

The group charge was reported at 14% of revenue, which benefitted from significant recoveries of prior-year impairments, most notably in Estonia (€0.3m) and Latvia (€0.23m). Further recoveries are expected but not at the current level. The underlying credit impairment ratio was 23% of revenue, which management expects to continue. Our 2011/12 charges are around this level although, given the nature of the business, we would expect a through-the-cycle loss ratio somewhat higher than this.

### Costs

Direct operating costs rose by c 37% against revenue of 43% and a 59% increase in credit issued. Administration expenses rose from €2.48m to €3.43m as the company invested heavily in marketing to take advantage of the economic opportunity. The stronger revenue growth ensured pro-forma pre-tax profits rose from €0.07m in H110 and €0.5m in H210 to €1.6m in H111.

## Update on growth opportunities

In addition to economic growth and improving product penetration, MCB has company-specific growth from new geographies, new distribution agreements, and new products. Growth from existing markets and entering new geographies appears to us the most likely.

### Economic growth

As can be seen from the IMF forecasts in Exhibit 2, GDP fell massively across MCB countries in 2009. This is expected to be replaced by moderate growth for 2011. The expectation remains for growth well below the boom years of 2006/07, but it is enough to lead to unemployment falling across the region. Investors will no doubt have their own views about the accuracy of these forecasts, but assuming they are correct, credit risk should improve along with the economy and also allow for even greater revenue opportunities. These forecasts have significantly faster growth in 2011 for both Estonia and Lithuania (Estonia forecast doubled) than was given in the April projections and the improvement in unemployment is c 1% better across the region. Eurostat forecasts issued on 30 July 2011 have similar growth forecasts for both 2011 and 2012 (eg 2011 Finland 3.7%, Estonia 4.9%, Latvia 3.3%, Lithuania 5.0%). Following the battle-testing of models through the economic crisis, management has shown accelerated appetite to lend into this economic recovery.

**Exhibit 2: Economic forecasts (%)**

Country	Real GDP							Unemployment			
	2006	2007	2008	2009	2010	2011e	2012e	2009	2010	2011e	2012e
Finland	4.9	4.2	1.0	(8.0)	3.1	3.5	2.2	8.3	8.4	7.8	7.6
Estonia	10.0	7.2	(3.6)	(13.9)	3.1	6.5	4.0	13.8	16.9	13.5	11.5
Latvia	12.2	10.0	(4.6)	(18.0)	(0.3)	4.0	3.0	17.3	19.0	16.1	14.5
Lithuania	7.8	8.9	3.9	(14.8)	1.3	6.0	3.4	13.7	17.8	15.5	14.0

Source: IMF, Forecasts in Table 2.2, p78 World Economic Outlook, September 2011

### Improving penetration in existing countries

MCB's below-prime, short-term lending is a relatively new product in the Fenno-Baltic region. The company believes it could be attractive to 20-30% of the population from time to time, although clearly not all would be borrowing at the same time. If this assumption is correct, the potential market share gain is significant, most notably in Latvia and Lithuania. With the interim results MCB noted it is once again one of the larger non-standard lenders in Latvia, but it has delivered market share gains with more opportunities to come.

### New geographies

MCB pays MC Global a licence fee for the perpetual, exclusive and irrevocable right to use the Credit 24 brand across a number of countries in addition to those mentioned above. The list includes Czech Republic, Slovakia, Hungary, Poland, Romania, Slovenia, Croatia, Serbia, Macedonia, Montenegro, Bosnia, Albania, Kosovo, Bulgaria, Moldova, Ukraine and Belarus. We would expect MCB to expand into one of these countries next, more probably in Central Europe rather than the Balkans. Incremental costs should be modest, primarily marketing, as the infrastructure is already in place and local fixed costs minor. The rapid growth seen by the company in 2008 was partially due to geographic expansion. We have not built any new

geographies into our forecasts because, although such growth is likely, the visibility of the effect on estimates is too poor at this stage. With these results management commented it is carefully evaluating several markets with the intention to enter one additional market by the end of 2011/early 2012.

## Expand distribution lines

The core model is online distribution but this can be supplemented through other channels. As outlined above, MCB has a distribution agreement with Maxima that currently generates around 20-25% of the Lithuanian credit issued (c 5% group). MCB is expanding this across Estonia and Latvia. It is also re-launching its lending through the Latvian post office. With a well-recognised brand in Credit24, MCB makes an attractive partner for retailers wanting to offer their customers on-the-spot finance (typically the funds are in the customer's account within 15 minutes). With these results management noted that its loans are now available through 80 offices of the Latvian post office.

## New products

We believe management is looking at expanding into product areas that are closely aligned to the existing business. In particular small-scale, short-term point of sale finance has many characteristics that are similar to the internet-based, low-cost model of MCB.

## MCB's business churns rapidly

With a current average duration of less than six months, MCB's business is very much about churn not just the balance sheet. The churn varies between countries with the most rapid turnover in Finland, where external data sources are more limited and so there is less appetite to lend longer term. Historically, it was slowest in Lithuania and Latvia, where there was a competitive market for longer-term loans and more external information is available. Latvia is distorted by the intentional slowdown in lending to manage credit risk in 2009, as well as a competitive environment that has seen massive changes since (allowing much more shorter-term lending with the re-launch of lending in H210). The churn rate will vary with both appetite to lend (typically better conditions mean that longer loans are acceptable), as well as the competitive environment.

### Exhibit 3: Churn rates (credit issued/end net receivables)

Note: We have used net receivables. Against receivables gross of provisions, the churn rate is closer to 2x, hence the average maturity of book is under six months.

	2008	2009	2010	H111	2011e	2012e
Finland	3.4	3.4	3.4	3.5	3.6	3.4
Estonia	3.3	3.4	2.9	2.7	2.0	1.6
Latvia	2.0	1.8	2.0	3.9	2.0	1.9
Lithuania	2.5	3.2	2.4	2.8	2.1	1.6
<b>Group</b>	<b>2.8</b>	<b>3.2</b>	<b>3.0</b>	<b>3.2</b>	<b>2.6</b>	<b>2.2</b>
<b>Group credit issued €m</b>	<b>57.3</b>	<b>40.4</b>	<b>36.0</b>	<b>25.9</b>	<b>58.0</b>	<b>71.5</b>
<b>Group net receivables €m</b>	<b>20.4</b>	<b>12.8</b>	<b>12.1</b>	<b>16.3</b>	<b>22.5</b>	<b>33.0</b>

Source: MCB, Edison Investment Research

Investors must recognise that having a business with rapid churn heavily distorts some traditional measures (see Exhibit 4) with the real impairment in 2010 in Finland, Estonia and Lithuania around 6-8% of credit issued, not the 19-66% reported on end balance sheet numbers. Investors should focus on credit issued rather than the balance sheet measures.

**Exhibit 4: Profitability to balance sheet ratios**

	2008	2009	2010	2011e	2012e		2009	2010	2011e	2012e		2008	2009	2010	2011e	2012e
<b>Revenue as % credit issued</b>						<b>Impairment as % credit issued</b>					<b>Pre-tax profit as % credit issued</b>					
Finland	22%	27%	26%	27%	26%	Finland	(9%)	(6%)	(7%)	(6%)	Finland	7%	8%	9%	9%	10%
Estonia	24%	45%	42%	41%	43%	Estonia	(22%)	(8%)	(3%)	(8%)	Estonia	5%	3%	9%	14%	13%
Latvia	25%	110%	108%	27%	24%	Latvia	(104%)	(83%)	(1%)	(5%)	Latvia	2%	(33%)	(80%)	2%	3%
Lithuania	22%	41%	39%	31%	30%	Lithuania	(17%)	(8%)	(5%)	(5%)	Lithuania	4%	7%	8%	11%	11%
<b>Revenue as % end net receivables</b>						<b>Impairment as % end net receivables</b>					<b>Pre-tax profit as % net end receivables</b>					
Finland	74%	90%	88%	94%	90%	Finland	(30%)	(19%)	(24%)	(22%)	Finland	25%	26%	31%	33%	35%
Estonia	78%	153%	124%	81%	65%	Estonia	(58%)	(66%)	(43%)	(29%)	Estonia	18%	9%	27%	28%	20%
Latvia	50%	200%	212%	54%	45%	Latvia	(189%)	(163%)	(2%)	(10%)	Latvia	3%	(60%)	(157%)	4%	5%
Lithuania	55%	129%	93%	67%	48%	Lithuania	(53%)	(19%)	(10%)	(7%)	Lithuania	11%	21%	20%	24%	18%

Source: MCB, Edison Investment Research

## Proposed delisting from AIM

Management has been discussing with its shareholders the value of the quote. The announcement of a possible delisting saw the share price plummet on minimal volumes as some investors tried to sell ahead of any delisting. Some major shareholders who had previously indicated support for the delisting withdrew this support and so the plan has been shelved. We believe management should explore all options to create shareholder value, and while announcing a potential delisting and then not completing it is not ideal, it does not change the fundamentals of the business. What it has done is create a significant valuation opportunity.

## Share buyback

In December last year, 700k shares became available at a price significantly below the market price then, and now. At the time, the structure of reserves meant the company was not able to purchase the shares directly. However, as these legal obstacles were technical and could be relatively easily overcome, management bought the shares and warehoused them, eventually selling them to the company, at no profit, on 15 September 2011. This explains the 700k shares traded at 10p that day and as the shares will be cancelled, the deal will be both earnings enhancing and accretive to NAV.

## Valuation

On our numbers, a DCF model indicates a value of 92p and our Gordon's growth model (GGM) indicates 109p. Every 1% growth or 1% on cost of equity is worth c 4p on the DCF and 5-6p on the GGM. We believe the near-term share price has been adversely affected by some investors potentially looking to sell ahead of the proposed delisting, and for an illiquid stock, this has had a disproportionate effect creating a buying opportunity.

Given the global economic uncertainties, we believe it is appropriate to be conservative in our forecasts, especially beyond 2011. We believe management's assessment will generate higher earnings than we are forecasting, and that this would naturally be reflected in a (materially) higher valuation. Over time, assuming market conditions stabilise, we believe we have left room to upgrade our estimates and so the valuation. We continue to adopt this conservative stance and note the near doubling of estimates following initiation in May. We also believe we use conservative assumptions in our valuation methods, which generate a fair value equivalent to c 5x 2012 EPS

and 1.25x NAV, both below the levels peers trade at. We outline the rationale for this approach below, and some investors will no doubt consider it over-conservative.

## Peer group comparisons

None of the direct competitors in the Fenno-Baltic region are directly quoted. International Personal Finance (2011e consensus P/E 7.6x, 2012 6.5x) is the closest comparator, although its operations are more Central Europe and Mexico and it uses an agent-distribution model. Its share price has nearly halved in the recent market turmoil. As a UK-listed name, MCB could also be compared with Provident Financial (2011e 11.8x, 2012 10.8x), S&U (2011 9.6x, 2012 9.1) and Cash Converters (June 2012 4.2x, dual listing in Australia and UK), although the underlying businesses are different. MCB is trading around half 2011e NAV, while IPF and Provident Financial are both at multiples of book.

Investors will note that should MCB trade on, say, the IPF 2012 valuation it would imply a price of 120p (against our fair value in excess of 100p and the current price of 37.5p). We believe there are a range of issues investors should consider in whether applying a premium or discount to the IPF level. Some investors will no doubt consider we have been overly conservative in suggesting a current fair value around 80% of the level and apply a significantly lower discount (and thus generate materially higher target price). The issues we believe investors should consider are:

- On the upside Investors should not ignore:
  - Upgrades to 2011 macroeconomic forecasts for the MCB region.
  - Near doubling of estimates consistently through the year, as the company has delivered accelerated growth.
  - The performance of the business model through economic conditions not experienced by the “peers”.
  - The higher operational gearing of the internet delivered model.
- Macroeconomic volatility – the 2008/9 GDP growth reported in Exhibit 2 shows the macro-volatility of the region. In an uncertain global environment this concern is likely to be above the long-term average, ie this discount will be less in more stable times.
- Youth of company – several peers have decades of proving the model through a full range of economic conditions. While MCB was profitable in all but one country, through a severe recession investors will take time to be as comfortable with the model as they are with longer-established players. This may also apply to building a long-term track record in the market for MCB’s specific nature of lending. Again this should reduce with time.
- Illiquidity of stock – over time we expect management actions will increase the ability of investors to buy/sell without moving the market price. At present we believe it is appropriate to apply a discount for the current level of illiquidity.
- Potential capital raising – we believe organic growth and geographic expansion mean that some equity raising will be probable over the near/medium term. While this should

improve stock liquidity, uncertainty over timing and amounts deserve a discount. Internal generation of capital and the steady geographic expansion will moderate this concern.

We also note DFC Global Corp (NASDAQ, DLLR) on 6 July 2011 acquired for \$46m, Risicum, a competitor to MCB in Finland. The trailing annual EBITDA for Risicum was \$9.2m. For MCB, we are forecasting pre-tax profits of €3.4m in 2011 and €4.6m in 2012 after financing costs of €1m and €1.4m respectively. At first, on Risicum multiples, this would imply an MCB valuation well in excess of £20m. On company 2012 EPS guidance of US\$2-2.15 DFC Global Corp (the old Dollar Financial Corporation), is trading at c 11.5x P/E, and c 2x current NAV (both on US GAAP).

We note that in the recent turmoil, and after announcement of the proposal to delist, MCB has traded independently of IPF, other peers and the market.

### **Discounted cash flow model – 97p**

Our DCF model assumptions are company specific, forecast to 2012, 8% compound growth for 10 years and a 10x multiple applied for the terminal cash flow. Discounting these cash flows by 15% per year generates a value of €18.6m, which converting at €1.15/£, gives 97p per share. Just 31% of the value is in the terminal value.

### **Gordon's growth model – 109p**

Assuming long-term RoE of 20% (conservatively below the level the 2012 forecast of 25% and the returns consistently seen by PFG [c 30%] and IPF [c 22%]), growth of 8% and a 15% CoE generates a P/BV value of 1.7x. Applying this to the end-2011 BV per share (61.2c) indicates 105c, which we then inflate by 20% to reflect the fact that near-term returns are above long-term, sustainable returns; this suggests a value of 126c (converting at €1.15/£ gives 109p).

## **Financials**

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Despite the near doubling of estimates on MCB's four-month trading update on 16 May, we have further increased our estimates with these results. This reflects the accelerated credit issued and above-expected recoveries in the period. Our 2012 estimates benefit from the former although the latter is less of an issue. More significantly, we have cut the tax rate to 25% for each year. Our 2011 pre-tax has increased from €2.75m to €3.35m and 2012 from €4.13m to €4.5m, and our normalised EPS to 15.3c in 2011 and 21.1c in 2012.

**Exhibit 5: Profit and loss and balance sheet**

	€'000s	2007	2008	2009	2010	2011e	2012e
Year end 31 December							
<b>PROFIT &amp; LOSS</b>							
<b>Revenue (net of financing cost)</b>		<b>3,818</b>	<b>12,071</b>	<b>14,346</b>	<b>11,058</b>	<b>16,420</b>	<b>19,700</b>
Cost of Sales (exc amortisation and depreciation)		(5,423)	(7,777)	(7,135)	(7,662)	(10,010)	(10,808)
Credit losses		(1,387)	(4,030)	(7,764)	(2,805)	(3,000)	(4,300)
<b>EBITDA</b>		<b>(2,991)</b>	<b>264</b>	<b>(553)</b>	<b>591</b>	<b>3,410</b>	<b>4,592</b>
Depreciation		(11)	(38)	(45)	(21)	(23)	(26)
Amortisation		(74)	(16)	(20)	(36)	(36)	(36)
<b>Operating profit (pre exceptional)</b>		<b>(3,076)</b>	<b>209</b>	<b>(619)</b>	<b>534</b>	<b>3,351</b>	<b>4,530</b>
<b>Profit Before Tax (FRS 3)</b>		<b>(3,076)</b>	<b>209</b>	<b>(619)</b>	<b>534</b>	<b>3,351</b>	<b>4,530</b>
<b>Profit Before Tax (pro forma)</b>		<b>(2,743)</b>	<b>487</b>	<b>(634)</b>	<b>577</b>	<b>3,470</b>	<b>4,650</b>
Tax		0	(82)	(422)	(343)	(838)	(1,133)
<b>Profit After Tax (FRS 3)</b>		<b>(3,076)</b>	<b>127</b>	<b>(1,041)</b>	<b>191</b>	<b>2,513</b>	<b>3,398</b>
<b>Profit After Tax (pro forma)</b>		<b>(2,743)</b>	<b>405</b>	<b>(1,056)</b>	<b>234</b>	<b>2,632</b>	<b>3,518</b>
Average Number of Shares Outstanding (m)		17.4	17.4	17.4	17.2	16.7	16.7
<b>EPS - normalised (c)</b>		<b>(15.77)</b>	<b>2.33</b>	<b>(6.07)</b>	<b>1.34</b>	<b>15.30</b>	<b>21.07</b>
<b>EPS - FRS3 (c)</b>		<b>(17.7)</b>	<b>0.73</b>	<b>(5.98)</b>	<b>1.11</b>	<b>15.05</b>	<b>20.35</b>
Dividend per share (c)		0.00	0.00	0.00	0.00	0.00	0.00
EBITDA Margin (%)		(78.3%)	2.2%	(3.9%)	5.3%	20.8%	23.3%
Operating Margin (before GW and except.) (%)		(80.6%)	1.7%	(4.3%)	4.8%	20.4%	23.0%
<b>BALANCE SHEET</b>							
<b>Fixed Assets</b>		<b>829</b>	<b>984</b>	<b>828</b>	<b>1,318</b>	<b>1,929</b>	<b>1,448</b>
<b>Debtors (Net receivables)</b>		<b>8,188</b>	<b>20,909</b>	<b>12,965</b>	<b>11,876</b>	<b>22,500</b>	<b>33,000</b>
<b>Total Assets</b>		<b>9,523</b>	<b>23,065</b>	<b>16,007</b>	<b>15,144</b>	<b>26,429</b>	<b>37,948</b>
<b>Current Liabilities</b>		<b>(6,258)</b>	<b>(2,493)</b>	<b>(8,541)</b>	<b>(7,444)</b>	<b>(16,215)</b>	<b>(24,337)</b>
Long term Liabilities		0	(12,050)	0	0	0	0
<b>Net Assets</b>		<b>3,265</b>	<b>8,523</b>	<b>7,467</b>	<b>7,700</b>	<b>10,214</b>	<b>13,611</b>
<b>CASH FLOW</b>							
<b>Operating Cash Flow</b>		<b>(8,303)</b>	<b>(11,680)</b>	<b>6,665</b>	<b>1,084</b>	<b>(7,341)</b>	<b>(6,269)</b>
Net cash from investing activities		(105)	(98)	(23)	(89)	(50)	(50)
Net cash from (used in) financing		8,640	12,435	(5,590)	(1,260)	8,378	7,898
<b>Net Cash Flow</b>		<b>233</b>	<b>657</b>	<b>1,052</b>	<b>(265)</b>	<b>988</b>	<b>1,579</b>
<b>Opening cash</b>		<b>274</b>	<b>506</b>	<b>1,163</b>	<b>2,214</b>	<b>1,950</b>	<b>2,937</b>
<b>Closing net (debt)/cash</b>		<b>506</b>	<b>1,163</b>	<b>2,214</b>	<b>1,950</b>	<b>2,937</b>	<b>4,517</b>

Source: MCB, Edison Investment Research

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