

Recommendation **Speculative BUY**
Target Price **\$0.49**

Market Stats

Market Capitalisation	m	12.7
52 Week H/L	\$	0.35 / 0.22
Shares on Issue	m	46.2
Options	m	8.5

Valuation

Stock price as of 20 November 07	\$	0.275
12-month price target	\$	0.49
12-months Total return	%	77.6

ASX Stock code	EPD
Sector	software & services

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Investment summary

Year end June 30		FY07(A)	FY08(E)	FY09(E)	FY10(E)
Sales revenue	m	7.1	10.6	14.9	20.1
EBIT	m	0.5	0.9	1.8	3.1
Reported Profit	m	(2.1)	0.8	1.4	2.2
Adjusted Profit	m	0.5	0.8	1.4	2.2
Free cashflow	m	0.3	0.5	1.2	1.8
FCFPS	¢	0.6	1.1	2.5	3.9
FCFPS growth	%	NA	82.3	130.3	55.1
EPS(adj)	¢	1.0	1.8	3.1	4.7
EPS growth	%	NA	68.0	75.2	52.9
PE	x	26.3	15.6	8.9	5.8
ROA	%	4.1	5.0	7.8	9.5
ROE	%	7.8	8.0	12.0	13.9
EV/EBITDA	x	24.0	13.1	6.9	4.2

OVERVIEW

Empired is a Perth based, national provider of IT services and solutions.

The company listed on the ASX in October. We have completed this report following a visit to the company's head office earlier in November.

STRONG EARNINGS GROWTH EXPECTED

Strong growth and corporate activity across a range of industries is expected to keep demand for IT services strong across Australia. Empired, given its market position, knowledge and workforce capacity is expected to benefit from strong IT service demand, particularly in its enterprise solutions business line, but also over time in its outsourcing solutions line.

We are currently forecasting strong double digit revenue growth of 50% in FY08, 40% in FY09 and 35% in FY10. Slight EBITDA margin improvement, as billable hours per head improves is expected to boost EBITDA 84% in FY08 to \$1.03m. Likewise we are forecasting adjusted NPAT to improve 71% to \$0.8m. This implies Empired is currently trading at a PE ratio of 15.6x, a reasonably high multiple given that there was no earnings guidance provided in the prospectus and that management are yet to report a set of results to the market place.

However, we must note that our forecast does not account for the recent acquisition of Quadrant, which is expected to add marginally to FY08 EBITDA and NPAT. In addition, given the strong industry demand and a deep tendering line, we remain confident that our forecasts are relatively conservative and actual headline performance will be stronger.

VALUATION

Our initial valuation and twelve month price target for Empired is \$0.49 per share. We are confident in Empire's ability to tender for and secure ample specialist project business, while the company continues to develop outsourcing solutions.

Key price catalysts during the 2H08 will be continued acquisition and the release of 1H08 results, expected January.

RECOMMENDATION

Empired represents a speculative investment in Australia's IT services industry. Potential investors should be aware that the company's current and forecast earnings level is highly dependant on specialised discrete engagements. However we understand the company plans to grow its multi-year revenue contracts substantially moving forward.

Earnings growth will be driven by the company's ability to secure new customers, acquire competitive businesses and maintain operating margins and adequate working capital. We believe Empired is a speculative BUY.

COMPANY OVERVIEW

Empired is a national provider of Information Technology (IT) services, support and solutions.

The company provides services to medium and large corporate and government organisations, with a focus on organisations of 300 employees and upwards.

Headquartered in Perth the company has approximately 150 staff and a presence in Melbourne.

Empired focuses on providing IT outsourcing services to clients complimented by project and consulting engagements within their areas of specialisation.

Empired is a well established business, with long term recurring revenue contracts in place and several blue chip customers.

Blue chip customers



Source: Empired

Empired was founded in 1999 as a software company and expanded into IT services in 2002. IT services were initially focussed on enterprise solutions and in early 2006 the company expanded into outsourcing solutions. In July 2007 the company divested its interest in software, wholly owned subsidiary BigRedSky Limited - a talent management software developer, becoming a dedicated IT services business. The company listed in October 2007.

Since listing, the company has acquired fellow West Australian IT consulting and service provider Quadrant Group for \$1.74million plus 300,000 options.

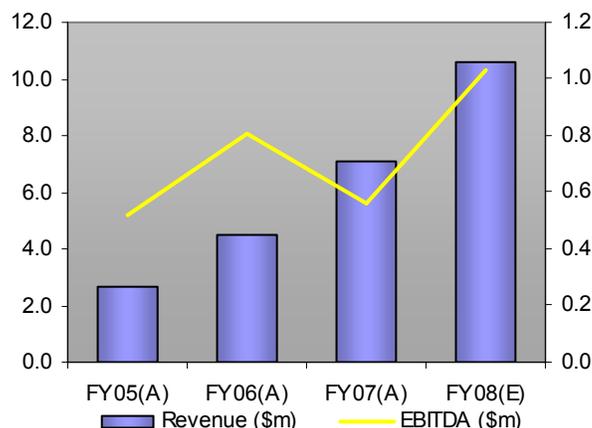
Empired's IT services business (excluding the now divested BigRedSky software business) has experienced double digit revenue growth since 2005.

Operating revenue grew 69% in 2006, to \$4.5million and 59% in 2007, to \$7.1million. Gross profit grew 40%, to \$1.4million in 2006 and 57% to \$2.2million in 2007.

However, gross profit margins declined over this period, gross margins fell from 37% in 2005, to 31% in 2006 and 2007. The

decline reflects a substantial increase in the cost of sales, attributable to higher billable staff costs.

Strong revenue and earnings growth



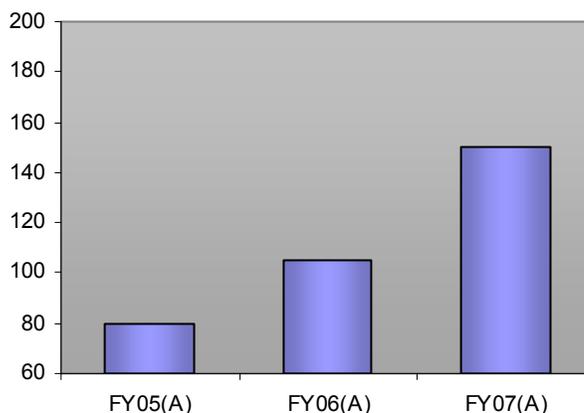
Source: Extion Investment Management & Company data

FY06 - FY07 financial results

\$million	FY06(A)	FY07(A)
Revenue	4.47	7.08
COGS	(3.1)	(4.9)
Gross Profit	1.39	2.17
GP margin	31%	31%
Overheads	(0.6)	(1.6)
EBITDA	0.81	0.56
EBITDA margin	18%	8%
NPAT(adj)	0.75	0.47

Source: Company data

Staff growth



Source: Empired

Empired's aim is to continue to achieve double digit earnings growth rates through organic growth of current operations and acquisition.

THE IT SERVICES INDUSTRY IN AUSTRALIA

The Australian IT services industry has shown strong growth in recent years, and organic growth across the sector is expected to grow between 4% and 8% per annum over the next three years. Growth has been driven in part by the increasing investment in IT solutions, by both private and public sector organisations, to meet their growing demands.

Investment in IT solutions has translated to increased demand for new or replacement infrastructure, new bespoke applications and packaged software, enhanced networking and faster telecommunications. To support this growth many organisations have reassessed their IT support models to now include a mix of outsourcing, co-sourcing and multisourcing, as well as the traditional in-sourced IT model.

IT outsourcing agreements have also changed, with many organisations moving away from traditional large single supplier contracts to a more selective outsourcing model, where a number of suppliers each deliver specific components around their core competencies. The move towards selective outsourcing of IT needs has allowed IT service companies to specialise services offered and increase the number of clients these services are offered to.

Overall the industry is mature, but remains highly fragmented, with a large number of relatively small and new players operating, offering substantial consolidation (acquisition) opportunities. Total growth in IT spending on software and services is expected to be strong, IDC expects total IT spending to grow by \$3.9 billion per annum between 2007 and 2011, reaching A\$33.9 billion in 2011.

STRATEGIC POSITION

Empired offers clients a full service solution, from planning, design, implementation and ongoing management the company can support and service each stage of a projects lifecycle. The company is completely focused on IT services relating to infrastructure and software solutions. The company is not currently involved in the construction and procurement of computer hardware.

Empired provides its services through two dedicated business units:

- **Outsourcing Solutions** – the provision of day to day operational support and management of client's IT and communications infrastructure. IT outsourcing services are generally provided through multi-year re-occurring revenue contracts; and
- **Enterprise Solutions** – discrete engagements to provide services or deliver projects encompassing the planning, design and implementation of a number of high-end technical capabilities. These services aim to optimise an organisation's processes and integrate related technology applications and platforms.

OUTSOURCING SOLUTIONS

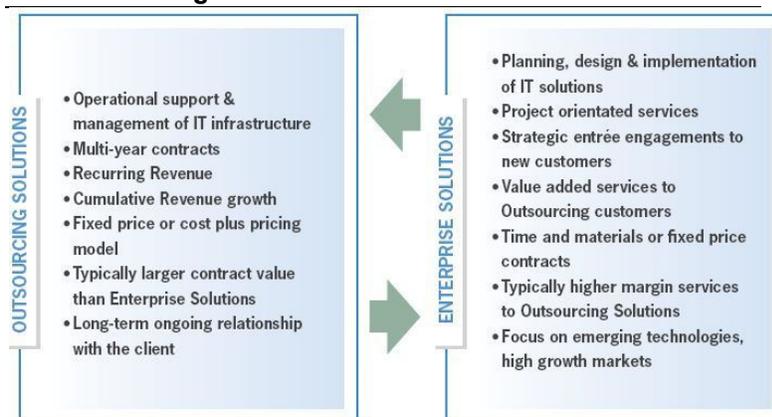
Empired's outsourcing solutions model is based primarily on the delivery of a full suite of operational services from a remote central site. This model is complemented by onsite support however, due to the high cost low margins associated with onsite support, the company's strategy is to keep onsite technical support to a minimum.

There are seven operational services provided by outsourcing solutions. Entry level support is provided by the service desk, a single point of contact for ownership and management of all incidents, requests for service and queries.

Specialist second level support is provided through the remaining six service lines:

- Desktop management
- Server management
- Network & communications management
- Storage & Data management
- Security & administration services
- Field Services

Service offerings



Source: Empired

ENTERPRISE SOLUTIONS

The company's enterprise solutions model is delivered through six specialist practices:

- Data management (assessment, migrations, recovery & backup)
- Advanced infrastructure (internet / intranet infrastructure, desktop & server management)
- Contracting solutions (ad hoc services, staff secondment)
- Project & Program Management
- Collaboration Solutions (bespoke applications, internet / intranet solutions, remote access solutions)
- Enterprise Strategy & Architecture (management consulting, business continuity, risk and audit services)

Each service line has different characteristics regarding contract lengths, utilisation rates and the level of technical expertise required.

Historically, relationships with outsourcing solutions clients have begun at the enterprise solution project level. This is both a function of the size of Empired, where its small, skilled and flexible workforce have a comparative advantage over larger organisations with higher fixed costs per individual project, and the relative age of the groups two business lines.

QUADRANT GROUP

Empired acquired a 100% interest in the Quadrant group in October 2007 for \$1.74m in cash, and 300,000 options.

Quadrant group provide IT planning and strategy, business analysis, project management and business continuity management. The groups operations fit under Empired's enterprise solutions business unit, adding significant expertise to the enterprise strategy and architecture service line.

Quadrant is an established business with an existing portfolio of customers. The company previously employed 28 staff and all are expected to migrate to Empired.

Management reported unaudited revenue of \$2.74m and EBIT of \$463k in FY07 and forecast FY08 revenue at \$3.37m, up 23%, and EBIT of \$636k, up 37%.

Empired financed the deal with an upfront payment of \$1.1m in cash from its existing balance sheet. Secondary payments of approximately \$348k and a further \$268k will be paid in April and October of 2008.

The acquisition was completed on a forward multiple of 2.7x FY08 (management forecast) EBIT and is expected to be earnings accretive to Empired from November. Quadrant is expected to be fully integrated into the Empired's business model by the end the first quarter of calendar 2008.

In our view the acquisition offers significant value to Empired's shareholders. The initial payment of \$1.1million was financed from the cash raised by Empired during its IPO, while the second and third payments are essentially self funding, using Quadrant's free cash flow. There is no immediate dilutive impact to Empired's existing shareholders from the acquisition.

Empired management are expected to make further acquisitions over the coming year. The company intends to use a mixture of free cash and debt to fund acquisitions, management are not expecting to issue additional script or raise equity for acquisitions in the immediate future.

REVENUE MODEL

The Company's revenue stream comprises recurring revenue from multi-year outsourcing agreements, together with project based enterprise solutions revenues. Revenues from enterprise solution projects are either on a fixed price or time and materials basis.

The company's client base is spread across a number of different clients and industries. Revenues from Enterprise solutions contributed to 73% of total FY07 revenue and 70% of FY07 EBIT. Enterprise solutions revenues are collected from a number of different clients and are spread across a diverse range of industries. The majority, 74%, of project work is charged to the client on a time and materials basis, which is generally driven by the number of billable hours Empired's consultants spend on a project. The profitability of this business unit is easily understood:

- Income from sales is derived from the effective daily charge out rate of consultants; and
- The cost of sales equals the cost of employing consultants.

Drivers of profitability include:

- Ensuring high levels of consultant utilisation, i.e. consultants are busy working billable hours, therefore maximising billable hours per day.
- Maintaining fixed costs at a minimum to maximise margins.

The balance of enterprise solutions projects, around 26%, is costed on fixed price. Fixed fee work can be lucrative, particularly if Empired can leverage its previous experience and providing similar solutions to multiple clients. Here the maximum profit margin solution is to minimise work time and fixed costs per job, while maximising client satisfaction.

Revenues from outsourcing solutions offer a more stable source of revenue and cash flow, however the majority of outsourcing solutions revenue at this point is collected from two major clients. In FY07 outsourcing solutions contributed 27% to total revenue and 30% to FY07 EBIT. Revenue from outsourcing solutions is generally collected on multi-year reoccurring revenue basis.

Operating margins from enterprise solutions workflow are higher than from outsourcing solutions, reflecting the lumpy nature of project work and finite length of each project. However, outsourcing solutions are a more stable source of multi-year reoccurring revenue.

In the long run the company expects that growth in the outsourcing solutions business will outstrip growth in the enterprise solutions business, consequently outsourcing solutions is expected to become the main contributor to total revenue.

INVESTMENT THESIS

Macro-environment

- **Corporate IT spend** - A strong corporate IT spend is expected to drive strong revenue growth across the IT services sector. Like all IT services businesses Empired's revenue growth is directly tied to the intended level of future IT investment by public and private sectors. Over the medium term IT investment is likely to be driven by the following factors:

- **M&A activity** – Consolidation in a variety of industries will drive many companies to revisit their IT service requirements, this could involve streamlining existing platforms or rolling out new platforms across merged entities. Empired's outsourcing and enterprise solutions units are well positioned to take advantage corporate activity, particularly activity in the resource sector.
- **Cost reduction and efficiency initiatives** – There continues to be strong corporate demand for IT services. Many corporations are embarking on new IT projects in an effort to streamline systems, increase efficiency and reduce fixed costs by implementing new enterprise solutions projects. Empired's full service solution model is well positioned to take on these types of projects which normally require input at the planning, design and implementation phases. Quadrant is also expected to benefit strongly from this trend.
- **Product & service improvement** – Companies continue to seeking innovative solutions that will give their products or services that competitive edge. Increasingly these 'innovative solutions' involve a significant spend on new software or systems.
- **Cyclical replacement** – Strong economic growth and high corporate profits over the last several years, is expected to drive cyclical upgrading of current systems and services.

Overall the macro outlook for all IT services providers is positive, however there are several key possible negatives that could impact profit margins over the medium term.

- **IT spending sentiment** – While a downturn in IT spending is not currently expected over the medium term, it should be acknowledged that Empired's business lines would be negatively impacted if a downturn were to occur. Sensibly, Empired's strategy is to grow its outsourcing solutions business, even though this is generally lower margin work, revenues are reoccurring, substantially lowering cash flow and business risk.
- **Domestic labour costs** – Given current tight labour market conditions, specialist IT consultant salaries have jumped significantly. In many cases this cost increase is difficult, particularly in the short term, to pass onto customers, which means Empired will need to optimise staff retention, staff utilisation and keep fixed overheads as low as possible. Increased staff salary costs is arguably the biggest downside risks to our current earnings forecasts. However, following a significant investment in staff last year, high staff moral and the addition of approximately 28 staff from the Quadrant acquisition we don't expect this to be a problem for Empired, at least in the short term.

Company Growth Strategy

Empired is focussed on continuing to grow its business both organically and through strategic acquisitions which provide synergistic benefits to the Company and compliments its current growth strategy. The Company's growth strategy focuses on three key elements:

- Increasing staff skills and range of IT service offerings;
- Expanding the Outsourcing Solutions business;
- Regional diversification; and
- Acquisition opportunities.

SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> ● Sound board with diversified experience ● Highly motivated and driven management team ● Division of company into clear lines of service allowing management to specialise and offer niche products/services ● Blue chip client base ● Long-term contracts delivering multi-year revenue ● High growth market ● Double digit revenue & earnings growth ● Limited financial debt and strong balance sheet ● Strong cash flow 	<ul style="list-style-type: none"> ● Reliance on key customers ● Exposure to an unexpected down turn in IT spend ● Absence from Eastern Australia ● Limited client diversity in current earnings base ● Increasing costs ● Declining operating margin ● Dependence on key information systems ● Reliance on key personnel and management
Opportunities	Threats
<ul style="list-style-type: none"> ● Expansion through Acquisition ● Expansion into Eastern Australia ● Expansion offshore, by leveraging existing client base ● Increased demand for IT service providers ● Increasing industry value through emerging technologies ● Industry consolidation 	<ul style="list-style-type: none"> ● Highly competitive and fragmented industry, making it difficult to build brand image and reputation ● Competitors operating margins are higher ● Slowdown in capital spend by clients ● Slowdown in Australian economic activity

Board & Management

Both the board and management of Empired appear to be highly skilled in their respective areas. The Managing Director

of Empired, Mr Russell Baskerville, has over ten years experience in the IT industry, and has successfully founded and managed a number of companies during that time.

Other members of the board include:

- Chairman, Mr Mel Ashton is Vice-President Fremantle Football Club, Councillor at the Institute of Chartered Accountants, Chairman for Venture Minerals Ltd, Gryphon Minerals Ltd and Empire Beer Group Ltd.
- Non-Exec Director, Mr David Taylor is former general manager of BankWest operating divisions, Chairman of the Peth Marketing Authority and the Forest Products Commission.
- Company Secretary, Mr Craig Ferrier is a CPA with 20 years experience at the chief financial officer and company secretary level in ASX listed companies.

Management team:

- CFO, Mr Mark Waller has extensive corporate experience from previous employment with Ernst & Young and founding and running his own businesses previously.
- GM Service Delivery, Mr Greg Leach has extensive experience in delivering large system development, infrastructure projects and managed services.
- GM Strategic Growth, Mr Brendon Jarvis has over 25 years experience in IT, much of this time working for service providers.

FORECASTS & VALUATION

Our financial forecasts are outlined in the table below. The primary assumptions underpinning our forecasts are continued strong double digit growth in revenue in FY08, FY09 and FY10 and a significant improvement in operating margins from FY09 onwards.

Gross profit margins are expected decline slightly into FY09 and improve as new consultancy staff taken on by Empired in FY07 and FY08 return billable hours per consultant to more reasonable levels.

Note we have presented figures for the Empired business alone as it stood at its IPO.

We have separately valued the Quadrant business as a stand alone bolt on acquisition, however over time we do anticipate that the Quadrant group will be fully integrated into the Empired business model, consequently we do expect some upside to our full year revenue and earnings figures as a result of the Quadrant acquisition.

FY08 - FY10 financial forecasts

\$million	FY08(E)	FY09(E)	FY10(E)
Revenue	10.62	14.87	20.07
COGS	(7.5)	(10.3)	(13.9)
Gross Profit	3.08	4.61	6.22
GP margin	29%	31%	31%
Overheads	(2.0)	(2.7)	(3.0)
EBITDA	1.03	1.94	3.21
EBITDA margin	10%	13%	16%
NPAT(adj)	0.81	1.42	2.17

Source: Exton Investment Management Forecasts

Our valuation for Empired is in two parts. First using a discounted free cash flow model (DCF) we have valued the Empired business, as it stood on the day of its IPO.

Our valuation for Quadrant group is calculated by applying an EBITDA multiple of 9x to forecast FY08 earnings. This is the same multiple applied by analysts to value similar IT services business ASG Group Limited.

Our valuation for the Empired business, as it stood at IPO, is \$0.41 per share, using a beta of 1.96 and a WACC of 16.6% as the discount rate.

Our valuation for the Quadrant business as a pure bolt-on acquisition is \$0.08 per share.

INVESTMENT RISKS

Upside risks to our forecasts and valuation include bolt-on acquisitions and better than expected staff utilisation, resulting in stronger operating and EBIT margins.

Downside risks include higher than expected labour costs (reducing margins), an unforeseen downturn in corporate IT spending and the loss of key clientele to competition or from corporate activity where a key client is taken over, with Empired losing its existing contracts.

RECOMMENDATION

Given our relatively conservative assumptions, it is our belief that the risks to our earnings forecasts are to the upside. The company's ambitions to build scale and acquire new businesses with out dilution to existing shareholders could lead to potentially stronger earnings and margins than currently anticipated.

While the company is currently cash flow positive, the loss of one of its key customers could see profit margins under significant pressure and could result in negative earnings. Despite this we are confident in the ability of the company's management to deliver strong double digit growth rates in revenue and earnings for at least the next 3 years.

We believe Empired is a speculative buy and any holding in the stock should reflect its speculative nature. Our current twelve month target price is set at \$0.49 per share, a 78% premium to the companies current share price.

FINANCIAL TABLES

Profit & Loss	FY07(A)	FY08(E)	FY09(E)	FY10(E)	Ratios	FY07(A)	FY08(E)	FY09(E)	FY10(E)	
Revenues	7.1	10.6	14.9	20.1	Profitability					
Net income	2.2	3.1	4.6	6.2	Revenue growth	%	58.4	50.0	40.0	35.0
EBITDA (before abnormals)	0.6	1.0	1.9	3.2	EBITDA margin	%	7.9	9.7	13.1	16.0
Depreciation	(0.1)	(0.1)	(0.1)	(0.1)	EBIT margin	%	6.8	8.7	12.4	15.5
Amortisation	0.0	0.0	0.0	0.0	Effective tax rate	%	0.0	12.0	22.7	30.0
EBIT	0.5	0.9	1.8	3.1	ROE	%	4.1	5.0	7.8	9.5
Net Interest	0.0	0.0	0.0	0.0	ROA	%	7.8	8.0	12.0	13.9
Tax expense	0.0	(0.1)	(0.4)	(0.9)	EV/EBITDA	x	32.4	17.6	9.3	5.7
NPAT before Abnormals	0.5	0.8	1.4	2.2	Balance sheet					
Reported NPAT	(2.1)	0.8	1.4	2.2	Net Debt (Cash)	\$m	0.1	(1.3)	(2.4)	(4.2)
Balance Sheet	FY07(A)	FY08(E)	FY09(E)	FY10(E)	Net Debt/Equity	%	7.2	(37.4)	(50.7)	(60.9)
Cash	0.0	1.3	2.5	4.3	Current ratio	x	0.9	1.6	2.1	2.5
Receivables	1.2	1.9	2.7	3.6	Acid test	x	1.1	2.1	2.5	2.9
Fixed Assets	0.3	0.3	0.3	0.4	Interest cover	x	34.9	117.0	233.5	394.1
Intangibles	1.9	1.9	1.9	1.9	NTA (\$/share)		0.0	0.0	0.1	0.1
Total Assets	3.6	5.4	7.3	10.2	Price/NTA	x	257.3	8.5	4.4	2.5
Bank overdraft	0.4	0.4	0.4	0.4	EFPOWA	m	46.2	46.2	46.2	46.2
Creditors	1.0	1.4	1.9	2.6	Valuation					
Provisions	0.1	0.1	0.1	0.1	Discounted cash flow - (pre-Quadrant)					
Short-Term Debt	0.1	0.0	0.0	0.0	Cost of Equity		18.3% WACC			16.6%
Long-Term Debt	0.1	0.1	0.1	0.1	Cost of Debt		11.7% Terminal growth rate			2.0%
Other	0.0	0.0	0.0	0.0	Target Debt/Equity		25/75 Value (pre-Quadrant)	\$		0.41
Total Liabilities	1.7	2.0	2.6	3.2	Risk free rate		6.5%			
Minority Interests	0.0	0.0	0.0	0.0	Market risk premium		6.0%			
Net Assets	1.9	3.4	4.8	7.0	Beta		1.96			
Cash Flow	FY07(A)	FY08(E)	FY09(E)	FY10(E)	Quadrant Valuation - EBITDA multiple					
EBITDA	0.6	1.0	1.9	3.2						
Net Interest	(0.0)	(0.0)	(0.0)	(0.0)	EBITDA	\$m				FY08F 0.4
Tax paid	0.0	(0.1)	(0.4)	(0.9)	EBITDA multiple	x				9
Working capital change	(0.1)	(0.3)	(0.2)	(0.3)	Enterprise value	\$m				3.6
Other Cashflows	(0.5)	0.0	0.0	0.0	Net Debt	\$m				0.0
Operating Cashflow	(0.1)	0.6	1.3	2.0	Equity value	\$m				3.6
Capital expenditure	(0.1)	(0.1)	(0.1)	(0.2)	Per share	\$				0.08
FCF after tax	(0.3)	0.5	1.2	1.8	EPD Valuation	\$				0.49
Investments	(0.3)	(1.7)	0.0	0.0						
Equity raised	0.3	2.7	0.0	0.0						
Net Borrowings	0.1	(0.1)	0.0	0.0						
Dividends Paid	0.0	0.0	0.0	0.0						
Other Cashflows	0.0	0.0	0.0	0.0						
Net change in cash	(0.0)	1.3	1.2	1.8						
Closing cash balance	0.0	1.3	2.5	4.3						

Note: Forward looking data is normalised for the acquisition of Quadrant in October 2007. That is forward looking figures are presented for the Empired business before the acquisition of Quadrant in October 2007.

ANALYSTS CERTIFICATION

I Piers Dumaresq, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers.

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