

Marks Electrical Group



Connecting the growth drivers

8th November 2022

In addition to the previously announced 15.1% sales growth, market share gains, margin resilience and strong cash generation were key features of the Marks Electrical (MRK) FY2023 H1 performance. Despite a competitive market, the company continued to invest in its brand and customer service levels. Moreover, MRK expects to meet current market expectations of profit growth for the full year. We maintain our 150p fair value for the shares.

Marks Electrical's 15.1% first half sales growth was announced in a trading update on 11th October 2022, with market share gains being the driver of that growth. Today's interim results release evaluates those share gains in more detail, as well as including three important indicators of ongoing and sustainable progress within the business – margin resilience, a strong return profile and the company's net cash position. The company is well placed to make further share gains in H2.

MRK gained market share in both Major Domestic Appliances (MDA) and Consumer Electronics (CE) in the latest reporting period. MDA's market share is estimated to have risen to 2.1% in the first half of FY2023 from 1.5% in the same period in FY2022, while CE share rose from 0.2% to 0.3%. Performance across all categories was strong with a notable 35% increase in energy efficient laundry appliances, as MRK matched demand for lower running costs and sustainability.

A combination of factors – notably the impact of price discounting and fuel costs on gross margins, PLC costs and increased marketing - led to adjusted EBITDA margins being lower than in FY2022 H1. These profit measures fell from £3.0m to £2.7m and from 8.1% to 6.3% respectively, despite some benefit from improved operating leverage. Marketing costs increased as a proportion of sales from 5.1% to 5.6% of revenue which was arguably rewarded by an increase in brand awareness to 10% from 7% in FY2022 H1.

A number of important structural areas of progress were made in FY2023 H1. These included expanded reach to include Glasgow, Edinburgh, and Cornwall. In addition, the company introduced a new in-house installation offering using its own team of installation engineers.

Significant potential upside to our 150p fair value

The company's intrinsic value incorporates its industry-leading 4.8 Trustpilot score, arguably superior service, and significant headroom in terms of both market share and brand awareness levels. A positive cash position was reflected in the announcement of a 0.30p interim dividend. We base our fair value of 150p per share on 1.7x FY2023 sales revenue and 21.5x FY2023 EV/EBITDA and support this with a DCF valuation.

Company Data

EPIC	MRK
Price (last close)	71p
52 weeks Hi/Lo	128p/55p
Market cap	£75m
ED Fair Value/share	150p

Share Price, p



Source: ADVFN

Description

Marks Electrical Group PLC (MRK) is a fast growing online electrical goods retailer, which was founded by its current CEO Mark Smithson in 1987.

MRK focuses on premium branded Major Domestic Appliances, which it can deliver with its in-house wholly owned fleet of vehicles to more than 99% of the English population on a next day basis.

The company operates from a single site in Leicester, which also houses its headquarters.

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Key Financials

Year to 31st March	2019A	2020A	2021A	2022A	2023E	2024E
Revenue (£m)	31.2	31.5	56.0	80.5	89.0	112.8
Revenue growth (%)		0.8	77.7	43.8	10.6	26.7
EBITDA (£m) (adj)	1.9	1.3	7.7	7.2	6.9	9.6
EPS adjusted (p)	1.10	0.66	5.05	5.01	4.32	5.74
DPS (p)				0.67	0.86	1.15
EV/sales (x)	2.1	2.1	1.2	0.8	0.7	0.6
EV/EBITDA (x)	35.1	51.6	8.6	9.1	9.5	6.9
P/E ratio (x)	64.3	108.0	14.1	14.2	16.4	12.4
Yield (%)				0.9	1.2	1.6

Source: ED estimates, company historic data

Connecting the growth drivers

The sales growth case for Marks Electrical (MRK) remains the company's ability to gain market share by raising awareness of its delivery of premium, branded Major Domestic Appliances (MDAs) and Consumer Electronics (CE) products to UK retail customers on a next day basis via its online platform. The simplicity of that message is supported by a clearly articulated, focused approach to doing business.

This report looks first at today's interim results statement before discussing market share, service quality, relative profitability (including returns on capital and cash conversion) - and a relative valuation supported by DCF analysis. We conclude with our financial forecasts which are unchanged.

Interim results overview

MRK's 15.1% first half revenue growth confirms the number which was released in the company's 11th October 2022 trading update and discussed in our report [Market share gains drive strong sales growth in H1](#). In addition to full FY2023 H1 financial data, today's release includes data for overall and online market share gains, as well as brand awareness. We summarise financial results highlights in Figure 1.

Figure 1 - Marks Electrical FY2023 H1 - financial results highlights

All figures in £'000s	FY2022 H1	FY2023 H1	change
Year to 31st March			
Sales revenue	37,470	43,146	15.1%
Gross profit	7,200	7,808	8.4%
Gross margin	19.2%	18.1%	-1.1 points
Adjusted EBITDA	3,031	2,704	-10.8%
Adjusted EBITDA margin	8.1%	6.3%	-1.8 points
Adjusted EBIT	2,707	2,130	-21.3%
Adjusted EBIT margin	7.2%	4.9%	-2.3 points
Adjusted profit after tax	2,234	1,741	-22.1%
Adjusted EPS (pence)	2.14	1.66	-22.4%
Statutory profit after tax	1,626	1,738	6.9%
Statutory EPS (pence)	1.55	1.66	7.1%

Source: Company data

While margins clearly thinned relative to the same period in FY2022, some specific factors should be noted. Heavy competitor discounting as well as increased fuel costs not surprisingly put downward pressure on gross margins in the period to the tune of around 110 basis points. MRK increased advertising as a proportion of sales, which should be seen as investment in the future of the business. These costs rose from 5.1% to 5.6% of sales revenue – i.e. 50 basis points with a similar impact from PLC costs. Improved operating leverage delivered around 30 basis points of margin benefit.

Importantly, MRK is a cash generative business. Shareholders will benefit significantly from the company's high rates of cash conversion; better deals are able to be struck on opportunistic stock purchases, and MRK should have no problem going forward in matching net profit gains with increased dividends. The company announced a 0.30p interim dividend in these results.

Despite a challenging overall backdrop for consumer facing companies, some downward pressure on gross margins and increased investment behind the Marks Electrical brand, free cash flow remained strong in the period. The company generated £4.5m in free cash flow in the first half of FY2023 and ended the half-year with a healthy £7.7m closing net cash position.

Furthermore, MRK operates on a capital-light basis, which was reflected in today's interim results with a 49% ROCE based on adjusted EBIT divided by total assets less current liabilities. This figure is well in excess of the 8.5% that we consider to be a reasonable WACC or hurdle rate for the business – i.e., the company is capable of growing sales revenue and generating substantial economic profit simultaneously.

Figure 2 - Marks Electrical FY2023 H1 - cash highlights

All figures in £'000s	FY2022 H1	FY2023 H1	change	
Operating cash flow for conversion	6,578	5,117	-22.2%	
Operating cash conversion	217%	189%	-28.0	points
Free cash flow	5,940	4,523	-23.9%	
Free cash flow margin	15.9%	10.5%	-5.4	points
Net cash	1,276	7,692	6,416	
Return on capital employed	71%	49%	-22.0	points

Source: Company data

Raising market share through increased brand awareness

In addition to publishing profit data, the interim results detail the important **market share gains** that the company made in both its categories – i.e. Major Domestic Appliances and Consumer Electronics. These share gains are summarised in Figure 2, both for the overall markets and for online only. The company's gains in online – where it is a specialist operator – were not surprisingly more pronounced.

Figure 3 - Marks Electrical FY2023 H1 - market share and brand awareness

	FY2022 H1	FY2023 H1	change	
Overall market				
Major domestic appliances	1.5%	2.1%	0.6	points
Consumer electronics	0.2%	0.3%	0.1	points
Online segment only				
Major domestic appliances	2.6%	3.9%	1.3	points
Consumer electronics	0.4%	0.6%	0.2	points
Brand awareness	7%	10%	3	points

Source: Company data

MRK's commitment to investment in its brand through advertising was not only rewarded by market share gains but also by a significant increase in brand awareness in the half-year. Awareness is now estimated to stand at 10%.

As well as positive trends, MRK's share data reveal how much headroom the company has for expansion within the UK market. Moreover, the company enjoys headroom to expand towards its brand awareness level which - as the data above show - is currently four times its actual market share.

Marketing activities in FY2023 H1 included digital advertising, where the company continued its focus on paid media and search engine optimisation.

In mainstream media there were further on-screen campaigns across Sky, the ITV channels, Channel 4 and YouTube. Social media activity included brand development programmes on Facebook, Instagram and TikTok.

The company expects to reduce its level of brand and marketing investment in the second half of the year so as to match its stated 5.0% of sales target and acknowledges that it is in a position to leverage the investments made in the first half. Importantly, recent years' sales skewed into the second half, so MRK appears well set to benefit from its raised brand profile during the company's busier trading period.

Reinvesting in superior service levels

As well as steadily rising brand awareness, MRK's ability to demonstrate superior service levels should also be seen as fuel for further market share gains, in our view. In particular, a significant portion of MDA purchases are made on a "distress" basis, where promptness of delivery and a quick turnaround are major selling points for the company. MRK commits itself to delivering products on a next day basis when orders are placed ahead of 6pm.

Introduction of the company's **in-house installation capability** post the half-year end was highlighted in today's statement. MRK will use its own employed team of installation engineers which also enables the company to interact directly with the consumer base. Furthermore, there should be margin benefits associated with not sub-contracting this service to third parties.

The company has ordered 10 new installation vehicles and 12 additional delivery vehicles which it expects to come on stream in late calendar 2022 and 2023. MRK's geographical reach was also expanded in FY2023 H1 and now includes Glasgow, Edinburgh and Cornwall.

Superior Trustpilot scores tend to confirm superiority of service through ongoing commitment to operational delivery and customer satisfaction. As we highlighted in our 11th October report, MRK continues to enjoy a stronger endorsement from this source than its key competitors with a score of 4.8. The relative position, which benefits from significant management focus on the measure, is summarised in Figure 4.

Figure 4 - Relative Trustpilot scores

Company	Website	Trustpilot rating
Marks Electrical	www.markselectrical.co.uk	4.8
AO	www.ao.com	4.6
John Lewis	www.johnlewis.com	3.9
Currys	www.currys.co.uk	3.8

Sources: uk.trustpilot.com

Capital employed and cash

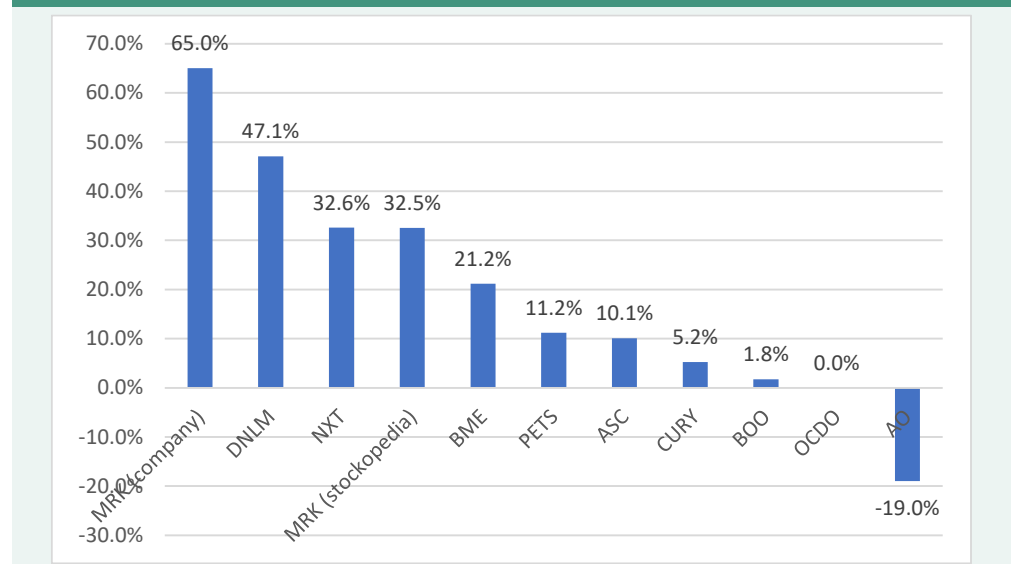
MRK is a capital-light business which not only enjoys – since its IPO – a strong net cash position, but also one which should continue to convert a significant portion of its operating profits and net income into cash.

Return on capital employed

Return on capital employed comparisons for Marks Electrical with the peer groups which we use for our relative valuation analysis are shown in Figure 5. We make two comparisons for MRK for the benefit of consistency with the company's own reported figure and the methodology used by Stockopedia from whom we source the comparator data.

MRK's approach – which we defined earlier as adjusted EBIT divided by total assets, less current liabilities – generates a higher figure than Stockopedia. However, the central message is still clear that MRK is at the top end of this group, which has important implications for valuation. Higher return on capital businesses should command a higher valuation based on key multiples.

Figure 5 – Return on capital employed comparisons – latest reporting year



Source: Company data and Stockopedia

Cash flow generation

A benefit of being relatively capital-light in relation to profitability is that the business is better equipped to generate free cash flow, which in turn can be used to finance future expansion and reward shareholders with dividends.

In addition to having the market share headroom, superior service quality and awareness generation headroom to grow, **MRK is also capable of generating free cash flow simultaneously with growing sales revenue** - hence the title of this report: "Connecting the growth drivers."

Figure 6 uses Stockopedia data for normalised (i.e. adjusted) EPS in the most recent reported year and figures from the same source for operating cash flow and free cash flow per share. The table ranks the profitable companies by the rate of EPS conversion into free cash flow and includes numbers for MRK based on its own reported data and the Stockopedia definition.

Figure 6 - Cash conversion comparisons using per share data

Company	EPS p	Op CF per share	FCF per share	Op CF conversion	FCF conversion
PETS	20.9	48.9	37.9	234%	181%
CURY	15.7	36.4	25.1	232%	160%
DNLM	83.6	123.0	111.0	147%	133%
MRK (Company)	5.0	8.2	5.5	164%	109%
BME	42.2	49.0	39.0	116%	92%
MRK (Stockopedia)	6.4	4.5	3.6	70%	56%
NXT	584.0	537.0	303.0	92%	52%
AO	-5.2	-10.9	-13.0		
ASC	-2.7	-12.1	-30.4		
BOO	-90.3	0.8	-20.3		
OCDO	-30.2	-2.2	-95.6		

NB - data refer to most recently reported full year. EPS refers to normalised or adjusted numbers.

Source: Company data and Stockopedia

Valuation & financials

Relative valuation

Our relative valuation assesses Marks Electrical against peer groups of MDA and CE providers and online retail businesses. Given MRK's confidence in achieving its full year targets and stated positive momentum going into the second half of the financial year, we maintain our fair value at 150p.

At such a fair value, MRK would trade on a 1.7x EV/sales ratio and 21.5x EV/EBITDA. Both of these valuations would represent a premium to the two peer groups. However, it should be noted that MRK is profitable, generates high returns on capital employed and is cash generative. These relative qualities are clear from the comparative ROCE and cash flow comparisons which we showed in Figures 5 and 6.

In addition, MRK has substantial headroom to grow in terms of market share headroom, the scope to grow brand awareness, superior service level and potential to expand geographically. **In our view, these qualities should be reflected in a premium valuation.**

We summarise relative valuation in Figures 7 and 8 and include our discounted cash flow calculation in Figure 9. That our DCF valuation is in excess of our fair value gives added comfort to our view that MRK has the potential to trade at a significantly higher share price than the current one.

Figure 7 - Relative valuation - online MDA providers

	Share price	Mkt cap	Net debt	EV	Sales 2023	EV/sales	EBITDA 2023	EV/EBITDA	EPS 2023	P/E 2023	DPS 2023	Yield
	(p)	(£m)	(£)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(x)	(p)	(%)
AO World (AO)	49	283	57	340	1172	0.3	19.0	17.9	-1.5	n/a	n/a	n/a
Currys (CURY)	68	771	232	1003	9436	0.1	528.0	1.9	8.8	7.8	3.1	4.6
Marks Electrical (MRK)	71	75	-9	66	89	0.7	6.9	9.5	4.3	16.4	0.9	1.2
Average						0.4		9.8		12.1		2.9

Share prices at 7 Nov close

Source: ADVFN, MarketScreener, Stockopedia and ED estimates.

Figure 8 - Relative valuation - online consumer goods providers

	Share price	Mkt cap	Net debt	EV	Sales 2023	EV/sales	EBITDA 2023	EV/EBITDA	EPS 2023	P/E 2023	DPS 2023	Yield
	(p)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(x)	(p)	(%)
ASOS (ASC)	647	647	193	840	4156	0.2	208	4.0	38.9	16.6	n/a	n/a
B&M (BME)	357	3577	2048	5625	4849	1.2	776	7.2	35.3	10.1	17.0	4.8
Boohoo (BOO)	47	596	56	652	1861	0.4	70	9.4	-1.1	nmf	n/a	n/a
Dunelm (DNLM)	935	1880	164	2044	1544	1.3	257	8.0	67.7	13.8	41.2	4.4
Marks Electrical (MRK)	71	75	-9	66	89	0.7	6.9	9.5	4.3	16.4	0.9	1.2
Next (NXT)	5258	6797	1610	8407	5070	1.7	1132	7.4	545.0	9.6	189.0	3.6
Ocado (OCDO)	674	5561	1400	6961	3003	2.3	-59		-41.2	nmf	n/a	n/a
Pets at Home (PETS)	288	1413	312	1725	1379	1.3	255	6.8	21.1	21.2	11.9	4.1
Average						1.1		7.5		14.6		3.6

Share prices at 7 Nov close

Source: ADVFN, MarketScreener, Stockopedia and ED estimates

DCF valuation

We include a DCF valuation for MRK in Figure 9, which sends a valuation message consistent with our 150p fair value – i.e., an intrinsic value per share which is well above the current share price.

The discounted free cash flow calculation in the table is based on unlevered free cash flow. It excludes any finance costs because these are captured in the group's net cash position.

We use a standard 8.5% discount or hurdle rate as a proxy for the company's weighted average cost of capital (WACC). The terminal growth rate is 2.0%, which is consistent with a long-term GDP growth trajectory for the UK economy.

However, this should be seen as conservative given the company's consistent ability to gain market share from its current low single digit market share position.

Figure 9 - DCF calculation

31st March year-end	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
All figures in £'000s										
Free cash flow (unlevered)	5,724	3,097	8,593	8,047	8,208	8,372	8,540	8,710	8,885	9,062
WACC (%)	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
Timing factor	0.50	1.50	2.50	3.50	4.50	5.50	6.50	7.50	8.50	9.50
Discount factor	0.96	0.88	0.82	0.75	0.69	0.64	0.59	0.54	0.50	0.46
Present value	5,495	2,740	7,008	6,048	5,686	5,345	5,025	4,724	4,441	4,175
Sum of discounted cash flows	50,687									
Terminal growth rate	2.0%									
Terminal value	151,269									
Net debt/cash if positive	8,524									
Equity value	210,480									
No. of shares (m)	104.9									
Value per share (pence)	201									

Source: Equity Development

The DCF derived value per share is translated into implied valuation multiples in Figure 10. Given that our above calculation is in excess of the fair value which we use, these implied multiples are all in excess of those which we use to calculate fair value. As a result, our fair value approach can be seen as conservative relative to DCF.

Figure 10 - Implied Marks Electrical valuation at DCF result

£'000s	
Implied EV	201,957
Sales revenue FY2023	89,036
EV/sales	2.3
EBITDA FY2023	6,936
EV/EBITDA	29.1x
EPS FY2023, p	4.3
P/E	46.4x

Source: Equity Development

Financial forecasts

The central thrust of our financial forecasts is profitable, cash generative growth. Positive expectations for sales revenue reflect the messages borne out by our FY2023 H1 trading update commentary and the scope for ongoing share gains driven by service quality and improved brand recognition.

We leave our financial forecasts, which we most recently updated in our aforementioned 11th October report, unchanged. We note the company's statement in today's release that, in addition to seeing revenue accelerate in October and business in November starting well, it believes a robust platform will generate profitable market share growth and that the company will achieve its full year targets.

Our financial forecasts are summarised in Figures 11, 12 and 13.

Figure 11 - Income statement						
31st March year-end	2019A	2020A	2021A	2022A	2023E	2024E
All figures in £'000s						
Revenue	31,247	31,500	55,984	80,478	89,036	112,780
Increase (%)	0.0	0.8	77.7	43.8	10.6	26.7
Cost of sales	-25,411	-26,381	-44,064	-64,583	-72,150	-90,675
Gross profit	5,836	5,119	11,920	15,895	16,886	22,105
Gross margin (%)	18.7	16.3	21.3	19.8	19.0	19.6
Other operating income	26	159	165			
Advertising & marketing	-2,296	-1,772	-1,641	-4,004	-4,450	-5,639
Other operating expenses (exc depn)	-2,133	-2,637	-2,580	-4,644	-5,500	-6,849
Total operating expenses	-4,429	-4,409	-4,221	-8,648	-9,950	-12,488
As % sales revenue						
Advertising & marketing	-7.3%	-5.6%	-2.9%	-5.0%	-5.0%	-5.0%
Other operating expenses	-6.8%	-8.4%	-4.6%	-5.8%	-6.2%	-6.1%
Total operating expenses	-14.2%	-14.0%	-7.5%	-10.7%	-11.2%	-11.1%
EBITDA (adjusted)	1,882	1,280	7,699	7,247	6,936	9,617
EBITDA margin adj. (%)	6.0	4.1	13.8	9.0	7.8	8.5
Depreciation & amortisation	-420	-506	-875	-861	-1,200	-1,520
Operating profit (adjusted)	1,404	964	6,824	6,386	5,736	8,097
Operating margin adj (%)	4.5	3.1	12.2	7.9	6.4	7.2
Finance expense	-96	-116	-70	-65	-70	-70
Share based payment expense				-75		
Net fair value gains	107	123	400	195		
Pre-tax profit (adjusted)	1,308	848	7,154	6,441	5,666	8,027
Taxation (adjusted)	-149	-158	-1,458	-991	-1,133	-2,007
Tax rate (adjusted) (%)	-11.4	-18.6	-20.4	-15.4	-20.0	-25.0
Net income (adjusted)	1,159	690	5,296	5,255	4,533	6,020
EPS (adjusted) (pence)	1.10	0.66	5.05	5.01	4.32	5.74
DPS (pence)				0.7	0.9	1.1

Source: Company historic data and Equity Development estimates

Figure 12 - Balance sheet

31st March year-end	2019A	2020A	2021A	2022A	2023E
All figures in £'000s					
Assets					
Non-current assets					
Investments	665	746	1,146	1,293	1,543
Property, plant & equipment	5,268	5,091	5,623	841	1,199
Right-of-use assets	445	418	779	2,328	2,328
Total non-current assets	6,378	6,255	7,548	4,462	5,070
Current assets					
Inventories	4,772	4,322	11,432	14,389	13,950
Trade and other receivables	1,968	1,642	2,839	2,627	2,906
Cash and cash equivalents	670	179	1,493	3,872	8,524
Total current assets	7,410	6,143	15,764	20,888	25,380
Total assets	13,788	12,398	23,312	25,350	30,450
Liabilities					
Current liabilities					
Trade and other payables	5,155	4,592	8,303	13,067	14,457
Corporation tax liabilities	265	244	1,557	145	145
Borrowings	1,592	961	233		
Lease liabilities	332	137	330	938	1,038
Total current liabilities	7,344	5,934	10,423	14,150	15,639
Non-current liabilities					
Other payables	512	197	17		
Borrowings	1,743	1,529	1,304		
Lease liabilities	54	185	422	1,324	1,324
Deferred tax liabilities	368	383	618	466	1,122
Provisions for liabilities	155	155	155		
Total non-current liabilities	2,832	2,449	2,516	1,790	2,446
Total liabilities	10,176	8,383	12,939	15,940	18,086
Issued capital and reserves					
Share capital	6	6	100,000	1,049	1,049
Share premium account				4,694	4,694
Treasury shares				-4	-4
Merger reserve			-99,994	-100,000	-100,672
Revaluation reserve	573	573	1,235		
Retained earnings	3,033	3,436	9,132	103,671	107,297
Total equity	3,612	4,015	10,373	9,410	12,365
Total liabilities and equity	13,788	12,398	23,312	25,350	30,450

Source: Company historic data and Equity Development estimates

Figure 13 - Free cash flow

31st March year-end	2019A	2020A	2021A	2022A	2023E	2024E
All figures in £'000s						
Cash from operating activities	1,882	1,280	7,747	4,417	6,866	9,547
Changes in operating assets and liabilities						
Inventories	-381	450	-7,110	-2,957	439	-5,550
Receivables	-78	326	-1,197	212	-279	-775
Payables	369	-759	3,513	4,925	1,390	3,855
Cash from operations	1,792	1,297	2,953	6,598	8,415	7,077
Corporation tax paid	-82	-297	-66	-2,042	-1,133	-2,007
Net cash from operating activities	1,710	1,000	2,887	4,556	7,282	5,070
Cash flows from investing activities						
Property, plant & equipment - purchases	-218	-57	-216	-583	-1,558	-1,974
Deposits on right of use assets				-304		
Property, plant & equipment - disposals	48	156	26	65		
Income from investments				48		
Net cash from investing activities	-170	99	-190	-774	-1,558	-1,974
Dividends received		42				
Issue of ordinary share capital				4,740		
Repayment of borrowings			-227	-1,537		
Interest paid	-75	-105	-42	-11	-70	-70
Interest paid on lease liabilities			-28	-54		
Principal repayment of lease liabilities			-312	-657		
Net cash from finance activities exc dividends	-75	-63	-609	2,481	-70	-70
Free cash flow before dividends on shares	1,465	1,036	2,088	6,263	5,654	3,027
Dividends paid	-352	-315		-3,884	-1,002	-1,005
Free cash flow after dividends	1,113	721	2,088	2,379	4,652	2,022

Source: Company historic data and Equity Development estimates



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