P2P Lending: Opportunity & how to invest

**Reaching critical mass**
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£5bn of volume on top 5 platforms in 2014; P2P volumes have grown at 136% CAGR since 2009

- **2005**: Zopa launched in the UK;

- **Lending Club** - originated £1.3bn+ in 2013

- **Strong UK govt backing for P2P**: committed to lend £75m via P2P

### UK Govt lending via P2P £m

<table>
<thead>
<tr>
<th>Platform</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014e</th>
</tr>
</thead>
<tbody>
<tr>
<td>MarketInvoice</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Zopa</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Funding Circle</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>70</td>
</tr>
</tbody>
</table>

Source: Lending Club, Prosper, Funding Circle, Zopa, RateSetter, Liberum
P2P lending is a global phenomenon: largest markets US, China and UK

$2.4bn = 2013 annual gross volume

* Estimate based on historic and Celent forecast
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P2P awareness rising everywhere; up by 70% since start of 2012

“Peer to Peer Lending” Google Trend

“Lending Club” Google Trend

“Prosper Loans” Google Trend

“Zopa” Google Trends

“RateSetter” Google Trends

“FundingCircle” Google Trends

Source: Google Trends
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No efficiency gains in banking since 1900

- Unit cost of financial intermediation relatively constant for the last 30 years at just under 2%
- No economies of scale suggests an oligopoly

- Finance share of GDP is at a historical – high- surprising vs. similar intermediation sectors

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Productivity gains in Wholesale & Retail trade but not Finance; inefficient banks cost UK est. £30bn annually

- Wholesale and Retail trade have become much more efficient due to IT investment. **Opposite is true for the finance industry**
- Internet enabled supply chain innovation has revolutionised retail and wholesale trade but not finance – so far…
- **Financial sector currently at 9% of GDP, about 2% higher than it ‘should’ be** (vs. other sectors and IT investment) =>lost annual income of $325bn in the US (UK £32bn) - £10 per person / week

---

**Source:** Finance vs. Wal-mart: Why are Financial Services so expensive, Thomas Philippon, 2012
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P2P is the ‘Walmart’ / ‘Ryanair’ of financial intermediation; with costs 60% lower than banks.

- Lending Club expects to be 60% more efficient than the equivalent banking business, on costs as % of loan balances, by 2015e
- P2P has no expensive branches/legacy systems/expensive regulatory capital to service
- In 2013e, P2P platform costs were 420bps of loan balances vs. 695bps for comparable banking business; 40% more efficient
- Over time, economies of scale will further increase P2P’s relative efficiency

**Cost base comparison 2015e: Banks vs. Lending Club (costs as % loans outstanding)**

- **Banks**
  - Cost inefficiencies
  - High margins
  - Restrictive lending
- **Lending Club**
  - 100
  - 100
  - 100
  - 100
  - 100
- **Total OPEX**
  - 695

**425bps Lower Operating Expenses**

Source: McKinsey / Lending Club

**2013e costs as bps of outstanding loans for P2P platforms and credit card providers***

- **Banks avg**
- **P2P ex prosper**

---

*P2P Platforms: Lending Club, Zopa, RateSetter, Funding Circle
Source: Liberum
Basic recap: revenue fee structure for P2P Platforms

- **Platform revenue from borrower:**
  Upfront 2-5% of principal.

- **Platform revenue from lenders:**
  Annual fee of typically 1% of loan balances (details vary slightly by platform)
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P2P just as competitive in high or low interest rate environment; 50%+ lower fee structure remains

• Current low interest rate environment viewed by some as temporarily enabling P2P to thrive. However...
  • With BoE base rates at 0.5% banks:
    • Charge borrowers 7.0%
    • Pay term depositors 2.8%
    • Banks earn rate gap of 4.2%
  • P2P platform fees: only 2.0%

• With higher rates P2P price advantage remains
  • When BoE rates normalise to 4.0% banks:
    • Charge borrowers 10.5%
    • Pay term depositors 6.3%
    • Banks earn rate gap of 4.2%
  • P2P platform fees: only 2.0%

P2P price advantage is independent of BoE rates
Current P2P rates are meaningfully better for savers & borrowers

- **For US savers:** Prosper and Lending Club offer savers a c. 6-9% yield pickup compared to US deposit accounts.

- **For UK savers:** UK P2P platforms offer savers a 3% pick up vs. cash ISA rates.

- **For US Consumer Finance borrowers:** P2P offers rates 1-25% lower
  - Particularly for more credit worthy customers

- **For UK borrowers:** Consumer Finance borrowers, P2P platforms offer loan rates 1.1% lower than typical bank rates.

US: Bank deposit rates vs. P2P net yields

UK: Deposit rates vs. P2P net yields

Note: 3y expected net yields. Source: Prosper, Lending Club, Liberum

US: Bank loan rates vs. P2P loan rates

UK: Bank loan rates vs. P2P loan rates

Note: 3y loan rates. Source: Prosper, Lending Club loan rates, bankrate.com
Credit risk is manageable, driving relatively stable returns despite some margin erosion

- Prosper and Lending Club provide the highest net yields due to their higher risk appetite: 9.3% and 6.9% respectively

- We expect RateSetter will gradually increase their risk appetite somewhat to potentially broaden available net yields

- Since 2010 Trustbuddy has delivered an average annualised net yield of 13.8%
Post financial crisis credit card delinquencies declining

- Post the financial crisis we see there has been a marked improvement in consumer finance credit quality

- Credit card delinquency trends relevant for US P2P lending as debt consolidation is a main use of the funds
  - Lending Club 83% of loans used to consolidate debt
  - Prosper 52% of loans used to consolidate debt
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Regulation still embryonic and uneven by geography

Selected regulatory comments

US: P2P lending in the US is subject to SEC regulation and other state and federal regulation. In the US, P2P loan notes are SEC registered securities. Prosper and Lending Club use Webbank to issue registered securities.

UK: FCA to start regulating P2P platforms from the April 2014. Platforms that currently operate in the UK market are licensed by the OFT and require a Consumer Credit Licence.

Germany: Platforms need to use a bank; rates are capped at 2x average rate.

France: Need Credit License which takes 12-18months (Key advantage for Pret du Union, since it creates a barrier to entry). Regulated by the French Central Bank.

Italy: Need to operate with banking/financial institution licence. Regulated by the Bank of Italy. Rates are capped.

Key issues regulation and / or the market place need to address:
- Calculation of historic returns on ‘apples to apples’ basis by cohort
- Client fund segregation and disclosure
- Adequate platform credit risk assessment for loans on platform
- Rigorous IT system KPI reviews
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P2P sceptics highlight some valid issues...

What key issues do critics flag?

No skin in game: Many lenders rely heavily on the platforms’ credit risk assessment; Platform incentives not aligned (source: FT AV)

Lack of borrower relationships (source: hedge fund)

‘Illusion of safety’ from Safeguard & Provision funds (source: FT AV)

Liquidity risk (source: FT AV)

Litigation risk (source: hedge fund)

Future margin pressure (source: Hedge Fund)

Procyclicality: Lack of macroprudential control of P2P (source: FT AV/ Bloomberg)

Our view

• Platforms should risk some of own capital e.g. Wellesley & CO model

• Link CEO’s compensation to 3 year credit performance

• Zopa actually has more customer contact than many banks where processes are fully automated

• Terms and conditions are clearly explained in lending process for both Zopa and RateSetter.

• Liquidity run impossible; loans match funded

• Platforms need to ensure i) credit processes are robust & ii) clear terms and conditions

• Margins already much lower than banks; longer term economies of scale will compensate

• P2P too small to matter currently (c 1% share)

• Longer term, easy to fix via increased capital requirements or increased platform ‘skin in the game’
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… but even banks starting to invest in P2P sector

South Africa

Barclays acquires 49% of South African P2P Platform RainFin (5th March 2014)

- **RainFin** launched their platform in July 2012. Offers unsecured consumer loans, ranging up to 1 year. 1st year they loaned $0.35m; Average net return to lender 10.2%.
- Barclays Africa’s investment will allow RainFin to develop their corporate product range that will include supply chain finance, enterprise development funding, fixed asset purchases and mid-sized corporate debt products.

Australia

Westpac buys into Society One (6th March 2014)

- **SocietyOne**: founded in August 2012 has lent more than $4 million; currently offers unsecured consumer and business loans ranging from $5,000-$30,000.
- Reinventure Group, the new Westpac-funded venture capital manager, has invested $5 million in Australia’s first P2P lender – Society One.

UK

Santander partners with Funding Circle, (19th July 2013)

- **Funding Circle**: founded in 2010 has lent more than £233million; currently offers unsecured business loans ranging from £5,000-£1,000,000.
- **Santander have partnered with Funding Circle** to help finance loans passing on leads to Funding Circle that they are unable to finance.
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UK P2P lending will accelerate sharply once ISA-able and SIPP-able

- P2P most likely to become ISA-able in the UK **later this year**

- **Using ZOPA as an example:**
  - After tax return for top 45% tax rate payer is 2.5% currently vs. 2.8% in a cash -ISA.
  - Once ISA-able the tax free return increases to 4.6% which is 65% higher than the highest cash ISA currently on offer.

- If P2P was to take 10% of the total cash and equity ISA market, UK gross P2P balances would increase 48x to £44bn.

**Best cash ISA rate vs. i) Zopa yield net of tax and ii) Zopa yield if ISA-able**

- **Current total ISA outstanding balances £bn, potential P2P market size if ISA eligible, £bn**

Source: Bank of England, Zopa, Funding Circle, RateSetter
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**Growth projections:** annual gross volume CAGRs of leading 5 platforms 2014 to 2024e:
- **base case:** 48%
- **bull case:** 59%.

**Base case:** leading P2P platforms will originate £267bn by 2024e; **25% of the gross volumes** in UK & US consumer and UK SME market.

**Bull case:** leading P2P platforms will originate £535bn by 2024e; **50% of the gross volumes** in UK & US consumer and UK SME market.

2024 P2P platform revenue pool likely to be at least £12-25bn by 2024 (for just UK and US consumer finance and UK SME)

---

**P2P end game by 2024: 25-50% share of consumer finance and SME…**

**P2P gross loan volume, base case £bn**

![Graph showing P2P gross loan volume trends from 2009 to 2024e for five platforms: Prosper, Lending Club, Funding Circle, Ratesetter, Zopa.](Image)

**P2P as % annual gross lending in US & UK consumer & UK SME £bn**

![Graph showing P2P and bank lending as a percentage of total annual gross lending in US & UK consumer and UK SME market from 2014e to 2024e.](Image)

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Source: Lending Club, Prosper, Funding Circle, Zopa, RateSetter, Liberum

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Other financial disintermediation besides P2P…

- **Square** threatens the banks point of sale revenue stream. Processed $20bn last year.

- **Digital wallets**: Apple and Google each creating their own versions

- **Money transfer disruption**: Xoom transfers money across borders: 69% cheaper than banks

- **P2P Retail FX disruption**: Transferwise is 90% cheaper for customers

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**Square Reader**

Merchants can request a Square reader for free. After receiving the reader, the merchant can download the Square app and sign up for an account.

Customers simply pay by swiping their credit card on the Square reader, as they would any other credit card reader. No signup is required for them.

The Square reader takes the credit card information, and the merchant’s smartphone transmits this information to the processor for payment.

Source: Squareup.com

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**Google wallet, “Tap and Pay” payment technology**

1. Look for these symbols at checkout
2. Tap your phone on the reader
   - Your phone sends payment, and, at some merchants, offer and loyalty information

---

**Retail FX Transferwise cost advantage vs. banks (indexed to 100)**

Source: Transferwise, Halifax, HSBC

<table>
<thead>
<tr>
<th>Avg Bank FX cost</th>
<th>TransferWise Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>10</td>
<td>90%</td>
</tr>
</tbody>
</table>

**Xoom cost advantage vs. banks (indexed to 100)**

Source: Xoom, Western Union, Citi, Bank of America

<table>
<thead>
<tr>
<th>Avg Bank transfer cost</th>
<th>Xoom Cost Advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>69%</td>
</tr>
</tbody>
</table>

- [Image of Square Reader diagram]
- [Image of Google wallet Tap and Pay technology diagram]
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P2P clearly negative for overall bank sector: we’ve seen this movie before!

“Retail banks are dinosaurs”, Bill Gates, October 1994

“The banking middle men may in time become the surplus links in the chain”, Andrew Haldane, Executive Director Bank of England, March 2012

“Banking is very digitisable… Lending Club’s peer-to-peer model is changing personal lending”, Peter Sands CEO Standard Chartered, June 2013


Rates of Adoption of New Technologies


HMV Share Price £ (Music)

Source: Bloomberg

Border Share Price $ (Books)

Source: Bloomberg

Sun Time Share Price $ (Newspapers)

Source: Bloomberg
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- P2P expected net yield **compares favorably** with other asset classes

- **New asset class** = valuable diversification.

- **Attractive risk adjusted returns:**
  4.4x P2P Sharpe ratio for Lending Club loans originated in 2009/10 vs 1.1x for FTSE all Share over same time period.

**P2P yields vs. other asset classes**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>2007-2013 Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>3y gilt yield</td>
<td>2.0%</td>
</tr>
<tr>
<td>IG 3y bond yield</td>
<td>1.5%</td>
</tr>
<tr>
<td>Commercial Real Estate*</td>
<td>6.0%</td>
</tr>
<tr>
<td>Equities</td>
<td>4.0%</td>
</tr>
<tr>
<td>Levered Active P2P Portfolio</td>
<td>12.0%</td>
</tr>
</tbody>
</table>

**Distribution of Lending Club monthly returns, from inception to December 2013**

- Assumes investment in every loan from inception to December 2013 (Dashed line average monthly return 0.56%)

Source: Prosper, Lending Club, Bloomberg, Liberum
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DCF analysis suggests equity of P2P platforms is still significantly undervalued

### Lending Club revenue and net income

[Lending Club revenue and net income chart]

- Lending Club rumored to IPO in Q2 2014
- Most recently valued at $2.3bn or 12.0x 2014 revenues.
- Our DCF valuation $6.2bn (15% cost of equity)

### Trustbuddy revenue and net income

[Trustbuddy revenue and net income chart]

- Trades on c 4.9x 2014e revenues and 13.5x 2015e EPS.
- Since July 2011 TBDY has appreciated by c400%.
- Only listed P2P platform globally
- Liberum research estimates a DCF fair value of $462m (15% cost of equity) vs. a current diluted market cap of $137m

### Current valuation as a multiple of revenues

[Current valuation as a multiple of revenues chart]

Source: Lending Club, Liberum

Source: Trustbuddy, Liberum

Source: Liberum
Liberum active in raising P2P equity and lending capital

**Trustbuddy**

- €18.3m raise; €9.3m sell down which was put on the platform as lending capital, along with an additional €3.0m of loan capital; €6.2m new equity
- Transaction at SEK1.1 per share, post money valuation SEK359m, Nov 2013. Current market cap SEK 846m, fully diluted.

**Zopa**

- £15m private placement equity raise, Jan 2014.

**Marshall Wace – Exchange Associates**


**AltFi**

- Liberum AltFi Index - establishing a range of data on the UK P2P / Alternative Finance sector, Dec 2013.
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3 key conclusions

1. **P2P sector is the Walmart / Ryanair of financial intermediation**: costs 60% lower than banks; will help save the UK est. 2% of GDP or £30bn per annum ($280bn for US) as savers and borrowers connect more efficiently.

2. **ISA-ability of P2P will drive sharp acceleration in UK P2P lending**: not unreasonable to expect 48x growth in UK gross P2P balances within 5-10 years to c £45bn.

3. **BUY P2P equity & debt and prepare to SHORT banks.** P2P offers at least 5-10x equity upside by 2024 with sector market of $100-200bn+ ; likely to start negatively impacting bank valuations within 5 years as investors start to extrapolate P2P’s growth trends.
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## Summary main platforms

<table>
<thead>
<tr>
<th>Platform Characteristics</th>
<th>PROSPER</th>
<th>LendingClub</th>
<th>Funding Circle</th>
<th>Zopa</th>
<th>RateSetter</th>
<th>Total/Avg</th>
</tr>
</thead>
<tbody>
<tr>
<td>£m</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inception Date</td>
<td>2006</td>
<td>2007</td>
<td>2010</td>
<td>2005</td>
<td>2010</td>
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</tr>
<tr>
<td>Location</td>
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<td>US</td>
<td>UK</td>
<td>UK</td>
<td>UK</td>
<td></td>
</tr>
<tr>
<td>Loan Type</td>
<td>Consumer</td>
<td>Consumer</td>
<td>SME</td>
<td>Consumer</td>
<td>Consumer</td>
<td></td>
</tr>
<tr>
<td>Cumulative lending to 2013</td>
<td>508</td>
<td>2,068</td>
<td>200</td>
<td>442</td>
<td>151</td>
<td>3,369</td>
</tr>
<tr>
<td>Gross Volume 2013 £m</td>
<td>228</td>
<td>1330</td>
<td>130</td>
<td>189</td>
<td>96</td>
<td>1,973</td>
</tr>
<tr>
<td>Dec 13 monthly volume</td>
<td>38</td>
<td>154</td>
<td>15</td>
<td>14</td>
<td>12</td>
<td>233</td>
</tr>
<tr>
<td>YoY volume growth 2013</td>
<td>139%</td>
<td>191%</td>
<td>164%</td>
<td>109%</td>
<td>194%</td>
<td>175%</td>
</tr>
<tr>
<td>Loan Term</td>
<td>3yr or 5y</td>
<td>3yr or 5y</td>
<td>6m, 1-5yr</td>
<td>2,3, 4, or 5yr</td>
<td>6mths - 5 yrs</td>
<td></td>
</tr>
<tr>
<td>Loan amortising?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Avg gross yield 2H09-2H12</td>
<td>19.8%</td>
<td>13.2%</td>
<td>8.9%</td>
<td>7.4%</td>
<td>7.3%</td>
<td>13.0%</td>
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<tr>
<td>Avg annual default 2H09-12</td>
<td>9.5%</td>
<td>5.50%</td>
<td>2.4%</td>
<td>1.0%</td>
<td>1.8%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Fee to borrower upfront</td>
<td>2 – 5%</td>
<td>1.1-5%</td>
<td>2-5%</td>
<td>NA</td>
<td>N.A</td>
<td></td>
</tr>
<tr>
<td>Fee charged to lender</td>
<td>1% per annum</td>
<td>1% of borrower payments</td>
<td>1% per annum</td>
<td>1% per annum</td>
<td>10% of Interest</td>
<td>1.0% per annum</td>
</tr>
<tr>
<td>Avg net yield 2H09-2H12</td>
<td>9.3%</td>
<td>6.9%</td>
<td>5.7%</td>
<td>5.4%</td>
<td>6.6%</td>
<td>7.3%</td>
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<tr>
<td>Lending Model Description</td>
<td>Fixed rate auction</td>
<td>Fixed rate auction</td>
<td>Floored auction</td>
<td>Fixed rate</td>
<td>Fixed rate</td>
<td></td>
</tr>
</tbody>
</table>

Source: Liberum
**Securitization / P2P backed debt market is being developed**

- **The Sofi transaction** closed in December marked the first time a P2P lender has completed a public securitization.
  - $152m of Senior Notes backed by post graduate student loans.
  - Rated Single A by DBRS.
  - Sold to “top tier institutional investors”.
  - Sofi transaction followed smaller private deals by Eaglewood and Insikt.
- **Springleaf** originate and service personal loans (secured and unsecured) in the US – useful comparator for P2P assets.
  - Their consumer business segment is considered to be non-prime or sub-prime.
  - As illustrated: the charge off has been trending down over recent years.

### Securitization Deals to date

<table>
<thead>
<tr>
<th>Institution</th>
<th>Size</th>
<th>Leverage</th>
<th>Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-13</td>
<td>Eaglewood</td>
<td>$53m</td>
<td>03:01</td>
</tr>
<tr>
<td>Dec-13</td>
<td>Sofi</td>
<td>$152m</td>
<td>09:01</td>
</tr>
</tbody>
</table>

*Source: Liberum*

### Springleaf yields for Consumer Segment

- **Springleaf vs. Sofi Yields**

*Source: Springleaf, SoFi*
P2P is more profitable than Barclaycard:
- an active unlevered P2P portfolio would have an RoTCE of 7.3% vs. 5.2% for Barclaycard unlevered.
- At the same 9.3x leverage ratio a P2P portfolio would have an RoE of 34.5% vs. 31.8% for Barclaycard.

P2P loan portfolios are 50-67% cheaper than equivalent bank companies
- Capital One trades on 1.5x tangible book; Barclaycard standalone would likely trade on 3.0x tangible book.
- Investors can buy P2P portfolios at 1.0x book value.

RoTCE of Barclaycard vs. P2P portfolio unlevered

RoTCE of Barclaycard vs. P2P portfolio levered (9.3x)
Key risks for P2P equity investors

- **Litigation / Investor redress risk** – Prosper Marketplace Inc and a number of executive officers were the subject of a class action lawsuit, brought by those who purchased loan notes on Prosper platform during the period January 1 2006 to October 14 2008 (“Hellum V Prosper Marketplace, Inc”). The lawsuit claimed that the Prosper platform offered and sold unqualified and unregistered securities.

- **Reputation / Fraud/ risk** from the failure or fraud of one significant platforms could reduce lender inflows.

- **Credit Cycle deterioration** – China P2P lending market $940m in 2012. Of the 1000 platforms operating in China 58 went bankrupt in Q4 2013- symptomatic of China macro problems rather than P2P model issues.

- **Competition** (Google, Amazon, Facebook) – Facebook launched an app, a form of peer to peer lending between friends. The ‘Agree It’ app which is freely downloadable, will earn revenues through advertising rather than charging users a fee. More broadly **Google own a 8% stake in Lending Club and are widely anticipated to get more involved in P2P (similarly for Amazon and EBAY etc)**.
Liberum in numbers

- Liberum is 100% staff owned with 155 employees, with offices in London and New York
- Liberum’s Research team core 18 sectors – 80% of the FTSE 100
- Liberum Currently have 71 corporate clients with an average market cap of over £233m
- £11bn raised by Liberum and syndicates over the past 6 years
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