

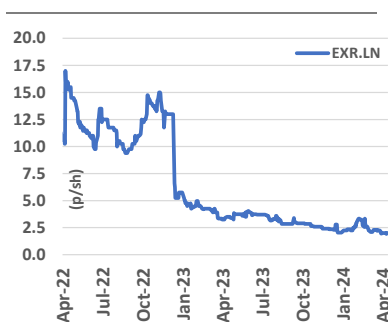
15th April 2024

Sector: Software

Specialised Virtual Reality (VR) communications platform company

Market data

Ticker	EXR
Price (p/sh)	2.00p
12m High (p/sh)	4.24p
12m Low (p/sh)	1.90p
Shares (m)	524.5m
Mkt Cap (£m)	10.5m
Markets	AIM



Source: Alpha

Description

ENGAGE XR is a leading virtual reality ('VR') technology company, focused on becoming the world's largest crossed reality ('XR') communications, training and virtual events platform provider, through commercialisation of ENGAGE, its proprietary online virtual platform www.engagexr.co

Board & key management

Chairman	Richard Cooper
CEO	David Whelan
COO	Sandra Whelan
CFO	Seamus Larrisssey

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ENGAGE XR Holdings

FY23 results in line – and a flying start to FY24

ENGAGE XR has published its FY23 full year results, the headlines of which reflect the details provided in February's post close trading update in terms of revenue, EBITDA loss and net cash. The group has provided a more detailed split of its ENGAGE platform revenues, which were flat in aggregate compared with FY23. The segmental growth rates underpin the focus shift highlighted in the trading update. In addition, and most pleasingly, the group has booked record quarterly revenue of €2m in Q1, with over 70% generated in the professional education sector.

- ▶ **FY23 results:** Total group revenue saw a 4% decline to €3.7m over FY22, driven by declining revenues from non-ENGAGE activities. ENGAGE revenues were flat at €3.3m, due to the tough global economic backdrop for its enterprise customers. This translated into some non-renewals by enterprise customers or renewing at lower levels than in FY22. Gross profit increased by 5% to €3.3m, with gross margin improving to 90% (cf 82% in FY22). Combined with targeted cost savings measures, most notably a 12% reduction in staff and contractor costs, the EBITDA loss was reduced to €4.0m compared to €5.8m in FY22. Similarly, the loss before tax improved to €4.1m from €6.0m in FY22. ENGAGE XR ended the FY23 financial year with a net cash balance of €7.9m.
- ▶ **ENGAGE platform details:** The growing importance of the North American market is evident from the rise in ENGAGE revenue mix to 60% from 35% in FY22. Likewise the growing importance of education and custom development work can be seen from an improved segmentation of revenue. Education License revenue grew by 41% to just under €1.2m, with Professional Services revenue growing by more than 15% to €1.1m. Due to the reasons cited above, in contrast Enterprise License revenue declined by a third to €1.0m. Thus, Education has expanded from the smallest to the largest segment in just 12 months, with further strength emerging from recent contract wins and the record revenues booked in Q1 2024. ENGAGE XR ended FY23 with over 15,000 licensed enterprise and education customers on its ENGAGE platform, some 50% more than at the end of FY22. The average contract value across the group rose strongly to €25K, compared with €21K for FY22.
- ▶ **A positive outlook for FY24E:** The relative setback of FY23 should not detract from the positive outlook for the company, as witnessed by the €5.0m pipeline for the rest of FY24E. FY23 underlined the relevance of the company's service offering to entities operating in education, training, and development (ETD), which has clarified the group's focus on the importance of the EDT vertical. The launch of Apple's Vision Pro headset has driven considerable media and consumer interest in spatial computing and metaverse services. The launch of more affordable new headsets from the likes of Sony, Samsung, Google and Meta later this year, should also help drive larger numbers of consumers and enterprises into the arenas of augmented (AR) and mixed (MR) reality.
- ▶ **Forecasts broadly unchanged:** We updated our FY24E forecasts following the February updates on trading and major contract wins. These are broadly unchanged following the FY23 results. Our headline figures for FY24E are predicated on conservative revenue growth of €1.76m (+48%) to €5.45m, delivering a further improvement in EBITDA loss to €4.0m and year-end net cash of €3.6m. In light of the still early stage of the commercial relationships with both its new Middle East-based client and its partnership with Lenovo, we withdrew our previous FY25E forecasts, awaiting further newsflow and data points as these ventures develop and mature. *Full details of our forecasts can be found in the Summary financials section at the end of this note.*

ENGAGE XR has signed a rapidly growing number of strategic and commercial partnership agreements with companies invested in promoting the VR medium and the development of corporate metaverses. This reflects the significant changes in how people work, study and travel following the pandemic, favouring remote working with more immersive communication and conferencing platforms. This has underpinned ENGAGE XR's finances and ability to support the wider uptake of ENGAGE platforms in the enterprise, education, and events communities.

Continuing evolution – back to the future

Education, development, and training to the fore

ENGAGE XR is in our view successfully navigating its way through a rapidly changing spatial computing and metaverse market. The mission (to be a leading global provider of virtual communications solutions) is unchanged. The company has an established and referenceable platform for creating, sharing, and delivering VR content for education, training, and online events. This is not a single point product as there are three solutions targeting these specific markets and customers. After a challenging 2023, the moat remains intact. Indeed, with the broader service offering and value-added content of the ENGAGE platform, management believes that competitors providing only collaboration services in the past are at a significantly higher risk of failure this year against a more difficult backdrop following the events of 2023.

For 2024 we will see ENGAGE XR focus more on the Education, Training and Development verticals. Despite the initial rush of enthusiasm for the new Apple headset and new devices from Sony, Samsung, Google and Meta launching later this year, we envisage a back to the roots approach for 2024. When coupled with a more focused and targeted sales team, this gives ENGAGE XR the opportunity to industrialise its sales process, improve Go-to-Market, improve close rates from the current visible pipeline, and thereby return to growth. Concurrent to this the better capitalised balance sheet combined with a lower cost base gives credibility to the ambition to reach breakeven by the end of 2025.

The shape of ENGAGE XR's revenue mix underwent a significant shift in 2023. Difficulties and declining confidence in the enterprise sector has resulted in reduced revenues from this vertical for the company. In contrast, ENGAGE XR has both gained new clients and renewed contracts at higher levels with existing customers, including Optima Domi Academy and Victory XR, in the education, development, and training (EDT) vertical.

These large contract wins in the US have re-inforced the importance of this sector to ENGAGE XR and prompted a re-alignment of commercial effort and resource focus towards it. This should not be regarded as a strategic pivot, insofar as the enterprise sector will continue to be a core strategic vertical for the company and will remain a pillar for growth going forward.

It should be remembered that when the company was originally founded, it was as a virtual reality (VR) education company, whose goal was to transform the delivery method of digital education and corporate training by utilising VR. The company has always seen the education sector, in the broadest context, as a core and fertile area for its enhanced technology to add value to the teaching, learning, and training process.

Investors will undoubtedly have noted the elevation of the EDT vertical within the company's growth plans, which in our view re-affirm the founding principles and objectives of the group. CEO, David Whelan, clearly expects the EDT vertical to be the "main source of future growth". This should not be seen as a return or retrenchment back to its educational roots, as other verticals, notably the enterprise vertical, will continue to be important sources of revenue.

ENGAGE XR continues to strengthen its relationship with its partners and to focus on its work with strong platform partners such as Meta and Lenovo, with a view to growing the market away from single pay entertainment purchases. Both Meta and Lenovo are highly focused on recurring revenue generators with education, training and development sectors, which is key to the group's strategy.

ENGAGE has recently launched the School of AI service offering. This is an immersive learning environment, where students can speak to notable figures from history, such as Marie Curie and Nikola Tesla, powered by conversational and GenAI with a release to schools and universities in Q2. This capitalises on the upsurge of interest in AI seen in 2023 and will provide new revenue opportunities. The development plan is to release AI features for the K-12 (Kindergarten to 12th grade in the US education system) market as a test bed before deploying them within the enterprise sector in H2 of 2024. ENGAGE is currently also working with a small selection of enterprise clients on AI-enhanced training for bank and hospitality workers in the USA and the Middle East. ENGAGE's AI capabilities (termed Athena AI) interact with users verbally and with core ENGAGE programmes. Use cases include training scenarios from natural language prompts.

The swift development and integration of AI capabilities into the ENGAGE ecosystem underlines the group's keen antennae for broader market developments and commercial opportunities.

FY23 results

We review below the performance for the financial year FY23. Much of the key detail had been previously published in the trading updates of December 2023 and February 2024. The former indicated the delay in the signing of some major contracts, which rolled into - and account for the very strong start to - Q1 2024. The latter refined the headline data given in the December trading update, most notably with a higher year end net cash position of €7.9m (from the initial €7.3m estimate) benefiting primarily from an earlier than expected receipt of an R&D tax credit, alongside the EBITDA loss coming in around €0.1m better than the figure indicated in December.

The following table provides a summary of the key financial metrics from ENGAGE XR's FY23 full year financial, focussing on the P&L and net cash.

Summary of FY23E full year results – key financials for FY23 and FY22

€'000 unless otherwise stated	FY22A	FY23A	Change	% change
Turnover	3,869	3,690	(179)	(5%)
Gross profit	3,160	3,311	151	5%
<i>Gross margin (%)</i>	<i>81.7%</i>	<i>89.7%</i>		
EBITDA	(5,751)	(4,033)	1,718	30%
<i>EBITDA margin (%)</i>	<i>(149%)</i>	<i>(109%)</i>		
Operating profit/(loss)	(5,974)	(4,241)	1,733	29%
<i>Operating margin (%)</i>	<i>(154%)</i>	<i>(115%)</i>		
Pre-exceptional pre-tax loss	(6,005)	(4,054)	1,951	32%
Fully diluted pre-exceptional EPS	(0.019)	(0.007)	0.012	63%
Net cash	2,209	7,911	5,702	258%

Source: ENGAGE XR, Shard Capital

The 5% in group turnover was more than offset by an 800bps increase in gross margin to 89.7%, which drove a 5% increase in cash gross profit to €3.3m. In response to the growing challenges in the broader economy, most notably companies mandating a return to office working and layoffs within the global tech sector, ENGAGE undertook its own rightsizing measures to deliver a more sustainable operating cost base. The table below shows the scale of layoffs within the global tech sector.

Average headcount for the year fell to 67 from 85 in FY22, and we expect headcount to remain at a similar level in FY24E. Total cost of sales and administrative expenses fell by almost 20% to €7.9m (from €9.8m in FY22), delivering a €1.7m improvement at the operating loss level to €4.24m from the €5.97m operating loss in FY22.

The balance sheet remains strong with year-end net cash of €7.9m following the oversubscribed net equity raise of €10.0m in March 2023. Funding is deemed sufficient to reach the important milestone of break-even in the short- to medium-term, with the current monthly cash utilisation running at around €300K - €400K. This is expected to reduce further over time as revenue grows.

Tech sector layoffs – employees and companies

Source: Layoff.fyi

The following table shows a more detailed segmentation of the group’s revenues, most notably within the core ENGAGE platform area. ENGAGE revenue data is now presented in three segments, namely Education License, Enterprise License and Professional services. The first two segments comprise the license revenue from customers with either an education or enterprise focus. The Professional Services segment comprises two key elements, namely bespoke development work performed by the ENGAGE studio team (primarily for Education and Enterprise customers), and one-off VR events, the best example being the FatBoy Slim concert last year. Showcase Experience revenue covers the revenue generated from the sale of the group’s original showcase experiences, with Other Revenue coming from VR installations in museums.

Summary of revenue generation – FY23 and FY22

€'000 unless otherwise stated	FY22	FY23	Change	% change	Mix FY22	Mix FY23
Education License	824	1,165	342	41%	21%	32%
Enterprise License	1,528	1,007	(520)	(34%)	39%	27%
Professional Services	982	1,133	152	15%	25%	31%
ENGAGE revenue	3,333	3,306	(27)	(1%)	86%	90%
Showcase Experiences revenue	374	325	(49)	(13%)	10%	9%
Other revenue	161	60	(102)	(63%)	4%	2%
Total group revenue	3,869	3,691	(178)	(5%)	100%	100%

Source: ENGAGE XR, Shard Capital

The table above shows the growth rates of these sub-segments in FY23, together with their sales mix participation within group revenue to facilitate an easier overview of the moving parts. As outlined above when discussing the group’s shift in focus in FY23 to the ETD vertical and a renewed focus on recurring revenue streams (driving high net revenue retention streams) through more bespoke services with high value added, strong growth has been delivered in the Education License segment (+41% year-on-year growth) and in the Professional Services business stream (+15% YOY growth) – despite a decline in one-off VR events.

In contrast, reflecting broader difficulties in the enterprise arena, which resulted in some customer losses, Enterprise License revenues declined by 34%. While all three segments delivered revenues of just over €1m in FY23, this was not the case in FY22, where Enterprise Licence revenue amounted to €1.5m, accounting for just under half of total ENGAGE revenues and almost 40% of total group revenues.

While we expect to see further strong growth from the Education sector in FY24, not least because of contracts already signed (and further prospects in the pipeline), management expects to see a stabilisation within the Enterprise arena, with both a lower churn in the client base and a higher level of net revenue retention.

Showcase Experience essentially comprises a declining legacy revenue stream from products developed in the early stages of the group's development to showcase its VR technology. This said, it still delivers just over 10% of group revenues in conjunction with the Other revenue stream.

In terms of revenue by geography, North America is by far the most important market for the group, accounting for 60% of ENGAGE revenue in FY23, compared with around 35% in FY22. Europe and Ireland & UK account for 14% and 15% respectively. The group has acknowledged the importance of the North American market through the strengthening of its sales & marketing teams with individuals well-acquainted with and well-connected in these markets, which has also been replicated in the Non-Executive Director cohort.

The group also continues to foster relationships and partnerships with other global organisations, which can effect introductions to potential clients, which ENGAGE might struggle to make with its own resources, and given its relative size. With revenues generated from a combination of sales from direct, indirect (with third parties) and re-seller efforts, it is important to create a strong network across the global market. We believe ENGAGE is well positioned in this respect, as recent substantial contract wins have shown.

In terms of the balance sheet, FY23 net assets of €8.5m were around €0.8m higher than our forecast of €7.7m. This was driven by three posts, namely Tangible fixed assets (including ROUA), Trade and other receivables, and Trade and other payables. In broad terms, these accounted for €100K, €300K and €400K respectively.

Forecasts

With regard to the forecasts published in our February note following the FY23 trading update, we have amended FY23 to reflect the results as published in the final results document. This has entailed primarily minor changes in terms of profit & loss account, cash flow and balance sheet. These can be seen in the more detailed tables at the end of this note.

In essence, the broad shape of our recently updated FY24E forecasts is unchanged. This applies at the turnover, gross profit, EBITDA, operating loss, and pre-tax loss levels, along with year-end net cash. These can likewise be seen in the more detailed historical and forecast tables. The balance sheet figures for FY24E reflect the higher base of FY23 as outlined above.

As outlined in our February note, given the challenges encountered in 2023, our start point with regard to FY24E forecasts is one of being conservative and prudent. The global economic backdrop remains uncertain, with inflation still running above its recent long-term average despite recent falls, and interest rates remaining stubbornly high in many countries.

To that conservative end, we are forecasting a group revenue increase of €1.7m to just over €5.4m in FY24E. While this equates to just under 50% revenue growth, we view this as prudent in relation to the quantum of the contract wins announced in February, in particular the group's first seven-figure contract win. It is not known what constitutes the exact make-up of this contract, and the timing of revenue flows, but we are implicitly assuming that the majority of revenues should flow through in the course of 2024. In terms of core ENGAGE revenues, our assumption is for growth of 56%, offset by further declines from non-ENGAGE revenues.

While the group moved promptly last year to cut overheads from its operating cost base, we forecast these to move up again in FY24E, including modest salary increases in a still inflationary environment. The group has shown that it will not shy away from making difficult short-term operating cost adjustments when required, while still remaining mindful of not damaging future growth opportunities.

The combination of our assumed increase in the total operating cost base and prudent gross margin assumption translates into a more modest improvement at the EBITDA and operating loss levels. This in turn is reflected at the net cash level, with a projection of year-end FY24E net cash of €3.6m.

It should be noted that with a focus on gaining larger contracts, there can be delays in closing contracts as seen in recent months. This suggests that revenue generation could be lumpier than seen in the past.

We are not publishing forecasts for FY25E at this still early stage of FY24E. As outlined above, ENGAGE XR is in the initial stages of its commercial relationship with a significant new customer, and its relationship with Lenovo is still in its relative infancy. We would hope to have more insight on how these important relationships are developing, possibly at the interim stage, before publishing forecasts for FY25E.

The following table summarises the key financial elements of our forecasts up to 2024.

<i>Summary of key ENGAGE XR forecasts – 2020 – 2024E</i>					
	2020	2021	2022	2023	2024E
Turnover	1.417	2.386	3.869	3.691	5.453
Gross profit	1.013	1.894	3.160	3.311	4.206
<i>Gross margin (%)</i>	<i>71.5%</i>	<i>79.4%</i>	<i>81.7%</i>	<i>89.7%</i>	<i>77.1%</i>
EBITDA	(2.067)	(2.478)	(5.507)	(4.095)	(3.977)
<i>EBITDA margin (%)</i>	<i>(145.9%)</i>	<i>(103.9%)</i>	<i>(142.3%)</i>	<i>(111.0%)</i>	<i>(72.9%)</i>
Operating profit	(2.721)	(3.114)	(5.974)	(4.241)	(4.044)
<i>Operating margin (%)</i>	<i>(192.1%)</i>	<i>(130.5%)</i>	<i>(154.4%)</i>	<i>(114.9%)</i>	<i>(74.2%)</i>
Pre-exceptional pre-tax loss	(2.728)	(3.130)	(6.005)	(4.054)	(4.069)
Pre-exceptional EPS (€)	(0.011)	(0.010)	(0.019)	(0.008)	(0.008)
Net cash/(debt)	2.033	7.790	2.209	7.911	3.564

Source: Shard Capital, ENGAGE XR

For reference, we have included a more detailed summary of our P&L, cash flow and balance sheet forecasts, which are presented below as the Summary Financials section of this note.

Summary financials

Profit and loss account and cash flow forecasts – 2019 – 2024E

Profit and loss account						
Year to December	2019	2020	2021	2022	2023	2024E
Turnover	1.025	1.417	2.386	3.869	3.691	5.453
Cost of sales	(0.401)	(0.404)	(0.492)	(0.709)	(0.380)	(1.247)
Gross profit	0.623	1.013	1.894	3.160	3.311	4.206
<i>Gross margin (GM) (%)</i>	<i>60.8%</i>	<i>71.51%</i>	<i>79.37%</i>	<i>81.7%</i>	<i>89.7%</i>	<i>77.1%</i>
Operating costs	(2.555)	(3.734)	(5.007)	(9.134)	(7.552)	(8.250)
Operating profit	(1.932)	(2.721)	(3.114)	(5.974)	(4.241)	(4.044)
<i>Operating profit margin (%)</i>	<i>(188.6%)</i>	<i>(192.1%)</i>	<i>(130.5%)</i>	<i>(154.4%)</i>	<i>(114.9%)</i>	<i>(74.2%)</i>
Depreciation and amortisation	(0.494)	(0.655)	(0.635)	(0.467)	(0.146)	(0.068)
EBITDA	(1.438)	(2.067)	(2.478)	(5.507)	(4.095)	(3.977)
<i>EBITDA margin (%)</i>	<i>(140.4%)</i>	<i>(145.9%)</i>	<i>(103.9%)</i>	<i>(142.3%)</i>	<i>(111.0%)</i>	<i>(72.9%)</i>
Interest charge	(0.007)	(0.007)	(0.017)	(0.031)	0.187	(0.025)
Pre-exceptional PBT	(1.939)	(2.728)	(3.130)	(6.005)	(4.054)	(4.069)
Exceptional charges	0.000	0.000	0.000	0.000	0.000	0.000
Profit before tax	(1.939)	(2.728)	(3.130)	(6.005)	(4.054)	(4.069)
Adjusted diluted EPS (c)	(0.010)	(0.011)	(0.010)	(0.019)	(0.008)	(0.008)
Diluted EPS (c)	(0.010)	(0.011)	(0.010)	(0.019)	(0.008)	(0.008)
Dividend (c)	0.000	0.000	0.000	0.000	0.000	0.000
Cash flow						
Year to December	2019	2020	2021	2022	2023	2024E
Operating profit	(1.933)	(2.721)	(3.114)	(5.974)	(4.241)	(4.044)
Depreciation and amortisation	0.494	0.655	0.635	0.467	0.146	0.068
Inventory (increase)/decrease	0.000	0.000	0.000	0.000	0.000	0.000
Debtors (increase)/decrease	0.189	(0.153)	(0.288)	(0.720)	0.171	(0.263)
Creditors increase/(decrease)	(0.002)	0.165	0.124	0.741	(0.607)	(0.010)
Other	0.000	0.000	0.000	0.000	0.000	0.000
Operating cash flow	(1.252)	(2.055)	(2.642)	(5.486)	(4.532)	(4.249)
Interest	(0.007)	(0.007)	(0.017)	(0.031)	0.187	(0.025)
Tax	0.000	0.000	0.000	0.000	0.000	0.000
Dividends	0.000	0.000	0.000	0.000	0.000	0.000
Deferred tax	0.000	0.000	0.000	0.000	0.000	0.000
Capital expenditure	(0.036)	(0.013)	(0.116)	(0.074)	(0.017)	(0.060)
Trading cash flow	(2.185)	(2.190)	(2.774)	(5.591)	(4.362)	(4.334)
Acquisition of businesses	0.000	0.000	0.000	0.000	0.000	0.000
Disposal of businesses	0.000	0.000	0.000	0.000	0.000	0.000
Share issues	0.000	2.938	8.466	0.000	10.040	0.000
Currency effects, other	0.000	0.000	0.000	0.000	0.000	0.000
Net cash inflow/(outflow)	(2.192)	0.740	5.757	(5.581)	5.702	(4.347)
Net (debt)/cash	1.293	2.033	7.790	2.209	7.911	3.564

Source: Shard Capital, ENGAGE XR

Summary of balance sheet forecasts – 2019 – 2024E

Balance sheet						
Year to December	2019	2020	2021	2022	2023	2024E
Tangible fixed assets	0.116	0.084	0.102	0.096	0.124	0.116
Intangible fixed assets	1.434	0.964	0.426	0.039	0.000	0.000
Investments and other	0.000	0.000	0.000	0.000	0.000	0.000
Total fixed assets	1.550	1.048	0.529	0.136	0.124	0.116
Stock	0.000	0.000	0.000	0.000	0.000	0.000
Trade and other debtors	0.205	0.358	0.646	1.366	1.195	1.458
Deferred tax	0.000	0.000	0.000	0.000	0.000	0.000
Cash and short term deposits	1.293	2.033	7.790	2.209	7.911	3.564
Current assets	1.498	2.391	8.436	3.575	9.106	5.022
Total assets	3.047	3.439	8.964	3.711	9.230	5.138
Trade and other payables	(0.193)	(0.357)	(0.482)	(1.222)	(0.615)	(0.605)
Borrowings	0.000	0.000	0.000	0.000	0.000	0.000
Other current liabilities	(0.033)	(0.039)	(0.013)	(0.008)	(0.053)	(0.041)
Current liabilities	(0.226)	(0.396)	(0.494)	(1.230)	(0.668)	(0.647)
Borrowings	0.000	0.000	0.000	0.000	0.000	0.000
Other non-current liabilities	(0.034)	(0.020)	(0.008)	0.000	(0.035)	(0.035)
Non-current liabilities	(0.034)	(0.020)	(0.008)	0.000	(0.035)	(0.035)
Total liabilities	(0.260)	(0.417)	(0.502)	(1.230)	(0.703)	(0.681)
Net assets	2.788	3.022	8.463	2.480	8.528	4.457

Source: Shard Capital, ENGAGE XR

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