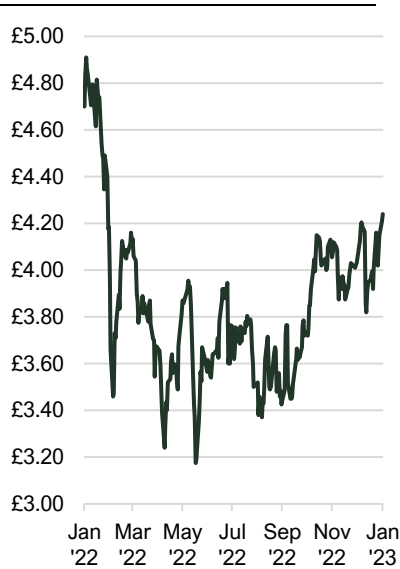


FY results – Strong finish to year, ahead of initial expectations

1 Year Chart



Final results show a performance that was significantly ahead of expectations at the start of the year. SThree also provided a great deal of detail around the technology improvement programme. This significant investment (£26m - £31m over the next two years with £4m already expensed) is a fundamental driver behind SThree’s strategic growth and margin ambitions and could see SThree move beyond a linear relationship between growth and sales headcount.

The tone of commentary around current trading continues to be a blend of caution and optimism. When we look across the UK peer group; unsurprisingly we see the two contract focused names; SThree and Hays striking the most positive tone. We continue to see SThree’s focus on the combination of STEM and contract as a key, positive differentiator to the peer group.

Estimates have long factored materially slower growth in FY23 so risks in the near term trading environment should be captured within the current valuation. With a solid start to the new year (good contract extensions offsetting slower new business), we are leaving our net fee estimates unchanged. We are ticking down our margin expectations over the next couple of years as the technology improvement programme costs kick in fully and headcount investment continues to be robust compared to others.

SThree PLC is a research client of Radnor Capital Partners Ltd.

MiFID II – this research is deemed to be a minor, non-monetary benefit.

2nd February 2023

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- **Strong growth despite tough comparatives:** Full year net fee growth was +19%, in-line with Q3 and down slightly on the 25% delivered in H1. All of SThree’s key markets delivered healthy growth across the year. The contractor order book exited FY22 +19% YoY and underpins H1 FY23. Fully diluted EPS was ahead +30% and the full year dividend was ahead +45%. Net cash came in at £65.4m, +14% YoY, as net fee growth was supported by working capital investment.
- **Productivity gains continue but FY23 will see reversion:** Productivity is +7% YoY reflecting the targeted approach to headcount re-investment coupled with impressive net fee momentum. Whilst we expect some of the exceptional productivity of the last two years to revert, we see a clear pathway to a structural improvement in margins over the next two years.
- **FY23 net fee estimates unchanged.** The outlook is best characterised as cautiously optimistic. The important contract extension period over December / January ended better than initial expectations. New business activity is mixed and it is clearly still too early to build a clear trend picture. Headcount investment commentary was more positive than many would have expected, and coupled with the technology investments landing fully this year and next, we are ticking down margin expectations, while leaving net fees unchanged.

November, £m	Net Fees	PBT adj	EPS (fully diluted, p)	Div (p)	Net Cash	Fiscal PER x	Yield %
FY 2021A	355.7	60.0	30.8	11.0	57.4	13.8	2.6
FY 2022A	430.6	77.0	39.9	16.0	65.4	10.7	3.7
FY 2023E	445.7	80.2	41.3	16.5	70.9	10.3	3.9
FY 2024E	477.7	88.7	45.0	18.0	80.0	9.5	4.2
FY 2025E	504.5	102.8	51.8	20.7	100.3	8.2	4.9

Source: Radnor Capital Partners

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## FY22 results – Key highlights

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- FY22 net fees **£430.6m (+19% YoY constant currency** and +21% reported) compared to H1 FY22 net fees +25%. The FY22 net fee outcome was +2% ahead of our prior estimate of £423.5m, which itself had been upgraded through the course of the year. As a point of reference, £430.6m is +15% ahead of our January 2022 net fee estimate for FY22 of £374.2m
- The Contractor Order Book (the single best measure for forward visibility) ended Q4 **+19% YoY**
- **Contract** net fees (**78%** of the group total) grew +23% YoY, with double digit growth across all the group's key markets:
- **Permanent** net fees (**22%** of the group total) grew +6% YoY
- Breaking net fees down by key geographical segments
  - DACH +17% YoY
  - EMEA (excl DACH) +24% YoY
  - USA +13% YoY
  - APAC +42% YoY
- All the Top 5 individual countries delivered net fee growth in excess of +10%.
  - Germany (30% of group) +14% YoY
  - USA (26% of group) +13% YoY
  - Netherlands (17% of group) +34% YoY
  - UK (11% of group) +23% YoY
  - Japan (2% of group) +47% YoY
  - Rest of the World (14% of group) +18% YoY
- EBITA of **£77.6m**, +28% YoY on a reported basis), with an EBIT / net fee conversion margin of **18.0%** (+90 basis points on FY21).
  - Included with operating expenses in FY22 are £4.1m of costs relating to the initial phase of the Technology Improvement Programme. These initial costs actually came in lower than initially expected (with no spill over into later periods) and represented c.1% of EBIT conversion margin.
  - Also included within operating expenses are c.£2m of non-recurring expenses relating to the restructuring of the group's Ireland and Singapore operations. SThree does not treat these as exceptional items.
  - If we add these back on top of the technology investment costs, we can see that underlying EBIT conversion margins were closer to 19.4%,

comfortably ahead of the UK staffing peer group average (14.0% to 18.7% range) for 2022.

- PBT of **£77.0m** and fully diluted EPS of **39.9p**, up +28% and +30% YoY respectively.
- Final dividend proposed of 11.0p, making **16.0p** in total for the year, +45% YoY with dividend cover of 2.6x.
- Net cash of **£65.4m**, +14% YoY.
- Group average headcount was +12% YoY.

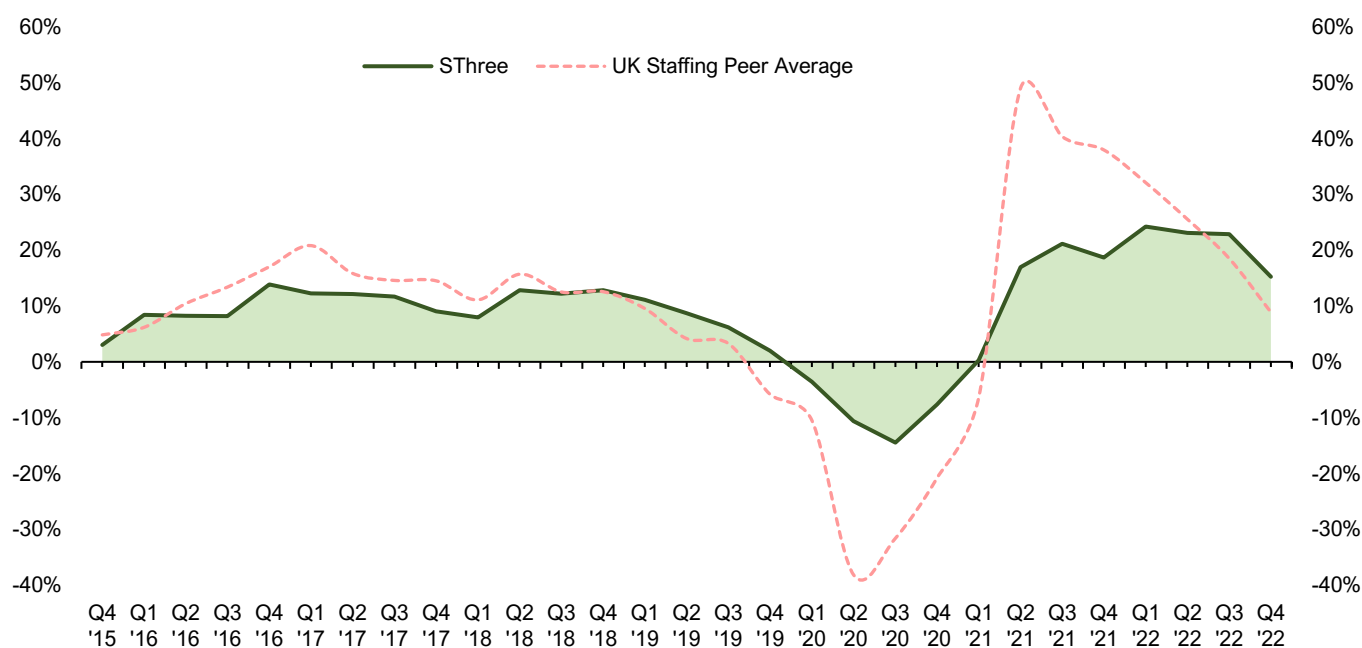
At the Q4 trading update, management alluded to a “softer” current trading environment heading into the calendar year end. We saw this comment as a broader reference to the combination of tough comparatives the group is now lapping alongside the weaker macro backdrop as well as a more specific reference to the near term business pipeline.

The tough macro and comparatives point has been clear for some time and has informed market consensus for SThree for much of the last year with consensus FY23 net fee growth sitting in the low to mid single digit range. As we discuss later, we are leaving our FY23 net fee estimates unchanged, which implies FY23 net fee growth of 3.5%.

The immediate trading environment plays out in two areas. Firstly, the pace and duration of existing contract extensions and secondly, new placement leads. Both December and January are important months for contract extensions and management have been able to provide more colour on the outturn, which was marginally better than expected with both the number of extensions and the average duration of the contract length ahead YoY.

The broader new business picture is mixed and varies considerably by geographical market and STEM discipline. Management have characterised the current environment as more muted but still at too early a stage to build a clear trend picture for the year.

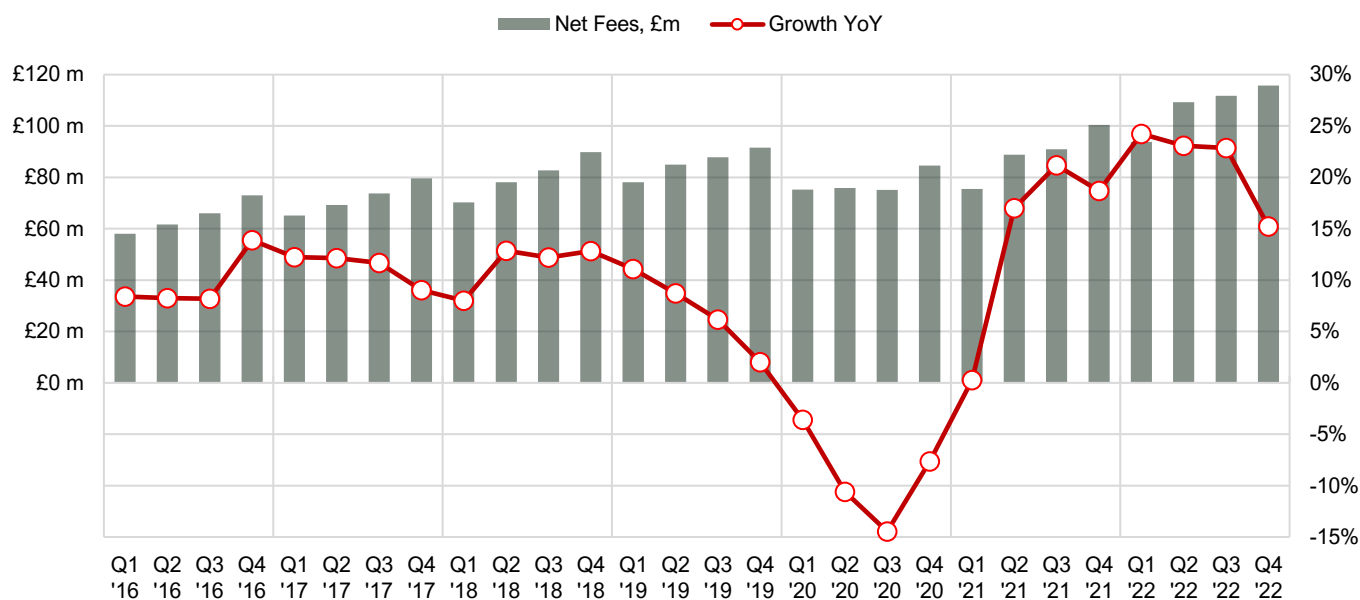
**Figure 1:** SThree quarterly YoY net fee growth vs Peer Group (reported basis)



Source: Radnor

In Figure 1 above and 2 below, we show SThree's net fee progression relative to the UK staffing peer group and then in isolation. In-line with the group's clear focus on contract, we can see the extent to which SThree outperformed the peer group heading into and through the pandemic. More recently, SThree again has begun to outperform the peer group. We can see that Q4 FY22 was a record quarter for the group. In fact Q2, Q3 and Q4 FY22 were all record quarters. Q4 is traditionally the strongest quarter for the group.

**Figure 2:** SThree quarterly net fee income since Q1 2016 (reported basis).



Source: Radnor

## Technology Improvement Programme

Early in FY22, SThree announced its intent to implement a significant transformation of its internal technology platform. Following the release of the FY22 results, management hosted an investor briefing which provided a great deal of detail on the scale and breadth of the programme and its intended outcomes. The investor briefing presentation can be accessed here (please follow [link](#)).

The broad context to this programme can best be seen in the strategic ambitions outlined back at the 2019 Capital Markets Day, where the group stated its intent to both grow market share across its key STEM markets and deliver a sustainable EBIT conversion margin of at least 21%.

The technology improvement programme currently underway is a critical component in achieving and potentially surpassing these original ambitions, with a particular emphasis on the EBIT conversion margin.

SThree's historic EBIT margin range (excluding the Covid low of 10.1%) has trended between 14.8% and 17.8% and compares to a blended staffing peer group range of 16.6% and 20.8%.

Interestingly, SThree is currently running the highest EBIT margins in the peer group if we adjust for non-operating items. The underlying **19.4%** reported in FY22, compares to consensus expectations of **13.9%** for Robert Walters, **18.6%** for Page and **16.1%** for Hays. On a fully reported basis, SThree comes in as second highest in the peer group.

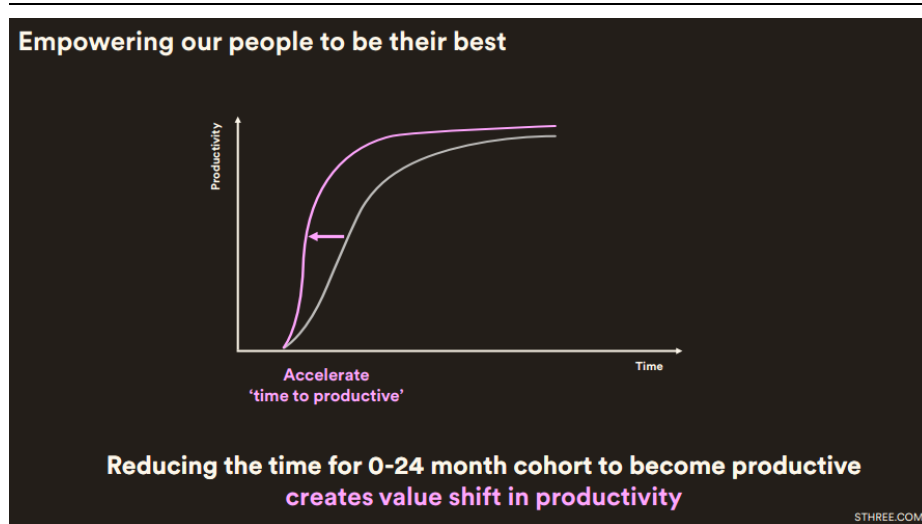
However, the company has been at pains to point out that this margin outperformance has been driven by short term productivity gains that are non-structural in nature and a function of very strong top line growth not being matched by headcount growth. In short, the business has been running “hot”; a situation that cannot be maintained indefinitely.

However, rather than redress this through raw headcount growth, the opportunity has been identified to invest in technology that will enable SThree to decouple the linear relationship between headcount and net fees that is such a well recognised feature and, arguably a headwind, for the staffing peer group.

How will these structural margin improvements be delivered? The answer is through a combination of factors, each of which is a direct function of the new platform capability.

- **Systematising existing best practice.** Like all sales led organisations, SThree’s internal productivity is not uniform. Over a period of time, the behaviours and practices of the most productive consultants have been analysed and collated into what SThree term their “blueprint”. The new technology platform will, for the first time, create a framework where all sales consultants within SThree will be able to access and be guided by this blueprint in an intelligent and real time manner.
- **Accelerating the pace of sales productivity.** Whilst all consultants within SThree will be able to see productivity benefits, the most material value gain will be seen in the more junior cohorts, in particular the 0 – 24 month cohort. Here, new joiners take time to learn the role and become fully productive. In Figure 3 below, we show a visual from the Investor Briefing that shows how this productivity curve can be changed.

**Figure 3:** Shifting the productivity curve



Source: SThree

- **Reducing churn.** Like all staffing companies, employee churn is a material cost to the business and in a similar fashion to productivity, sales consultant churn varies according to tenure. SThree has delivered good improvements to churn rates in recent years (from c.40% to c.30%) but further reducing churn rates amongst newer joiners has been identified as a key value driver. By

accelerating the time it takes a new consultant to become productive, this accelerates the pace of both individual job satisfaction and earnings. Hiring is expensive and each new hire at entry level resets the productivity clock to zero.

- **Reducing cost to serve.** The new technology platform is not just focused on the CRM layer and is much more fundamental and broader in scope. The new platform will also incorporate new ERP and finance layers and will bring significant simplification and automation to a number of analogue heavy processes within the group. This will bring wide ranging “cost to serve” and operational scale benefits across the group although the ECM business is likely to be the most obvious beneficiary.

ECM has been the fastest growing element within SThree’s contract business for a number of years with a number of structural drivers likely to drive further adoption of this “all in” candidate model across SThree’s top markets. ECM is a higher value net fee proposition for SThree but also incurs a higher cost to serve as SThree is taking on board the compliance and HR burdens associated with the candidate placement. To date, this has required significant manual process and interventions. Whilst SThree have developed a fit for purpose proposition, technology led efficiencies and processes offered by the new technology platform, combined with an enhanced client and candidate experience, is significant.

These are the key outcomes from our perspective. We would encourage investors to go through the more detailed presentation from the company at the link above. Other key headlines:

- **Total programme cost is expected to be between £30m and £35m.** In FY22, £4m of initial cost was expensed with the remaining £26 - 31m to be incurred in FY23 and FY24. The company has provided guidance around timing and recognition.

In FY23, total spend of £15m - £17m, of which £6m - £7m will be expensed.

In FY24, total spend of £11m - £14m, of which £5m - £6m will be expensed.

The capitalised element of the programme will be depreciated over a 4 year period.

- The programme is expected to deliver a positive ROI by FY25.
- Rather than taking a modular approach, SThree is adopting a Microsoft based platform approach with the cloud based Microsoft Dataverse, Azure and OpenAI enterprise platforms underpinning an end to end solution across the organisation, comprised of a suite of Microsoft Power and Dynamics 365 applications.
- At the user layer, SThree will be deploying a new CRM solution in partnership with Mercury alongside new customer, invoicing and management analytics solutions.

This investment programme has been positioned against the strategic ambition to deliver and sustain EBIT conversion margins of 21% and beyond. It is worth considering what this implies relative to current consensus estimates for SThree.

- Our net fee estimates for FY24 and FY25 are for £477m and £504m respectively (we are within 2% of consensus). If we take FY24 as our starting point, then a 21% EBIT margin implies EBIT of £100m, which c.£11m ahead of our current £89m estimate, a 12% uplift

## Estimate Revisions & Valuation

Figure 4: Radnor estimate revisions

	FY'22A	Previous		New		Revision, %	
		FY'23E	FY'24E	FY'23E	FY'24E	FY'22E	FY'23E
<b>Group Gross Revenue</b>	1,639.4	1,694.0	1782.8	1,694.6	1,816.2	+ 0%	+ 2%
EMEA (ex DACH)	156.5	162.0	171.7	162.0	171.7	- 0%	- 0%
DACH	148.9	154.1	166.4	154.1	166.4	+ 0%	+ 0%
USA	89.3	115.4	124.6	115.4	124.6	+ 0%	+ 0%
APAC	13.7	14.2	14.9	14.2	14.9	- 0%	- 0%
<b>Group Net Fees</b>	<b>430.6</b>	<b>445.7</b>	<b>477.6</b>	<b>445.7</b>	<b>477.7</b>	<b>- 0%</b>	<b>+ 0%</b>
<b>EBITA</b>	<b>77.6</b>	<b>82.1</b>	<b>89.9</b>	<b>80.7</b>	<b>89.3</b>	<b>- 2%</b>	<b>- 1%</b>
- margin %	18.0%	18.4%	18.8%	18.1%	18.7%		
<b>Adj. PBT</b>	<b>77.0</b>	<b>81.4</b>	<b>89.3</b>	<b>80.2</b>	<b>88.7</b>	<b>- 2%</b>	<b>- 1%</b>
<b>Adj. EPS (p)</b>	<b>39.9</b>	<b>42.0</b>	<b>45.3</b>	<b>41.3</b>	<b>45.0</b>	<b>- 2%</b>	<b>- 1%</b>
Dividend (p)	16.0	16.8	17.4	16.5	18.0	- 2%	+ 4%
<b>Net Cash (Debt)</b>	<b>65.1</b>	<b>70.6</b>	<b>80.7</b>	<b>70.9</b>	<b>80.0</b>	<b>+ 0%</b>	<b>- 1%</b>

Source: Radnor

In Figure 4 above, we highlight our estimate revisions. At the headline level we are leaving our net fee estimates unchanged but have ticked down our FY23E and FY24E PBT expectations by -1% / -2% respectively.

These revisions are driven primarily by the detail provided on the phasing of Technology Improvement Programme costs between FY23E / FY24E and also the split between P&L and balance sheet recognition. We are also factoring in a more robust headcount guidance for FY23E (flat to 4% growth) as the group continues to focus headcount investment behind the key discipline areas and territories where SThree is gaining the most ground.

In Figure 3 & 4 below, we show the evolution of the two-year prospective PE multiple for both SThree and the UK staffing Peer group in the UK (Hays, Page, Robert Walters).

Figure 3: 2 Year prospective PE multiple

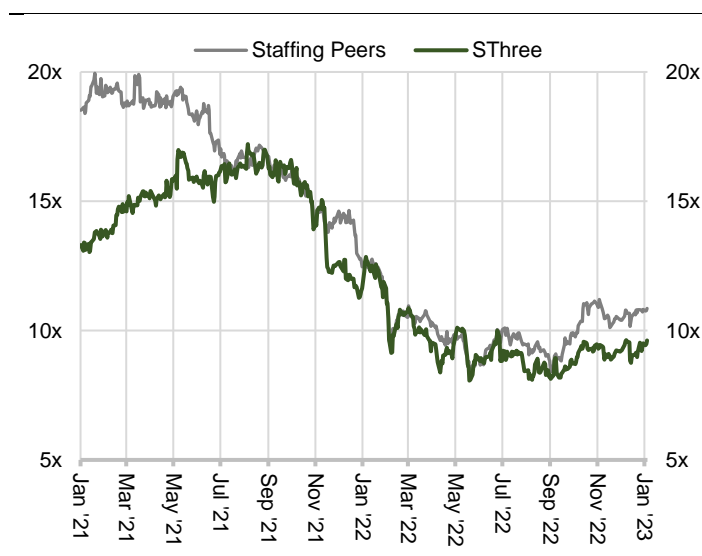
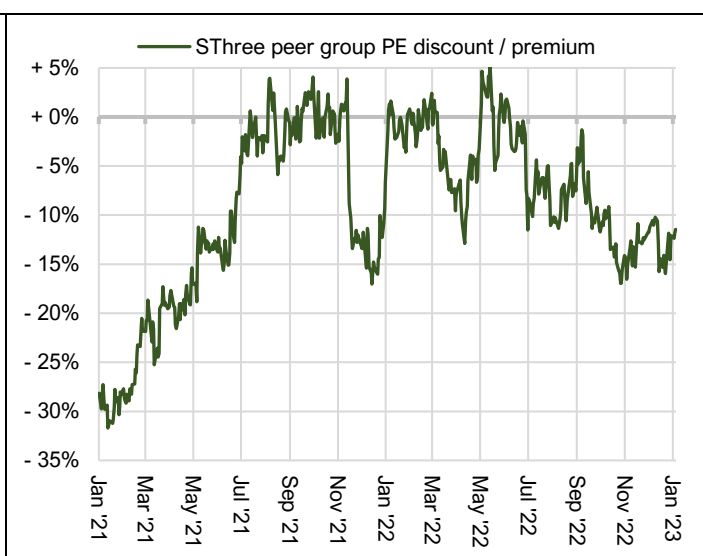


Figure 4: SThree PE discount / premium



Source: FactSet, Radnor

We can see from the above that SThree's forward valuation has been moving in line with the UK Staffing peer group average through much of the second half of 2021 until October 2022, since when we have seen SThree move to a clearer discount to the UK Staffing peer group, although we note this discount remains well below historic averages. This discount has been driven primarily by peer group estimate downgrades not being reflected in share price performance which has remained positive.

**We have long believed that SThree offers a unique play on the structural growth opportunity underpinning STEM skills in modern economies that are undergoing significant technology and energy transitions. Critically, these transitions exist independent of the economic cycle. SThree's contract focus also aligns the group with a flexible working trend that is especially pronounced within highly technically skilled roles. SThree's outperformance through the pandemic, coupled with its technology improvement programme and targeted approach to headcount investment, positions the group well over the medium to long term. Despite its many points of positive differentiation, SThree is not wholly immune from cyclical pressures, but we do believe the case for continued peer outperformance is strong. The current valuation discount to the peer group, in our eyes, continues to offer an interesting opportunity for investors.**



## SThree PLC

STEM

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Price (p): 426 p  
Market Cap: 565 m  
EV: 500 m

## PROFIT &amp; LOSS

Year to 31 November, £m	2020	2021	2022	2023E	2024E	2025E
<b>Group Sales</b>	<b>1,202.6</b>	<b>1,330.7</b>	<b>1,639.4</b>	<b>1,694.6</b>	<b>1,816.2</b>	<b>1,918.1</b>
EMEA (ex DACH)	117.6	127.2	156.5	162.0	171.7	180.3
DACH	105.8	129.4	148.9	154.1	166.4	176.4
USA	77.2	89.3	111.5	115.4	124.6	132.1
APAC	7.9	9.8	13.7	14.2	14.9	15.6
<b>Group Net Fees</b>	<b>308.6</b>	<b>355.7</b>	<b>430.6</b>	<b>445.7</b>	<b>477.7</b>	<b>504.5</b>
Op. Exp.	(257.8)	(277.2)	(334.1)	(345.8)	(368.8)	(381.2)
<b>EBITDA</b>	<b>50.7</b>	<b>78.5</b>	<b>96.5</b>	<b>99.9</b>	<b>108.8</b>	<b>123.2</b>
Depr & Amort	(6.4)	(4.7)	(5.9)	(6.2)	(6.5)	(6.8)
Lease Depreciation	(13.0)	(13.0)	(13.0)	(13.0)	(13.0)	(13.0)
<b>EBITA - Adjusted</b>	<b>31.3</b>	<b>60.8</b>	<b>77.6</b>	<b>80.7</b>	<b>89.3</b>	<b>103.4</b>
<b>EBITA conversion %</b>	<b>10.1%</b>	<b>17.1%</b>	<b>18.0%</b>	<b>18.1%</b>	<b>18.7%</b>	<b>20.5%</b>
Associates & JV's	-	-	-	-	-	-
Net Bank Interest	(1.2)	(0.8)	(0.5)	(0.5)	(0.6)	(0.6)
<b>PBT - Adjusted</b>	<b>30.1</b>	<b>60.0</b>	<b>77.0</b>	<b>80.2</b>	<b>88.7</b>	<b>102.8</b>
Non Operating Items	(1.3)	-	-	-	-	-
Other Financial Items	-	-	-	-	-	-
<b>PBT - IFRS</b>	<b>28.8</b>	<b>60.0</b>	<b>77.0</b>	<b>80.2</b>	<b>88.7</b>	<b>102.8</b>
Tax - Adjusted	(11.7)	(17.9)	(22.8)	(23.6)	(26.6)	(30.8)
Tax rate - Adjusted	39.0%	29.8%	29.6%	29.5%	30.0%	30.0%
Minority interests	-	-	-	-	-	-
No. shares m, diluted	136.4	136.7	135.9	136.9	137.9	138.9
<b>Adj EPS (p), diluted</b>	<b>13.5</b>	<b>30.8</b>	<b>39.9</b>	<b>41.3</b>	<b>45.0</b>	<b>51.8</b>
Total DPS (p)	5.0	11.0	16.0	16.5	18.0	20.7

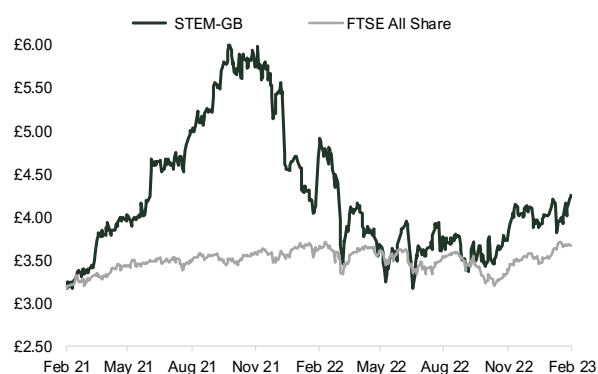
## CASH FLOW

Year to 31 November, £m	2020	2021	2022	2023E	2024E	2025E
EBITDA	50.7	78.5	96.5	99.9	108.8	123.2
Working Capital	25.3	(26.6)	(38.6)	(17.3)	(20.9)	(21.9)
Provisions / Exceptionals	0.8	2.5	6.5	-	-	-
<b>Gross Op Cashflow</b>	<b>76.9</b>	<b>54.5</b>	<b>64.3</b>	<b>82.5</b>	<b>87.9</b>	<b>101.3</b>
Cash Tax	(10.5)	(16.8)	(18.9)	(22.8)	(23.6)	(26.6)
Cash Intererest	0.1	(0.9)	(0.7)	(0.5)	(0.6)	(0.6)
<b>Net Op Cashflow</b>	<b>66.5</b>	<b>36.8</b>	<b>44.8</b>	<b>59.2</b>	<b>63.7</b>	<b>74.1</b>
Capex	(5.3)	(2.6)	(3.7)	(9.0)	(9.0)	(6.0)
<b>Free Cashflow</b>	<b>61.2</b>	<b>34.2</b>	<b>41.1</b>	<b>50.2</b>	<b>54.7</b>	<b>68.1</b>
Dividends	(6.7)	(6.7)	(14.8)	(21.7)	(22.6)	(24.8)
Acquisitions & Inv.	-	-	-	-	-	-
Other Non Operating	(13.3)	(12.5)	(13.7)	(13.7)	(13.7)	-
<b>Net Cashflow</b>	<b>41.3</b>	<b>15.0</b>	<b>12.6</b>	<b>14.8</b>	<b>18.4</b>	<b>43.3</b>
<b>Net Cash (Debt)</b>	<b>49.9</b>	<b>57.4</b>	<b>65.4</b>	<b>70.9</b>	<b>80.0</b>	<b>100.3</b>

## BALANCE SHEET

Year to 31 November, £m	2020	2021	2022	2023E	2024E	2025E
Intangibles	4.4	2.5	0.8	0.8	0.8	0.8
P,P+E	40.8	38.1	35.2	32.4	29.9	30.8
Tax Asset & Other	1.5	4.5	4.6	4.6	4.6	4.6
<b>Total Fixed Assets</b>	<b>46.7</b>	<b>45.0</b>	<b>40.7</b>	<b>37.9</b>	<b>35.4</b>	<b>36.2</b>
Current Assets	237.4	298.0	363.9	384.7	412.3	437.3
Current Liabilities	(179.5)	(218.4)	(243.2)	(246.7)	(253.4)	(256.5)
<b>Net Current Assets</b>	<b>57.9</b>	<b>79.6</b>	<b>120.7</b>	<b>138.0</b>	<b>158.9</b>	<b>180.8</b>
Long Term Liabilities	(26.0)	(24.0)	(26.4)	(26.4)	(26.4)	(26.4)
Net Cash (Debt)	49.9	57.4	65.4	70.9	80.0	100.3
<b>Net Assets</b>	<b>128.5</b>	<b>158.1</b>	<b>200.4</b>	<b>220.5</b>	<b>247.9</b>	<b>290.9</b>

## PRICE CHART - 2 YEAR ABSOLUTE vs FTSE ALL SHARE



Source: FactSet

## SHAREHOLDERS

	% of ord. Share capital
Kempen Cap Mgmt	10.0%
JPMorgan AM	6.0%
Littlejohn	5.6%
JO Hambro	5.2%
BlackRock	5.0%
Allianz	4.9%
Polar Capital	3.4%
<b>Total</b>	<b>40.1%</b>

## Announcements

Date	Event
30 January 2023	FY22 results
14 December 2022	Q4 update
20 September 2022	Q3 update
20 June 2022	Q2 update
21 March 2022	Q1 update
31 January 2021	FY21 results

## RATIOS

	2021	2022	2023E	2024E	2025E
RoE	26.6%	27.1%	25.6%	25.1%	24.7%
RoCE	60.4%	57.4%	53.9%	53.2%	54.2%
Asset Turnover (x)	0.1x	0.1x	0.1x	0.1x	0.1x
NWC % Revenue	6.0%	7.4%	8.1%	8.7%	9.4%
Op Cash % EBITA	89.6%	83.0%	102.3%	98.5%	98.0%
Net Debt / EBITDA	-0.7x	-0.7x	-0.7x	-0.7x	-0.8x

## VALUATION

Fiscal	2021	2022	2023E	2024E	2025E
P/E	13.8x	10.7x	10.3x	9.5x	8.2x
EV/EBITDA	6.4x	5.2x	5.0x	4.6x	4.1x
Div Yield	2.6%	3.7%	3.9%	4.2%	4.9%
FCF Yield	6.8%	8.2%	10.0%	10.9%	13.6%

Net Fees growth	15.3%	21.1%	3.5%	7.2%	5.6%
EPS growth	128.6%	29.5%	3.5%	9.1%	15.0%
DPS growth	120.0%	45.1%	3.5%	9.1%	15.0%

## REGULATORY DISCLOSURES

*Radnor Capital Partners Ltd is authorised and regulated by the Financial Conduct Authority.*

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