

**Analysts**

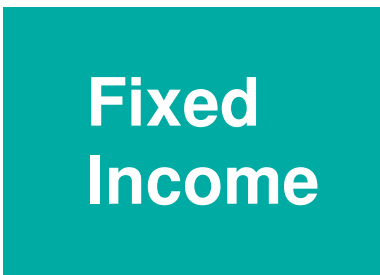
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# Crown Subordinated Notes II (CWNHB)



**Issue overview**

Issuer	Crown
Issue ASX code	CWNHB
Face value	\$100
Estimated offer size	\$400m
Bookbuild margin	4.00-4.20%
Franking	0%
Interest payments	Quarterly
First interest payment	14 Jun 2015
Minimum application	\$5,000
Call date	23 Jul 2021
Step-up date	23 Jul 2041
Step-up margin	1.00%
Maturity	23 Apr 2075

**Timeline**

Lodgement of prospectus	17 Mar 2015
Bookbuild margin	24 Mar 2015
Announcement of margin	24 Mar 2015
Offer opens	25 Mar 2015
Offer closes:	
Shareholder & General	14 Apr 2015
Broker Firm	21 Apr 2015
Issue date	23 Apr 2015
ASX listing (deferred settlement)	24 Apr 2015

**This report is to be read in conjunction with the Crown Subordinated Notes II prospectus.**

**Issuer diversification combined with a compelling 6.3% yield**

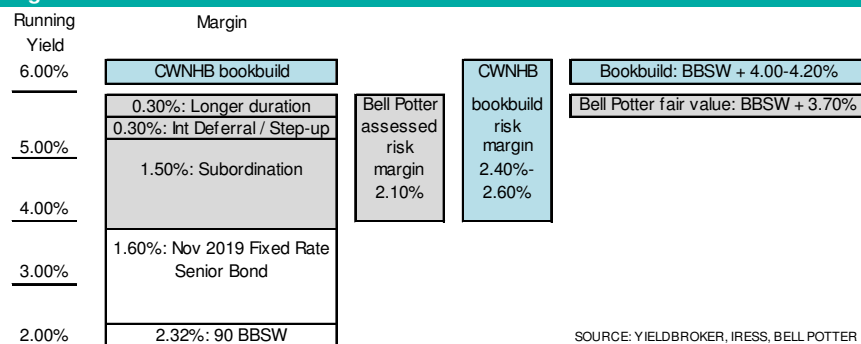
The new \$400m issue of unsecured, subordinated, cumulative notes by Crown (CWNHB) provides long overdue supply of new debt securities into the ASX listed debt and hybrid market. CWNHB represents the first ASX listed debt security launched since AMPHA in Nov 2013, while there has no issuance from ASX top 100 industrial companies since the previous Crown Subordinated Notes (CWNHA) issue was launched in Aug 2012. Banks & financial companies have dominated subsequent ASX listed hybrid issuance, representing over \$21bn of the \$21.7bn raised since Sep 2012.

CWNHB will assist in funding the \$645m Crown Towers Perth development due for completion in Dec 2016. In addition, the Crown Sydney development project to build a 350 room luxury hotel at VIP gaming facilities at Barangaroo South is nearing planning approval, while Crown Melbourne has entered a joint venture to develop and construct a five star hotel and apartment complex. In Aug 2014, a Crown subsidiary acquired a 34.6 acre vacant site on Las Vegas Boulevard, planning to construct a casino resort, with a potential equity investment of US\$400-\$500m of this US\$1.6-1.9bn project.

While the EBITDA track record of Crown Melbourne and Crown Perth has been strong, Crown's ability to execute on its development plans and to generate returns sufficient for the capital spend (debt burden) remain key risks. Overall we expect Crown's financial strength and issuer reputation should ensure redemption at the year 6 call date. CPH also intends to invest \$50m in the CWNHB Securityholder Offer.

In a market searching for yield, the 6.3% initial running yield appears attractive. Our 12 month fair margin assessment of 3.70% provides ~2.10% premium to the Nov 2019 Crown senior debt security trading in the wholesale over-the-counter market.

**Figure 1: Bell Potter fair value assessment**



**Key features**

- **6.32% initial floating yield:** Based on current 90BBSW of 2.32% + 4.00% margin.
- **Deferral Events:** Provision for interest deferral on a cumulative and compounding basis for both optional (subject to dividend stopper), and mandatory events if the Leverage Ratio is >5.0x (for two consecutive testing dates) or Interest Cover Ratio is <2.5x (for a testing date). Crown has stated it intends to undertake one or more measures to support these financial ratios and restore its credit profile if it is at risk.
- **Redemption likely at year 6:** Although CWNHB has a 60 year maturity, we expect the reduction of equity credit at the year 6 call date should be sufficient to ensure redemption.
- **Change of control trigger increases margin by 5.00%:** Applies if CWNHB is not redeemed under a change of control event. Excludes CPH and related entities.

# Crown Subordinated Notes II

## Crown overview

Crown is one of Australia's largest entertainment groups with businesses and investments in the integrated resorts and entertainment sectors in Australia and Macau. Crown a top 50 S&P/ASX company with a market cap of \$9.8bn, with Consolidated Press Holdings (CPH) owning 50% of its issued capital at 31 Aug 2014.

Crown's wholly owned operations:

- Crown Melbourne (1H15 EBITDA \$351.2m): The Crown Entertainment Complex comprises a casino with a licence extending to 2050 and licences to operate 2,628 electronic gaming machines (EGMs), 540 table games and 250 automated table game terminals. In addition, it has three hotels - Crown Towers, Crown Metropol and Crown Promenade - which combined have ~1,600 guest rooms, function rooms including the 1,500 seat Palladium ballroom, restaurants, retail and entertainment facilities.
- Crown Perth (1H15 EBITDA \$127.0m): Perth's premier integrated resort comprising a casino with a licence extending to 2060 and licences to operate 2,200 EGMs (EGMs are not permitted in hotels and clubs in WA) and 270 table games. In addition it has two hotels: Crown Metropol Perth (395 rooms) and Crown Promenade Perth (291 rooms), while the new Crown Towers Perth will add a further 500 rooms, and is scheduled to open in late 2016. Crown Perth also contains a convention centre, 22 restaurants and bars, a nightclub and a 2,300 seat theatre.
- Aspinall's Club (1H15 EBITDA \$20.7m): Located in Mayfair, London, it is one of only five licensed high-end casinos in the West End entertainment district.
- Betfair (100%): Online betting exchange in Australia and New Zealand.
- Crown Sydney (100%): Six star luxury hotel development and restricted gaming licence to be located at Barangaroo South (subject to planning approval and final agreements).

Crown's investments:

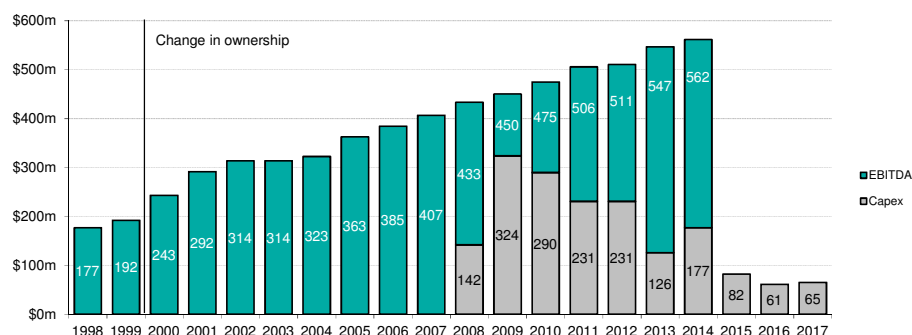
- Melco Crown Entertainment (MCE) (33.6%): A developer and owner of casinos and entertainment resort facilities and is one of only six companies granted regulatory gaming concessions in Macau. It owns City Of Dreams: an integrated casino entertainment resort with 500 table games and 1,400 EGMs. In addition, it has ~1,400 hotel rooms across its 3 hotels: Crown Towers Macau (300 rooms), Hard Rock (300 rooms) and Grand Hyatt (800 rooms); Altira Macau: a luxury casino ~120 table games and a hotel with 230 rooms; Mocha Clubs: 1,266 EGMs; Studio City (MCE 60%): large scale cinematically themed entertainment, retail and gaming resort expected to open in mid 2015; City of Dreams Manila (MCE 68.8%) opened in Feb 2015 includes a casino with 270 table games and 1,700 EGMs as well as a hotel complex with 950 rooms and 3 international hotel brands
- CrownBet (67%): BetEasy betting sportsbook in Australia and New Zealand.
- Aspers Holdings (50%): Regional UK casino business.
- Cannery Casino Resorts (24.5%): Operates casinos and resorts in Pittsburgh and Las Vegas.

# Crown Subordinated Notes II

## Crown Melbourne

Since the change in ownership 15 years ago, Crown has delivered a steady growth in EBITDA. An improvement in free cash flow could assist in funding the luxury hotel developments in Perth and the development pipeline in Sydney and Melbourne.

**Figure 2: Crown Melbourne Normalised EBITDA (1998-2014) and Capex (2008-2017f)**

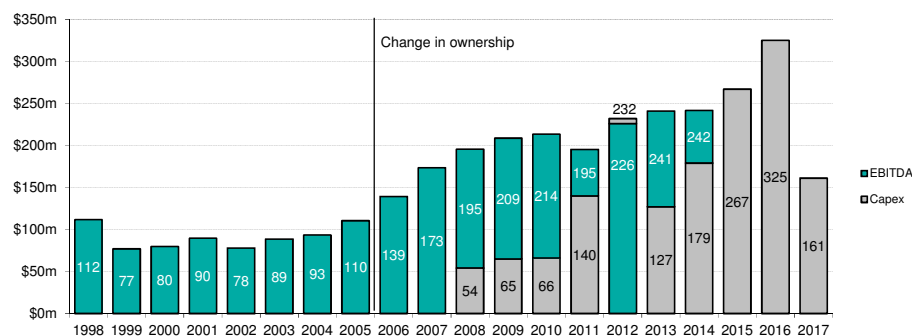


SOURCE: COMPANY DATA, BELL POTTER

## Crown Perth

Crown management has more than doubled Burswood EBITDA since it was acquired 9 years ago. At January 2015, \$200m of the \$645m budget for the 500 room Crown Towers Perth luxury hotel had been spent. This project remains on schedule, with targeted completion by December 2016.

**Figure 3: Burswood Normalised EBITDA (1998-2014) and Capex (2008-2017f)**



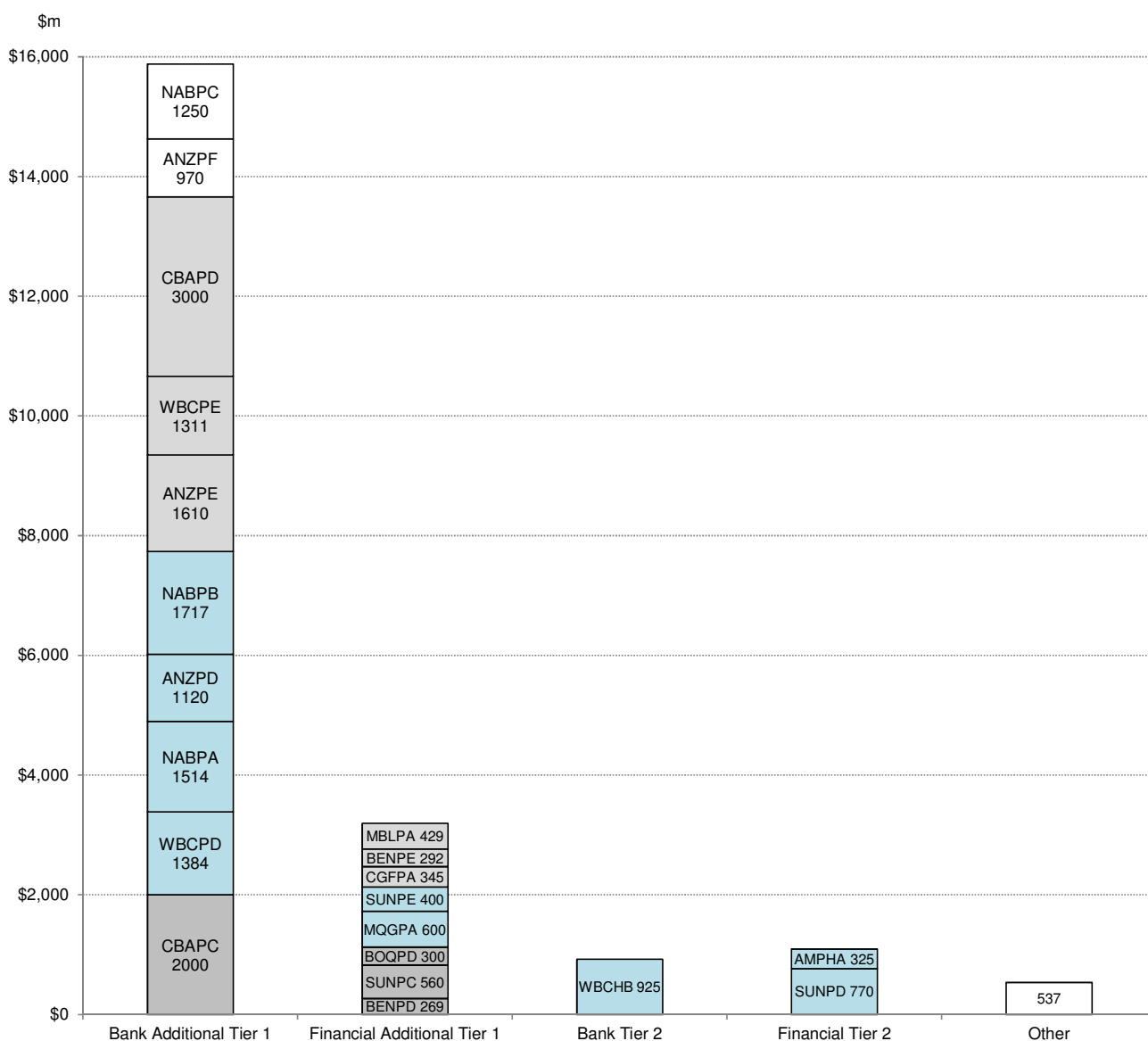
SOURCE: COMPANY DATA, BELL POTTER

# Crown Subordinated Notes II

## ASX listed equity credit subordinated debt drought broken

CWNHB has broken the drought of ASX listed equity credit subordinated debt securities. After the CWNHA issue was launched in Aug 2012, issuance ground to a halt, following the review S&P announced in Nov 2012 of assumptions used to determine equity credit content of certain hybrid securities put a halt on new issues. In April 2013, this review reduced the equity credit content on hybrids with 100% equity credit content to 50%, which impacted AGLHA, ORGHA and TAHHB. Since Sep 2012, issuance has been dominated by banks and financial issuers, with only MYOB (\$155m MYBG), Healthscope (\$305m HLNGA), IMF (\$50m IMFHA) and Contango (\$26.5m CTNG) the only other issuers to tap the ASX listed debt and hybrid market. Bank and financial issues have accounted for 21 of the 25 securities launched since Sep 2012, providing over \$21bn of the \$21.7bn raised.

Figure 4: ASX listed debt and hybrid market new issuance since September 2012



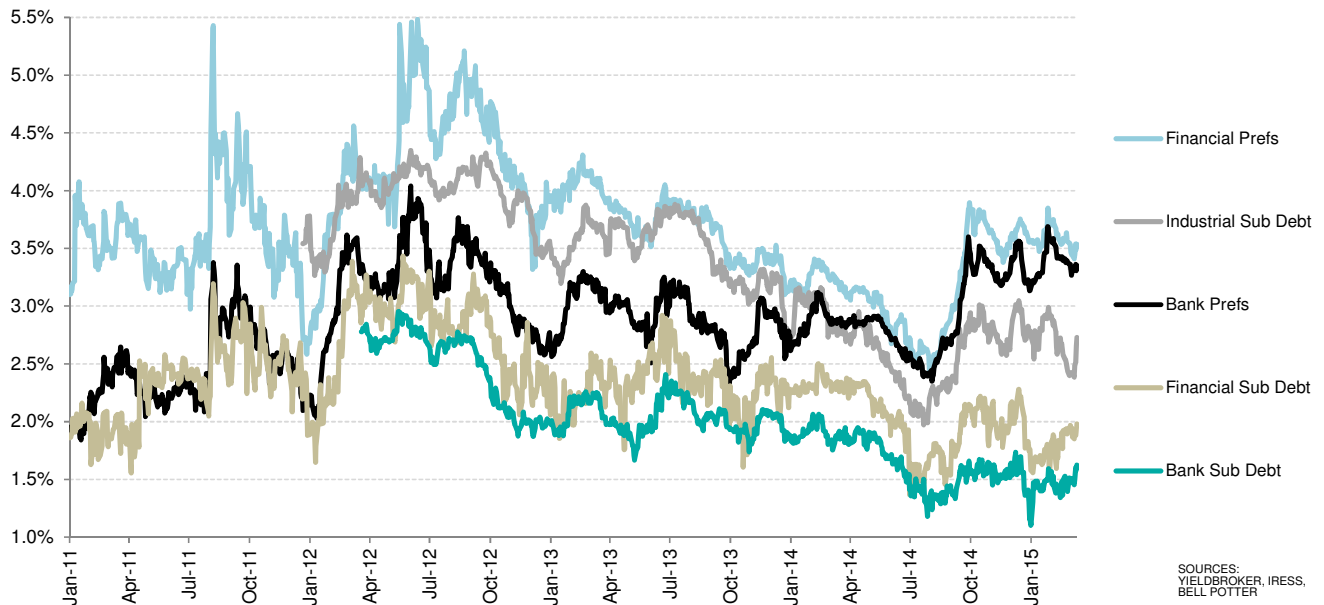
# Crown Subordinated Notes II

## New supply dominated by financial Additional Tier 1 hybrids

The supply of major bank and financial additional Tier 1 hybrids has been a key factor behind the widening in average trading margins when compared with industrial subordinated debt securities. Figure 5 tracks the average trading margins across the following five sectors:

- \* Financial Prefs (BENPD, BENPE, BOQPD, CGFPA, IAGPC, IANG, MBLPA, MQGPA, SUNPC, SUNPE)
- \* Industrial Subordinated Debt (AGLHA, AQHHA, CTXHA, CWNHA, ORGHA, TAHHB)
- \* Bank Prefs (ANZPA, ANZPC, ANZPD, ANZPE, ANZPF, CBAPC, CBAPD, NABPA, NABPB, WBCPC, WBCPD, WBCPE)
- \* Financial Subordinated Debt (AMPHA, AYUHA, CNGHA, SUNPD)
- \* Bank Subordinated Debt (ANZHA, NABHB, WBCHA, WBCHB).

Figure 5: Trading margins on ASX listed debt and hybrid sectors

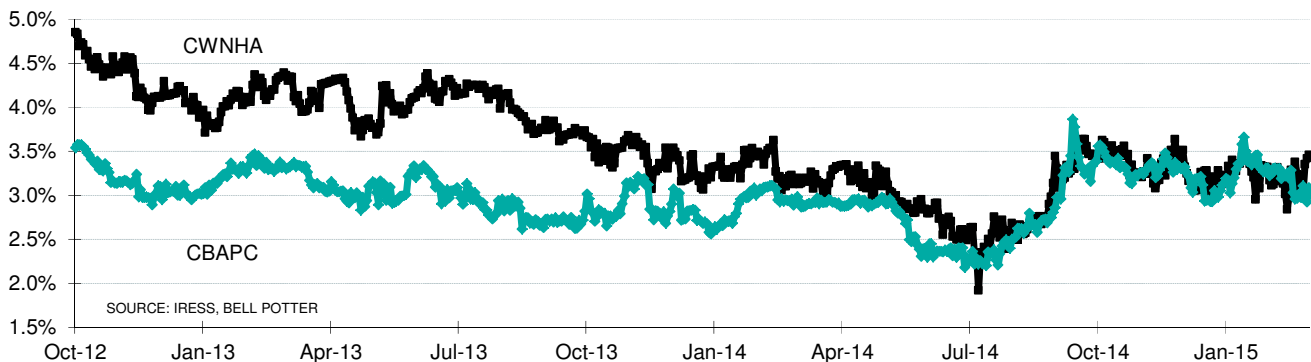


# Crown Subordinated Notes II

## Impact of ASX listed hybrid supply versus wholesale market

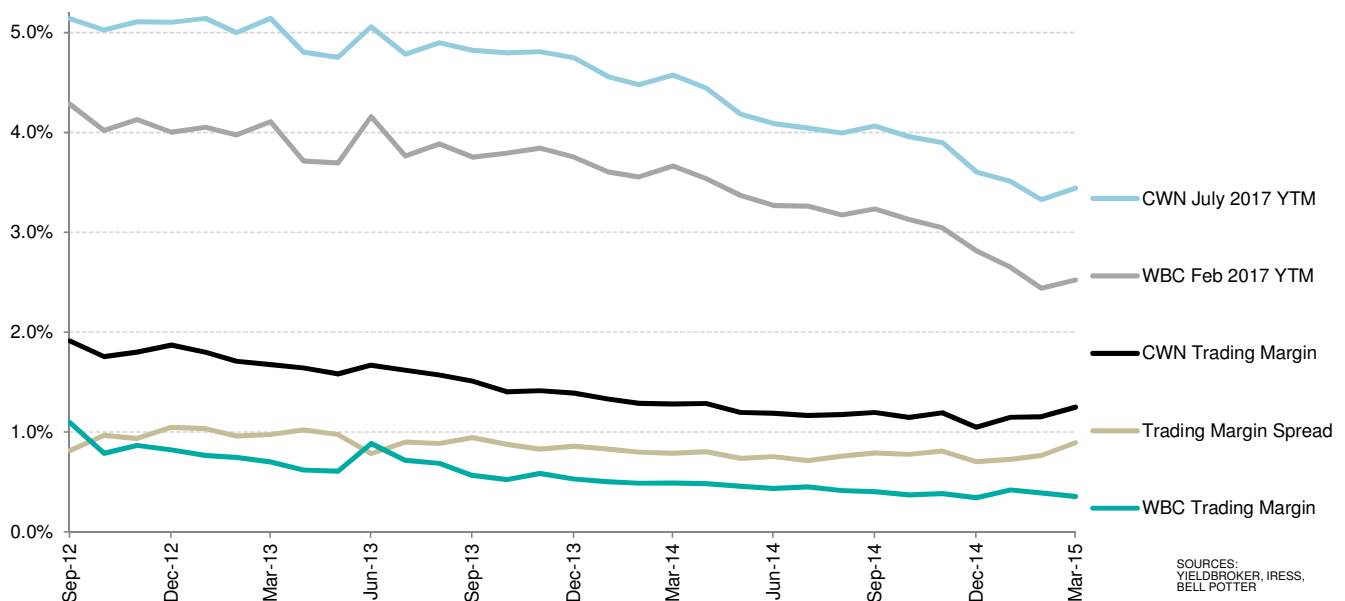
The impact of the new issuance for bank and financial securities can be seen when tracking the trading margins of CWNHA (Sep 2018 call) and CBAPC (Dec 2018 call). CWNHA was launched on 13 Aug 2012 and priced at a margin of 5.00% above 90BBSW. On 3 Sep, CBAPC was launched, and priced at a margin of 3.80% above 90BBSW. The lack of supply of industrial debt securities and ongoing issuance of major bank preference shares and capital notes has been a key factor to the trading margins of both securities virtually being in alignment since mid 2014.

**Figure 6: Trading margins on CWNHA and CBAPC since October 2012**



The wholesale market, by contrast, has seen a relatively steady spread between Crown July 2017 fixed rate senior debt and Westpac Feb 2017 fixed rate senior debt over the same period, with an average spread of 0.85%.

**Figure 7: Trading margin spreads on Crown July 2017 senior debt and Westpac Feb 2017 senior debt**



# Crown Subordinated Notes II

## Equity credit for some, debt for others

In order to obtain Equity Credit, the security must have equity like features such as deferral of interest payments and the provision for the issuer to extend redemption to the maturity date. The structure of CWNHB satisfies the requirements of S&P to allow 50% classification as equity in calculation of its financial ratios until the July 2021 call date, therefore providing ratings support to Crown.

While the structure satisfies the ratings agencies equity requirements, others view this as debt. As such CWNHB will be classified as debt by the ATO, allowing tax deductions on interest payments. Crown will also report this security as debt on its balance sheet.

Figure 8: ASX listed subordinated debt securities with equity credit features

	Crown	Goodman PLUS II (GMPPA)	Crown Subordinated Notes (CWNHA)	APA Group Subordinated Notes (AQHHA)	Caltex Subordinated Notes (CTXHA)	AGL Energy Subordinated Notes (AGKHA)	Colonial Group Subordinated Notes (CNGHA)	Tabcorp Subordinated Notes (TAHNB)	Origin Energy Notes (ORGHA)	Woolworths Notes II (WOWHC)
Issue size	\$400m	\$327m	\$532m	\$515m	\$550m	\$650m	\$1,000m	\$250m	\$900m	\$700m
ASX Listing	24 Apr 2015	26 Sep 2012 (EGM)	17 Sep 2012	19 Sep 2012	6 Sep 2012	5 Apr 2012	29 Mar 2012	23 Mar 2012	23 Dec 2011	25 Nov 2011
Margin: 90BBSW+	3.80%	3.90%	5.00%	4.50%	4.50%	3.80%	3.25%	4.00%	4.00%	3.25%
Maturity	Apr 2015 (Year 60)	Dec 2073 (Year 61)	Sep 2072 (Year 60)	Sep 2072 (Year 60)	Sep 2037 (Year 25)	Jun 2039 (Year 27)	Mar 2037 (Year 5)	Mar 2037 (Year 25)	Dec 2071 (Year 60)	Nov 2035 (Year 25)
First call date	Jul 2021 (Year 6)	Sep 2017 (Year 5)	Sep 2018 (Year 6)	Mar 2018 (Year 5.5)	Sep 2017 (Year 5)	Jun 2019 (Year 7)	Mar 2017 (Year 5)	Mar 2017 (Year 5)	Dec 2016 (Year 5)	Nov 2016 (Year 5)
Step-up date	Jul 2041 (Year 26)	Sep 2022 & Dec 2038	Sep 2038 (Year 26)	Mar 2038 (Year 25)	Sep 2017 (Year 5)	Jun 2019 (Year 7)	n/a	Mar 2017 (Year 5)	Dec 2036 (Year 25)	Nov 2016 (Year 5)
Step-up margin	1.00%	0.25% and 0.75%	1.00%	1.00%	0.25%	0.25%	0.00%	0.25%	1.00%	1.00%
Optional interest deferral	Yes, subject to dividend stopper	Yes, subject to dividend stopper	Yes, subject to dividend stopper	Yes, subject to dividend stopper	Yes, subject to dividend stopper	No	Yes, subject to dividend stopper	No	Yes, subject to dividend stopper	Yes, subject to dividend stopper
Mandatory interest deferral	Yes, if Crown's Leverage Ratio is above 5.0x or Interest Cover Ratio is below 2.5x	No	Yes, if Crown's Leverage Ratio is above 5.0x or Interest Cover Ratio is below 2.5x	No	No	Yes, if AGL's Leverage Ratio is above 4.0x or Interest Cover Ratio is below 3.0x	No	Yes, if Tabcorp's Leverage Ratio is above 3.5x or Interest Cover Ratio is below 3.0x	Yes, if Origin's Interest Cover Ratio is below 3.5x or Leverage Ratio (above 4.0x) will next be tested Dec 2016	No
Interest deferral	Interest can be deferred on a cumulative and compounding basis	Interest can be deferred on a cumulative and compounding basis	Interest can be deferred on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis
Assessed equity credit	50% first 6 years	50% first 6 years	50% first 6 years	50% first 5.5 years	50% first 5 years	50% first 7 years	50% first 5 years	50% first 5 years	50% first 5 years	50% first 5 years
Ranking	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity by Commonwealth Bank	Subordinated, ranks above ordinary equity	Subordinated, ranks equal with Euro Capital Securities and above ordinary equity	Subordinated, ranks above ordinary equity

SOURCE: COMPANY DATA, BELL POTTER

# Crown Subordinated Notes II

## Mandatory Deferral of Interest

CWNHB provides for Mandatory Deferral of Interest if Crown's Leverage Ratio is above the Maximum Level (5.0x) in relation to two consecutive Testing Dates, or the Interest Cover Ratio is below the Minimum Level (2.5x) in relation to one Testing Date.

Assuming EBITDA remains constant, Crown appears it has sufficient headroom under these key covenants to utilise debt funding for its pipeline of casino and hotel developments. We would also expect continued growth in EBITDA particularly once the Perth redevelopment nears completion in late 2016.

Essentially a breach would require an EBITDA decline of at least 50%. Crown has stated that if its financial profile materially deteriorates such that it risks having an Interest Cover Ratio below the Minimum Level or a Leverage Ratio above the Maximum Level, it intends to take a number of measures to restore its credit profile. These measures may include asset sales, equity issuance, discontinuation of certain businesses and suspension of ordinary dividends.

**Figure 9: Pro Forma Leverage Ratio and Sensitivity**

6 Months Ended (pro-forma)	31 Dec 2014	30 Jun 2014	31 Dec 2013	30 Jun 2013
	\$m	\$m	\$m	\$m
Gross Debt	2,680.8	1,742.8	1,751.9	1,635.3
Less 50% of Crown Subordinated Notes on issue	-453.7	-259.1	-259.1	-259.0
Relevant Gross Debt	2,227.1	1,483.7	1,492.8	1,376.3
<b>Relevant Gross Debt</b> (divided by two)	<b>1,113.6</b>	<b>741.9</b>	<b>746.4</b>	<b>688.2</b>
<b>Normalised EBITDA</b>	<b>450.2</b>	<b>390.4</b>	<b>392.3</b>	<b>357.9</b>
<b>Leverage Ratio</b> (Relevant Gross Debt / Normalised EBITDA)	<b>2.5x</b>	<b>1.9x</b>	<b>1.9x</b>	<b>1.9x</b>
<b>Sensitivity to reach 5.0x Leverage Ratio</b>				
Increase in Relevant Gross Debt (constant EBITDA)	102.1%	163.1%	162.8%	160.0%
Decline in Relevant EBITDA (constant Net Debt)	50.5%	62.0%	61.9%	61.5%

SOURCE: COMPANY DATA, BELL POTTER

**Figure 10: Pro Forma Interest Cover and Sensitivity**

6 Months Ended (pro forma)	31 Dec 2014	30 Jun 2014	31 Dec 2013	30 Jun 2013
	\$m	\$m	\$m	\$m
<b>Normalised EBITDA</b>	<b>450.2</b>	<b>390.4</b>	<b>392.3</b>	<b>357.9</b>
Interest Paid	76.3	62.4	60.3	71.1
Interest Received	-8.7	-7.2	-4.7	-6.7
Net Interest Paid	67.6	55.2	55.6	64.4
Less 50% of Interest on Crown Subordinated Notes	-16.5	-10.1	-10.4	-10.7
<b>Relevant Net Interest Paid</b>	<b>51.1</b>	<b>45.1</b>	<b>45.2</b>	<b>53.7</b>
<b>Interest Cover Ratio</b> (Normalised EBITDA / Relevant Net Interest Paid)	<b>8.8x</b>	<b>8.6x</b>	<b>8.7x</b>	<b>6.7x</b>
<b>Sensitivity to reach 2.5x Interest Cover</b>				
Decline in Normalised EBITDA (constant Net Interest)	71.6%	71.1%	71.2%	62.5%
Increase in Net Interest Paid (constant EBITDA)	252.4%	245.8%	247.2%	166.6%

SOURCE: COMPANY DATA, BELL POTTER

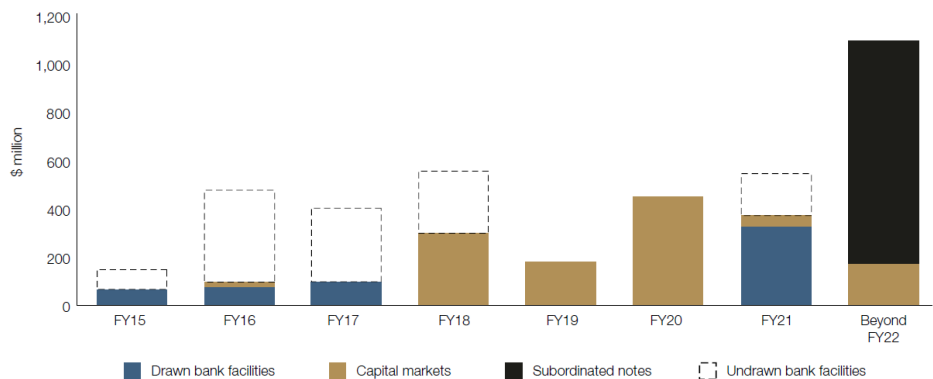


# Crown Subordinated Notes II

## Minimal near term debt refinancing

Crown has successfully extended its debt maturities over recent years. It also has sufficient undrawn debt facilities to cover near term debt refinancings.

**Figure 11: Debt maturity profile - pro forma at 31 December 2014**



SOURCE: COMPANY DATA

**Figure 12: CWNHB ranking - pro forma as at 31 December 2014**

Ranking	Existing Instruments	Amount
Higher Ranking Debt	Bank debt, US private placements, European Medium Term Notes, Australian Medium Term Notes	\$2,152m
Subordinated debt / hybrids	CWNHA	\$532m
	<b>CWNHB</b>	<b>\$400m</b>
Lower Ranking Equity	Ordinary shares	\$4,330m

SOURCE: COMPANY DATA, BELL POTTER

## Investment risks:

### ASIC “Be wary of the risks” warning: Money Smart website

The ASIC publication should be used as guidance which may be relevant to your consideration of CWNHB – namely, information for retail investors who are considering investing in hybrid securities.

Copies of the ASIC Guidance can be obtained from ASIC’s website at:

[www.moneysmart.gov.au/investing/complex-investments/hybrid-securities-and-notes](http://www.moneysmart.gov.au/investing/complex-investments/hybrid-securities-and-notes)

Basically, hybrid securities (including subordinated notes and convertible preference shares) may be from well-known companies but they are very different from 'normal' corporate bonds.

Some hybrid securities make investors take on 'equity-like' risks. Some also have terms and conditions that allow the issuer to exit the deal or suspend interest payments when they choose. Some are very long-term investments (for example, more than 20 years).

Hybrid securities may be unsuitable for you if you need steady returns or capital security typically from a bank term deposit style of investment.

# Crown Subordinated Notes II

## Investment risks

Investment risks are essentially split between Crown Business and Security Risks.

Key Business Risks include:

- Regulatory risks: Including new licences to third parties, loss of licences, enforced reduction / restrictions / taxes applied to EGMs and table games.
- Volatility of VIP gaming: Due to restriction of bet limits, changing casino preferences, and variations in win rates.
- Adverse changes to economic conditions and consumer sentiment, leading to a reduction of customer patronage.
- Increased indebtedness of Crown with its pipeline of hotel and casino developments. Crown's also needs to execute on its development plans and to generate returns sufficient for the capital spend. These risks may impact Crown's ability to refinance debt and maintain its investment grade credit rating.
- Overpaying for acquisitions and investments could weaken Crown's credit profile. Crown may also lack sufficient knowledge of the risks associated with entering a new geography.
- Fraud and IT failures. Counterfeit of casino chips could result in a material loss to Crown. A prolonged IT system failure could result in a significant loss of revenue to Crown.

Key Security Risks include:

- CWNHB are subordinated obligations of Crown, therefore, rank behind senior debt but ahead of shareholders in the event of a wind-up.
- Adverse movement in credit spreads as a result of a tightening in the availability and cost of credit.
- The interest rate margin is fixed for an initial period of up to 26 years. If credit margins widen beyond the initial range as a result of market forces or a deterioration of Crown's credit metrics, CWNHB may trade at a discount. New issues may also offer more attractive issue terms and margins, placing pressure downward pressure on the security price.
- Deferral of interest payments is likely to have an adverse effect on the market price of CWNHB. An adverse changes in Crown's operating performance could potentially trigger a Mandatory Deferral of Interest Payments and reduce the ability of Crown to redeem at the first call date. Interest payments may also be deferred at the sole discretion of Crown.

**Refer page 69 of the prospectus for further information on risks.**

# Fixed Income

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