Hindalco Industries Ltd

Lower production hits Q3 earnings

Hindalco Industries (Hindalco) reported a lower-than-expected EBITDA of Rs 7.4bn (+12% YoY, +2% QoQ) for Q3FY11, as against our estimate of Rs 8.6bn, mainly due to (1) lower copper production on account of cooling tower outage, higher energy costs and an appreciating rupee, (2) lower aluminium volumes arising from smelter outage at Hirakud and higher energy costs and (3) lower-than-expected premium on its products as sales of value-added products declined during the quarter. PAT, at Rs 4.6bn, was lower than our estimate of Rs 5.7bn, largely on account of below-expected other income and lower interest costs (as average cost of debt was lower).

In our view, the strong operating performance of Novelis, led by (1) higher shipments, (2) increase in product premium, (3) effective cost management and (4) a better product mix, has offset the unimpressive results of Hindalco's India business. We therefore maintain a HOLD on the stock with a target of Rs 280.

Smelter outage hits Q3FY11 aluminium production: Aluminium business revenues grew 5% YoY to Rs 19.8bn, mainly on higher metal prices. Metal production, however, declined 4% YoY due to smelter outage at Hirakud, resulting in lower sales of value-added rolled products. We believe that high energy costs along with lower volumes of value-added products led to a below-expected aluminium business EBIT of Rs 4.6bn. Average realisations, at US$ 3,245/ton, were impacted by adverse cross-currency movements as well as lower product premiums.

Copper EBIT declines on low TcRc margins, high energy costs: Hindalco's cathode production at 80kt (-10% YoY, -15% QoQ) was hit by cooling tower outage at its Dahej smelter. This resulted in lower contribution from the copper business and a 10% YoY decline in its EBIT. According to the management, the breakdown at the copper plant resulted in 10kt lower production for the quarter. Despite cost efficiencies, operating performance of the copper business was impacted by lower TcRcs, higher energy costs and an appreciating rupee.

Expansions, improvement in Novelis' performance to drive growth: In our view, Hindalco's performance over FY12-FY13 will largely be driven by (1) timely completion of its green-field expansions at Utkal (refinery) and Aditya/Mahan smelting projects, (2) a stronger operating performance at Novelis led by capacity expansions and stable EBITDA margins and (3) improved outlook on aluminium/copper prices. We maintain our HOLD rating on the stock with a SOTP-based target price of Rs 280. We value Hindalco (India) at 6x FY13E EBITDA and Novelis at 7x FY13E EBITDA.

What's New?	Target	Rating	Estimates

CMP	TARGET	RATING	RISK
Rs 211	Rs 280	HOLD	MEDIUM

BSE	NSE	BLOOMBERG
500440	HINDALCO	HNDL IN

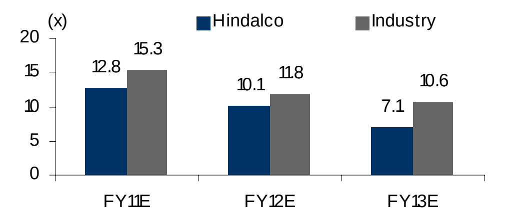
Company data

Market cap (Rs mn / US$ mn)	403,758/ 8,838
Outstanding equity shares (mn)	1,914
Free float (%)	69.7
Dividend yield (%)	0.47
52-week high/low (Rs)	253/ 129
2-month average daily volume	10,419,580

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Hindalco	211	(11.2)	(5.4)	26.3
BSE Metals	15,278	(6.7)	(10.2)	(0.4)
Sensex	17,729	(6.0)	(12.0)	(2.4)

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	10.6	12.8	10.1	7.1
P/E @ Target	14.0	16.9	13.4	9.4
EV/EBITDA @ CMP	5.8	7.1	6.8	5.5

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	607,221	738,574	807,675	887,130
Growth (%)	*(7.9)*	*21.6*	*9.4*	*9.8*
Adj net income	38,225	31,637	39,896	56,934
Growth (%)	*1041.8*	*(17.2)*	*26.1*	*42.7*
FDEPS (Rs)	20.0	16.5	20.8	29.7
Growth (%)	*914.4*	*(17.2)*	*26.1*	*42.7*

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	16.0	11.8	12.6	14.5
EBIT margin	11.5	8.0	9.4	11.2
Adj PAT margin	6.3	4.3	4.9	6.4
ROE	17.7	12.9	14.1	16.9
ROIC	11.0	8.8	9.2	10.5
ROCE	10.1	7.1	7.5	8.5

Amit Agarwal
(91-22) 6766 3449
amit.ag@religare.in

Varun Lohchab
(91-22) 6766 3458
varun.lohchab@religare.in

Result highlights

Performance lower than estimates on (1) lower volumes due to smelter outage and (2) lower interest costs/other income

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	59,746	64,194	(6.9)
EBITDA	7,401	8,606	(14.0)
Adj net income	4,603	5,757	(20.0)
FDEPS (Rs)	2.4	3.0	(20.0)

Source: RCML Research

EBITDA flat YoY even as revenues grew 12% YoY. Operating performance impacted by lower production of value-added products

Interest costs decline on lower cost of debt

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Revenue	**59,746**	**53,153**	**12.4**	**58,599**	**2.0**
Expenditure	52,345	45,677	14.6	51,616	1.4
Operating profit	**7,401**	**7,476**	**(1.0)**	**6,984**	**6.0**
Other income	606	496	22.2	821	(26.2)
Depreciation	1,707	1,676	1.8	1,718	(0.7)
EBIT	**6,301**	**6,296**	**0.1**	**6,087**	**3.5**
Interest	516	729		526	
PBT	**5,785**	**5,566**	**3.9**	**5,561**	**4.0**
Tax	1,181	1,295	(8.8)	1,222	(3.4)
PAT	**4,603**	**4,271**	**7.8**	**4,338**	**6.1**
EBITDA margin (%)	12.4	14.1	(11.9)	11.9	3.9
FDEPS (Rs)	2.4	2.2	7.8	2.3	6.1

Source: Company, RCML Research

Fig 3 - Quantitative details

Key ratios	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Alumina production (tons)	320,310	339,899	(5.8)	347,071	(7.7)
Aluminium production (tons)	135,829	142,048	(4.4)	123,325	10.1
Copper cathode production (tons)	80,224	89,152	(10.0)	94,104	(14.7)
Copper rods production (tons)	26,996	32,969	(18.1)	43,274	(37.6)
Average realisations (Rs/ton)					
Aluminium	145,523	132,697	9.7	154,919	(6.1)
Copper	498,600	384,991	29.5	419,836	18.8
Average realisations (US$/ton)					
Aluminium	3,245	2,852	13.8	3,447	(5.9)
Copper	11,117	8,275	34.3	9,341	19.0

Source: Company, RCML Research

Result highlights

Aluminium business negatively impacted by smelter outage, resulting in lower production of value-added products

- **Aluminium business:** Hindalco's India operations were hit by smelter outage at Hirakud, resulting in lower metal production; this, in turn, impacted production of value-added rolled products. According to the management, pot outage caused by heavy rains resulted in production being lower by 8.9kt during the quarter. Earnings were also impacted by an appreciating rupee and cost pressures.

  Aluminium revenues grew 5% YoY and 3% QoQ to Rs 19.7bn, mainly driven by a sharp increase in metal prices. Average realisations increased 10% YoY (in rupee terms) but declined 6% QoQ even as average LME prices in Q3FY11increased 15% YoY and 13% QoQ. The QoQ hit on realisations was mainly due to lower sales of value-added rolled products. Q3FY11 EBIT margin was flat YoY at 23.5%.

Lower TcRc, higher energy costs and decline in production hit Q3 copper earnings

- **Copper business:** Copper segment revenues grew 17% YoY to Rs 40bn, driven largely by rising copper prices (average realisations were up 30% YoY). However, given the custom smelting nature of the business, LME prices had little impact on its operating performance. Q3FY11 EBIT declined 10% YoY to Rs 1.4bn as TcRcs for the quarter were lower while higher energy costs, cooling tower outage and an appreciating rupee offset efficiency gains.

  Q3FY11 copper production, at 80kt, was hit by the breakdown of the cooling tower for the sulphuric acid plant at Dahej, resulting in disruption of cathode production to the extent of 10kt. Consequently, copper rod production also suffered. According to the management, normal production has resumed with restoration work being completed.

Novelis' revenues/adj. EBITDA up 21%/20% YoY; strong operating performance to continue on demand recovery across markets/product segments

- **Novelis:** Novelis reported a strong Q3FY11 operating performance with net revenues of US$ 2.6bn (+21% YoY), shipments of 751kt (+10% YoY), adjusted EBITDA of US$ 238 mn (+20% YoY) and adjusted pre-tax income of US$ 85mn (+23% YoY). EBITDA growth was largely on account of (1) higher shipments, (2) increase in product premium, (3) effective cost management and (4) a better product mix. However, on a sequential basis, adjusted EBITDA declined 18% on higher input costs while net income was lower because of restructuring costs and expenses related to debt refinancing. Novelis reported a net loss of US$ 46mn for Q3FY11. However, this was on account of: (1) one-time charges of US$ 74 mn on account of debt refinancing and (2) restructuring expenses of US$ 20 mn related to closure of Bridgnorth and Aratu facilities. Adjusted for these expenses, pre-tax income stood at US$ 85mn, up 23% YoY.

  In our view, Novelis will continue to report strong operating results aided by demand recovery across all its markets and product segments. Novelis intends to increase rolling capacity through (a) debottlenecking and b) investing in increasing recycling capacity. We believe this along with rising demand for its products will drive revenue/EBITDA growth over the next 2–3 years.

Fig 4 - Segment performance

Segment revenues	Q3FY11	Q3FY10	% chg YoY	Q2FY11	% Chg QoQ
Aluminium	19,766	18,849	4.9	19,105	3.5
Copper	40,000	34,323	16.5	39,508	1.2
Segment EBIT					
Aluminium	4,652	4,382	6.1	4,239	9.7
Copper	1,429	1,593	(10.3)	1,289	10.9
Segment capital employed					
Aluminium	137,510	96,974	41.8	123,137	11.7
Copper	59,090	55,720	6.0	60,121	(1.7)
Unallocated/ corporate	183,161	210,405	(12.9)	193,622	(5.4)
Segment EBIT margins (%)					
Aluminium	23.5	23.2		22.2	23.5
Copper	3.6	4.6		3.3	3.6

Source: Company, RCML Research

Fig 5 - Revised estimates (consolidated)

Key parameters (Rs mn)	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue	742,472	738,574	(0.5)	807,826	807,675	(0.0)
EBITDA margin (%)	87,802	87,049	(0.9)	102,364	102,070	(0.3)
Net profit	32,943	31,637	(4.0)	40,181	39,896	(0.7)
FDEPS (Rs)	17.2	16.5	(4.0)	21.0	20.8	(0.7)

Source: RCML Research

Capacity expansion plans

India operations: Hindalco is in the midst of a large capacity expansion plan in India through both, the brownfield and greenfield routes. We believe that most of these projects will be commissioned towards the end of FY12E and will see full ramp-up in FY13E.

- **Hirakud:** Expansion of the Hirakud smelter capacity from 155ktpa to 161ktpa is nearing completion. Meanwhile, plans on increasing the smelter capacity to 213ktpa and setting up a 100MW captive power plant have been finalised and are expected to be completed by Q4FY12E. Hindalco is also planning to expand its smelting capacity at Hirakud from the proposed 213ktpa to 360ktpa with a corresponding increase in captive power capacity from 467.5MW to 967.5MW.

Hirakud smelter capacity to expand to 161ktpa from 155ktpa and special alumina capacity at Belgaum to be ramped up to 316ktpa from 138ktpa

- **Hirakud Flat Rolled Products Project:** Hindalco intends to set up a flat rolled product project in Hirakud to manufacture can-body stock for local as well as export markets. It is transferring all key equipment for flat rolled products from the Novelis plant at Rogerstone, UK, to Hirakud. The project is slated for completion in October '11.

- **Belgaum Special Alumina Project:** The special alumina capacity at Belgaum is to be ramped up to 316ktpa from 138ktpa. A cogen power plant of 18MW and a railway siding facility have also been included in the project, which will reduce the cost of production significantly. This project is likely to be completed by 2011-end.

- **Utkal Alumina:** Construction of the 1.5mtpa alumina refinery along with a 90MW captive cogen plant is on schedule. The management has indicated that 87% of the project cost (total cost estimated at Rs 56bn) has been committed and the company is well on track to begin alumina production by Q2FY12. Further, Hindalco has received all statutory clearances and achieved financial closure for this project. The alumina produced from Utkal would provide the necessary feed for the Mahan and Aditya smelters.

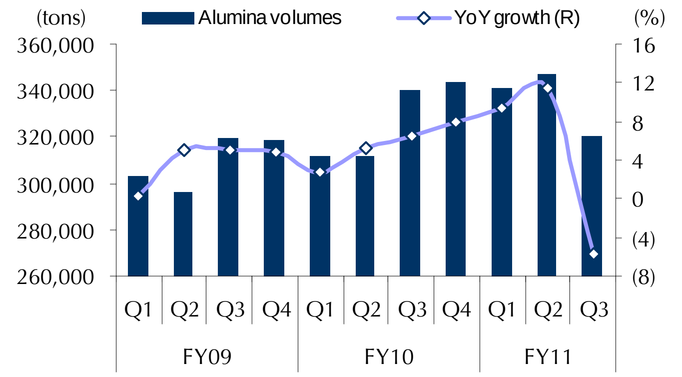
- **Mahan Aluminium:** This integrated project involves setting up a 359ktpa smelter along with a captive power plant of 900MW at Bargwan, Madhya Pradesh. Major approvals for the plant are in place and the project is on schedule for completion by October '11. Of the project cost of Rs 92bn, 90% has been committed.

Integrated projects, involving setting up of smelters and captive power plants, to come up in Madhya Pradesh and Orrisa

- **Aditya Aluminium:** This integrated project (estimated cost Rs 92bn) involves setting up a 359ktpa smelter along with a captive power plant of 900MW in Orissa. Major approvals for the plant are in place and the project is on schedule for completion by end-2012. About 77% of the total project cost has been committed.

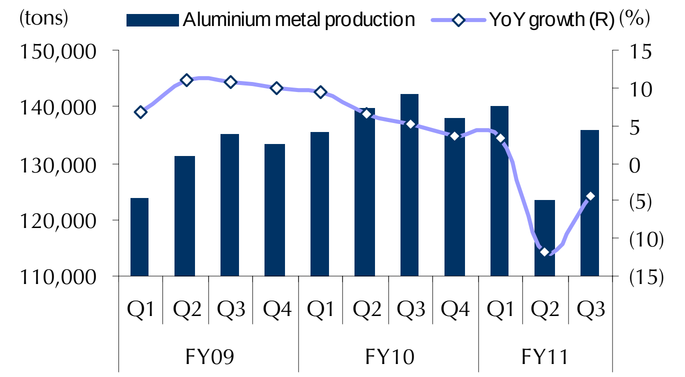
- **Novelis:** Novelis intends to expand its rolling capacity by 2–4% each year. We believe that debottlenecking efforts will result in incremental capacity of 200kt–250kt over the next 3–4 years at a low capex spend of US$ 80mn–100mn. It is also expanding its rolling capacity at its Pinda plant in Brazil by 220ktpa, resulting in significant value accretion. Besides, Novelis' management has also stated that it intends to invest in increasing the company's recycling capacity across all its locations. This will ensure continuity in supply of feed for its rolling facilities besides serving as a low-cost alternative for inputs. Moreover, it is exploring opportunities in Asia through investments in Korea and working closely with Hindalco on its greenfield rolling capacities.

Fig 6 - Trend in Hindalco's alumina production



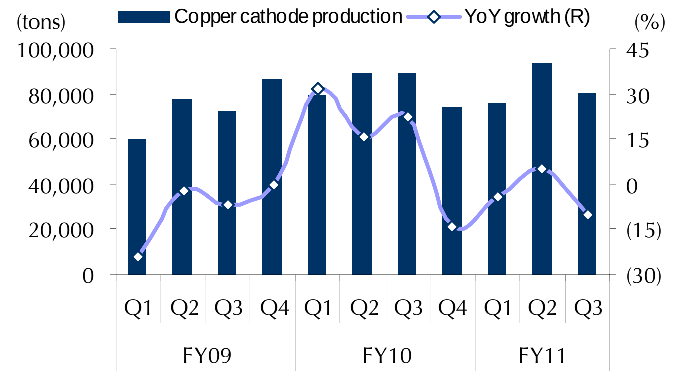
Source: Company, Religare Research

Fig 7 - Trend in Hindalco's aluminium metal production



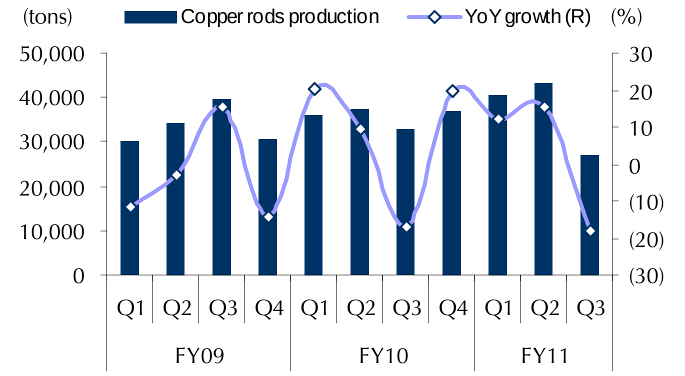
Source: Company, Religare Research

Fig 8 - Trend in Hindalco's copper cathode production



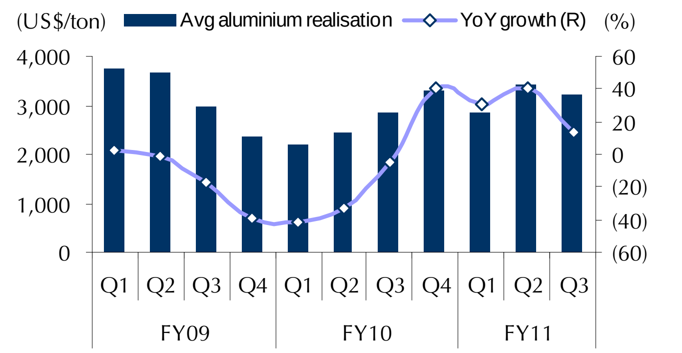
Source: Company, Religare Research

Fig 9 - Trend in Hindalco's copper rods production



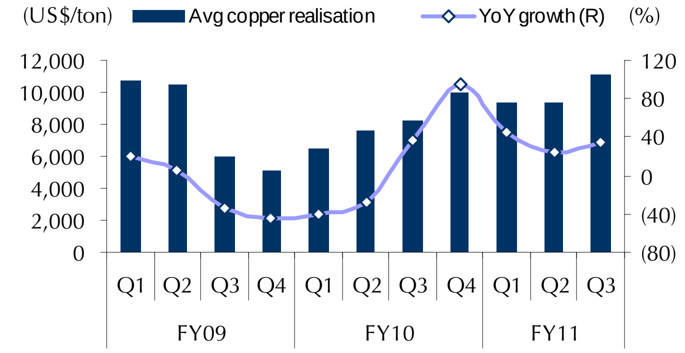
Source: Company, Religare Research

Fig 10 - Trend in Hindalco's average aluminium realisations



Source: Company, Religare Research

Fig 11 - Trend in Hindalco's copper realisations



Source: Company, Religare Research

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	**607,221**	**738,574**	**807,675**	**887,130**
Growth (%)	*(7.9)*	*21.6*	*9.4*	*9.8*
EBITDA	**97,458**	**87,049**	**102,070**	**128,465**
Growth (%)	*228.2*	*(10.7)*	*17.3*	*25.9*
Depreciation & amortisation	(27,836)	(27,845)	(26,311)	(29,483)
EBIT	69,622	59,205	75,759	98,982
Growth (%)	*(10,301.0)*	*(15.0)*	*28.0*	*30.7*
Interest	(11,041)	(18,790)	(24,250)	(25,017)
Other income	3,227	4,952	7,067	7,066
EBT	62,837	45,366	58,576	81,031
Income taxes	(19,319)	(12,179)	(16,988)	(22,455)
Effective tax rate (%)	*(30.7)*	*(26.8)*	*(29.0)*	*(27.7)*
Extraordinary items	-	-	-	-
Min into / inc from associates	(4,264)	(1,550)	(1,693)	(1,643)
Reported net income	**39,255**	**31,637**	**39,896**	**56,934**
Adjustments	1,030	-	-	-
Adjusted net income	**38,225**	**31,637**	**39,896**	**56,934**
Growth (%)	*1041.8*	*(17.2)*	*26.1*	*42.7*
Shares outstanding (mn)	1,914.0	1,914.0	1,914.0	1,914.0
FDEPS (Rs) (adj)	**20.0**	**16.5**	**20.8**	**29.7**
Growth (%)	*914.4*	*(17.2)*	*26.1*	*42.7*
DPS (Rs)	**1.4**	**1.0**	**1.0**	**1.0**

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	21,954	114,531	123,269	159,641
Accounts receivable	65,437	78,022	85,875	91,690
Inventories	112,754	108,183	118,208	130,728
Other current assets	31,739	31,739	31,739	31,739
Investments	112,455	112,482	112,509	112,536
Gross fixed assets	375,915	416,467	439,575	604,804
Net fixed assets	245,672	258,379	255,176	390,923
CWIP	58,008	140,347	250,629	186,096
Intangible assets	44,334	44,334	44,334	44,334
Deferred tax assets, net	-	-	-	-
Other assets	0	0	0	0
Total assets	**692,353**	**888,018**	**1,021,740**	**1,147,687**
Accounts payable	97,420	105,222	115,066	123,955
Other current liabilities	33,576	33,576	33,576	33,576
Provisions	49,170	54,099	57,111	60,574
Debt funds	239,987	391,534	472,634	527,734
Other liabilities	56,754	58,742	60,852	64,654
Equity capital	1,914	1,914	1,914	1,914
Reserves & surplus	213,533	242,930	280,586	335,281
Shareholder's funds	215,446	244,844	282,500	337,194
Total liabilities	**692,353**	**888,018**	**1,021,740**	**1,147,687**
BVPS (Rs)	112.6	127.9	147.6	176.2

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	89,644	73,211	84,886	110,514
Non-cash adjustments	(34,339)	2,098	613	(2,346)
Changes in working capital	(5,984)	5,512	(5,022)	(5,984)
Cash flow from operations	49,321	80,821	80,477	102,185
Capital expenditure	(41,708)	(122,892)	(133,390)	(100,696)
Change in investments	(16,514)	(27)	(27)	(27)
Other investing cash flow	3,854	4,952	7,067	7,066
Cash flow from investing	(54,368)	(117,967)	(126,350)	(93,657)
Issue of equity	27,539	-	-	-
Issue/repay debt	(3,209)	151,547	81,100	55,100
Dividends paid	(3,274)	(3,034)	(2,239)	(2,239)
Other financing cash flow	(16,771)	(18,790)	(24,250)	(25,017)
Change in cash & cash eq	(764)	92,577	8,738	36,372
Closing cash & cash eq	21,068	114,531	123,269	159,641

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	16.0	11.8	12.6	14.5
EBIT margin	11.5	8.0	9.4	11.2
Net profit margin	6.3	4.3	4.9	6.4
ROE	17.7	12.9	14.1	16.9
ROCE	10.1	7.1	7.5	8.5
Working Capital & Liquidity ratios				
Receivables (days)	39	39	39	38
Inventory (days)	68	39	39	39
Payables (days)	59	52	52	51
Current ratio (x)	1.2	1.1	1.2	1.2
Quick ratio (x)	0.5	1.0	1.0	1.2
Turnover & Leverage ratios (x)				
Gross asset turnover	1.6	1.8	1.8	1.5
Total asset turnover	2.0	1.9	1.6	1.5
Interest coverage ratio	6.3	3.2	3.1	4.0
Adjusted debt/equity	1.1	1.6	1.7	1.6
Valuation ratios (x)				
EV/Sales	2.9	2.6	2.7	2.2
EV/EBITDA	5.8	7.1	6.8	5.5
P/E	10.6	12.8	10.1	7.1
P/BV	1.9	1.6	1.4	1.2

Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	53,153	54,044	51,783	58,599	59,746
YoY growth (%)	*29.1*	*43.3*	*32.9*	*19.2*	*12.4*
QoQ growth (%)	*8.1*	*1.7*	*(4.2)*	*13.2*	*2.0*
EBITDA (Rs mn)	7,476	8,354	8,325	6,984	7,401
EBITDA margin (%)	*14.1*	*15.5*	*16.1*	*11.9*	*12.4*
Adj net income (Rs mn)	4,271	6,639	5,344	4,338	4,603
YoY growth (%)	*(21.6)*	*147.0*	*11.2*	*26.1*	*7.8*
QoQ growth (%)	*24.1*	*55.4*	*(19.5)*	*(18.8)*	*6.1*

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	(106.2)	62.5	69.7	68.1	70.3
Interest burden (PBT/EBIT)	667.9	90.3	76.6	77.3	81.9
EBIT margin (EBIT/Revenues)	(0.1)	11.5	8.0	9.4	11.2
Asset turnover (Revenues/Avg TA)	100.9	87.7	83.2	79.0	77.3
Leverage (Avg TA/Avg equtiy)	415.0	360.9	343.3	362.1	350.1
Return on equity	**3.1**	**20.5**	**12.2**	**14.1**	**17.4**

Company profile

Hindalco is an India-based company that operates in the segments of aluminium and copper. Novelis is a subsidiary of the company.

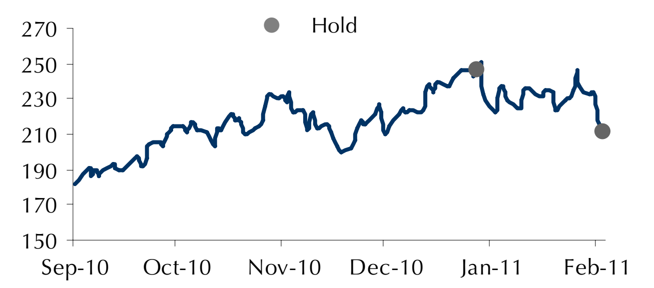
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	32.08	32.08	32.06
FIIs	27.01	28.16	29.78
Banks & FIs	15.88	15.73	14.36
Public	25.03	24.03	23.80

Recommendation history

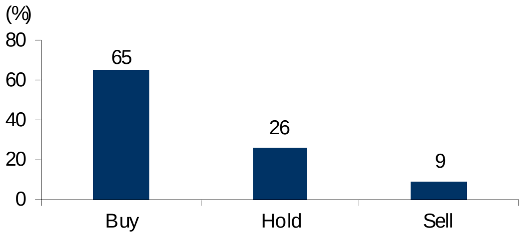
Date	Event	Reco price	Tgt price	Reco
6-Jan-11	Initiating Coverage	247	280	Hold
13-Jan-11	Results Review	211	280	Hold

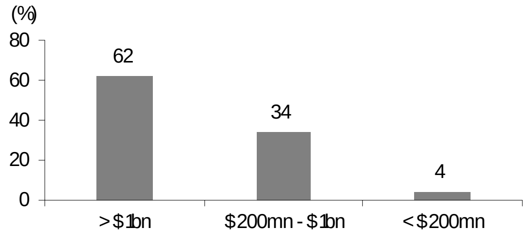
Stock performance



Coverage Profile

By recommendation	By market cap (US$)





Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

Religare Capital Markets Ltd

4th Floor, GYS Infinity, Paranjpe 'B' Scheme, Subhash Road, Vile Parle (E), Mumbai 400 057.

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