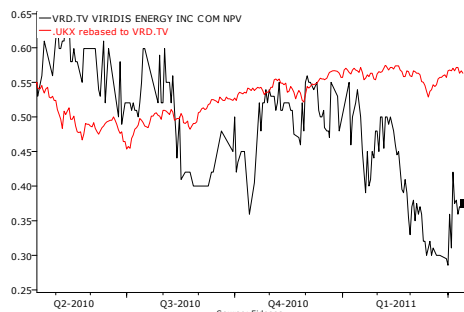


Viridis Energy Inc.
Broadening Into Biomass

37c.

18 April 2011



12m High: 65c

12m Low: 31c

Market Cap: CAN\$13m

Shares in Issue: 34.28m + warrants

NAV/Share: 14c ex intangibles at 30 September 2010

Gearing: 64% inc. goodwill, 126% ex goodwill at 30 September 2010.

Interest Cover: n.a.

EPIC Code: TSX: VRD.V / VRD.TV

Sector: Forest Products

Market: Toronto TSX Venture Exchange (move to Main Board planned). Also OTC QX. A European market quote likely shortly.

Broker: To be announced

PR: -

Website: www.viridisenergy.ca

Description: Manufacturer and distributor of carbon neutral wood pellets for domestic heating and commercial power generation.

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Wood pellet producer Viridis Energy is broadening its reach into other biomass products. A new contract, with a further one hopefully to follow, for oil palm residues could mean that from Q3 this year Viridis might have higher sales revenue – and profits – from other biomass products than from its core wood pellet business.

Also, on the core wood pellet activities, a large but very low margin new wholesale contract has been signed with what is probably the biggest Canadian company in the industry. We suspect that this is driven by a massive increase in wood pellet usage in Europe – and particularly the UK.

The off-take contract, and other wholesale contracts signed over the past month, are partly borne from necessity and partly from opportunity fuelled by new demand. A combination of a late and mild start to the winter in North America and the failure of the Viridis distribution arm Cypress Pacific Marketing to shift sufficient high price product to retailers mean that Viridis had got stuck with surplus stock, and something needed to be done to clear it.

However, efficiency improvements and cost savings at the mill mean that for the first time contracts such as this have become an option strategically, rather than simply a deal of last resort.

In the meantime the palm oil kernel residues agreement has the ability, if all goes well, to turn this company on its head, generating significant profits from Q3 2011 onwards, and with little or no requirement for additional capital.

Viridis Energy is not perfect. It is slow to report its results, its balance sheet could do with additional equity capital and a publicly announced equity raise is taking an inordinately long time to complete.

For environmental and clean energy funds, however, it is a stock that demands attention. While still 'high risk', there is far less risk attached to this than to the average quoted wind farm.

Y/E	Sale	Declared Pre-tax Profit	Adjusted Pre-tax Profit	EPS	P/E	Divi	Yield
Dec	CAN\$ m	CAN\$m	CAN\$m	c.	X	c.	%
2009A	0					-	-
2010E	7.81	-0.1	-2.9	-14.1	-	-	-
2011E	No	Forecast			-	-	-
2012E	No	Forecast			-	-	-

Forecasts dependent upon timing of biomass deal
See text.

Viridis Energy Inc.

18 April 2011

Background – The Product

Viridis Energy Inc. of British Columbia, Canada, is a producer and distributor of wood pellets, an environmentally sustainable, reduced carbon energy source used in domestic and small scale industrial heating in North America and on a larger scale for power generation in Europe.

The raw material for wood pellets is the sawdust and shavings produced by timber mills, so it is essentially a waste product, although wood pellet companies usually have to pay timber mills for it because much of this waste can also be used in MDF manufacture and for animal bedding, etc. It is recognised as carbon neutral, though the issue of carbon credits associated with wood pellet burning is not straightforward. There is a considerably higher hydrogen content, and considerably lower carbon content, in wood pellets than in coal. Wood pellets can be mixed up to 10% in conventional coal burning power stations and boilers without any loss of thermal efficiency and without any need for alteration to the boiler structure or mechanics.

Wood burns much more efficiently and predictably when in homogenous pellets than if chipped or in logs. Also, when pelletised it can be used in automatic feed hoppers, which is not the case for unprocessed wood.

There are vast areas of forest in Western Canada and North West USA that are suffering from beetle infestation. There are thousands of hectares of dead trees, more that are dying. These logs have no other industrial use, and certainly no environmental one. They are starting to be used as a raw material, supplementing and in some cases replacing timber mill waste. We, and most other industry observers, expect rapid growth in beetle kill as a raw material over the next five years.

An environmental product

No other use for beetle kill timber

The Product – Britain Wakes Up

In Britain, the country's largest power generator, RWE npower, has just announced that it is to re-engineer its 1,050 MW power station at Tilbury for conversion to wood pellet burning. The work will take place this year and the plant will be operating again, burning wood pellets, in H2 2011. The change will require c. 500,000 tonnes of wood pellet supplies annually. The Tilbury plant is currently scheduled to close in 2015, in order to comply with the European Acid Rain Directive. The change of power source may enable the plant to remain open beyond 2015, RWE npower hopes. RWE is also the largest power generator in Germany.

Britain starts burning wood pellets

Viridis pellets do not appear to be earmarked for use at Tilbury. These will at least partly come from RWE's own wood pellet plant in Georgia USA. Indirectly, however, Viridis and all other pellet producers will benefit, because the withdrawal of Georgia pellets from open sale will take overcapacity off the market.

In Britain, Renewable Obligation certificates were extended to cover biomass in July 2010.

Background – The Company

Viridis Energy Inc. of BC Canada was formed in June 2010 from the merger of Cypress Pacific Marketing, a BC based distributor of wood pellets to retailers in the Northern US, and Okanagan Pellet Co., a single mill manufacturer of wood pellets in BC that regularly tops the quality gradings for its product and rates high in satisfaction surveys. Both companies were privately owned previously. A shell company was used to obtain a quote on the TSX Venture exchange.

Intends to upgrade its share listing

The company has the stated intention of upgrading to the Toronto senior market, and possibly adding a London AIM or a German share quote. Recently, management has also initiated discussions with the NYSE and the executive of the NYSE expects to start the application process in late 2011.

Viridis Energy Inc.

18 April 2011

What's In A Name?

Unfortunately Viridis is a popular name for companies, both private and public. Care needs to be taken not to confuse Viridis Energy Inc. of BC, Canada with the identically named and quoted Viridis Energy in Australia (an investment fund), Viridis UK (a large glass producer) Viridis Tech, a UK LPG specialist, and so on. Worst of all, a seriously troubled British biomass company trades under the name of Viridas. We believe it would be helpful if Viridis Energy Inc. of BC changed its name. As far as we are aware this is not at present in the company's plans.

Reporting of Results

Viridis Energy has yet to report its results for the calendar year 2010. We expect the announcement to be made at the end of April. The company has given no formal indication of trading for Q4 2010, or for Q1 2011, which has now been completed.

Under TSE Venture rules, companies are given 120 days to report results, and Viridis Energy is well within this. The company has been planning to upgrade to the full Toronto Stock Exchange senior market, in which case 90 day reporting becomes mandatory, and clearly the company needs to move more quickly if this is to take place.

Q1 has now completed.

Q4 2010 Trading

The North American winter was late arriving last year; most regions experienced a longer and warmer autumn than usual, and therefore sales of wood pellets for domestic heating experienced a slow start. We pointed this out in our research note of 21.12.2010, and still feel our forecast of c. \$7.8m revenues for the year (which include only a part-year of the wood pellet activities) is in the right place. We expect a small loss to be declared. This includes a non-cash asset revaluation gain, and on an ongoing trading basis we expect a seven figure loss. *This is not an issue that need worry investors*, because FY 2010 was 'missing' three of the most profitable months of the year in this seasonal business, but included a full summer (when wood pellets invariably lose money).

Lower sales volumes are important for wood pellet mills. Almost all operators in the industry agree that the key factor in maximising profitability is to keep the mill turning over 100%, on a 24 hour 7 days a week basis. Viridis reached the end of its financial year with higher inventory than it would have liked, but surprisingly a larger book for Q1/Q2 than in past years.

Q1 2011 Trading

We believe that sales towards the end of winter were strong, approximately 3,000 tons per month, but were by no means sufficient to clear the inventory that had been warehoused for the winter. The booked orders for Q1 and Q2 for domestic, bagged sales are over 12,000 tons which is the majority of the inventory on the ground. This means that the company is selling much of their production capacity on the wholesale contracts with very little remaining for the domestic bag market. Had the early-buy or off-season market not been as strong, these high inventory levels at end of season could have been a significant problem for Viridis. Assuming customers take delivery of these orders, the volume is approximately 2400 tons per month just to the domestic bagged market, a very solid showing. The probability of customers taking delivery is higher than normal this year as one of Viridis's major competitors in the northeast (New England Wood Pellets) has increased prices for customers who have already placed orders (and presumably earlier agreed pricing) for April and May delivery. It has also imposed a price increase for June orders of \$10 a ton. This is unusual for the industry over the past couple of years but bears resemblance to the hot market of 2008 when demand outstripped demand.

Sales revenues will be lower than our original forecast, because we had assumed that an acquisition (Monte Lake) would complete in January and that Monte Lake revenues would

2010 results not important because of part-year in seasonal business

Strong backlog of orders

Viridis Energy Inc.

18 April 2011

be included for the full twelve months of 2011. However, the impact at the earnings level will not be significant, because we had expected Monte Lake to make a modest loss until new plant building had taken place.

Viridis Energy has also been working upon improving efficiency at the Okanagan wood pellet mill and in its downstream sales operation and its administration. A lot of cost has been taken out of the business, and Viridis's costs of production, which were already very low, will probably be as good as or better than that of any of its competitors *of a similar size*. In our October 2010 research note, we stated that we believed the Viridis cost of production from its Okanagan Pellet Co. mill to be c. \$90/tonne. We think that the efficiency improvements may have shaved up to \$3/tonne off that. Management is hopeful of making further savings of as much as another \$7/tonne.

The mill has been made more efficient

It needs to be borne in mind that size is important in the wood pellet business. The most efficient wood pellet mill in North America is the Pinnacle Renewable Energy Group facility at Burns Lake, which at 400,000 tonnes/year capacity had a capital cost per tonne of capacity that was 15% less than the price Viridis Energy paid when it purchased Okanagan Pellet Co., and probably has an operating cost per tonne 25% lower than Okanagan (we have been unable to obtain confirmation of this from Pinnacle).

Clearing The Inventory

It is important that Viridis Energy clear the surplus inventory. This is for two reasons. The first, obvious one, is that it needs to turn physical product into cash, for the sake of its balance sheet and to provide the capital for acquisitions. The second is that there is the risk of product damage if the wood pellets are stored until the start of the 2011 winter selling season. Even with the heavy grade plastic sacking used by Viridis (and others in the industry), there is a risk of the pellets becoming damp, and this seriously affects their thermal capacity. Once again, if the book of orders is fulfilled, the majority of this inventory will be clear by the end of May.

The Viridis management has signed a contract with one of the largest wood pellet companies in Canada to supply 2,000 tonnes/month of its pellets. From October 2011, the volume commitment rises to 4,000 tonnes/month. This deal is at a very low price, less than half the price that Viridis is able to obtain in its retail markets in the North East USA. On the other hand, Viridis saves on transport costs (the price is ex mill), bagging (the product is being sold bulk rather than bagged), and avoids the need to store the product over the summer months until it can be sold in the winter. It also has a much reduced credit risk, and good payment terms.

Important new bulk contract

The deal is undoubtedly better for the larger producer than it is for Viridis Energy. However, because cost has been taken out of the mill, we believe that Viridis will be able to make a margin on this contract. The output of Viridis's Okanagan pellet mill is 5,000 tonnes/month, so the contract initially takes 40% of output. What makes this a strategic deal, however, rather than merely a short term convenience in order to clear excess inventory, is the ramping up of supply to 4,000 tonnes/month from October. If Viridis Energy does not expand capacity, this will mean that 80% of group output will be contracted to a low margin (but secure) customer. If Viridis Energy is to keep the second part of its business functioning – this is the high margin distributor Cypress Pacific Marketing – then by October 2011 it will need new capacity. Besides, almost anything is better than running a wood pellet mill at less than 100% capacity.

Viridis will need more capacity

This contract has already started shipping.

Other Q2 Orders

A bulk order from another BC wood pellet company is taking 1,000 tonnes/month until May, with an option to continue through to the end of 2011. This, like the first order, is on very tight bulk pricing. Also an order has been received from an Italian customer for 1,000 tonnes, for supply of pellets to Italy. Italy has been affected by oil shortages because of its historic links with Libya. Several other enquiries have been received from Italy, and Italy may become an important customer short term.

Expansion – To Buy Or To Build?

In June 2010, Viridis Energy announced the proposed acquisition of Monte Lake, a privately owned log processing specialist and post and rail (fencing) producer in mid-BC. The acquisition has not yet been completed. Viridis has little interest in the post and rail business. The attraction is the site – a permitted wood processing facility on a railhead with easy access to a high voltage power line. Viridis plans to erect a 100,000 tonne/yr wood pellet plant here, with beetle kill timber being the raw material. Monte Lake already has contracts for timber felling in the area. It has also been considering building on the site a power generation plant, fuelled by its own wood pellets, selling electricity to the grid via the conveniently located power line. We estimate that the new pellet mill will cost US\$11m, and the power generation plant probably a similar amount.

The current intention is to proceed with the acquisition from May or June. However, investors need to be aware that the completion date has been put back several times already.

If the Monte Lake acquisition is consummated, we now expect the plant build-out there to be undertaken on a joint venture basis, possibly with Indian or South Korean industrial sources, giving Viridis a 'free ride' on someone else's capital in exchange for a percentage of the equity.

In March, Viridis announced the proposed purchase of Confluence Energy, the largest wood pellet producer in the Western half of the USA. Confluence has been producing solid EBITDA, but is struggling with high interest and amortisations, thus rendering it barely profitable, but Viridis is confident that it can make further operational improvements, cut distribution costs, and by exporting some of its product to Canada can expand both its margins and its market. The deal has yet to be completed.

In the past, Viridis has also mooted a doubling of capacity at Okanagan Pellet. This would not be straightforward, because the existing site has a limited footprint, and also the site has no rail sidings. The company is actively pursuing options for a move to a new site, within the same fibre basket, and has identified some potential targets. The requirement is for owned land, not leased, on a rail siding with a minimum of 20 acres.

We believe boardroom thinking at Viridis is currently moving towards buying extra capacity, rather than building it. This is because the current price for existing pellet mills/companies is, per tonne of capacity, lower than the cost of new build for all except the super-size plants such as the one Pinnacle has at Burns Lake and RWE has in Georgia.

Capital Raising, Short Term and Long Term

In December, Viridis announced that it was in the process of bookbuilding for a private placement for \$5m of shares and warrants at 50c. a share, very slightly above the market price at that time. The attached warrants were to have a strike price of 75c; a sensible premium to the share price. The closing of this short term fundraising has been delayed, and this delay is the prime reason for the fall in the share price from 48c to 37c over the past four months. It creates uncertainty – why buy a share if nobody else wants to? It also makes buyers delay; why buy a share in the market today if you might get it offered to you more cheaply in a placing later on? The company had allocated very little time and resource to these fund raising efforts and has now commenced efforts to meet alternative energy funds who are eager to undervalued, high growth potential investments in this space.

This issue has still not been closed, and until it is, Viridis will be operating under certain capital constraints. It certainly will not be in a position to authorise new plant construction or close either of its outstanding announced acquisitions.

In later 2011 or 2012, Viridis will need a more substantial capital injection to enable it to fulfil its objective of consolidating this fragmented industry. Given the interest in Viridis shares both in Germany and London, and the interest in Asian industrial organisation in partnering

Construction possibly now on a JV basis?

Potential new site identified

Capital constraints

Viridis Energy Inc.

18 April 2011

Viridis or signing long term offtake agreements for its products, a second share quote in Germany, on London's AIM, in Hong Kong or in Seoul is highly likely.

Biomass – Could Be Bigger Than Wood . . .

Viridis has signed a Letter of Intent with Heracles, a Hong Kong headquartered trading firm, for the supply of 40,000 tonnes/month of biomass energy, the co-products generated from the oil palm processing industry to sites in mainland China. Shipments are due to start from June, provided a formal signing between Heracles and its mainland Chinese customers takes place this next week. The pricing on this contract is worth \$2.8m/month. This is almost as much revenue as Viridis makes out of its wood pellet operations. Suddenly, it looks as if Viridis is becoming a downstream value adding biomass company, or at least a multiple product biomass provider, rather than a single product wood pellet specialist.

\$2.8m a month of biomass

Under the agreement, Heracles will serve as exclusive agent for Viridis biomass products in the Greater China area (mainland China, Taiwan, Hong Kong and Macao). In return, Viridis will be the exclusive biomass supplier to Heracles in the Greater China area.

The contract is renewable annually, over a ten year period. The buyer bears freight and loading costs, and currency and credit risks.

Further orders are under negotiation that, Viridis management suggests, could take total shipments up to 200,000 tonnes/month by the end of the current financial year. That would suggest business worth \$14m/month, or \$160m/year.

The Viridis statement says that there would be 'gross revenue of \$33.6m over the first twelve months, of which Viridis expects to net approximately 10% to 15% after all costs'.

This is a dramatic claim, and Viridis management must be very sure of itself to put such a statement into print. It suggests net revenue to Viridis of \$3.6m/year, or 7c/share after allowing for 30% tax. That is pretty impressive for a company with a share price of only 37c. It suggests Viridis might be on a p/e ratio of only 5 on its biomass activities alone, with the wood pellet side valued at nothing, or less than nothing.

A dramatic and company changing claim

If it all happens smoothly, Viridis will be a very different industry category. If this contract works according to plan, Viridis will be a company that derives more than two thirds of its revenues from a broader biomass market.

. . . But The Money Isn't Yet In The Bank

While shipments are due to start in June, it is worth noting that this is a letter of intent, not a firm contract. Not all LOI's end up as a contract, and Viridis has a bit of a record in this respect, having signed an LOI on the Monte Lake acquisition but still not consummated the deal after eight months.

It is also important to remember that 40,000 tonnes/month of biomass product is a very significant quantity, that will require a great deal of organisation and logistical effort to aggregate and get in the right place for shipment. For 200,000 tonnes/month, the issues would be exponentially greater. It will place considerable pressures upon Viridis's suppliers, one being St. Bunkers, an unlisted broker that is not itself an oil palm plantation owner. Viridis is in direct discussions with one of the major plantation operators in Malaysia, but does not yet have a signed Letter of Intent for this second, or expanded off take agreement.

The Viridis press release on April 6 described the biomass in question as 'palm kernel shell'. The whole pressed kernel, nut and shell, produced in Malaysia each year probably amounts to only 4m tonnes/year, so if this agreement strictly follows the wording of the press release, c. 10% of Malaysia's pressed kernel residue would be passing through Viridis's hands – an unlikely event especially as much of it is already used as fuel locally on plantations. The agreement actually encompasses a wider range of biofuel, in particular the pressed flesh of the fruit, and the empty fruit bunches; the fruits are grouped around a central stem in very much the same way as a fir cone, or corn-on-the-cob.

Viridis Energy Inc.

18 April 2011

Viridis has set up a base of operations with offices in the Petronas twin towers in Kuala Lumpur. From here the company has been scouting out locations near several ports, where it intends to set up processing facilities to pre-process the biomass co products from the oil palm industry and if necessary produce briquettes or pellets from the biomass stream.

**Base
established
in KL**

Biomass – Why Viridis Can Make It Work

One of the co products, Empty Fruit Bunches, due to a low melt point of about 900c, gives serious problems on industrial scale combustion, because it tends to create slag deposits in boilers, necessitating frequent shut downs and maintenance. Viridis has a Licence on a pre treatment technology that reduces deposit formations, and this gives the company an advantage in being able to provide this high calorific value added product for energy generation. Consequently, Viridis Energy is becoming the link man – or hopes to become the link man – between major palm oil plantations in Malaysia and Indonesia, and power generators in fast growing Asian countries such as China and Korea.

The pre-treatment technology is the reason why Heracles is not sourcing these biomass feedstocks directly, and also why the major Malaysian and Indonesian plantation companies, which dwarf Viridis with their cash rich balance sheets and market capitalisations in the tens of billion dollars, allow Viridis any slice of this action at all.

**Pre-
treatment
may be
important**

For the plantation owners, being able to use the Empty Fruit Bunches with little to no value as a fuel in their own energy and processing facilities will free up the more valuable PKS co-product for Viridis customers. It may become a win win situation for all parties.

Our Estimates

We have withdrawn our 2011 estimate until we can see what will be in the company from Q2 onwards – Monte Lake, Confluence, Malaysian biofuel or all three. We have always expected Viridis to report a loss for 2010 and this remains the case, although the loss will probably be small because Viridis will book a revaluation gain on some assets (these have been stripped out of 'adjusted profits' in our estimates on page 1). If all goes well on the biofuel front, however, the loss we previously expected for 2011 may now not happen. It is possible to envisage a scenario where Viridis turns a 2011 profit, because of the favourable impact of the Malaysian oil palm deal.

We still believe that Viridis will require additional equity capital before the end of the year.

Conclusion

Viridis is adapting its business model to the realities of the current wood pellet market, but while the way forward for wood pellets is turning out slightly differently than we expected, the economics still make sense. Joining a secure, low margin wholesale business onto its existing high margin retail business in order to maintain plant volumes and gain economies of scale is attractive, and reducing forward capital requirements by joint venturing new plant build is also utterly logical.

As for the palm business, if all goes well, Viridis may well have a tiger by the tail here. Capital requirements appear to be either largely or entirely for working capital, and as long as the Viridis additive performs satisfactorily on scale up, and as long as the additive gives Viridis exclusivity, shareholders should benefit.

**A tiger by
the tail?**

The profitability of both arms of the business will be very dependent upon the Viridis management having accurate costings. Even a wafer-thin loss per tonne on the volumes that Viridis has negotiated would be extremely uncomfortable for a company of this size.

This company has an above average risk profile, and we will be happier once the capital base has been enlarged. Also we are unhappy with the amount of time it takes to produce results statements. But 'above average risk' is a relative term – there is rather less risk here than in the average quoted wind farm. Viridis Energy is moving in the right direction, and we await the forthcoming results with interest.

Viridis Energy Inc.

18 April 2011

Management	Major Shareholders
<p>Chairman: John Campbell. He is also CEO of Stealth Energy.</p> <p>Chief Executive Officer: Chris Robertson, founder of Cypress Pacific Marketing, the largest subsidiary of Viridis Energy. Previously an executive with Forest City, a NYSE listed company.</p> <p>Chief Financial Officer: Michele Rebiere. 18 years senior management experience. Studied finance at Wharton.</p> <p>Vice President Sales and Marketing: Geordie Munro, part of the Cypress Pacific management team for five years.</p> <p>Export Manager: Bob Wood, part of Cypress Pacific management team.</p> <p>Non-Executive Directors:</p> <p>John Heimbecker, Vice President of Parrish & Heimbecker, an agricultural company with \$1.7bn of sales. Also chairman of Canada Ports Clearing Association.</p> <p>Isaac Moss, a director of Syntaris Power, a developer of hydro-electric power projects in British Columbia, and a history of private equity involvement in environmental investment.</p> <p>Alphonse Plaktis, Principal of Soho Ventures Inc.</p>	<p>Cornwall Investments llc of New Jersey 14.8%</p> <p>Jesson Chen 5.4%</p> <p>Insider Shareholdings: 34%</p>
Key Dates	Key Milestones
<p>Late April/early May: Release of Full Year 2010 Results.</p> <p>June: Closing of private equity offer.</p> <p>July: First shipments of oil palm biomass to China.</p>	<p>June 2009: Sale of Grid Sense Systems, its previous business leaving a clean shell. Change of name to Viridis Energy.</p> <p>March 8 2010: Acquisition of Cypress Pacific Marketing, a wood pellet distribution company.</p> <p>April 30, 2010: Acquisition of Okanagan Pellet Company (known at the time as Westwood Fibre Products), a wood pellet producer in BC.</p> <p>October 2010: Proposed acquisition of Monte Lake, a log processing specialist and post and rail producer with railhead and suitability for a new wood pellet plant.</p> <p>March 2011: Proposed acquisition of Confluence Energy, wood pellet manufacturer in Colorado.</p> <p>April 2011: Letter of Intent signed to supply oil palm biomass from Malaysia to China and other Asian countries.</p>

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