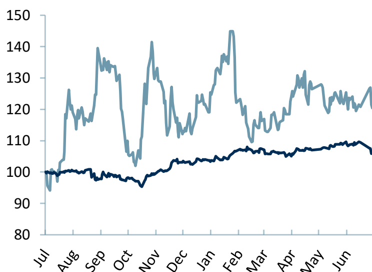
ACF EQUITY RESEARCH

INITIATION

VALUE RANGE

USD 1.08 – 1.11



LC 12m Price Rel. vs. NYSE Composite (darker)

Thursday, 13 July 2017

Intrinsic Price	$1.11
Value Range Low	$1.08
Value Range High	$1.13
Implied MCAP (bn)	$0.443
Implied EV (bn)	$3.94
NYSE Index	LC
Financial YE	31-Dec
Currency	USD

Business Activity

Consumer retail near-prime lending

Key Metrics

Close Price	$5.39
MCAP (bn)	$2.158
Net Debt (Cash) (bn)	$3.500
EV (bn)	$5.66
52 Wk Hi	$6.68
52 Wk Lo	$4.10
NAV trailing	$2.44

Key Ratios

S/P premium to NAV	121.12%
Charge off	5.09%
Net Debt / Shareholder Equity %	358.73%

Financials Sector Research

NYSE Best Market Index

Analyst Team

ACF Financials Team

+44 20 7419 7928

financials@acfequityresearch.com

Lending Club…Trust Bust

Holed below the waterline?

Lending Club Corp.(LC:NYSE) is the world's largest online market place matching lenders (investors) to borrowers looking for loans between $1,000 to $50,000. And, in our view, it is in a lot of trouble. Lending Club does not utilise its own balance sheet in the majority of cases but rather acts as an intermediary taking a processing and management fee. Lending Club was doing very well until 2Q16, before the first of what we see as a series of potential trust and so brand eroding problems surfaced. We are sceptical about the stability of the business model and the extent of repair that can be achieved. We question the relevance of the current board (all brought up in firms at the centre of the GFC, and expensive) and believe that new products are creating more or a new fog than a new hope

- 2Q governance scandal continues to burn cash, time and loyalty;
- Income verification concern climbs in deteriorating credit markets;
- Institutional lenders are backing out after LC mis-selling;
- LC balance sheet cannot support short-term market place equilibrium;
- Springstone write down bodes ill for LC acquisition growth.

	Revenue	EBITDA	FCF	EPS	EPS (diluted)	CPS
2017E	619	-15	-83	-0.30	-0.30	-0.21
2018E	774	140	74	0.04	0.04	0.19

Multiples	EV/ Revenue	EV/ EBITDA	EV/ FCF	P/ EPS	P/ EPS (diluted)	P/ CPS
2017E	9.14x	-389.70x	-68.22x	-17.73x	-17.73x	-26.01x
2018E	7.31x	40.52x	75.98x	126.93x	126.93x	28.98x

13/05/2017		
Share Price History	No. of Shares in issue	Fully diluted
NoSh (m)	400.31	400.31
Implied Intrinsic Price	$1.11	$1.15
Value Range Low	$1.08	$1.08
Value Range High	$1.14	$1.14
NYSE	LC	
Financial YE	31-Dec	
Reporting Currency	USD	
NoSh (m)		400.31
NoSh (m) expected dilution (Exp D)		400.31
NoSh (m) full dilution (FD)		400.31

Key Metrics		adj.
MCAP (bn)	$2.2	$2.2
Net Debt (Cash) (bn)	$3.50	$3.50
EV (bn)	$5.7	$5.7
52 Wk Hi	$6.7	$6.7
52 Wk Lo	$4.10	$4.10
Free Float	96%	96%

*Key Metrics FCF adj.	2017E	2018E
CPS (USD)	-0.21	0.19
CPS (Exp D) (USD)	-0.21	0.19
CPS (FD) (USD)	-0.21	0.19
P/CPS	-5.4x	6.2x
P/CPS (Exp D)	-5.4x	6.2x
P/CPS (FD)	-5.4x	6.2x

Above we show full dilution (FD) and expected dilution (Exp D). LC shares in issue at the date of this note are 400,308,521. We assume there are no dilutive effects over our 5-yr valuation horizon.

Investment Case

Competitive background

Peer to peer (P2P) lending, also referred to as crowdlending and more recently as online marketplaces aims to reduce the cost of lending (to borrowers) and increase the returns to investors (lenders) whilst LC adds a management fee in the middle.

This is achieved by using an online marketplace, effectively disintermediation. Online market places save costs – they don't have expensive physical branch networks and need fewer employees. Instead LC and its competitors such as Prosper Marketplace Inc., Social Finance Inc. and Goldman Sach's Marcus rely of online data collection, machine learning and proprietary algorithms alongside FICO scores to collect, assess and process data from potential borrowers.

LC's loans are dominated by unsecured retail loan products (99.6% of the outstanding principal balance of USD 4,322m), though SME loans and auto financing and other specialist products add to the portfolio. Lenders (investors) are dominated by institutional investors accounting for 61% of investment by USD value (see exhibits page 8).

Mis-selling - In 2Q16 Lending Club announced it was embroiled in a **mis-selling** scandal that brought down its founder and Chairman and CEO, Renaud Laplanche. Lending Club now faces possible law suits from investors and has significantly raised costs thanks to expenditures required to redress the plethora of margin effects and brand damage.LC stated this year that the crisis is behind it, but this is not what its OPEX line structural increases suggest.

Income verification - In June 2017, Bloomberg wrote that it had obtained information that stated that Lending Club verified the income of borrowers on just 35.6% of its most popular loans down from 47% in 2013 but up from 16% in 2008.

Systemic risk – The verification statistics for LC revealed by Bloomberg compare very unfavourably with the **income verification** that banks carry out or online lenders such as IEGH, which approximates 100%. None of these verifications exclude the proportion of applications that are fraudulent. LC says that 11% of its customers materially overstate their income. LC also says that being too intrusive leads best borrowers finding alternative providers.

Increased regulatory oversight coming? – The US Treasury Department is also showing much greater interest in online marketplaces for lending and borrowing since LC's 2014 USD 5bn IPO, and subsequent share price collapse 2Q16.

Catalysts for further valuation downgrades

Poor 2Q loan origination growth; Credit scoring scandals; Sub-prime credit market deterioration; further bad news from Springstone; charge-offs remain at 7-8% or deteriorate further. Significant regulatory oversight introduced. Investors lending volumes fall; Lending costs rise.

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Operational Strategy

LC claims it is the largest online marketplace (previously referred to as peer to peer (P2P) lending or crowdlending).

Lending Club's target is to transform the banking system to reduce the cost of borrowing and increase the return to investors (lenders) whilst taking a management fee via its online market place. The central approach is to use an online platform to cut out the costs of bricks and mortar branches and use fewer employees – Lending Club is a Fintech business.

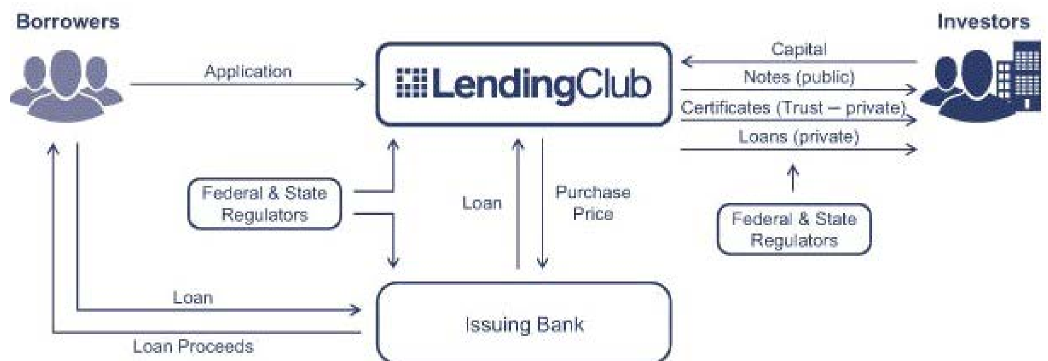
● **Network effects** - With scale, LC claims there are significant network effects, which amounts to greater liquidity for the marketplace and so improved probability for borrowers to get funded and investors to find acceptable risk and return profiles for their lending capital. Network effects are based on marketplace trust, which we think for now is in short supply for LC.

● **Trapped pools of capital** - LC argues that its online marketplace has released trapped pools of capital inside the banking system, which we interpret as cash deposits that have not been earning significant interest in a low interest rate environment. LC's model will be tested by a rising interest rate environment.

Lending Club distributes loans in 26 US states and is aiming to have national distribution by YE17.

● **Technology platform** - The technology platform allows LC to deliver cost and time competitive advantages compared to bricks and mortar banks and related lenders. Lending Club's system is highly automated and is based upon LC's own proprietary software.

Exhibit 1: **LC loan issuance mechanism across technology platform**



Source: Company reports

The platform is scalable and LC has developed proprietary fraud detection using a combination of third-party data, artificial intelligence and algorithms in combination with FICO scores during the application process. However, LC does not verify the income level of the majority of its borrowers on its most popular products.

The Company provides an Application Programming Interface (API) allowing investors and partners to access loan information and to integrate LC's API into third party services.

Lending Club Open Integration (LCOI) was launched in August 2015 and this allows advisors and broker-dealers to offer Lending Club investments (loans) rapidly to their clients using a suite of API functions that integrate into the advisor's or broker-dealer's websites.

Exhibit 2: **LC loan product range**

Loan product	Investor	Range $k	Term (m)	Interest	Penalties for early redemption
Standard Personal	Anyone	1 to 40	36-60	Fixed rate	Nil
Custom Personal	Qualified	1 to 50	36-50	Fixed rate	Nil
EPF Installment	Qualified	2 to 50	24-84	Fixed rate	Nil
EPF True no-interest	Qualified	0.5 to 32	12,18,24	0%	Nil
Auto refinancing	Qualified	5 to 50	24-72	Fixed rate	Nil
Small Bus. unsecured	Qualified	5 to 300	36-60	Fixed rate	Nil
Small Bus. lines of credit	Qualified	5 to 300	36-50	Variable ra	Nil

* EPF - Education & Patient Finance (Springstone acquisition)

Source: Company reports; ACF Estimates

● **Low distribution costs online** - An online strategy lowers costs of customer acquisition (CCA), is efficient for clients, is essential to digital natives and neo-natives (25s-35s) and makes a company highly scalable (see exhibit 4 below).

● **Long run Growth market in online marketplaces coming to an end?** – The FDIC estimated in 2013 that 1 in 13 US households were underbanked (7.7% of pop. or 9.6m households). The Centre for Financial Services (CFS) estimated that the product category – short term credit – grew 37% from 2012-14 whilst single-payment credit, the primary competing product category grew 0.1%. Given statistical error, this suggests to us that the single lump-sum repayment market is probably contracting in favour of the instalment based market.

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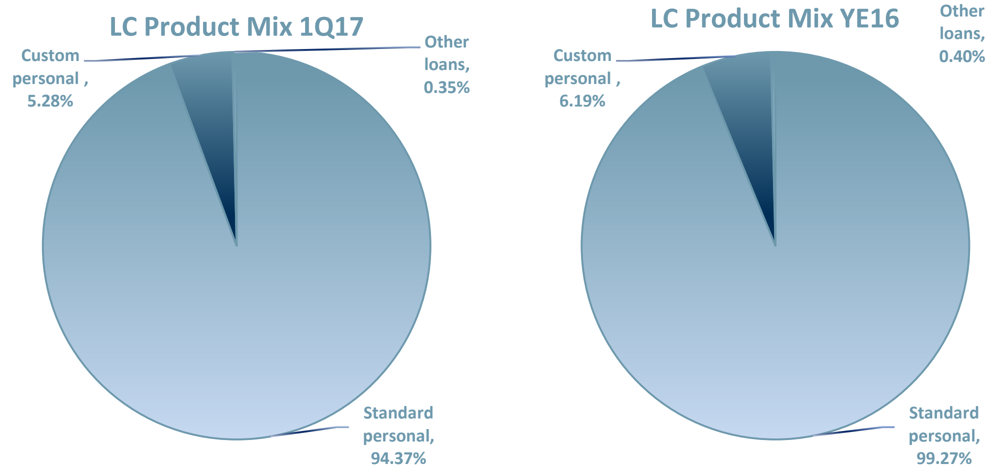
Exhibit 3: LC Product mix 1Q17 vs. YE16



Source: ACF Research Estimates; Company Reports. Source: ACF Research Estimates; Company Reports.

LC is taking action that suggests it is expecting a worsening profile for its loan delinquency. This may be driven by the inevitable downside created by attempts to grow loans aggressively. However, in our view, it is more likely this is a result of brand damage- better quality borrowers are going elsewhere.

Lending Club observed in 2Q16 that it was noting 'pockets of underperformance' in higher risk loan segments (LC defines its segments as grades) and that by 3Q16 underperformance was permeating all grades. These observations led LC to 'optimise' its credit model more than once during 2016 and again in January 2017 and May 2017. LC has invested in innovating its collections and recoveries capabilities and strategies and has grown its collections team capacity, this is reflected in a jump in OPEX and in our financial projections and valuation.

● **Subprime loan market value** – this market can be broadly broken into two product categories – short term credit and single repayment loans (where the entire loan is paid down by the borrower in one payment). The short term credit market FY14A was estimated at USD 29bn and growing vs. single payment credit of USD 38bn contracting in favour of short term credit products. According to online competitors US short term credit markets already generate 2x revenue of the US single payment credit market.

In s strategic departure LC Is considering using its own balance sheet to generate funds to lend.

LC is unable to source enough investors (lenders) since the 2Q disaster and a string of negative stories about the frim and the credit market environment for unsecured personal loans and auto loans.

However, Lending Club appears to be facing both firm specific problems of its own creation, whilst sailing into credit market headwinds over which it has little direct control or impact. In response LC is looking for new investors (significant investors have not returned after the 2Q scandal in our assessment) and is considering using its own balance sheet to bulk up its ability to lend more money to borrowers. This is new, and we don't currently view it as either a sustainable or sensible strategy. This move represents a key departure from LC's core strategy and positioning of its online marketplace platform. In turn, LC's departure of strategy – deploying its balance sheet for supply borrowers, changes the equity risk profile, our WACC is over 9% for LC, which we assess is probably relatively modest in its attempt to capture the new risks facing equity holders of LC..

● **Market development** – The CFS suggests that upcoming regulatory changes will make the single lump-sum consumer loan payment market unattractive to operate. This suggests that investment in the lump-sum repayment market is probably on hold or diverted to the consumer instalment market, suggesting growth potential remains for LC to capture if it can regain the trust of investors (lenders).

Exhibit 4: **Customer CCA online advantage**

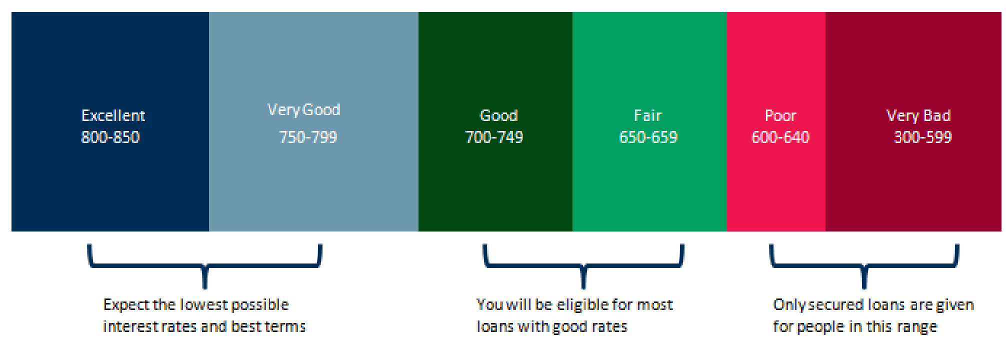
	CCA Online %			CCA Traditional media %		
	4%	5%	6%	8%	9%	10%
USD						
Loan Principal	5,000	5,000	5,000	5,000	5,000	5,000
Cash CCA	200	250	300	400	450	500
Loan Revenue	5,975	5,975	5,975	5,975	5,975	5,975
Cash CCA	239	299	359	478	538	598

Source: ACF Research Estimates; Company Reports.
*CCA – Cash Cost of Acquisition of loan customers

● **Client selection criteria** – LC uses a combination of FICO scores (see exhibit below), Artificial Intelligence and in-house algorithms to filter loan applicants. LC's software is proprietary.

Competitors see online customer acquisition as the driving force for their businesses, and much of the marketing and loan approval process is also fully automated, Income verification appears to better at some competitors, including LC bidder, IEGH.

Exhibit 5: **ACF's normalised credit score range (FICO based)**



Source: ACF Research Estimates; credit scoring agencies.

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Exhibit 6: Average transaction fees for product lines

Loan product	YE14	YE15	YE16	4Q16	1Q17
	Weighted average transaction fees				
Standard personal	4.4%	4.4%	4.9%	5.1%	5.0%
Custom personal	4.9%	4.9%	5.3%	5.5%	5.6%
Other	4.8%	4.4%	4.5%	4.6%	4.5%
Total	**4.5%**	**4.5%**	**4.9%**	**5.1%**	**5.0%**

Source: Company reports

Exhibit 7: **Charge-off rates for total loans**

Total Platform	1Q16	2Q16	3Q16	4Q16	1Q17
	Charge-off rates net annualised				
Standard personal	5.0%	4.9%	6.1%	8.0%	8.5%
Weighted average age	9.5	10.3	11.3	12	12.5
Custom personal	8.2%	8.6%	11.0%	14.6%	15.7%
Weighted average age	7.3	8.4	9.1	9.8	10.5

Source: Company reports

Exhibit 8: **Charge-off rates for loans on Lending Club's balance sheet**

LC b/s Loans	1Q16	2Q16	3Q16	4Q16	1Q17
	Charge-off rates net annualised				
Standard personal	6.2%	6.5%	8.2%	10.4%	10.9%
Weighted average age	10.9	12.1	12.9	13.5	14.2
Custom personal	5.6%	8.2%	14.0%	19.1%	19.6%
Weighted average age	5.8	8.4	10.9	12.4	14.3

Source: Company reports

Exhibit 9: **Analysis of origination of money for loans for borrowers**

Origination by investor class	1Q16	2Q16	3Q16	4Q16	1Q17
Managed accounts	30%	35%	55%	43%	33%
Self-directed	15%	17%	14%	13%	15%
Banks	34%	28%	13%	31%	40%
Other institutional investors	21%	20%	18%	13%	12%
Total	100%	100%	100%	100%	100%
Percentage of loans invested in by 10 largest investors by $	51%	62%	72%	68%	61%

Source: Company reports

Offer for Lending Club (NYSE:LC) from IEGH

IEGH makes 4:1 stock offer for 9.99% of LC

IEGH last night after market close formally made a formal tender offer for LC. to exchange four shares of IEGH common stock for one LC common stock, up to an aggregate of 40,345,603 shares of Lending Club common stock, representing approximately 9.99% of Lending Club's outstanding shares as of April 28, 2017. The offer is scheduled to expire at 5:00 p.m., Eastern time, on Thursday, August 10, 2017.

IEGH is fresh from its OMF tender offer, OMF declined to move into the 21st Century leaving IEGH with no choice but to sell its stake.

IEGH (OTCQB:IEGH) is fresh from its attempt to persuade OMF to move into the 21st Century (OMF declined this move and so IEGH was forced to sell its stake because it was not having any influence). IEGH now sees LC as an entity to which it can bring value generation via its income verification processes and its own strong corporate governance processes.

IEGH sees opportunities to create shareholder value.

IEGH is undoubtedly punching above its weight but in of itself this is not a negative.

IEGH is undoubtedly punching above its weight, and its own equity is volatile as it makes the transition from a start-up to grown up. IEGH's metrics are broadly going the right direction, it is more or less profitable (unlike LC) and pays a dividend (unlike LC). There is a significant practical free float in spite of the founders 54% holding giving the CEO and founder control and so long as the practical free float does not fall below 20-30%, for a business of IEGH's scale, with positive directional metrics…we have seen a lot worse levels of practical liquidity on public markets.

As such, we have some empathy with IEGH's approach and proposition. We have, in contrast, very little empathy for the way in which the Lending Club brand has had an axe taken to it by its own founder, via a mis-selling scandal, which LC announced in its own submission 2Q16.

Whether the board likes it or not, or it is equitable, the board is inevitably seen as part and parcel of the scandal, and most of the current board should probably resign if the interests of shareholders and the re-building of trust in the LC brand is be the priority. Ex-CEO and founder Renaud Leplanche is fighting to avoid shareholder litigation but a federal judge rejected the attempt to dismiss during late May.

The Board at LC is expensive and LC needs to cut costs. The LC board is also made of individuals who were working at the heart of the institutions at the centre of the **Great Financial Crisis** (GFC) i.e. the large international commercial lenders and investment banks. The board structure also looks tokenistic, with just a single women on the board amongst 15 men i.e. only 6.25% of the board is female.

In contrast, the board could be filled entirely by highly qualified untainted female directors as opposed to the team who were brought up with the culture that arguably caused the GFC, and a culture, which according to our inferences from Bloomberg's June 15th article is still very much alive and well at Lending Corp.

Hopes for 2Q17 revenue growth (after 4Qs of straight losses, with slowing new loans and increased OPEX) is leading investors to infer the 2Q16 problem may be behind LC, this might be the case if new problems and another possible 'scandal' were not overhanging the LC stock and management team.

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New growth hopes are based upon a number of LC product innovations and entry into the Auto loans market. Investors should be wary of any short-term growth delivered by this strategy – Auto Loans look as if they are in line to suffer a severe reversal and go ex-growth.

The consumer credit market, the core of LC's business, is looking something like the bubble in the mortgage lending market just before the GFC and for the same reasons (poor or no verification of borrower incomes and liabilities).

Is there something wrong at the heart of the LC technology platform meaning that income verification (underwriting checks) cannot be executed for many potential borrowers.

Bloomberg reported 14th June 2017 that Lending Club verified incomes claims on less than 36% of the loans on one of its most popular products during 2016. Lending Club's charge-off rate rose to 8.5% annualized for 1Q17 vs. 5% yoy and 4.5% for the industry average. The argument is that volumes and higher interest rates make this a manageable development…but LC's model is to reduce costs for borrowers, increase returns for investors, take a management fee in the middle and to achieve this through technology, not branch network and reduced staffing levels.

After the 2Q16 scandal a number of key institutional investors (lenders) declined to take further loans from LC clients and we understand that a significant number have not returned.

LC relies on WebBank (Utah) as its primary issuing bank to originate its loans. If the relationship with LC's issuing banks breaks down this will present a challenge for LC, which would have to find a replacement issuing bank, or banks. Currently LC has a similarly non-exclusive arrangement with Cross River Bank. However, Cross River Bank had not originated any loans via the LC platform as of FY16A. This suggests that Cross River Bank is wary of LC's model. After the 2Q16 scandal, deteriorating charge-off ratios, LC's low level of income verification and recent negative signals coming from the sub-prime unsecured personal credit markets, Cross River Bank is unlikely to be alone in what we infer are its concerns.

The resignation of the CEO and the internal board review has piqued the interest of the government, has led to demands for books and records and LC is facing litigation, including class actions and individual lawsuits.

Is the LC strategy coming away at the seams? Perhaps not quite, but there is pressure on the model, sitting still won't save LC.

These issues are causing loan costs to rise for LC borrowers; investor (lender) returns will fall and equity investor returns will continue to decline because of higher OPEX underpinned by litigation and increased regulatory burden.

● IEGH is asking LC in light of just some of the above items to cut costs elsewhere to compensate for the higher operational costs caused by the 2Q16 mis-selling scandal at LC. In addition, without change LC is likely to face a higher regulatory burden in the future.

● IEGH also wants to see LC change the focus of its lending model and use its technology platform to encourage new prime (FICO) clients to take on high gross margin loans, as opposed to the current high volume low margin (and identifiably lower FICO scored clients) LC is currently attracting.

● IEGH is asking LC to change its positioning in the market and so to give credibility to efforts to rebuild the highly damaged LC brand and concept. In light of recent disasters and future likely new ones to come, this seems an essential and relatively obvious change for LC to make.

● **Dropbox paradigm** - The table shows FY16 revenues and staff for LC and Dropbox and compares their relative efficiency with our FY17E revenues and employees for IEGH in order to attempt to normalise the comparison, as IEGH hits breakeven (1Q17E).

Dropbox, the disruptive online storage business, is included because certain metrics for online businesses recur. Revenue per employee is a key metric that amply demonstrates the difference between the potential efficiency (RoI and RoE) of online strategies compared to bricks and mortar strategies. And within this context of online vs. bricks and mortar, LC revenue per employee is lower than either IEGH or Dropbox. IEGH delivers around 2.5x more revenue per employee vs. LC.

Exhibit 10: **Efficiency per employee**

Company	Revs (m)	Emp	Rev/Emp	x diff
LC	424	1,530	277,124	5.6x
OMF	495	10,100	49,056	1.0x
IEGH	5.024	7	717,714	14.6x
Dropbox	1,000	1,200	833,333	17.0x

Source: ACF Research Estimates; Company Reports; Online sources.

Online businesses across sectors share certain commonalities, revs/employee metrics is one of them. LC appears to be performing poorly in comparison to online comparators IEGH and Dropbox, as LC's metrics are broadly pointing downwards and IEGH's broadly upwards it begins to suggest that IEGH's offer (38% below the LC closing price at launch on 29th June 2017, may not be quite as discounted or misleading as LC protests.

In our experience, nothing presages the end of a business model more than stubborn pride, comfortable remuneration packages and an entrenched culture. LC's defence is petty and quite inaccurate in our view and it seems really to rely on the argument that IEGH is a USD 10m MCap company and LC is a USD 2bn MCap company. However, IEGH's metrics are all going in the right direction and a large business could be built, LC on the other hand is travelling in the wrong direction, and though it is often said it is better to travel and arrive, investors have to decide which direction they want to travel in.

● **Aftermath** If IEGH managed to attract say a 5% minority stake it may drive LC to initiate change away from its current strategy. What we are very sure about is that LC needs to implement significant change rapidly, it has already been a year and not much value has been generated by the current LC approach.

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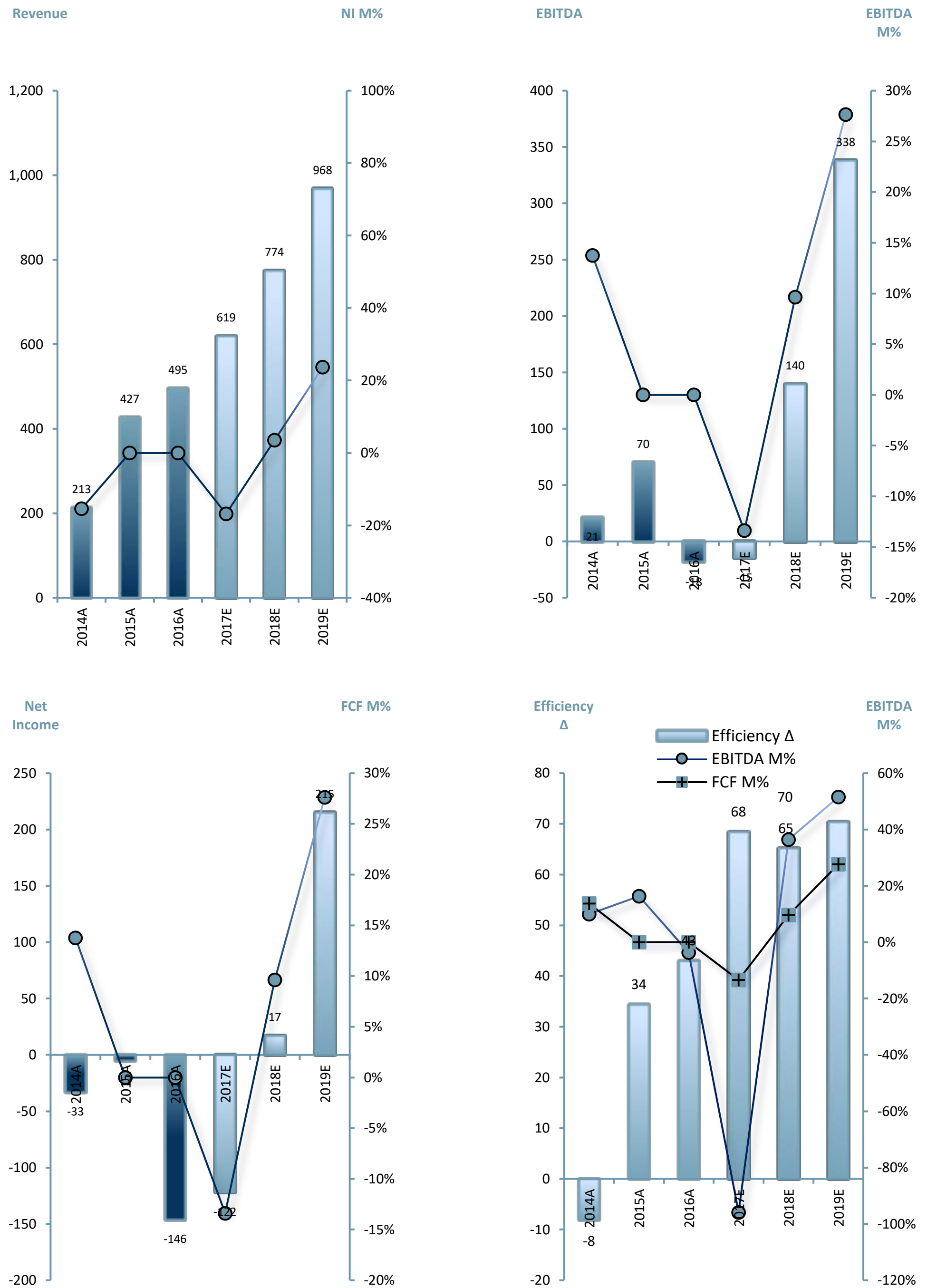
Forecasts

Darker values are historical, lighter values are forecasts



Our forecasts are based upon management guidance and our own sensitivity analysis. We focus on cash proxies (EBITDA) and free cash flow (FCF). However, Net Income remains important for assessing elements of balance sheet strength, nevertheless we are strongly of the view that only cash matters.

Valuation

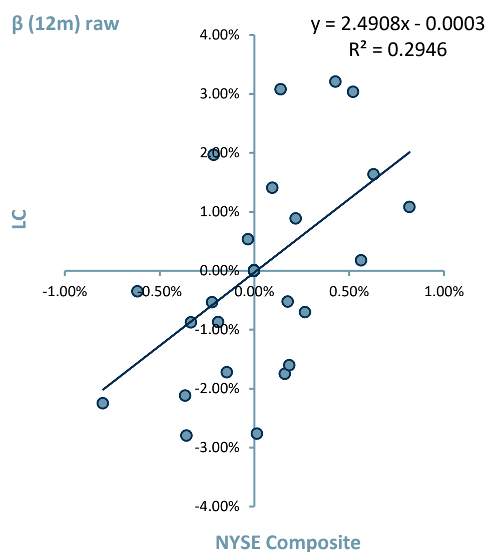
ACF est. USD (m)	2016A	2017E	2018E	2019E	2020E
Revenue	495	619	774	968	1,016
EBITDA	-18	-15	140	338	436
Net Income	-146	-122	17	215	303
FCF	-61	-83	74	267	356
CPS (diluted)	-0.16	-0.21	0.19	0.67	0.89

LC WACC Calc	
Pre-tax cost of debt	5.4%
ETR	40.0%
After-tax cost of debt	3.2%
Current Leverage	
Debt	187.0%
Equity	2,158
Target Leverage	
D / (D+E)	40.0%
ACF β adj levered	2.24
rf	0.80%
Rm	6.2%
ERP	5.4%
Cost of equity	12.88%
Risk adj.	0.00%
WACC	9.02%

*Bloomberg ticker indicates ACF market ERP

Note: We assume the conservative Debt / Equity target mix 40%.

β (12m) raw



we assumed a target Debt/Equity mix of 40%, this target assumption lowers our WACC for LC as the balance sheet becomes more optimally geared.

Valuation Range		
NPV FCF (m)	740	
NPV TV FCF (m)	3,205	
EVF (m)	3,945	
TV Mulitple	12.0x	
% TV of total NPV	81.24%	
Net Debt (m)	3,500	
Fair Value (m)	444	
NoSh (m)	400.31	
NoSh (diluted) (m)	387.76	
Intrinsic Value Per Share USD	1.11	
Close Price USD	5.39	
VR (low - high)	**1.08**	**1.14**
VR Spread	5.00%	
Implied VR Return (low - high)	-79.9%	-78.9%

Note: Close price on front page of this ACF research note is based on shares in issue (NoSh) on 13/07/2017 of 400,308,521.

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Sensitivity Analysis

We have assumed revenue growth of 25% FY17E to 19E before decaying the rate to below long-run US GDP growth. It is difficult to achieve a positive valuation for LC without such aggressive growth assumptions though in fact we find that our revenue growth is more or less in line with the higher end of consensus for FY17E and 18E. Where we differ is our risk profile, our assumptions for SGA development and Cost of Sales (Contribution margin), which we expect to remain structurally high over the next decade (financial sections below). Our LC WACC is 9.02% underpinned by a beta of 2.85. We could quite easily add an upwards risk adjustment for our LC WACC given our investment case. We have assumed an FCF TV multiple of 12x, which is justifiable for a stock with an aggressive top line growth rate of 25% for 3 years to 2019E. We believe this approach shows that LC is extremely sensitive to falls in top line growth. Our LC FCF TV multiple DCF VR of USD 1.08 to 1.14 is published in this note. When we run the valuation using an EBITDA TV of 10x (justifiable for a growth scenario), we generate a valuation range of USD 1.35 – 1.42. Using a perpetuity EBITDA growth rate of 2.5% and WACC's between 9% and 10% our valuation range is USD 1.62-2.56.

Exhibit 11: **IEGH multiples based on close price**

	Revenue	EBITDA	FCF	EPS	EPS (diluted)	CPS	CPS (diluted)
2017E	619	-15	-83	-0.30	-0.30	-0.21	-0.21
2018E	774	140	74	0.04	0.04	0.19	0.19

Multiples	EV/ Revenue	EV/ EBITDA	EV/ FCF	P/ EPS	P/ EPS (diluted)	P/ CPS	P/ CPS (diluted)
2017E	9.14x	-389.70x	-68.22x	-17.73x	-17.73x	-26.01x	-26.01x
2018E	7.31x	40.52x	75.98x	126.93x	126.93x	28.98x	28.98x

Source: ACF Research Estimates.

Exhibit 12: **WACC/Multiple table shows longer-term valuation potential**

Share Price

Terminal EBITDA Multiple \ WACC	6.00%	7.00%	8.00%	9.00%	10.00%	11.00%
7.0x	-0.85	-0.93	-1.00	-1.08	-1.14	-1.21
8.0x	-0.02	-0.10	-0.17	-0.25	-0.31	-0.38
9.0x	0.81	0.73	0.66	0.59	0.52	0.45
10.0x	1.64	1.56	1.49	1.42	1.35	1.28
11.0x	2.47	2.39	2.32	2.25	2.18	2.11
12.0x	3.30	3.23	3.15	3.08	3.01	2.95
13.0x	4.13	4.06	3.98	3.91	3.84	3.78

Source: ACF Research Estimates.

Exhibit 7 above shows the valuation range based on perpetuity EBITDA growth, whereas our actual DCF calculation uses a TV multiple derived from discounted FCF.

Peer Group Comparators

Exhibit 13: **Trailing OMF consumer lending peer group metrics**

Trailing 16A Metrics / Company Name	Market	MCAP (m)	Div %	EBITDA / M%	MCAP / REVS	MCAP / EBITDA	MCAP / NI
LendingClub Corp	**NYSE**	**2157.66**	**0.0%**	**-3.68**	**4.35x**	**-118.33x**	**-14.78x**
OneMain	NYSE	3483.23	0.0%	25.37	0.90x	3.54x	14.33x
World Acceptance	NASDAQ	695.14	0.0%	22.83	1.31x	5.73x	9.44x
Enova International	NYSE	574.08	0.0%	18.82	0.77x	4.09x	16.59x
IEG Holdings	OTCMKTS	7.35	0.6%	-221.66	3.43x	-1.55x	-1.55x
Average			**0.15%**	**-38.66%**	**1.60x**	**2.95x**	**9.70x**

Source: ACF Research Estimates; Companies reports; Factset.

Exhibit 14: **Trailing OMF consumer lending peer group metrics**

Trailing 16A Metrics / Company Name	Market	MCAP (m)	Gross Debt / Assets	Gross Debt / Equity	RoA %	RoE %	RoI %
LendingClub Corp	**NYSE**	**2157.66**	**22.26**	**131.58**	**-0.74**	**-4.76**	**1.25**
OneMain	NYSE	3483.23	77.02	455.28	1.24	7.32	1.25
World Acceptance	NASDAQ	695.14	36.86	64.01	9.16	17.26	9.67
Enova International	NYSE	574.08	66.77	270.13	3.81	15.46	4.13
IEG Holdings	OTCMKTS	7.35	0.00	0.00	-64.87	-65.85	-65.36
Average			**45.16%**	**197.36%**	**-12.67%**	**-6.45%**	**-12.58%**

Source: ACF Research Estimates; Companies reports; Factset.

Our LC peer group includes online lenders Enova and IEGH.

LC does not make up a constituent of our average or median values in the peer group metrics. We have excluded LC from these values to make comparison with the rest of the peer group as clean and undistorted as possible. We have used trailing metrics and we invite readers to compare the FY16A trailing metrics in the exhibits above with the forward multiples FY17E and 18E in our sensitivity analysis and on the front page of this note.

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Peer Group Selection

Lending Club Corporation (Lending Club; **NYSE:LC**, **NYSE** listed) is an online market place connecting borrowers and investors. LC offers **online** application installment loans with fixed monthly payments to consumers and loans and lines of credit to the SoHo/SME business market. The loans bare no prepayment penalty for early redemption. The potential loan book is then offered to qualified private investors and institutions to fill the book. The loan book attracts a wide range of investors from retail, HNW and family offices, through to banks and hedge funds. Standard loans are offered to all investors in the market place. The custom loan program is not made available to all on the market place and features higher risk unsecured loan products such as Education and Patient Finance.

OneMain Holdings, Inc., (**NYSE:OMF**, **NYSE** listed) is a **bricks and mortar** financial services company providing consumer finance and insurance (credit and non-credit insurance) in all 50 US states via its subsidiaries. OMF has >1,800 branches in 44 US sates and >10,000 employees. The Company historically has been acquisitive. OMF has three segments: Consumer and Insurance; Acquisitions and Servicing, and Real Estate (See ACF's OMF Initiation note).

IEG Holdings Corp. (**OTCQB:IEGH**, **OTC Markets** listed) is a US consumer finance company. The Company provides an **online** unsecured installment based consumer loans of USD 5,000 or 10,000 with a 60-month term and APRs between 19.9% and 29.9% (State regulation dependent) via an online-only platform under the brand Mr. Amazing Loans on its website www.mramazingloans.com. The Company has one office and 7 employees, but online lending licenses in 19 US states and is planning to raise this to 25 states by mid-2017. The Company's personal loan products are fully amortizing, fixed rate and unsecured installment loans.

World Acceptance Corporation (**NASDAQ:WRLD**, **NASDAQ** listed) is a US consumer finance company. WRLD provides installment and payment deduct loans of a standardized amount and maturity between USD 300 and USD 4,000 as its principal products via its 1,339 **bricks and mortar** branches in the US and New Mexico. WRLD also sells automobile club memberships for which it receives a commission on each sale but is not responsible for the administration of the club. WRLD also sells ParaData software systems to other loan providers.

Enova International (**NYSE:ENVA**, **NYSE** listed) provides **online** financial services to non-prime consumers and SoHo/SMEs. ENVA offers short term multi-installment unsecured consumer loans in 20 US states, the UK Australia and Brazil. The Company has over USD 17bn in loans and financing out to 4m customers.

Financial Analysis

● **Revenue model assumptions** – We assume that LC grows revenues at around 25% per annum during 2017-19 and then decline revenue growth to 2.5% as our long run perpetuity revenue growth rate. Anything much less than a 25% 3-year CAGR and we end up with a negative valuation for LC, suggesting that the LC model is very sensitive to changes in top line growth. In turn, this means that LC must drive originations growth very hard, the Company is doing this by introducing new products and raising its marketing spend.

● **SGA model assumptions** – we have assumed that the structural rise in OPEX that occurred post the 2Q16 mis-selling scandal is maintained as rebuilding brands and fighting legal cases, especially class actions, is a 10-year project in our experience. In addition, as we have alluded and pointed to in this note, we see further storms ahead for LC in particular.

● **Delinquent loans and fair value** – LC's delinquent loans were running at 3% for standard program personal loans 1Q17 and a principle balance of USD 4,079m with at fair value of 93.5% or USD 3,813.4. The standard program accounts for 94.2% of the Company's principal balance.

● **Charge off** - LC's charge off rate has soared. By YE16 the rate had jumped to 8% up from 5% 1Q16. For 1Q17 LC booked charge-off at 8.5% for the total platform of standard programme personal loans. For standard-program personal loans retained on the balance sheet the 1Q17 charge-off rate soared to 10.9% up from 6.2% 1Q16. Custom program personal loans on the balance sheet fared worse, with charge-off 1Q17E reaching 19.6% up from 5.6% 1Q16.

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Financial Projections

Exhibit 15: **LC P&L and forecasts**

P&L USD (m)	2015A	2016A	2017E	2018E	2019E
Revs	**427**	**495**	**619**	**774**	**968**
gr%	100%	16%	25.0%	25.0%	25.0%
GP	204	216	0.266	333	416
% Revs	48%	44%	43%	43%	43%
SGA	188	304	326	246	136
% Revs	44%	61%	53%	32%	14%
EBITDA	**70**	**-18**	**-15**	**140**	**338**
% Revs	16%	-4%	-2%	18%	35%
Provisions credit loss	0	0	38	40	41
% Revs	0%	0%	6%	5%	4%
EBIT	**-5**	**-156**	**-128**	**17**	**206**
EBT	-2	-150	-122	25	215
ETR	0%	0%	32%	32%	0%
Tax	-3	4	0	8	0
NI	**-5**	**-146**	**-122**	**17**	**215**
% Revs	-1%	-29%	-20%	2%	22%

Source: ACF Research Estimates; Company reports.

Exhibit 16: **LC Cash Flow and forecasts**

Cash Flow USD (m)	2015A	2016A	2017E	2018E	2019E
Profit/(loss) for period	-5	-146	-122	17	215
Provisions credit loss	0	0	38	40	41
D&A	22	67	30	30	33
Othe non-cash items	45	56	75	83	91
WCap Change	13	24	26	39	48
Net CFO	**74.7**	**0.5**	**47.8**	**208**	**429**
Cash Taxes	0	0	0	0	8
Capex maintenance	39	62	56	51	63
FCF	**35**	**-61**	**-8**	**157**	**358**
Capex for growth	2,035	275	275	275	275
CF from Investing	-2,407	-423	0	0	0
CF from Financing	2,086	314	0	0	0
Net Cash In/(Out)	-246	-108	48	208	421
Cash previous YE	870	624	516	563	771
Cash & CE	**624**	**516**	**563**	**771**	**1,192**

Source: ACF Research Estimates; Company reports.

Exhibit 17: **LC Balance Sheet and forecasts**

Balance Sheet USD (m)	2015A	2016A	2017E	2018E	2019E
Tangible Assets	56	89	93	97	102
Investments	4,853	4,608	4,604	4,601	4,597
Intangible Assets	104	62	52	42	31
Other	38	70			
Total Fixed Assets	**5,051**	**4,829**	**4,750**	**4,740**	**4,729**
Trade & Other rcvbls	38	40	273	341	426
Assets held for sale	81	178	190	0	0
Cash	624	516	563	771	1,192
Total Current Assets	**742**	**734**	**1,026**	**1,112**	**1,618**
Total Assets	**5,794**	**5,563**	**5,776**	**5,852**	**6,347**
Creditors	6	11	14	17	21
Other	73	126	0	0	0
Accruals	101	129	0	0	0
Deferred Tax	0	0	0	0	0
Loans	4,572	4,321	4,024	4,015	4,004
Total Liabilities	**4,752**	**4,587**	**4,038**	**4,032**	**4,025**
Net Assets	**1,042**	**976**	**1,738**	**1,821**	**2,322**
Share Capital	1,132	1,230	1,230	1,230	1,230
Reserves	0	0	0	0	0
Share Premium	0	-19	864	930	1,216
Accum. Profit/(loss)	-90	-235	-357	-340	-124
Non-cntrllng Interests	0	0	0	0	0
Total Equity	**1,042**	**976**	**1,738**	**1,821**	**2,322**
Total Equity & Liabilities	**5,794**	**5,563**	**5,776**	**5,852**	**6,347**

Source: ACF Research Estimates; Company reports.

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Glossary

CFPB	Consumer Financial Protection Bureau (CFPB) is an agency of the United States government responsible for consumer protection in the financial sector. CFPB jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, foreclosure relief services, debt collectors and other financial companies operating in the United States. The CFPB's creation was authorized by the Dodd–Frank Wall Street Reform and Consumer Protection Act. The CFPB was established as an independent agency, but this status is being reviewed by the US Court of Appeals.
CFS	Centre for Financial Services
Charge Off (Gross)	Gross charge off is the USD amount of debt that a creditor declares is unlikely to be collected. Gross charge off is triggered by a consumer becoming severely delinquent on a debt. A charge-off is a form of write-off.
Charge Off (Net)	Net charge off is the USD amount that is the difference between gross charge-offs and subsequent recoveries of delinquent debt. Net charge offs refer to the debt owed to a company that is unlikely ever to be recovered by that company i.e. bad debt
Closed-end	Closed-end lines of credit are those which are characterised by instalment repayments over a set schedule, e.g. auto (car) loans.
Contribution margin	Contribution margin (Gross Margin), or dollar contribution per unit, is the selling price per unit minus the variable cost per unit. "Contribution" represents the portion of sales revenue that is not consumed by variable costs and so contributes to the coverage of fixed costs. This concept is one of the key building blocks of break-even analysis and is part of the cost accounting method that allows a company to isolate the profitability of individual product lines. It is defined as Revenue less total variable costs (Cost of Sales).
CoS	Cost of Sales is, in ACF's financial models, a variable cost linked directly to revenue development, e.g. sales team commissions, but for example, not sales team salaries.
CT	Corporation Tax is the tax owed by corporation on taxable profits less exemptions to IRS.

Dodd-Frank Act	Dodd–Frank Wall Street Reform and Consumer Protection Act, was passed in 2010 and signed into law 21st July of that year by President Barack Obama as a legislative response to the financial crisis of 2007–08 and the subsequent Great Recession. The Act introduced the most significant regulatory reform to financial services in the US since the Great Depression. The Act touched almost every element imaginable of the US financial services industry and its regulation.
EAT	Earnings after tax. Also often expressed as PAT – profit after tax, and post-tax profit.
EBIT	Earnings before interest and tax (also often referred to or equates to operating profit).
EBITDA	Earnings before interest, depreciation and amortisation – the presentation of EBITDA by companies is not a requirement of UK GAAP or IFRS accounting standards. However, in certain cases it can act as a close proxy to free cash flow.
EBT	Earnings before tax. Also often expressed as PBT – profit before tax.
FCF	Free Cash Flow generated in ACF's models after all obligatory cash costs have been satisfied such as Interest payable (Ip), cash taxes and maintenance capex (as opposed to investment capex). FCF represents the cash remaining for theoretical distribution or investment after all obligatory cash based costs including net interest payable have been deducted.
FDIC	The Federal Deposit Insurance Corporation preserves and promotes public confidence in the US financial system by insuring bank deposits and thrift institutions for a minimum USD 250k. The FDIC is also responsible for identifying, monitoring and addressing risks to the deposit insurance funds. FDIC was set up on 1933 after the thousands of bank failures during 1920s and early 30s.

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HELOC	Home Equity Line of Credit (HELOC) - A loan in which the lender agrees to lend a maximum amount within an agreed period, where the collateral is the borrower's equity in his/her house. Because a home often is a consumer's most valuable asset, many homeowners use home equity credit lines only for major items, such as education, home improvements, or medical bills, and choose not to use them for day-to-day expenses. HELOC abuse is often cited as one cause of the subprime mortgage crisis. OMF refers to HELOCs as Open-End Home Equity Lines and by Open-End it means that the line of credit is revolving, so that if the customers pays down the credit the customer can use the credit again within the constraints of the customer’s credit limit.
IFRS	International Financial Reporting Standards are a set of standards developed by the International Accounting Standards Board. IFRS is an internationally recognised standard and in principle means that investors from different legal geographies can compare financial performance between potential competing investments more easily (cheaply) openly and fairly, when compared to say comparing UK GAAP vs. US GAAP or other “regional” accounting standards.
IRS	Internal Revenues Service. The IRS is the tax collecting government agency in the US (equivalent to HMRC in the UK), which is also responsible for administering the Internal Revenue Code – the US tax law. The IRS is a bureau of the Department of Treasury under the direction of the Commissioner of Internal Revenue.
JV	Joint Venture – generally a legal structure between two corporate entities involving participation in equity capital in the JV vehicle. JV can also refer to more informal arrangements.
NoSh	Number of Shares in issue (NoSh).

Ocean Finance

Ocean Finance was a loans and mortgages business set up in 1991 in Staffordshire, United Kingdom. It became infamous in the late 1990s and early 2000s for its advertising, including sponsoring its own channel on Sky TV and its advertising became widely parodied. The firm prospered on the back of rising house prices and the credit boom. By 2002 the firm was a leading player in the UK's secured loan market valued at over £14bn.

The firm was bought by US insurance company American International Group (AIG) in 2006 for over £200m, later wrapped into AIG’s Springleaf, itself sold to PE house Fortress and then floated on the US market. Springleaf bought OMF and rebranded. Paul Newey stepped down as Ocean Finance CEO in 2009.

Ocean Finance was the shirt sponsor of Tamworth F.C. from 2004 - 2009. In 2008, it launched the UK's first TV channel dedicated to promoting loans and mortgages.

Like many other mortgage businesses, it struggled after the 2008 global credit crunch.

The Ocean Finance brand was acquired by Think Money Group in 2012. In 2014 the company launched the Ocean Credit Card in conjunction with Capital One. In 2004, the firm was criticized by some for its focus on offering second charge (secured) loans, to sub-prime customers, often used for debt consolidation

RoA

Return on Assets is a ratio that provides insight into profitability. RoA is defined as Net Income divided by total assets. RoA is used to help investors understand how well a company management ream is using assets to generate earnings. Like most ratios a low value can also indicate an inflexion point or optimum time to buy rather than sell the related stock. Some analysts like to add back interest expense to net income as this gives a metric to compare operating returns before cost of borrowing. This is most helpful if borrowing costs are the same for the peer group under analysis.

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RoE Return on Equity is a ratio designed to provide insight into the profitability of a company by showing profit generated in comparison to cash invested by equity holders. RoE is defined as net income divided by shareholder's equity (see definitions in this glossary).

RoI Return on Investment is a ratio that provides insight into the efficiency of an investment. RoI attempts to measure the return on an investment vs. the cost of the investment. The ratio is defined as the gain from investment less cost of investment subsequently divided by cost of investment. Most RoI calculations do not account for the time value of money. This changes investment performance considerably and can easily lead to the wrong conclusions because no account is taken of the rate of return only of the total return.

SGA Sales, General and Administrative expenses, often equates to or is equivalent to Cost of Sales (CoS) plus operating expenses. However ACF uses SGA to classify relatively invariable expenses as opposed to variable expenses linked more or less directly to revenue generation, as such sales commissions might typically end up in CoS, whereas salaries for sales people would be classed as relatively invariable and be booked under SGA in an ACF model.

Shareholders' Equity Shareholders equity is a line on the balance sheet calculated from the deduction of total liabilities from total assets and represents the value (or lack of it) available for distribution to shareholders should the entity wind up operations. It differs from the equity value expressed in market capitalisation (MCap), which is number of shares in issue (NoSh) multiplied by share price. The ratio Debt/Equity commonly uses the Debt/MCap formula as opposed to the Debt/Shareholder equity formula.

TDR

Troubled Debt Restructuring (TDR) is defined as a debt restructuring in which a creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. As such, in order for a debt restructuring to be a considered a TDR, two conditions must be present: The debtor must be experiencing financial difficulties. The creditor must grant a concession in consequence of the debtor's financial difficulties.

uFCF

Unlevered Free Cash Flow is FCF from which cash based interest payments are not deducted. It represents the total maximum cash flow available to both bond and equity holders over a given period.

Uplift Potential

Uplift potential is the potential for a re-rating of the value of a stock. For example, a company is valued by market participants at the equivalent of 10x a particular metric such as EBITDA, the value then rises (due to an uplift) to the equivalent of 12x EBITDA, this is the rerating (by 2 turns in our example).

VIE

Variable Interest Entity (VIE) used historically by institutions to hide sub-prime lending exposure, in OMF’s case it is very open that it lends in the non-prime spectrum. Variable interest entity (VIE) is a term used by the United States Financial Accounting Standards Board (FASB) in FIN 46 to refer to an entity (the investee) in which the investor holds a controlling interest that is not based on the majority of voting rights. It is closely related to the concept of a special purpose vehicle (SPV). The importance of identifying a VIE is that a company needs to consolidate such entities if it is the primary beneficiary of the VIE. A VIE is an entity meeting one of the following three criteria as elaborated in FASB ASC 810-10 [formerly FIN 46 (Revised)] 1. The equity-at-risk is not sufficient to support the entity's activities (e.g.: the entity is thinly capitalized, the group of equity holders possess no substantive voting rights, etc.) 2. As a group, the equity-at-risk holders cannot control the entity 3. The economics do not coincide with the voting interests (commonly known as the "anti-abuse rule") Note: The guidance in FIN 46 and FIN 46R was subsequently revised when FASB issued Statement 167.

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Notes [Intentionally Blank]

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ACF Equity Research Limited, 125 Old Broad Street, London, EC2N 1AR, U.K.
Tel: +44 (020) 7558 8974
Website: www.acfequityresearch.com