

NORTHERN ENERGY CORPORATION LTD (NEC)

RESEARCH



TOLHURST

Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$0.985	\$2.50	Coal	HIGH	BUY	BUY

Company update	Initiation of Coverage
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Recommendation Change	Opening Rec
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Target Price Change	Set at \$2.50
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Forecast Change	NA
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Market Stats

Market Capitalisation	\$m	66.2
12 Month Price Range		\$0.38 - \$1.14
Monthly Turnover	\$m	1.5
Monthly Volume	#m	1.8
% of SOI traded per month	%	2.7

Valuation & Price Target Summary

	Unrisked Valuation	Risked Valuation	12 mth Price Tgt
Liquid Assets	\$0.11	\$0.11	
Elimatta	\$4.49	\$1.07	\$1.53
Yamala	\$4.42	\$0.81	\$0.92
Ashford	\$0.13	\$0.01	\$0.01
Maryborough	\$0.14	\$0.02	\$0.04
Total	\$9.28	\$2.02	\$2.50

The emergence of a mid-tier producer

Thesis

Northern Energy Corporation (NEC) is a junior coal explorer with thermal and coking coal projects predominantly in the Bowen and Surat basins. NEC has a suite of regional exploration activities in Queensland and New South Wales and a growing resource base which currently stands at 430mt (gross), making it one of the most exciting emerging players in the Australian coal industry.

Key Issues

NEC is developing a large quality asset base whose significant value will be unlocked by the increase of infrastructure capacity in Queensland. The following are seen as the key issues that will determine its success:

- NEC has retained a high calibre management team and board with the full range of expertise required to develop large multiple projects within a constrained environment.
- The current resource base is large, growing, of good quality and will likely lead to low cost operations with a significant mine life of approximately 20 years. This should provide opportunities for investors to earn significant returns and provide the company with strategic alternatives.
- Currently the projects are constrained by a lack of infrastructure access. However this situation will ease and project values will be realised. Proposed infrastructure such as the Southern Missing Link rail project, upgrades to the Blackwater rail system and the construction of the 25mt per annum (ultimate capacity 80mtpa) Wiggins Island terminal at the Gladstone port have state and federal government support and will provide an avenue to market for NEC's coal.
- The macro-environment is extremely favourable with coal benchmark prices expected to increase significantly for the following year. Tolhurst believes market fundamentals will favour coal suppliers into the medium term and Australian producers have cost advantages over other coal suppliers in exporting to growing Asian economies.

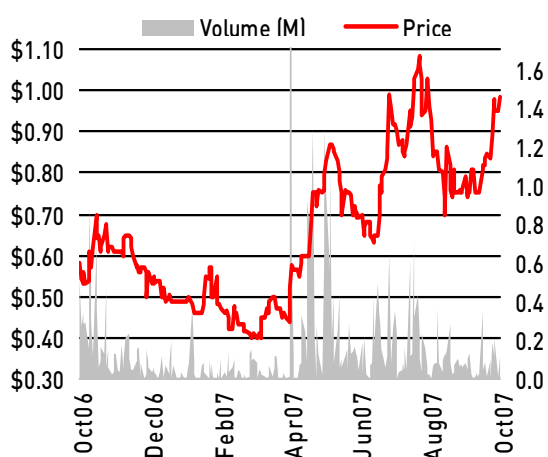
Valuation and Recommendation

We are initiating coverage with a Short Term **BUY** Long Term **BUY** recommendation on NEC. Our risked valuation of \$2.02 and 12 month price target of \$2.50 was calculated via a risked resource base approach and reflects the large quality asset base and the remaining uncertainties over their development. It should also be noted that we have placed a **HIGH** risk rating on the company and therefore it may not be suitable for all investors.

On a fully unrisked basis we have a valuation of \$9.32 although this does not reflect expected dilution of the company's interest at Yamala.

With a quality board and management team, strong project pipeline and a buoyant macro environment Tolhurst believe NEC is clearly undervalued. Price catalysts over the next 12 months will be a resource upgrade at Elimatta, increases in coal benchmarks, an initial resource certification at Maryborough and a resource category upgrade at Yamala. Trading at \$0.95, Tolhurst believes, NEC represents outstanding value to growth investors.

Share Price Chart 1 Year





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Northern Energy Corporation (NEC) – Risked Valuation

Liquid Assets	Equity	Value		Unrisked Value		Risked Value		
		A\$m	cps*	A\$m	cps*	A\$m	cps*	
Current cash:	100%	\$ 7.15	\$ 0.10	\$ 7	\$ 0.10	\$ 7	\$ 0.10	
Debt	100%	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
NPV Options:								
01/02/2008 Expiry, \$0.25-0.30	100%	\$ 1.058	\$ 0.01	\$ 1	\$ 0.01	\$ 1	\$ 0.01	
- Corporate o/hd (1 yr)	100%	\$ (0.3)	\$ (0.00)	\$ (0)	\$ (0.00)	\$ (0)	\$ (0.00)	
Producing/ liquid assets				\$ 8	\$ 0.11	\$ 8	\$ 0.11	
Approved Development Projects								
Project	Equity	Gross Reserves	Net Reserves	Resources	Resources	Unit Value	Unrisked Value	Risked Value
							A\$m	cps*
None yet approved								
Approved Development Projects							\$ -	\$ -
Producing + Approved Developments							\$ 8	\$ 8
Potential Development Projects		Potential Reserves						
	Equity	Gross Reserves	Net Reserves	Resources	Resources	Unit Value	Unrisked Value	Risked Value
							A\$m	cps*
Yamala								
Base Case	70%	190	-	133	\$ -	\$ 1.00	\$ 133	\$ 1.87
Upside to high case	70%	260	-	182	\$ -	\$ 1.00	\$ 182	\$ 2.55
Yamala Total - 100% basis	70%	-	450.0	-	315.0		\$ 315	\$ 4.42
								\$ 58
								\$ 0.81
Elimatta								
Base	100%	220	-	220	\$ -	\$ 1.00	\$ 220	\$ 3.09
Upside to high case	100%	100	-	100	\$ -	\$ 1.00	\$ 100	\$ 1.40
Elimatta Total	100%	-	320	-	320		\$ 320	\$ 4.49
								\$ 76
								\$ 1.07
Ashford								
Base Case	50%	18	-	9	\$ -	\$ 1.00	\$ 9	\$ 0.13
Upside to high case	50%	-	-	-	\$ -	\$ 1.00	\$ -	\$ -
Ashford Total	50%	-	18	-	9		\$ 9	\$ 0.13
								\$ 1
								\$ 0.01
Potential Development Projects							\$ 644	\$ 9.03
								\$ 135
								\$ 1.89
Exploration		Potential Resource						
	Equity	Gross Resources	Net Resources	Resources	Resources	Unit Value	Unrisked Value	Risked Value
							A\$m	cps*
Maryborough	100%	10	10		\$ 1.00	\$ 10	\$ 0.14	15%
Five Mile	100%	-	-		\$ 1.00	\$ -	\$ -	0%
Yamala East	100%	-	-		\$ 1.00	\$ -	\$ -	0%
Perrett's Road	100%	-	-		\$ 1.00	\$ -	\$ -	0%
Trigamon	100%	-	-		\$ 1.00	\$ -	\$ -	0%
Ena Creek	100%	-	-		\$ 1.00	\$ -	\$ -	0%
Exploration potential		-	10	-	10		\$ 10	\$ 0.14
								\$ 2
								\$ 0.02
Total Valuation							\$ 662	\$ 9.28
								\$ 144
								\$ 2.02

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Drivers / Catalysts

Positive price action over 2HCY2007 and CY2008 is likely to come as a result of investor's recognition of the value in the accumulated asset base. In terms of the specific events likely to drive the share price investors need to watch for:

- A potential resource upgrade at Elimatta in Oct 07.
- Benchmark coal price increase. Est Nov 07 – Mar 08.
- Initial JORC resource estimation at Maryborough. Est Feb 08
- Upgrades in Yamala resource categorisation. Est Feb 08
- Maryborough development planning. Est June 08.

Company Background

The company IPO'd in Jan 2005 and was created out of the defunct Poltech International business. Part of the IPO was the 50% interest in the Ashford Coking Coal project and the purchase of a private company Taroom Coal Pty Ltd which contained the Elimatta and Maryborough tenements and application over the Yamala prospect.

Since listing, continuing work on Elimatta, Yamala and Maryborough has confirmed the significant prospectivity of these tenements and has lead to the reprioritisation of the project pipeline to bring focus to these projects over Ashford. Tolhurst believes this was the correct assessment by management and simply underscores the value of the exploration package at IPO.

Summary of Operations

NEC's objective is to delineate high quality coal resources with the possibility of low cost extraction. The company has acquired exploration leaseholds in Queensland and NSW with 430mt of defined gross coal resources in the Bowen and Surat basins accumulated thus far. The intention is to rapidly evolve into a sizeable multi-project producer.

The company operates a staged approach to the exploration and evaluation program for each project. This is designed to create clear deliverables in building the resource base and assists in de-risking the projects. On satisfactory completion of Stage 3, projects are then submitted to a Bankable Feasibility Study (BFS).

As mentioned, focus is on the two most significant projects within the portfolio, namely Elimatta in the Surat basin and Yamala in the Central Bowen basin. Both projects have the capacity to launch NEC into the ranks of the most significant coal producers in Australia. Coal players of this size are characterised by market capitalisations in excess of A\$1bn.

Elimatta will be a large open cut thermal operation and recent infill drilling will potentially lead to a resource upgrade in October 2007. Stage 2 of the project will commence by early to mid 2008 with stage 3 to follow and be completed by early 2009. A BFS will be undertaken with completion scheduled for mid-2009. The company is indicating a mine size in the order of 5mt per annum from Elimatta although first production is unlikely until 2012.

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Yamala has the potential to be another large project with an initial small open cut moving into underground operation mining thermal and potentially semi-soft metallurgical coal. Stage 2 will commence October 2007 and focus on upgrading the resource category into early 2008. Stage 3 and BFS will then follow with completion scheduled for mid-2009. First production is unlikely until 2012.

Whilst the evaluation on the larger projects continues, NEC will also pursue earlier cash flow through the Maryborough project. It is a quality although smaller scale hard coking coal project that does not have the same infrastructure constraints as the larger projects and drilling is due to start on a resource definition within the month. A small JORC compliant resource is likely to be released by early 2008. Production could be achieved by early to mid 2010.

Resource Statement

Deposit	Equity	Type	Resource			Targeted*
			Indicated	Inferred	Total (Gross)	
			Mt	Mt	Mt	Mt
Elimatta	100%	Thermal	22.0	200.0	222.0	100.0
Yamala	51%	Thermal		190.0	190.0	260.0
Ashford	50%	Hard Coking		18.0	18.0	
Total			22.0	408.0	430.0	360.0

* Not JORC compliant

Exploration targets of 360mt demonstrate the potential upside to the resource base which would make the total gross coal resources 790mt. This resource estimation is unproven, requires further exploration and is used only to illustrate upside potential for investors. Current JORC compliant coal resources net to NEC are 326mt.

Leaseholds & Projects

Tenement	Location	Basin	State	Status	Interest
EPC 650	Elimatta	Surat	QLD	Granted	100%
EPC 927	Yamala	Bowen	QLD	Granted	100%*
EPC 923	Maryborough	Maryborough	QLD	Granted	100%
EL 6234	Ashford	North Gunnedah	NSW	Granted	50%**
EL 6428	Ashford	North Gunnedah	NSW	Granted	50%**
EL 6526	Atholwood	North Gunnedah	NSW	Granted	50%
EL 6539	Ashford North	North Gunnedah	NSW	Granted	50%
EPC 1158	Five Mile	Clarence Moreton	QLD	Under Application	100%
EPC 1169	Yamala East	Bowen	QLD	Under Application	100%
EPC 1171	Perett's Road	Clarence Moreton	QLD	Under Application	100%
ELA 3220	Trigamon	North Gunnedah	NSW	Under Application	100%
ELA 3221	East Yetman	North Gunnedah	NSW	Under Application	100%
ELA 3222	Ena Creek	North Gunnedah	NSW	Under Application	100%

* Sojitz to earn 30% on completion of exploration program and an option on a further 19%

** Additional interest earned by satisfying Farm-in Agreement with Renison Consol Mines

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RESEARCH



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Elimatta EPC 650 (NEC 100%)

Elimatta is located in the Surat Basin 30km from Wandoan. The tenement was acquired as part of the Taroom Coal Pty Ltd purchase. The tenement is surrounded by Xstrata's leaseholds and represents the current frontier of coal mining in Australia. The coal extraction from the Surat is limited as there is no effective infrastructure to get the coal to market. The Southern Missing Link rail project and upgraded capacity at the Gladstone port through the creation of the Wiggins Island terminal are expected to remove this impediment, allowing coal players to unlock the value of their resources in the region. These projects have been mandated and are recognised as having national importance at both a state and federal government level. (See Coal Sector Review – Industry, 6 Sep).

NEC has defined thermal coal resources of 222mt (22mt indicated, 200mt inferred) and is targeting a further 100mt in exploration work. Infill drilling at the site is expected to result in further upgrades in the size and the category of the resource and is to be announced in Oct 2007.

Commencement of stage 2 and 3 in the second half of the FY07/08 year will then lead to a BFS in early 2009. Current work is being co-ordinated with the timelines of the Southern Missing Link consortium and port authorities who will require contractual commitment of tonnages by mid-2009 for capacity allocations. This should minimise infrastructure risk and maximise allocated access. This is likely to lead to a Financial Investment Decision (FID) on Elimatta within 18 months to 2 years although the relevant infrastructure is not expected to be in place until mid-2011 meaning first production is not likely to occur until 2012.

When washed, the coal at Elimatta is a low impurity, high volatile, high quality thermal product which is very attractive for export to global power utilities. NEC has identified 100mt at Elimatta which can be accessed at a strip ratio of less than 5:1 making it amenable to a moderate to low cost open cut operation. Further seam work may reveal additional resources that may reduce this strip ratio. The company has highlighted potential production rates from Elimatta of 5mt per annum. This is comparable to any mid-tier Australian coal producer.

Yamala EPC 927 (NEC 100%- Sojitz earning 30% interest, optional 19%)

Yamala is located in the central Bowen basin on the Capricorn Highway in between Emerald and Blackwater. NEC has entered into a joint venture with Sojitz to explore and develop the Yamala coal deposit. Sojitz are a Japanese commodity trading house with a large presence in the Australian coal industry.

Under the terms of the JV, Sojitz will fund a three stage A\$5.3m exploration and evaluation program to earn a 30% interest in the project with an option to acquire another 19%. Stage 1 was completed earlier in the year with drilling work leading to an inferred resource of 190mt. Additional resource targets of 260mt have been identified although stage 2 work, which is due to commence in October 2007, will seek to develop the area of the permit where the defined resource exists rather than add to the stated resource of the prospect. In order to progress the project NEC has chosen to focus on the area most favourable for initial mine development.

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Initial indications suggest that Yamala could be an open cut operation with some shallow cover in parts of the deposit and then move into an underground phase. It is likely to produce a low ash thermal coal although has the potential for a semi soft metallurgical and higher ash thermal product mix. This is will be examined as part of the Stage 2 work. The insitu coal has low impurities and is suitable for export markets. This may mean the coal could attract a further price premium and assist the project economics. There has been no guidance from the company as to the likely production or cost profile for the project.

Similar to Elimatta, the lack of access to infrastructure is an impediment to the development of Yamala. The preferred route is the Blackwater rail line to the Gladstone port however there is no spare capacity on the rail line until upgrades are completed in 2010 and there is no port access until the Wiggins Island terminal is constructed at Gladstone which is due in mid-2011. NEC management is in close consultation with the above rail operators and the port authorities to achieve the most satisfactory outcome.

Maryborough EPC 923 (NEC 100%)

Presently no resource has been delineated at Maryborough but NEC have expressed some confidence that this prospect could be the first into production and therefore the quickest route to cash flow.

Maryborough is a brownfields hard coking coal prospect 20km north of the town Maryborough in Queensland. The initial exploration on the tenement has, to date, been 67% funded by the Japanese Government Agency NEDO (New Energy & Industrial Technology Development Organisation) with potential off-take by a Japanese steel mill.

The nature of the coal seams at Maryborough are providing challenges in terms of resource estimation and further work is currently being done to evaluate the deposit although the company has an exploration target of 5-10mt.

Unlike Yamala and Elimatta, access infrastructure is immediate in that the Gladstone port authority has signalled that capacity of 0.5mt per annum at the Barney's Point terminal is available. The company is exploring other alternatives to get the coal to market such as potentially barging or trucking the coal to the Bundaberg port for shipment. Coal handling facilities would need to be built in Bundaberg for it to be a viable terminal although NEC believes it would be a more cost effective option than rail to Gladstone which is 220km away. In Tolhurst's view, despite being small the Maryborough project is the only viable avenue to early term cash flows and would demonstrate management's skill in project delivery.

Ashford EL 6234 & 6428 (NEC 50%)

Located in the North Gunnedah basin in northern NSW, Ashford is a quality hard coking coal deposit with an inferred resource of 18mt. The project was the cornerstone to the company's IPO and much regional work has been done to extend the mineralised zone although to no avail. Surrounding leases have been relinquished as a consequence and the importance of the project, given other developments at Elimatta and Yamala, has understandably diminished. There are also significant challenges in getting the Ashford coal to market, meaning the deposit is effectively stranded with no reliable dates set on future infrastructure access.

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RESEARCH



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Five Mile, Perrett's Road, Trigamon & Ena Creek (EPCA 1158, 1171, ELA 3220- 3222 – NEC 100%)

Applications for these tenements have been submitted and represent field work being carried out to identify an extension to the Surat basin, targeting shallow, high volatile "Walloon – style" thermal coals of similar quality to Elimatta. It is too early to assess likely exploration success from these tenements.

Board & Management

The ability to negotiate the transition of explorer to producer depends heavily on the skills of the board and executive management. To be successful it is essential an exploration company possess the expertise in the following areas: deep industry experience; marketing capabilities, strong technical/geological skill, financing expertise, project and corporate management skills.

Based on these characteristics the board and management of NEC are considered to be of the highest calibre.

Non-Executive Chairman - Dr. Christopher Rawlings

20 years experience in the coal industry and until late 2000 was Managing Director of QCT Resources Ltd – the largest independent coal company in Australia until the takeover by BHP and Mitsubishi. Previously held positions as President of the Queensland Mining Council and the Chairman of the Australian Coal Association.

Managing Director – Keith Barker

Keith has an MBA from AGSM, graduated from Mining Engineering at the Royal School of Mines ICL (UK) and 25 years experience in the mining industry. He was also previously with QCT Resources Ltd as Corporate Development Manager handling project evaluation, infrastructure contracts and investor relations. Immediately prior to joining NEC, Keith was with the Queensland Resources Council as an industry policy advisor.

Non-executive Director – Kevin Maloney

Kevin joined the board in May 2007 and is the founder and Executive Chairman of The MAC Services Group. He has had extensive experience in finance and resources having spent 20 years with ANZ Bank and held the position CEO of Elders Resources Finance Ltd.

Company Secretary / CFO – Paul Marshall

Paul is a chartered accountant, law graduate and holds a Grad Dip from the London School of Economics. He has had 20 years experience in accountancy, initially with Ernst & Young and subsequently in commercial roles dealing with company reporting, due diligence and fund raising. He is also presently the company secretary of Renison Consolidated Mines.



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Financial Summary

Budgetary Commitments

	Amount A\$m	Total A\$m	Date
Cash	7.15		30 June 2007
Exercised Options	1.09	8.24	1 February 2008
Maryborough Exploration & Evaluation	-1.00	7.24	1 February 2008
Elimatta - Stage 2 & 3	-5.50	1.74	30 June 2009
Corporate O/H 2yrs	-0.60	1.14	30 June 2009

The above table demonstrates NEC's cash burn rate based on current commitments. Further funding is likely to occur early to mid-2009 at the latest however further progress on Maryborough or cost escalations may require additional funding be raised sooner (mid- 2008).

Key Risks & Mitigants

Infrastructure Risk. Rated: High

- Presently both the above rail operators and the port authorities have set deadlines of mid-2009 for tonnage commitments on the associated infrastructure where users will be required to sign Take or Pay contracts.
- Construction timelines for the additional infrastructure capacity are scheduled for mid-2011 however there is a high likelihood is completion will be delayed.

Mitigant

NEC recognises access to infrastructure will unlock the value of the resource base. Hence management has harmonized staged project evaluation to ensure they are well placed to make the correct level of commitment at the appropriate time.

Completion delays to infrastructure are outside the company's control although they have sought to diversify their earnings streams with multiple projects. This removes reliance on one particular infrastructure project. In our assessment with have factored in these delays and have an expectation production will occur in 2012.

Project Risk. Rated: High

- The company is running large project evaluation programs which will become increasingly challenging from a resources and logistics sense as NEC moves into the development phase. Being a small explorer NEC does not currently have the resources to deliver these projects through to production.

Mitigant

The management team have ample experience in identifying and working through the challenges of project delivery. Given the likelihood of Elimatta and Yamala being developed concurrently, NEC has signalled a willingness to sell down interests in these projects to bring in a partner who possesses the resources (human & capital) and the technical expertise required.

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RESEARCH



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Commodity Price Risk. Rated: High

- As cash flows from NEC projects are unlikely to be received until well into the medium term this leads to greater earnings uncertainty associated with fluctuations in coal prices. This is particularly relevant to movements in price differentials between ranks of coal.

Mitigant

The medium term outlook for global coal demand is robust and rapid growth in developing nations will see sustained levels of demand that will need to be satisfied, particularly in thermal coal. Australian producers are well placed to take advantage of the prevailing environment (see Coal Sector Review – Industry, 6 Sep). NEC is attempting to diversify its earnings streams across the different ranks of coal through its different projects. E.g Elimatta – Thermal; Yamala – Thermal / Semi Soft Metallurgical; Maryborough – Hard Coking. Hence earnings volatility is somewhat removed. Furthermore NEC is focused on low cost operations which provide further insulation from coal price movements.

Environmental Issues

There are no outstanding environmental issues relating to exploration permits or work currently being undertaken by NEC.

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Tolhurst's Recommendation and Risk Rating system:

Recommendations are assessments of each Tolhurst Analyst's view of potential total returns over Short Term and/or Long Term time horizons. A Short Term time horizon is less than 12 months; a Long Term time horizon is greater than 12 months.

Expected total Return is measured as (capital gain (or loss) + dividend)/purchase price

We have divided our recommendations into four main categories:

Buy: Expected Total Return more than 20%

Accumulate: Expected Total Return between 5% - 20%

Hold: Expected Total Return between -5% and 5%

Sell: Expected Total Return less than -5%

Risk Ratings:

Risk is a subjective assessment of overall risk within a company including price volatility and earnings variability, external liquidity, and size.

We divide our risk into three categories:

High: Company typically has high price volatility and earnings variability, low external liquidity and has a small market capitalisation.

Medium: Company typically has moderate price volatility and earnings variability, external liquidity and a medium size market capitalisation.

Low: Company typically has low price volatility and earnings variability, high external liquidity and is a large size market capitalisation.

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I verify that I, James Evans, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely my own personal opinions. In addition, I certify that no part of my compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

This report has been reviewed by peers within the research department.