



SAAS DISCUSSION

A discussion paper on the SaaS market
April 2021

SAAS IN BRIEF

SaaS Software vs Traditional Software

SaaS Software

- **Delivery:** SaaS is cloud-based and can be used either via browser or app or both. The software can be updated continuously.
- **License:** Users subscribe for the software and usually pay a monthly or annual fee for the software. No upfront payment is required.

Traditional Software

- **Delivery:** Software is installed on individual computers. Usually limited to one device. Software updates need to be downloaded or purchased.
- **License:** Users buy a one-time license and pay the software upfront. Additionally, the customer may pay for occasional updates.

SaaS Overview

As software is increasingly moving to the cloud, companies are steadily shifting their content environment to SaaS (Software as a Service). Over the past few years, SaaS has replaced other software delivery models due to its advantages over traditional software distribution.

The ongoing pandemic has further accelerated the adoption of SaaS in the workplace as people are working from home and more virtual collaboration tools are required.

SaaS is a cloud-based service in which software is accessed via subscription rather than a traditional one-time license. SaaS products can be accessed from any device with an internet connection, including mobile and browser.

The key characteristics of SaaS include accessibility, a flexible licensing model and the quick commissioning of services.

One of the most common examples of a SaaS product is email. Email is accessed via a browser or app. The software and data (messages in this case) are located on the service providers' network. The user can access the messages with any device able to make an internet connection. Additionally, the user never has to update the software.

Other well-known SaaS products on the market include Microsoft Office 365, DocuSign, Dropbox and Slack.

This paper will explore how SaaS has disrupted the software market with a particular focus on why SaaS companies have become so compelling among investors

Common SaaS Applications



CRM / Sales



Billing



ERP



eCommerce



HR



Marketing Automation



Collaboration



Project Management



CLOUD SERVICE MODELS

SaaS

“Software as a Service”

- Application
- End users
- Gmail, Salesforce CRM, Office 365

PaaS

“Platforms as a Service”

- Platform
- Software developers
- Google App Engine, AWS Elastic Beanstalk

IaaS

“Infrastructure as a Service”

- Infrastructure
- IT administrators
- Google Compute Engine (GCE), Microsoft Azure, AWS EC2

Cloud Service Models Explained

Software as a Service (SaaS) is one of three cloud service models that each serve a different purpose. SaaS, PaaS (Platform as a Service) and IaaS (Infrastructure as a Service) are three ways of describing how businesses are using the cloud.

Cloud infrastructure services, also known as **IaaS**, provide the most basic computing services such as cloud servers, data storage space and networking services. Users pay for IaaS based on consumption, and it reduces expenses as users don't need to buy and manage their own servers and other datacenter infrastructure.

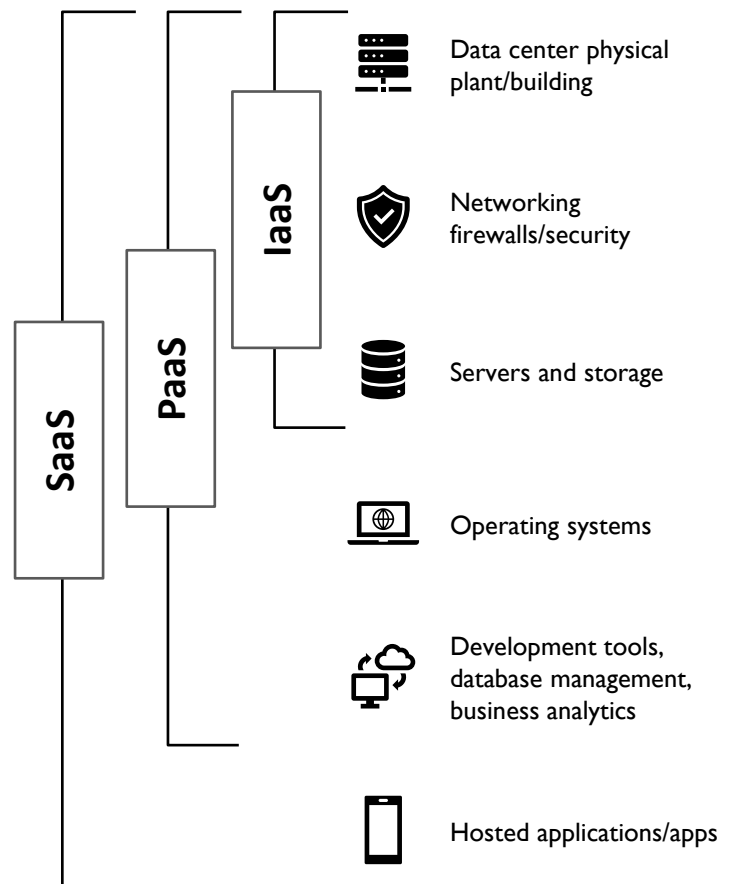
Since IaaS provides the most fundamental computing services, it is best suited for tech companies or to those with a high level of IT expertise.

Cloud platform services, or **PaaS**, provide a platform which allows its users to develop and manage cloud-based applications. In a similar way that a macro is created on Excel, developers can create applications using built-in software components with PaaS.

The advantages of PaaS include time and money savings as it makes coding more efficient and less time-consuming.

SaaS, at the top of the pyramid, is the most developed cloud service of the three cloud service models providing software or applications to end users.

SaaS providers are responsible for all the underlying infrastructure, middleware, software, data and data security. SaaS users can get access to applications with minimal upfront cost and on a pay-as-you-go basis.



BENEFITS OF SAAS

Benefits for SaaS companies

Higher Customer Lifetime Value (LTV)

If the company is able to maintain a high retention rate, the customer lifetime value becomes higher than for a traditional software company.

Cost-effectiveness

Cloud application services have a cost-effective operations model as cost structure is scalable. Scalability of SaaS applications allow a higher profitability.

Benefits for customers

Low Total Cost of Ownership

The total cost of ownership (TCO) is low. SaaS applications are quick and cost effective to set up, have predictable expenses and are scalable to one's needs.

Accessibility

One of the main advantages compared to traditional on-premise software is that SaaS can be accessed anywhere and on any device, as long as internet is available.

Always up-to-date

The SaaS provider is responsible for keeping the product up-to-date, and the user gets instant access to the latest version.

From CAPEX to OPEX

As SaaS products are moving software expenditures from CAPEX to OPEX, the barriers to purchase are lowered when a certain investment budget doesn't need to be met.

Benefits for investors

Scalability

As the business scales, the cost of an individual customer goes down, and eventually SaaS businesses become cash cows.

Growth potential

As companies are steadily shifting to the cloud, there remains significant growth potential when transferring products to the cloud.

Cash flows

Cash flows for subscription-based products are recurring and predictive.

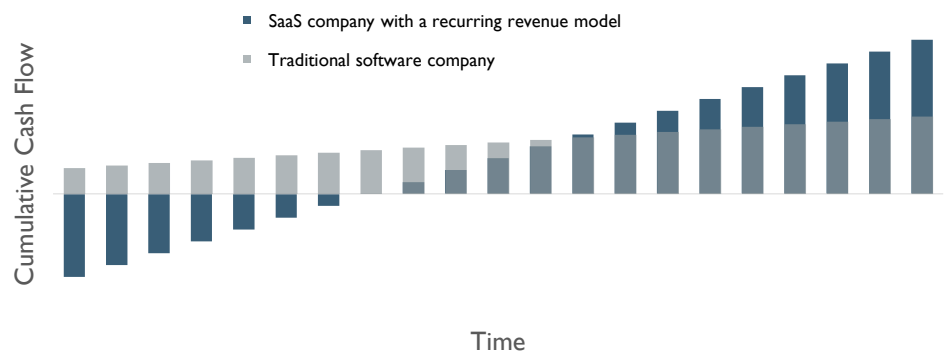


RECURRING REVENUE MODEL

Recurring Revenue Model

- SaaS businesses are based on a recurring revenue model, meaning that instead of a larger one-time up-front fee, the customer is billed on a monthly or annual basis making the future cash flows predictable.
- The provider of SaaS software benefits from the recurring revenue model through predictable cash flows, a higher customer retention rate and better scalability.
- The customers' benefit arises from low roll out cost and reduced risk as no large up-front payment is required.

Cumulative Cash Flow Comparison



A comparison of cumulative cash flows between a SaaS company with a recurring revenue generation model and a traditional software company is presented above.

Whereas cash flows for a traditional software company consist of an up-front payment and occasional updates, the payments for a SaaS provider occur more evenly over time. SaaS companies tend to have negative cumulative cash flows in the beginning of the customer relationship due to Customer Acquisitions Costs (CAC) such as marketing and sales expenses.

However, in the long run the Customer Lifetime Value (LTV) is usually higher for a SaaS company than a traditional software company due to the nature of the recurring revenue model.

For this reason, SaaS companies are often unprofitable during their growth phase. Customer Acquisition Costs are front-loaded, and positive cash flows start occurring in small monthly streams. As the business starts to scale and the number of customers with recurring payments increases, SaaS companies become, in some cases, extremely profitable.



SAAS METRICS

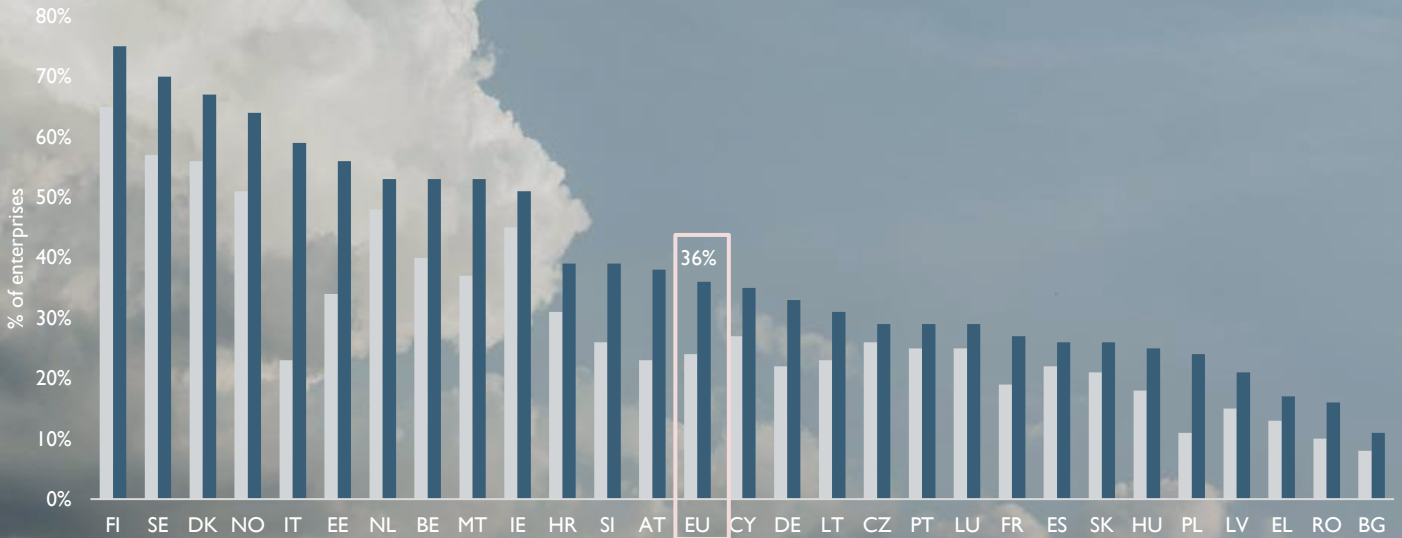
Since SaaS companies rely on a subscription-based model and revenues are realised in the future, SaaS businesses need KPIs to reflect this revenue structure.

KPI	Definition	Calculation
Average Revenue Per Account (ARPA)	ARPA is calculated by dividing the revenue during a period of time with the number of customers. Shows the impact of upselling or change in pricing.	$\frac{\text{Revenue (€/year)}}{\text{Number of Customers}}$
Customer Acquisition Cost (CAC)	The cost of acquiring a customer, usually sales and marketing.	$\frac{\text{Cost of Acquiring New Customers (€)}}{\text{Number of New Customers}}$
Customer Lifetime Value (LTV)	The average value of a customer based on cash flows generated by the customer during the whole future relationship. LTV also represents the upper limit of Customer Acquisition Cost. LTV should be larger than CAC for the company to be profitable.	$\text{ARPA (€/year)} \times \text{Average Customer Lifetime (years)}$
Monthly Recurring Revenue (MRR)	Revenue generated by subscriptions on a monthly basis. MRR is an indicator of growth of SaaS business month over month. MRR growth can be divided to New MRR and Expansion MRR. New MRR comes from new customer and Expansion MRR from current customer expanding their subscription.	$\text{ARPA per month (€/month)} \times \text{Number of Customers}$
Implied Annual Recurring Revenue (ARR)	The annualised Monthly Recurring Revenue.	$\text{MRR (€)} \times 12 \text{ months}$
Churn	Churn is a measure of customers lost during a month. Churn should not be larger than the sum of New and Expansion MRR. Churn can be calculated either as a customer or revenue churn.	$\frac{\text{Number of Customers/Revenue Churned}}{\text{Number of Customers/Revenue}}$
Customer Retention Rate	Measures the number of customers retained during a period of time. Customer retention rate is the inverse of churn rate.	$\frac{\text{Customers at the End of the Period} - \text{New Customers}}{\text{Customers at the Start of the Period}}$
CAC Payback Period	Measures the months that it will take to recover the customer acquisition costs.	$\frac{\text{CAC (€)}}{\text{ARPA per month (€/month)} \times \text{Gross Profit Margin}}$



CLOUD MARKET OVERVIEW

■ 2018 ■ 2020



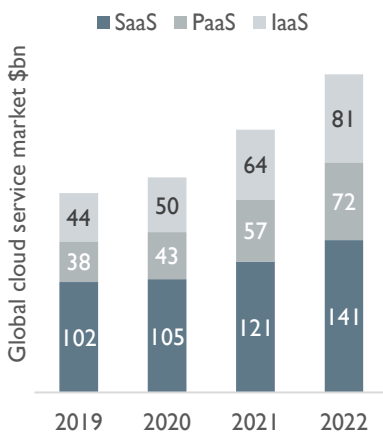
Use of cloud computing services in Europe, 2018 and 2020 (Eurostat)

Cloud Market Overview

Market development

Though SaaS is the largest and most developed cloud services model, growth in the market has slowed down as it has become more established.

COVID-19 has given SaaS an additional boost as people are working from home and need more collaboration and project management tools. In addition, companies are trying to cut back on IT spending and SaaS products provide an easy to roll out with minimal risk.



Cloud computing market in Europe

The use of cloud computing services in enterprises has increased during the past few years. 36% of all EU enterprises used cloud computing in 2020, an increase of 12 percentage points from 2018.

The most common use cases are email and storing files in an electric form. However, more sophisticated services such as office software and financial and accounting software have experienced high growth in recent years.

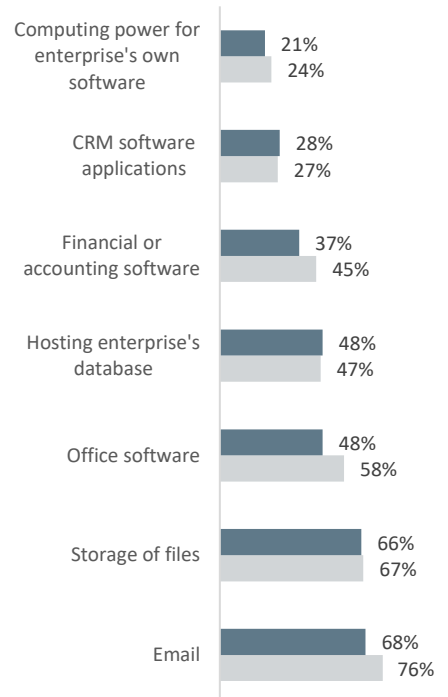
Even though 98% of EU companies with more than 10 employees have access to the internet, significant differences are seen between countries in consumption of cloud computing services.

The Nordics have by far the highest market penetration with an average of 69% of enterprises using cloud computing software. In contrast, Greece, Romania and Bulgaria have less than 20% of enterprises using cloud computing services.

The use of cloud computing services is more common in large companies than small ones. In 2020, 65% of large enterprises used cloud computing services whereas small and medium sized enterprises used less than 50%.

Use of cloud computing services in enterprises by purpose, 2018 and 2020 (Eurostat)

■ 2018 ■ 2020



MARKET OVERVIEW

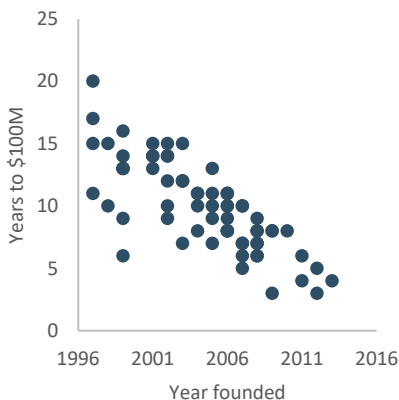


SaaS Market Overview

Market development

As SaaS is overtaking traditional software services, SaaS companies have become bigger, stronger and faster growing. 10 years ago in 2011, Salesforce was one of the only significant SaaS companies around. At present, the number of large public SaaS companies has grown, with nearly forty SaaS companies having a market cap above \$5 billion.

SaaS companies have also grown faster as it takes less and less time for companies to reach \$100 million in ARR.



Global SaaS companies

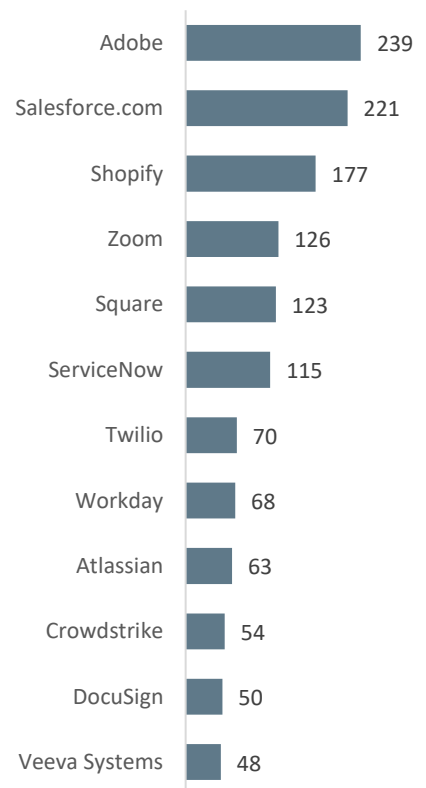
Listed as EMCLOUD, Bessemer Venture Partners has developed an index designed to track the performance of emerging public companies primarily involved in providing cloud software to their customers. The ETF has been tracking 54 public SaaS companies since August 2013.

The index has outperformed several traditional indices such as Nasdaq, S&P and Dow Jones during this time period. The average growth rate of the companies included in the index is 38% which partially explains the index growth as SaaS companies are often valued based on revenue multiples.

Due to their recurring revenue model, the companies are highly profitable with an average gross profit margin of 71%. Interestingly, Adobe has the highest gross profit of 88%. Adobe has successfully transformed from a traditional licensing software company to a completely cloud-based company. Approximately 90% of Adobe's revenue come from subscriptions.

Zoom has been one of the winners during the pandemic era as its value has increased by nearly 350% during the past year from \$90 per share to \$313 (31 March 2021).

Sector Top Players by Market Cap \$bn*



*Market caps taken on Feb 12, 2021



SAAS MARKET TRENDS

Vertical vs Horizontal

Mobile first

Artificial Intelligence

Micro-SaaS

SaaS trends

Vertical vs Horizontal SaaS

A global trend in the SaaS market is a shift from horizontal software towards vertical software, as vertical software is showing faster growth. Even though the market is heavily focused on horizontal SaaS, Europe is expected to follow the US who is leading this trend.

Vertical SaaS refers to software that caters to a specific industry or segment such as Hospitality, Entertainment and Media, Retail and Healthcare. Horizontal SaaS on the other hand refers to a more universal software that can be used in a range of industries. Examples of Horizontal SaaS are software focusing on HR, CRM, BI & Analytics, Marketing or Productivity & Collaboration.

Industries such as retail, healthcare and finance are increasingly updating their legacy IT structures. SaaS enables these industries to upgrade their software without large upfront payments. Even though some industries are adapting to new software more slowly, they are still expected to move to the cloud sooner or later. New industry specific SaaS companies have the opportunity to become market leaders as well as an industry standard within a specific industry, making vertical SaaS a more appealing option.

Compared to industry specific solutions, the horizontal SaaS market is viewed to be highly competitive. The horizontal industry is dominated by large players such as Microsoft, which generates a fifth of global SaaS revenue.

Mobile first

As people are increasingly spending more time on their phones and using it for their day-to-day activities such as banking and e-mailing, SaaS companies are leaning towards a mobile-first mindset. At the same time, desktop services are not going anywhere anytime soon since solutions such as Excel can't be easily replaced with mobile solutions. However, people want to be able to access SaaS solutions such as Zoom or Slack on the go, and therefore SaaS companies are continuously focusing more on mobile solutions and especially on the user-friendliness of mobile-web integrations.

Artificial Intelligence

As the definition of Artificial intelligence (AI) varies, many companies label themselves as using AI technology when in some cases the benefits of AI are very limited. Even though AI sometimes seems to be an overused marketing term among software companies, in SaaS, AI does provide significant benefits for its customers.

Advantages provided by AI include automation and predictive analytics as well as security. AI boosts efficiency as it can be used in workflow automation or in marketing automation to perform simple administrative tasks that otherwise would take significant amounts of time from sales and marketing departments. AI can speed data processing and find information, behaviours or patterns that humans are not able to find. In addition, AI is able to find data security threats more quickly. An increased adaption of AI is viewed to be a future trend for SaaS companies.

Micro-SaaS

The SaaS market has become increasingly competitive, and new companies have found it difficult to enter the market with such large and established players already present. Consequently, instead of competing with the established SaaS companies, more and more niche companies are looking to enter the market; so-called micro-SaaS companies.

Often these micro-SaaS companies do not offer any full product but various add-ons to current SaaS products to solve a particular problem. Micro-SaaS products usually have several integrations to other software products. Micro-SaaS companies may then gain a large share of the niche market that they have chosen.



VALUATION OF SAAS COMPANIES

SaaS businesses are commonly valued based on EV/Sales multiples

Valuation of SaaS companies

SaaS businesses are commonly valued based on EV/Sales multiples since valuations are more highly correlated with size and growth rate of revenues rather than profitability. This is typically attributed to the timing of cash flows and the strong growth profile of SaaS companies.

SaaS companies' cash flows are characterised by upfront sunk costs caused by customer acquisition costs. However, if the company is able to retain these customers, the recurring revenue will enable significant profit improvements as the business matures.

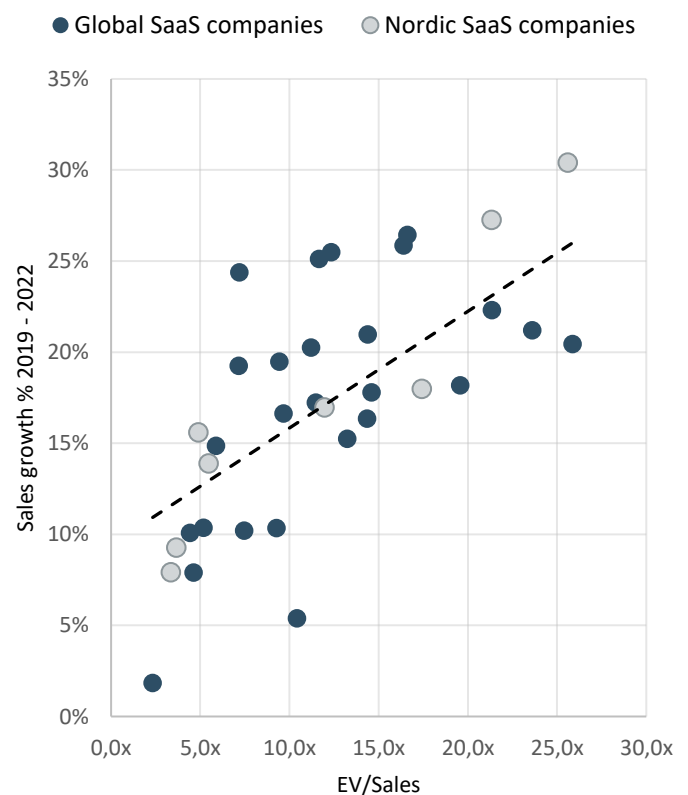
In the early days, SaaS companies are often unprofitable because of large investments in growth. In the long run, the steady stream of recurring revenue and scalability of the business start generating positive cash flows and improved profitability.

EV/Sales multiples used for SaaS companies are affected by several factors, such as revenue size, growth rate and share of ARR (Annual Recurring Revenue) of total revenue.

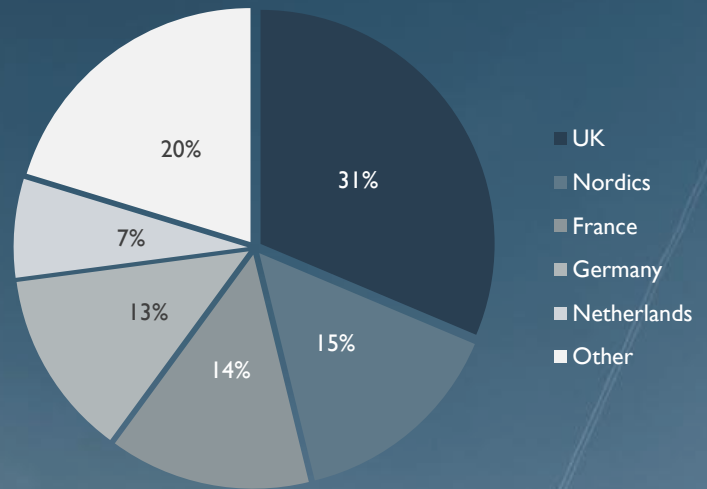
Sales growth tends to be highly correlated with EV/Sales multiples. Companies with a strong growth profile are usually valued with a higher multiple. The correlation between EV/Sales multiple and growth rate of global and Nordic SaaS companies is presented on the right. The valuation multiples of Nordic SaaS companies seem to be in line with those of global SaaS companies when sales growth is taken into consideration.

Similarly, a SaaS company's so called efficiency rate is commonly correlated with EV/Sales multiples. Efficiency rate is the sum of a company's free cash flow (FCF) margin and growth rate. For example, if a company had a FCF margin of 10% and a growth rate of 20%, the efficiency rate would be 30%. Consequently, companies with a higher efficiency rate typically have a higher valuation.

EV/Sales multiples of global and Nordic SaaS companies (data retrieved April 1, 2021)



M & A ACTIVITY



M&A Activity in Europe by geography 2018 - 2020

European SaaS M&A Landscape

M&A Activity

M&A activity in the European SaaS industry has increased significantly during the past 10 years. However, during the past few years the market has experienced some cool down as annual deal count has flattened. At the same time the average deal size has grown substantially, more than doubling from 2011 to 2020.

The UK is traditionally the largest European software market with the most SaaS deals in terms of target company. The Nordics market is quite mature in terms of cloud technology adaption and investments which can be seen in the number of deals made in the region.

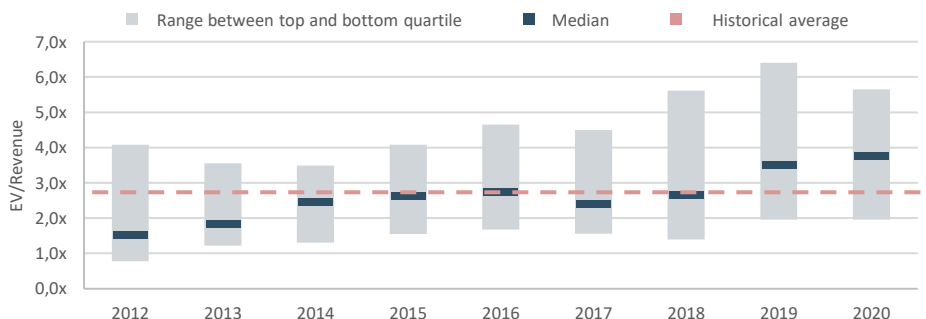
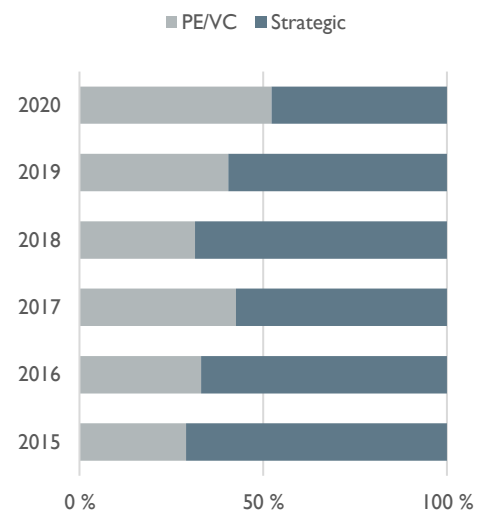
Private equity firms have increasingly gained an appetite for SaaS companies, accounting for more than half of deals during the past few years in Europe. Financial investors seem to be attracted by the predictable cash flows, promising growth profile and low capital expenditure requirements of SaaS companies. However, most SaaS investments are still early-stage venture capital investments.

Valuations

The 24-month median revenue multiple for European SaaS/Cloud companies was 3.8x in 2020 and the EV/EBITDA multiple was 16.3x. The valuations have been above historical averages during the past few years. However, there is much variation between the valuations of individual companies. Additionally, the valuations of transactions often lag behind the valuations of publicly traded companies usually due to liquidity and size.

Profitability, company size and growth rate drives multiples. Companies with a strong EBITDA tend to have higher valuation multiples. On the other hand, if the company is not profitable, it may still have a high valuation if it has a stronger growth profile. In other words, successful SaaS companies are either profitable or burning cash in order to reach significant growth.

Strategic vs PE acquirers



TOP ACQUIRERS

Top Acquirers in Europe

Selected Corporate Acquirers



Visma AS, Norway
Backed by HG Capital, Cinven, Intermediate Capital Group and Montagu Private Equity

37 deals in the past 3 years

Latest deals:
IT Minds
Compello AS
Khonraad Software Engineering BV



The Access Group, UK
Backed by HG Capital and TA Associates

18 deals in the past 3 years

Latest deals:
The Sage Group Plc (Asia)
Abintegro Limited
Unleashed Software Limited



ClearClouse Partnership, UK
Backed by Aquiline Capital Partners

11 deals in the past 3 years

Latest deals:
Adelante Software Ltd
FLG Business Technology Limited
Giftpro Limited

Selected PE/Buyout Investors



UK-based private equity (PE) firm investing in mid-market companies in the UK, Germany and the Nordics. Focus on technology, services and industrial tech.



US-based private equity firm making investments North America, Europe and Asia in the technology, financial services, healthcare and consumer industries.



UK-based venture capital firm providing mezzanine financing between €15m and €500m to companies.



UK-based PE firm investing in mid-market companies, primary investing alongside management teams in companies based in Europe, with a focus on the UK, France, Germany and the Nordics.



UK-based private equity firm seeking to make control equity investments in European companies.



Norway-based PE firm investing in Nordic companies with a focus on enterprise software, consumer retail, advanced industry and energy solutions sector.



CONCLUSION

Conclusion

Rise of European SaaS

Historically, the US has driven the growth of the SaaS market and has absorbed most of the investments made into the market. However, European SaaS companies are increasingly receiving investments and are currently growing at a similar rate as their US counterparts. The European SaaS market is expected to continue growing as investments keep coming in and companies are internationalising quickly.

Private Equity Activity

Private Equity firms have been actively investing in SaaS in the past few years due to the growth profile of SaaS companies as well as the unique revenue model. PE firms have been outbidding strategic buyers as deals can be highly leveraged due to low interest rates and predictable revenue streams of target companies. The growing valuations have also increased interest of PE firms as future valuations may be higher.

Future Market Development

The SaaS market has grown significantly in size and deal volume in the past several years, but a slight slowing down can be seen. Valuations of SaaS companies have grown steadily and are currently above historical averages both in public companies and transactions. However, the need for software and SaaS applications seem infinite and therefore it seems unlikely that market activity will decrease drastically. A slight market correction in terms of valuations in the short run may be more probable.

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CONTACT INFORMATION



 **AALTO CAPITAL HELSINKI**
FINLAND

AALTO CAPITAL PARTNERS OY


Mikonkatu 15 A
00100 Helsinki
finland@aaltocapital.com
+358 50 5394 781




 **AALTO CAPITAL LONDON**
UNITED KINGDOM

AALTO CAPITAL LLP

15 Flood Street
London, SW3 5ST
uk@aaltocapital.com
+44 207 839 7112



 **AALTO CAPITAL MUNICH**
GERMANY

AALTO CAPITAL AG

Bahnhofstr. 98
82166 Graefelfing / Munich
germany@aaltocapital.com
+49 89 89 86 777 0



 **AALTO CAPITAL STOCKHOLM**
SWEDEN

AALTO CAPITAL AB (PUBL)

Biblioteksgatan 8
SE 111 46, Stockholm
info@aaltocapital.se
+46 10 1011 390



 **AALTO CAPITAL ZÜRICH**
SWITZERLAND

AALTO CAPITAL AG

Seefeldstrasse 283, Seewurfel 5
CH-8008 Zurich
info@aaltocapital.ch
+41 79 635 73 40



















 **AALTO CAPITAL NEW YORK**
UNITED STATES

AALTO CAPITAL LLC

P.O. Box 773, New York
NY 10272, US
usa@aaltocapital.com
+1 646 447 2683



RECENT REFERENCES

 <p>Mergers & Acquisitions Sale of Munax Oy to DANÆG A/S (Denmark)</p> <p>2/2021</p>	 <p>Financial Advisory Corporate Bond Bondholders' meeting Euro Bonds 18/22</p> <p>1/2021</p>	 <p>Financial Advisory Growth financing (debt) EUR 5m</p> <p>1/2021</p>	 <p>Private placement</p> <p>12/2021</p>
 <p>Financial Advisory Fairness Opinion for a public tender offer</p> <p>12/2020</p>	 <p>Financial Advisory Corporate Bond Tap Issue EUR 10m</p> <p>11/2020</p>	 <p>Financial Advisory Corporate Bond Restructuring/Bond-holders' meeting Euro notes 16/21</p> <p>7/2020</p>	 <p>Financial Advisory Strategic advice and valuation</p> <p>6/2020</p>
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 <p>Financial Advisory Green Bond EUR 10m Luxembourg</p> <p>12/2019</p>	 <p>Financial Advisory Corporate Bond Tap Issue EUR 25m Frankfurt</p> <p>11/2019</p>	 <p>Mergers & Acquisitions Divestment of Pelsu Pelastussuunnitelma Oy to Caverion Oyj</p> <p>10/2019</p>	 <p>Financial Advisory Acquisition of Real Estate Portfolio Mezzanine EUR 5.2m</p> <p>9/2019</p>





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Aalto Capital LLP
15 Flood Street
London, SW3 5ST
United Kingdom