

CSC Research – Credit to Equity Insight

Weekly C2E Insight

CDS spreads were tighter in Asia over the past week, with particularly encouraging tightening in AX and major AX sovereigns.

June's flash manufacturing PMI in China has moved back above 50, supporting the recovery in the CESI to flat. Rising new orders and falling inventories bode well for Q3, whilst C2E divergence between the SHCOMP and China Sov CDS is back to mid May's and mid January's bullish peaks. We see scope to buy here.

Japan's flash PMI was also above 50 for the first time since March – an encouraging read given the tax hike in April – supporting the tightening in the iTraxx Japan to 65bps.

Recent Topix strength means C2E divergence is back at neutral suggesting any widening from here could shift us bearish.

Recent announcements on Abe's third arrow should prove positive, however. We look for restructuring of GPFI and corporate tax to support further equity upside and encourage a weaker yen. We remain positive.

- CDS spreads were tighter in Asia over the past week, led by the iTraxx AX which tightened by 7.5% despite a 1% correction in the MSCI AX. Equities elsewhere were higher, with the Topix up nearly 2.5%, running ahead of a 3.4% tightening in the iTraxx Japan, and the ASX rallying a more sedate 0.6%, a fair reflection of the 2.7% tightening in the iTraxx AUS.
- Sovereigns were also all tighter, bar Indonesia, with good tightening in China (-3.6%), and South Korea (-5.0%) belying the equity weakness in both the SHCOMP and the KOSPI. Implied upside in the SHCOMP is the most impressive in the region, with C2E divergence of 1SD above zero, near previous peaks seen in early May and mid January. This, combined with the recovery in the CESICNY back to flat (from -135 just over a month ago), bodes well for the SHCOMP for Q3, we believe.
- The recently announced Chinese manufacturing PMI rose from 49.4 in May to 50.8 in June according to the flash figure. This pushes the average for the second quarter up to 49.4 from 48.7 in Q1, suggesting growth in Q2 could have accelerated from Q1's 7.4% and indicates that the government's growth target of 7.5% for 2014 is on track. New orders rose for the first time since January, driven, for the first time in a while, by strong domestic demand. This suggests to us that recent stimulus measures are making an impact. Finally, and particularly encouraging for Q3, is the indication that stronger-than-expected sales have depleted inventory levels. Inventories fell at the fastest rate since late Q3 2011 and the ratio of new orders to inventories rose to its highest level since the start of 2013.
- This all bodes well for the SHCOMP, we believe, and with valuations near lows and EPS momentum picking up again, we are positive into the start of the second half of the year.
- Turning to Japan, we note the flash manufacturing PMI rose to 51.1 in June, the first time it has read above 50 since March. Encouragingly, this figure pushes the average for Q2 up to 50.1, indicating that Japan avoided a quarterly contraction despite the tax increase taking effect at the start of April. Given that Q1 saw the highest quarterly PMI in eight years, as households brought investments forward to beat the tax increase, the resilience of demand in Q2 is particularly impressive.
- There are a couple of concerns however, with export orders dropping for the third straight month. The order backlog also fell for the third month in a row, albeit at a minimal rate. This points us to the resilience of the yen, holding firmly in a range between 101-103, despite the efforts of the Abe administration to weaken the currency and boost export sales.
- There is, however, scope to suggest that this currency range will break higher in Q3, with the yen weakening toward 105. One of the key drivers to a weakening yen could

come from the Government Pension Investment fund which is coming under pressure to reduce its target holdings of domestic bonds to 40% from 60%, increase target holding of local shares to 20%, from 12% JGBs and increase exposure to foreign assets. Abe also wants to move the GPIF from out of the umbrella of the Health Ministry and by upping its allocation to domestic equities, use its influence to pressure companies to restructure and boost profitability. Cutting the GPIF's allocation of local bonds to 40% could release up to \$200bn into global financial markets.

- The move to restructure the GPIF, combined with a corporate tax cut to below 30% should prove a boon to the equity market in the second half.
- The Japanese CESI has been gradually building up again over the past few weeks whilst the iTraxx Japan has tightened to 65bps, below January's unadjusted lows and the tightest level since early 2008. A move below 65bps would suggest that these recent reform announcements have been well received by the credit market and would provide another boon to stocks, in our opinion.
- At the single name level, CDS momentum remains strong across all sectors. C2E divergence, however, has moved back to neutral, with meaningful upside really only evident in IT and Materials. Valuations are skewed positively at the sector level, with the most upside also evident in IT and Materials; though there is also evidence to suggest Industrials and Financials are also cheap relative to their risk adjusted averages. This attractive valuation, combined with the strong tightening risk momentum keeps us skewed positively, though we would ideally like to see the iTraxx break below 65bps in Japan to keep the tightening momentum going.
- Where there is already strong tightening momentum and decent CDS implied upside, we see good scope to buy to position for a rally in Q3.
- Below we highlight the names with the highest CDS implied equity upside and the strongest tightening CDS momentum in the region.

Asia top 15CDS implied equity upside

Company Name	CDS (BP)	CDS IMPLIED UPSIDE (%)
COCA-COLA AMATIL	50	17.9%
AGILE PROPERTY	627	16.9%
CROWN RESORTS LT	112	15.9%
HOKKAIDO ELEC	79	15.7%
OJI HOLDINGS COR	54	15.0%
NIKON CORP	38	12.7%
KAWASAKI HVY IND	44	12.6%
MITSUBISHI ESTAT	23	12.2%
EBARA CORP	37	12.1%
CSR LTD	72	11.8%
SONY CORP	145	11.5%
SHIMAO PROPERTY	588	11.1%
HITACHI LTD	22	9.9%
RIO TINTO LTD	87	9.3%
JFE HOLDINGS INC	66	9.0%

Asia top 15 tightening CDS momentum

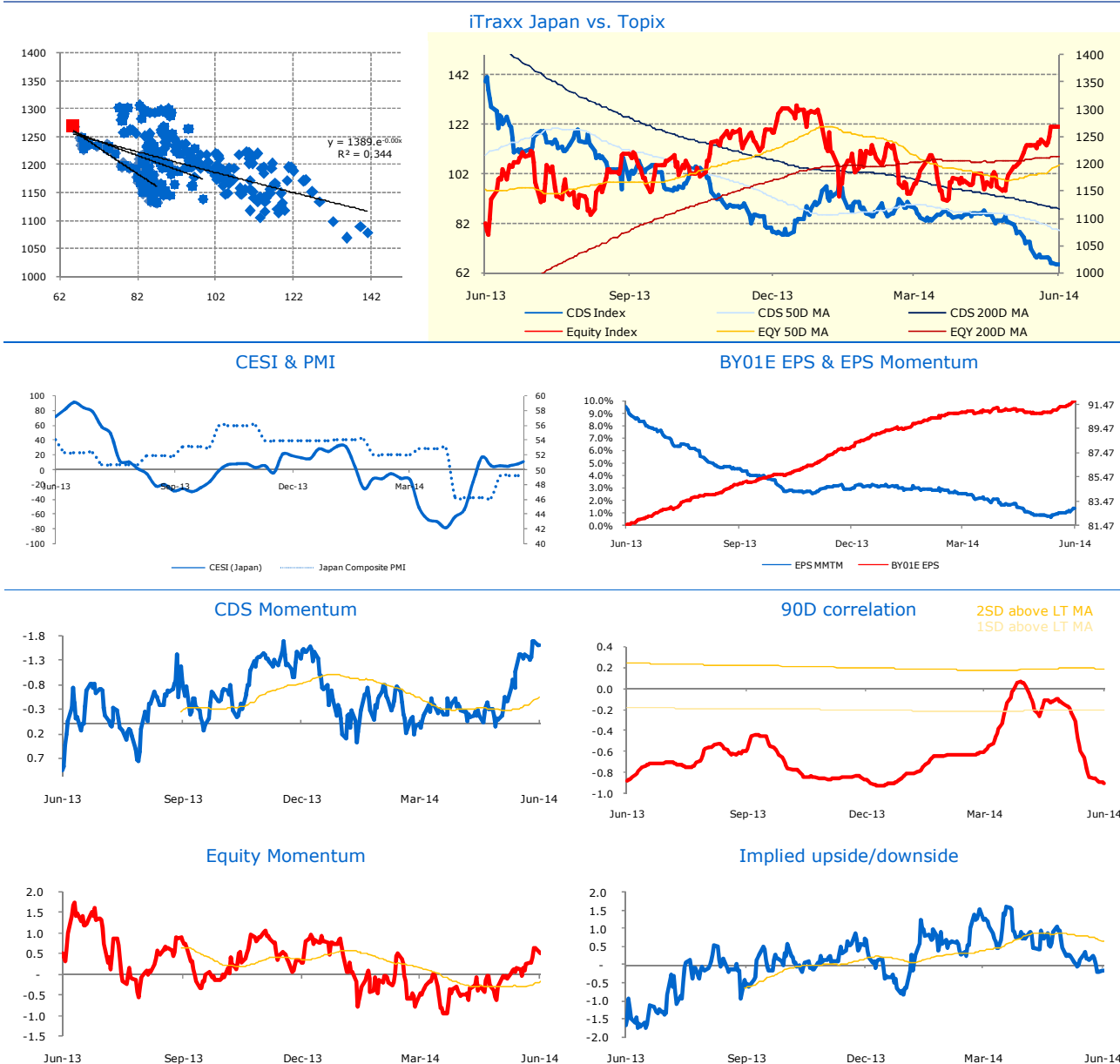
Company Name	CDS (BP)	CDS MMTM (%)
EBARA CORP	37	-36.8%
JAPAN TOBACCO	19	-33.8%
NEC CORP	48	-33.6%
KIRIN HOLDINGS C	12	-29.8%
MITSUBI MATERIALS	68	-28.3%
FUJITSU LTD	28	-27.7%
BRIDGESTONE CORP	16	-27.5%
RICOH CO LTD	22	-25.8%
STANDARD CHARTER	71	-25.8%
NISSAN MOTOR CO	31	-25.6%
MAZDA MOTOR	46	-25.0%
HSBC HLDGS PLC	41	-24.0%
TOYOTA MOTOR	22	-23.9%
DAIWA SECS GRP	73	-23.6%
TOKYO ELECTRIC P	168	-23.5%

- Ebara (6361 JT) – BUY – JPY700:** We are adding Ebara to our Buy Recommended List with a JPY700 price target. The CDS has accelerated tighter, recently trading at new tightests for the year, having moved from 60bps to 37bps so far in 2014. The equity is, however, down 5.5% over the same time period, a near 4% underperformance of the Topix. This has pushed C2E divergence to new bullish highs, above the previous peak seen in October 2013, which came prior to a 40% rally from early November to mid-January highs.
- Our CDS implied equity upside model currently supports upside to JPY700, over 10% above current levels, and with the 200DMA acting as good support nearby, we see an attractive risk/reward profile.
- Ebara looks comfortably on track to deliver record OP in FY15, with shale gas projects in the US ensuring the order book continues to grow. A weaker yen in H2 would, of course help, with JPY105 broadly consistent with JPY680-700 for the equity.
- Valuations are attractive. The stock trades on a BY01E PE multiple of less than 14x, comfortably below the RAAVGE of 15.3x and close to its lowest level since early 2013. The near 10% discount to RAAVGE is also close to being the largest discount since the start of 2013, when the stock was below JPY400.
- The forward yield too, whilst low at just 1.3%, is over 20bps ahead of its RAAVGE close to the largest we have seen since late 2012.
- Our price target of JPY 700, which is based on our CDS implied equity upside model, would equate to a BY01E PE of 15.3x, in line with the RAAVGE.

CDS indices vs. Equity indices

iTraxx Japan: The iTraxx Japan was tighter over the past week, extending its tightening for this series to 27%. C2E divergence is now back at equilibrium, though momentum is strong in both asset classes, EPS momentum is improving again and macro indicators are skewed positively. Valuations have moved back to their risk adjusted averages.

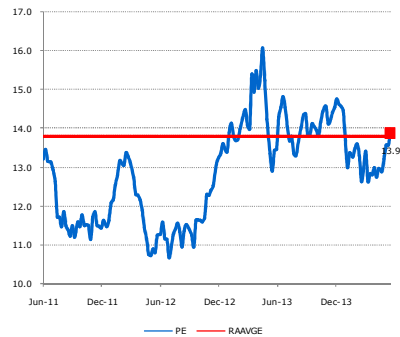
We would look for a move below 65bps in the iTraxx Japan to keep upward pressure on equities, with a move back above 72bps the first indication that momentum may be shifting more negatively.



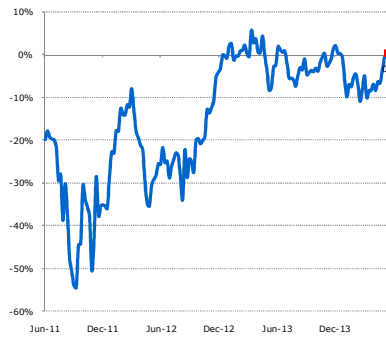
Source: CSC research, Bloomberg, Citi

Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield

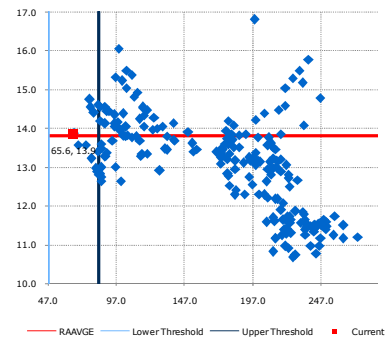
Topix PE vs. RAAVGE & 5YR AVGE



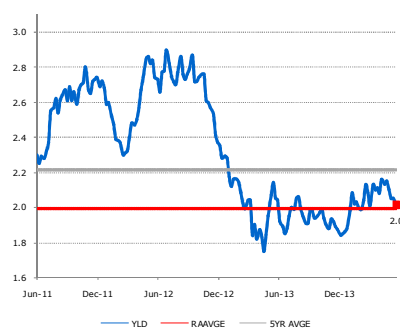
Premium/Discount to RAAVGE (%)



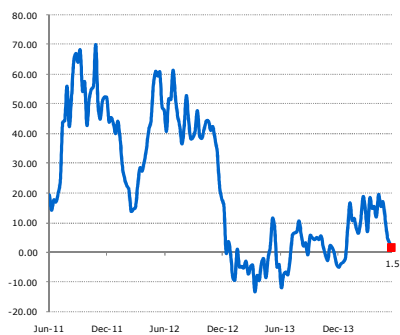
PE Range at current risk levels



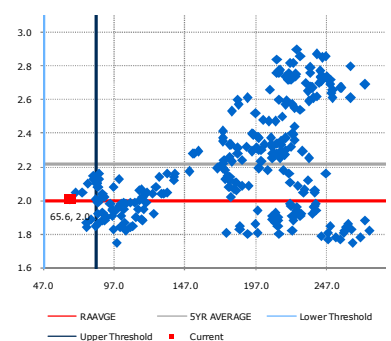
Topix YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



YLD Range at current risk levels



Source: CSC research, Bloomberg

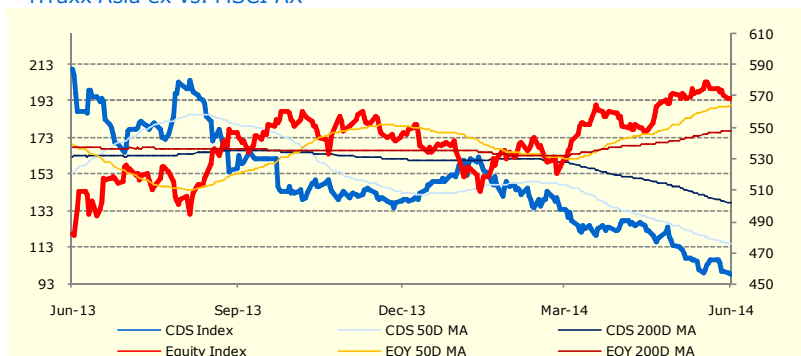
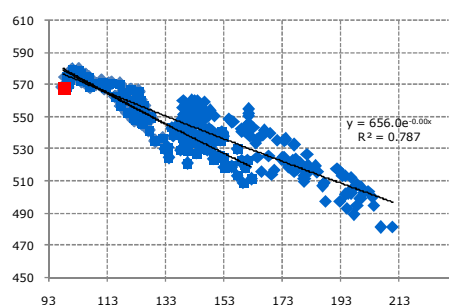
CDS indices vs. Equity indices

iTraxx Asia Ex: The iTraxx AX was the leading tightener over the past week, despite a correction in the equity market, which has brought the C2E divergence indicator back to a positive skew. With the MSCI AX close to its 50DMA, we believe there is scope for the correction to be staunched above 565, whilst upside potential to 580 leaves a reasonably attractive short-term risk/reward profile.

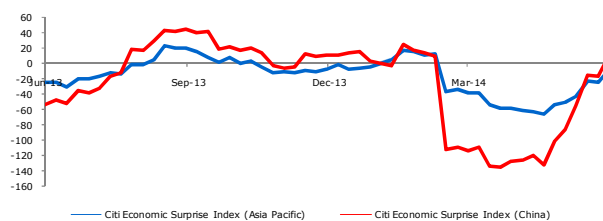
Valuations have moved back in-line with their risk adjusted averages, which suggests that the high multiples we had been seeing recently is no longer a drag.

The pickup in the CESIs should also be positive, especially in China, where the CESICNY is back at zero – a significant improvement from the -135 read in mid May.

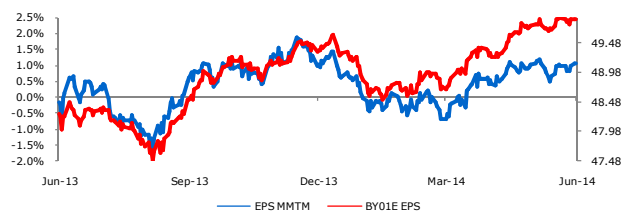
iTraxx Asia ex vs. MSCI AX



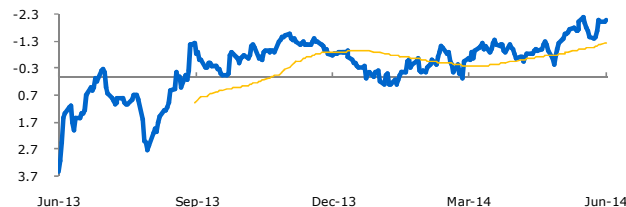
CESI (AX & China)



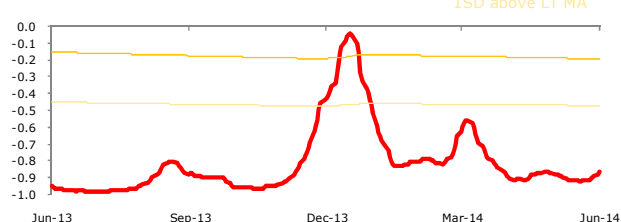
BY01E EPS & EPS Momentum



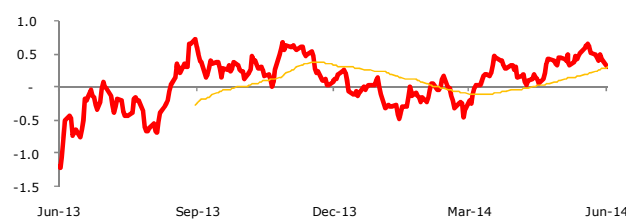
CDS Momentum



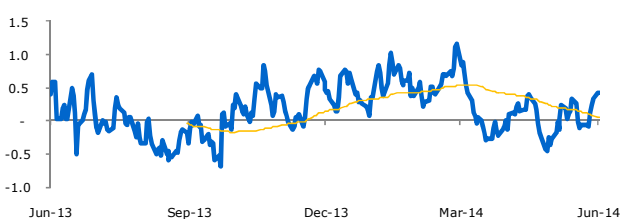
90D correlation



Equity Momentum



Implied upside/downside



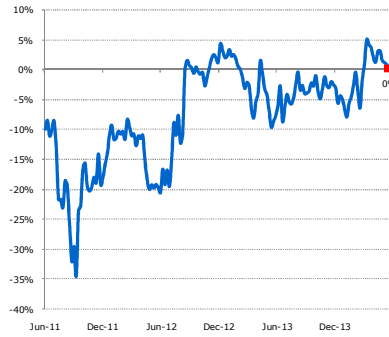
Source: CSC research, Bloomberg, Citi

Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield

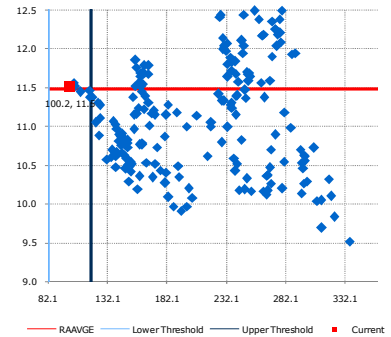
MSCI AX PE vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (%)



PE Range at current risk levels



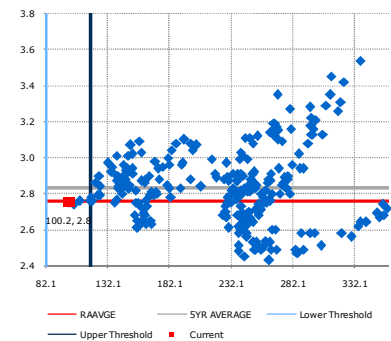
MSCI AX YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



YLD Range at current risk levels

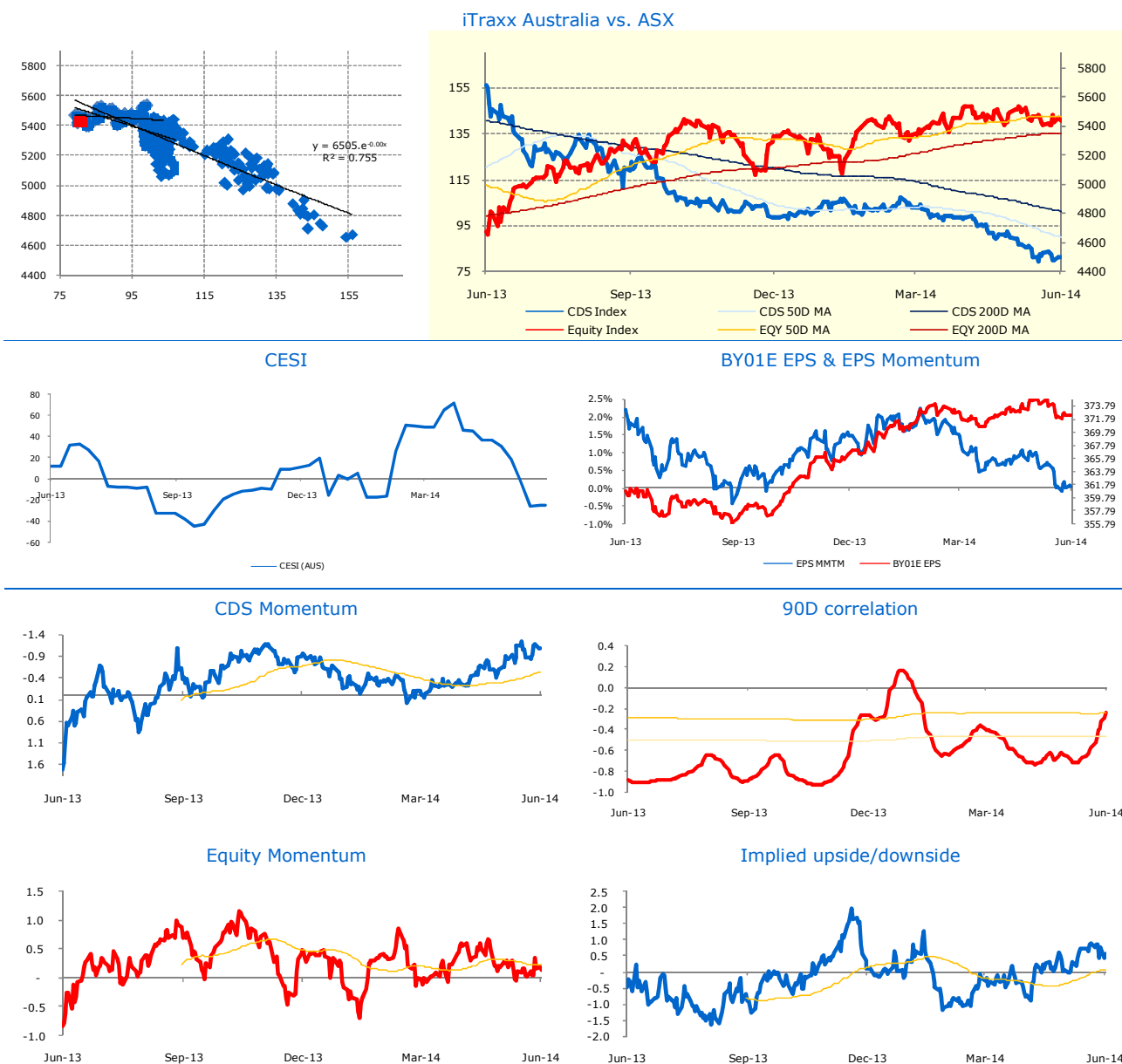


Source: CSC research, Bloomberg

CDS indices vs. Equity indices

iTraxx Australia: The iTraxx AUS was slightly tighter last week, supporting the ASX above 5400. Whether there is enough in the iTraxx and peripheral metrics to support a break above the 5400-5550 range the equity index has been in for a while is more questionable.

EPS momentum is back at neutral and the CESIAUD has slipped below zero to its lowest level since October 2013. We would not expect the ASX to rally meaningfully without this index turning positive again.



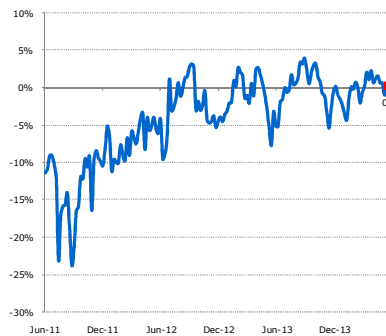
Source: CSC research, Bloomberg, Citi

Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield

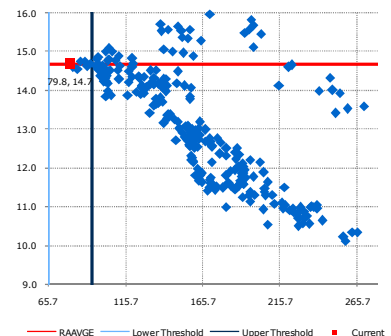
ASX PE vs. RAAVGE & 5YR AVGE



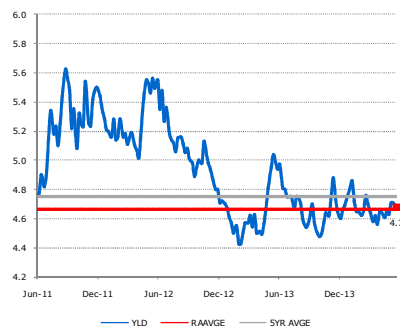
Premium/Discount to RAAVGE (%)



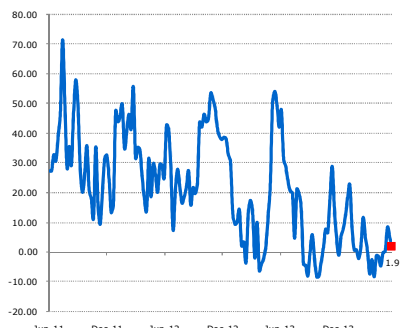
PE Range at current risk levels



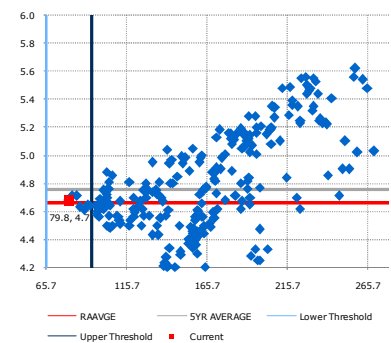
ASX YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



YLD Range at current risk levels



Source: CSC research, Bloomberg

CDS, Equity & EPS movers: Asia

Index and country CDS, Equity & EPS change (5D)

Index	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
iTraxx Japan	-3.42	2.45	0.45
iTraxx AsiaX	-7.48	-1.08	0.06
iTraxx Australia	-2.69	0.59	-0.06
CHINA SOV	-3.64	-1.59	0.12
INDONESIA SOV	1.04	-1.06	0.52
JAPAN SOV	-0.41	2.45	0.45
MALAYSIA SOV	-5.32	0.81	-0.18
PHILIPPINES SOV	-3.84	1.31	0.20
SOUTH KOREA SOV	-5.01	-0.36	0.03
THAILAND SOV	-4.13	-1.19	0.22

Index and Country CDS, Equity & EPS change (1M)

Index	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
iTraxx Japan	-19.25	7.46	1.13
iTraxx AsiaX	-13.27	-0.47	0.22
iTraxx Australia	-9.12	-1.09	-0.52
CHINA SOV	-7.90	-0.03	0.98
INDONESIA SOV	2.41	-2.32	2.36
JAPAN SOV	-9.30	7.46	1.13
MALAYSIA SOV	-11.59	1.10	-0.21
PHILIPPINES SOV	-6.88	-0.27	0.99
SOUTH KOREA SOV	-9.24	-1.13	-0.14
THAILAND SOV	-11.36	4.06	1.26

Sectors CDS, Equity & EPS change (5D)

Sector	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
Consumer Staples	-1.81%	1.17%	-1.59%
Consumer Discretionary	-1.81%	1.67%	-0.43%
Industrials	-1.08%	2.68%	0.24%
Utilities	-0.78%	1.81%	-1.47%
Materials	-0.52%	2.51%	-0.04%
Energy	0.57%	-0.62%	0.25%
Telecommunication Services	1.11%	0.51%	0.71%
Financials	1.25%	0.29%	0.06%
Information Technology	2.34%	2.20%	0.19%
Overall	-0.28%	1.57%	-0.12%

Sectors CDS, Equity & EPS change (1M)

Sector	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
Information Technology	-22.91%	8.57%	0.81%
Consumer Staples	-17.61%	3.56%	-1.01%
Materials	-14.43%	4.45%	-0.62%
Industrials	-14.24%	6.93%	1.44%
Utilities	-13.74%	1.97%	-235.63%
Consumer Discretionary	-13.63%	4.88%	-5.93%
Financials	-8.97%	1.61%	0.06%
Energy	-5.77%	1.26%	2.45%
Telecommunication Services	-4.82%	1.14%	4.81%
Overall	-12.78%	4.30%	-14.55%

Single name Tighteners (5D)

Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
MAZDA MOTOR	-16.82%	4.25%	0.06%
DAIWA SECS GRP	-13.14%	3.28%	-1.26%
CHUBU ELEC POWER	-13.05%	2.26%	0.95%
AEON CO LTD	-12.50%	2.21%	0.29%
TAKASHIMAYA CO	-11.80%	4.17%	0.30%
ASAHI GLASS CO	-11.43%	4.97%	0.59%
EBARA CORP	-11.07%	1.94%	0.42%
TABCORP HLDGS	-11.06%	-0.87%	0.09%
MARUI GROUP	-8.36%	6.16%	0.15%
KUBOTA CORP	-7.91%	3.20%	0.15%

Single name Tighteners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
EBARA CORP	-42.87%	1.94%	1.87%
KIRIN HOLDINGS C	-38.60%	5.71%	1.97%
SEIKO EPSON	-36.41%	32.65%	6.96%
AEON CO LTD	-36.35%	0.08%	-1.83%
BRIDGESTONE CORP	-34.58%	5.20%	0.05%
NEC CORP	-33.78%	10.03%	2.74%
NISSAN MOTOR CO	-29.79%	8.01%	2.52%
KAWASAKI HVY IND	-29.22%	7.30%	-1.19%
TOSHIBA CORP	-29.11%	20.31%	0.19%
mitsubishi heavy	-28.92%	12.32%	2.76%

Single name Wideners (5D)

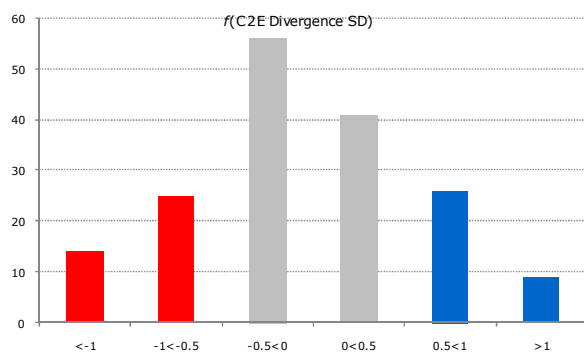
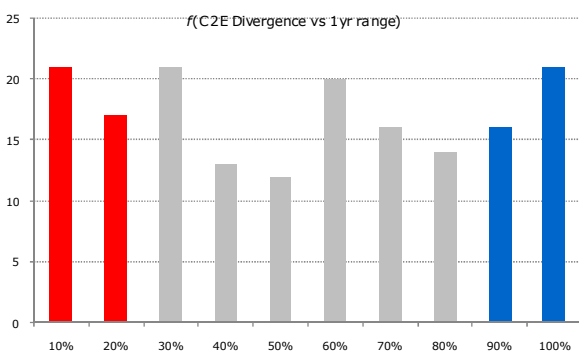
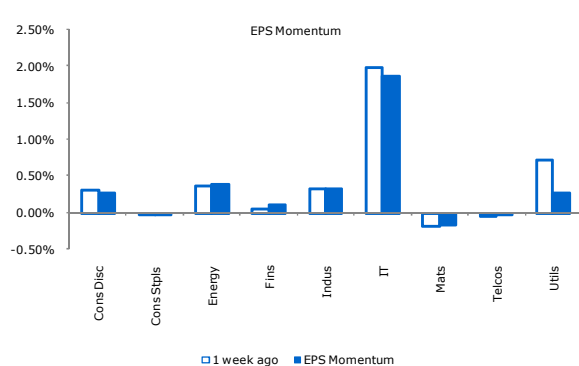
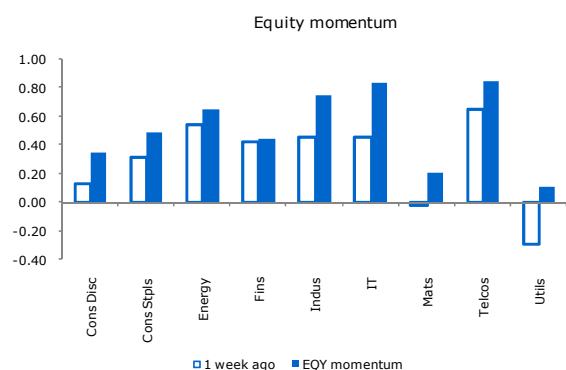
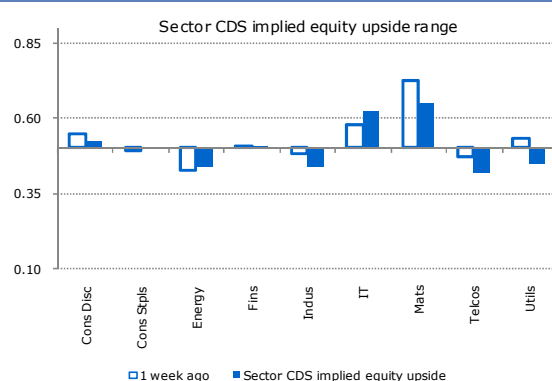
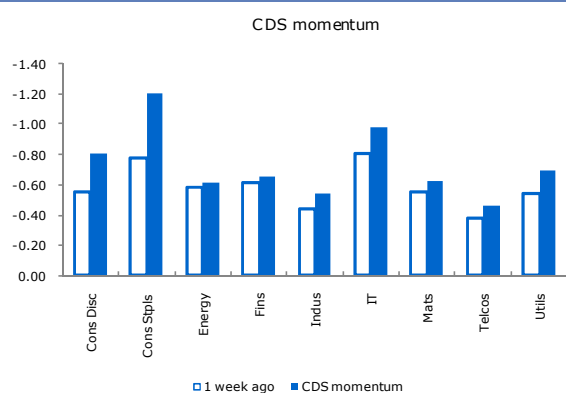
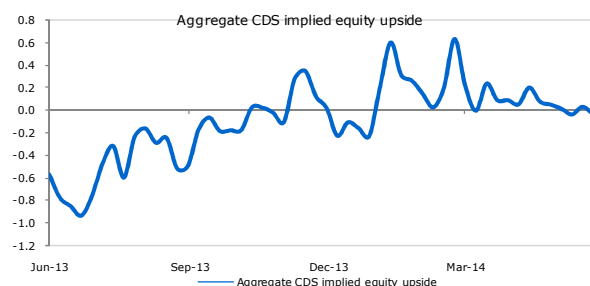
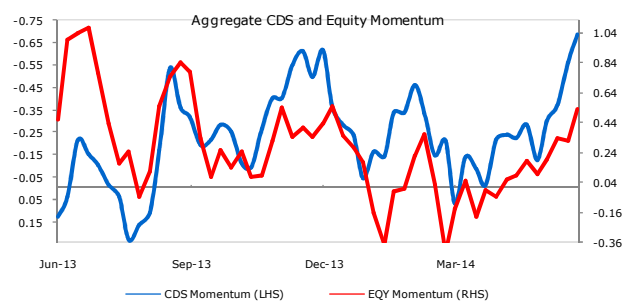
Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
CANON INC	9.62%	0.86%	0.06%
mitsubishi estat	8.70%	4.65%	0.05%
TOYOTA MOTOR	8.33%	2.73%	0.10%
TENAGA NASIONAL	8.18%	1.02%	0.40%
NOBLE GROUP LTD	7.56%	1.08%	0.26%
mitsui fudosan	7.41%	3.90%	0.10%
EAST JAPAN RAIL	6.85%	3.05%	-0.00%
mitsui osk lines	6.67%	0.79%	0.14%
TELEKOM MALAYSIA	6.48%	0.96%	0.12%
PTT PCL	5.76%	0.67%	-0.19%

Single name Wideners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
EAST JAPAN RAIL	10.64%	4.31%	1.20%
AGILE PROPERTY	3.99%	-10.72%	0.06%
WHARF HLDG	3.73%	-1.76%	0.91%
WESTFIELD GROUP	3.47%	-1.36%	0.40%
CNOOC LTD	1.23%	1.03%	0.34%
ICICI BANK LTD	1.10%	-3.19%	
KDDI CORP	1.01%	4.37%	3.08%
WAN HAI LINES	0.68%	4.04%	9.37%
SHIMAO PROPERTY	0.62%	-12.17%	-0.25%
BANK OF INDIA	0.43%	-17.44%	

Source: CSC research, Bloomberg

Credit to Equity analytics: Asia

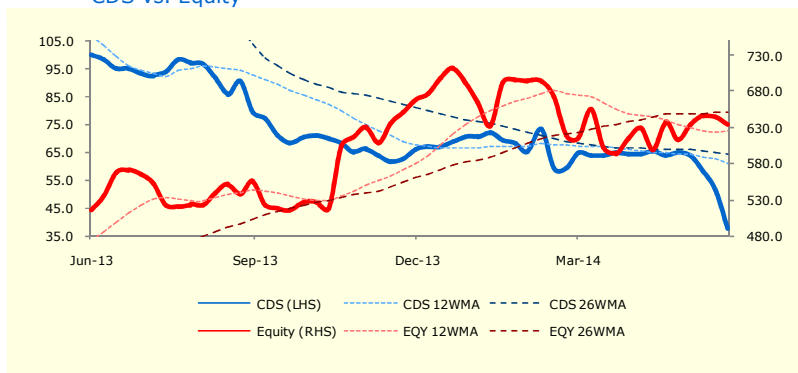
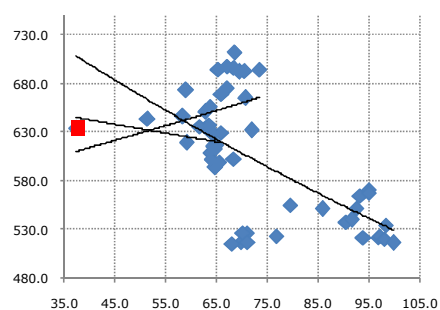


Source: CSC research, Bloomberg

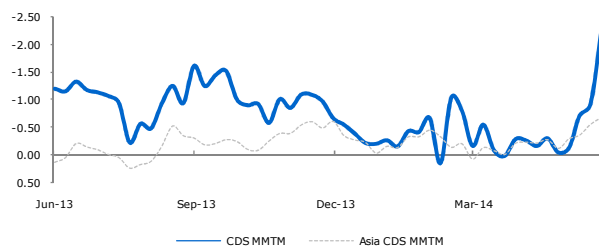
Credit to Equity Analytics

- Ebara (6361 JT) – BUY – JPY700:** We are adding Ebara to our Buy Recommended List with a JPY700 price target. The CDS has accelerated tighter, recently trading at new tights for the year, having moved from 60bps to 37bps so far in 2014. The equity is, however down 5.5% over the same time period, a near 4% underperformance of the Topix. This has pushed C2E divergence to new bullish highs, above the previous peak seen in October 2013, which came prior to a 40% rally from early November to mid-January highs.
- Our CDS implied equity upside model currently supports upside to JPY700, over 10% above current levels, and with the 200DMA acting as good support nearby, we see an attractive risk/reward profile.
- Ebara looks comfortably on track to deliver record OP in FY15, with shale gas project in the US ensuring the order book continues to grow. A weaker yen in H2 would, of course help, with JPY105 broadly consistent with JPY680-700 for the equity.

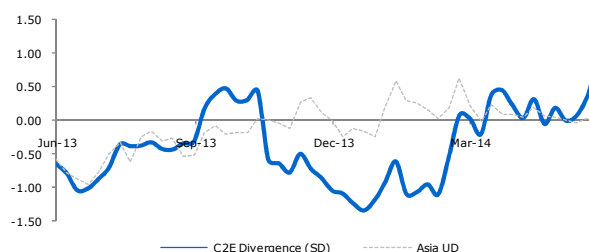
CDS vs. Equity



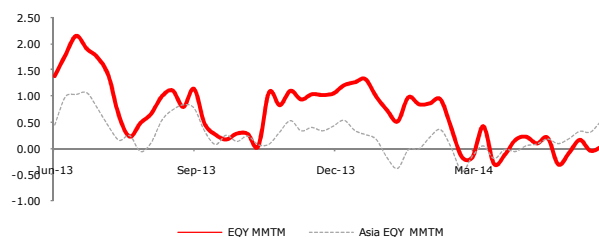
CDS Momentum



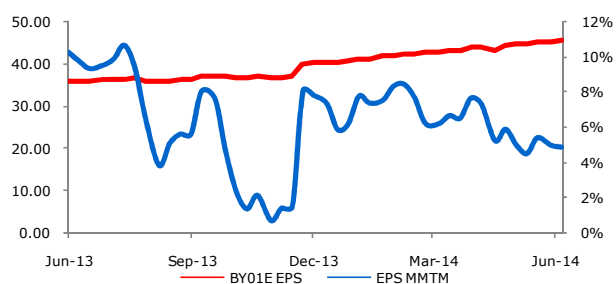
Implied upside/downside



Equity Momentum



BY01E EPS & Momentum



Source: CSC research, Bloomberg

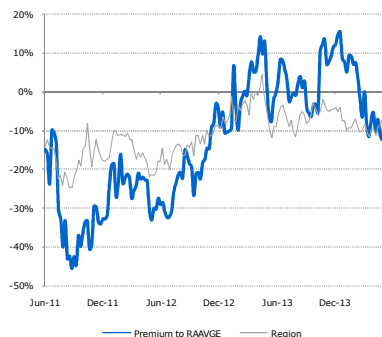
Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield

- **Ebara (6361 JT) – BUY – JPY700:** Valuations are attractive. The stock trades on a BY01E PE multiple of less than 14x, comfortably below the RAAVGE of 15.3x and close to its lowest level since early 2013. The near 10% discount to RAAVGE is also close to being the largest discount since the start of 2013, when the stock was below JPY400.
- The forward yield too, whilst low at just 1.3%, is over 20bps ahead of its RAAVGE close to the largest we have seen since late 2012.
- Our price target of JPY 700, which is based on our CDS implied equity upside model, would equate to a BY01E PE of 15.3x, in line with the RAAVGE.

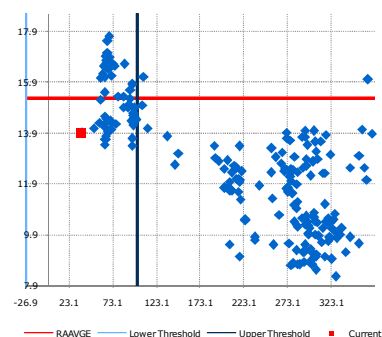
BY01E PE vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (%)



Range at current risk levels



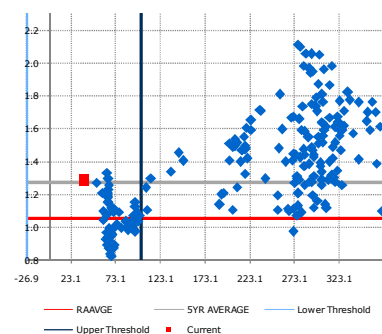
BY01E YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



Range at current risk levels



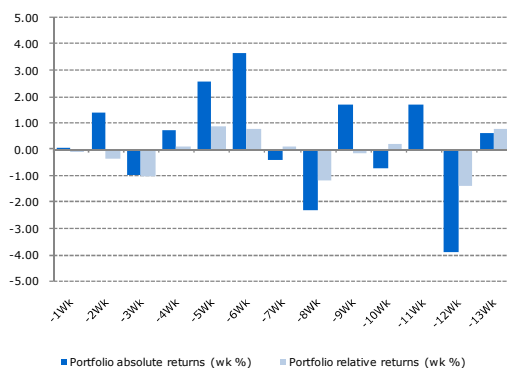
Source: CSC research, Bloomberg

Credit to Equity Research – Asian Portfolio

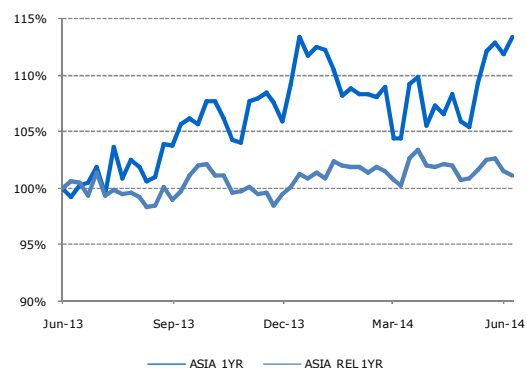
Portfolio

Company Name	Rating	Open	Close	Duration	Absolute	Relative	Price Target	Stop Loss
SONY CORP	Buy	18/06/14		6	3.9	2.3	1,900.0	1,600.0
SUMITOMO CHEM CO	Buy	11/06/14		13	2.4	-0.0	420.0	360.0
HITACHI LTD	Buy	03/06/14		21	0.3	-3.0	800.0	700.0
OJI HOLDINGS COR	Buy	28/05/14		27	-2.3	-8.2	485.0	408.0
TAISEI CORP	Buy	20/05/14		35	18.4	8.4	580.0	540.0
CROWN RESORTS LT	Buy	14/05/14		41	-6.7	-5.6	17.5	14.6
KAWASAKI KISEN	Buy	29/04/14		56	5.4	-3.9	330.0	280.0
DAIWA SECS GRP	Buy	17/04/14		68	7.6	-1.1	340.0	339.0
PANASONIC CORP	Buy	09/04/14		76	12.6	2.3	1,300.0	1,200.0
MAZDA MOTOR	Buy	26/03/14		90	13.4	4.1	500.0	480.0

Weekly Portfolio Returns (rolling quarter %)



1YR Portfolio Performance (abs/rel %)



Source: CSC Research, Bloomberg

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