

## TURKEY– Building materials

# QUA Granite

### Solid prospects

**Initiating with a Buy recommendation.** We are initiating QUA Granite, the biggest technical granite manufacturer of Turkey, with a Buy recommendation. We expect the company to more than triple its revenues and earnings by mid-2024, after increasing its capacity early next year. Beyond growth driven by new capacity, QUA is likely to enjoy better margins as the share of lower margin trading goods in its sales decline. After a good start to year, we are slightly more bullish than company's guidance in the beginning of the year. Based on a DCF valuation, we set our 12-month price target (PT) at TL34.90 which offers 34% potential upside. Currently, the shares are trading 9.4x our 2022E net earnings estimate.

**Capacity to more than triple.** Utilising a distinctly efficient manufacturing process, QUA produces high quality technical granite which is used in building tiling including facades. Its focus and scale delivers highly competitive unit costs on a high value-added product, allowing a gross margin of around 40%. Additionally, its facilities are located in close proximity to its raw materials. Having reached near full utilisation in 2020, management decided to invest in capacity which will become operational in September 2021 and early 2022. A sizable portion of new capacity is earmarked for export markets which QUA can easily tap by its railway connection to Izmir port. The company employs 550 personnel, and generated TL703mn in revenues in 2020.

**3-4% market share in domestic market.** Listed among the top 10 globally for capacity, Turkish ceramic tile market is highly vibrant with an average 255mn sqm annual usage. QUA has 3-4% volume market share in a fragmented market, and appeals to the upper segments. The industry is typically quite cyclical given that it is driven by construction activity, and export markets provide a balancing outlet for producers. In 2020, Turkey produced 383m sqm of ceramic tiles with a implied 70% utilisation rate, and exported 33% of its production, mostly to developed markets..

**More than half of revenues in hard currency.** By the same token, QUA exports around a third of its production, and more than half of its sales are denominated in hard currencies. Given that its expenses are mostly in Turkish Lira, it is well protected against currency depreciation. Typically, QUA has sold to the European market, but plans to enter the US after the completion of new capacity. The 10 fold increase in taxes on Chinese products by the US government provides a good opportunity for many Turkish players, and has propelled the US to number one export market.

**Beneficiary of economic recovery, positive earnings momentum.** Since its listing on 9 April, QUA Granite shares are up by 44% outperforming BIST 100 by the same amount. The shares were offered at a 20% discount to its pre-money fair value, and we see upside on the basis on good Q1 results and recovery in developed markets. On LTM figures, domestic peers USAK and EGSER are currently trading at 68x and 7x P/E, respectively vs. 16x for QUA. Post capacity increase, we see QUA's 2023E P/E shrinking to <7x.

QUAGR	2018	2019	2020	2021E	2022E	2023E
Net Income (TL mn)	20	14	145	196	335	462
Revenue (TL mn)	331	404	703	992	1,549	1,937
EBITDA (TL mn)	98	71	224	302	496	649
Net Debt/EBITDA (x)	1.32	2.26	0.82	1.12	0.77	0.12

Source: Company data, INFO RESEARCH estimates

## BUY

Price: TL26.14

Price Target: TL34.90

### Company Data

Stock Ticker	QUAGR
Stock Rating	BUY
Price Target	34.90
Up/downside to PT	34%
Share Price	26.14
8-week range (TL)	23.66 -26.1
No.of shares (mn)	120
Free Float	20%
MCAP (TL mn)	3,137
MCAP (USD mn)	359
Net Debt (TL mn)	254
3M ADV (USD mn)	17
3M ADV/FF MCAP (%)	24.2%

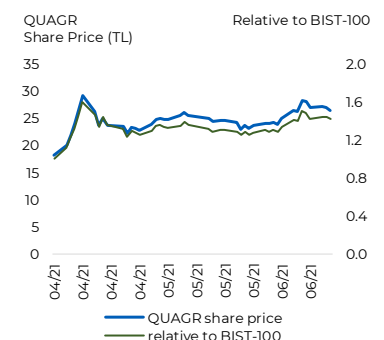
\* Net debt based on pre-IPO

### Valuation

	2020	21E	22E	23E
P/E (x)	21.7	16.0	9.4	6.8
EV/EBITDA (x)	13.7	10.2	6.2	4.7
EV/Sales (x)	9.2	4.0	2.8	2.0
Div. yield (%)	0%	0%	0%	0%

Source: INFO RESEARCH estimates

### Price Performance



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**For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.**

## Exhibit 1. Financial Summary

## Income Statement

(TL mn)	2020	2021E	2022E	2023E
Net Sales	703	992	1,549	1,937
Cost of Sales	-440	-610	-945	-1,162
Gross profit (loss)	262	382	604	775
Operating Expenses	-57	-99	-152	-193
Core EBIT	206	282	452	582
Inc.& Exp. from Other Operations	8	12	19	23
Reported EBIT	214	294	471	605
Financial Income/Expenses	-38	-87	-119	-118
Other income	0	0	0	0
PBT from continuing operations	177	207	352	487
Tax on Continuing Operations	-32	-10	-18	-24
Profit from continuing operations	144	196	335	462
Net Profit	145	196	335	462
EBITDA	224	302	496	649

## Balance Sheet

(TL mn)	2020	2021E	2022E	2023E
Cash and Marketable Securities	21	7	61	198
ST Trade and Related Receivables	255	272	509	637
Inventories	121	184	362	446
Other Short-Term Assets	35	50	77	97
Fixed Assets	224	726	758	729
Intangible Assets	1	3	3	3
LT Receivables	6	8	13	16
Other Long-Term Assets	45	63	98	123
TOTAL ASSETS	707	1,313	1,882	2,249
ST Financial Payables	141	101	101	101
ST Trade and Other Payables	153	181	311	382
Other Short-Term Liabilities	5	7	11	13
LT Financial Payables	64	244	344	173
LT Trade and Other Payables	2	2	2	2
Other Long-Term Liabilities	2	3	5	7
Equity	340	775	1,109	1,571
Minority Interest	0	0	0	0
TOTAL LIABILITIES AND S.HOLDERS' EQUITY	707	1,313	1,882	2,249

## Cash Flow Statement

(TL mn)	2020	2021E	2022E	2023E
Earnings before Adjustments	144	196	335	462
Depreciation and Amortization	19	20	43	67
Other Adjustments	66	-1	-3	-2
Changes in Working Capital	-201	-64	-311	-156
Cash Flow from Operating Activities	28	151	64	371
Investing Cash Flow	-17	-543	-110	-63
Capital Expenditures (CapEx)	-17	-525	-75	-39
Cash from Other Investment Operations	0	-18	-35	-25
Financing Cash Flow	10	379	100	-171
Changes in Financial Debt	36	140	100	-171
Net Cash from Capital Increase/(Decrease)	0	239	0	0
Dividends Paid	0	0	0	0
Cash from Other Financing Operations	-27	0	0	0

## Financial Analysis

	2020	2021E	2022E	2023E
<b>Growth (%)</b>				
Sales	74.0	41.1	56.2	25.1
EBIT	283.1	37.2	60.3	28.5
EBITDA	216.0	34.7	63.9	31.0
Net Profit	956.1	35.9	70.4	38.1
<b>Margins (%)</b>				
Gross Margin	37.3	38.5	39.0	40.0
EBITDA Margin	31.9	30.5	32.0	33.5
EBIT Margin	29.3	28.5	29.2	30.0
Net Margin	20.6	19.8	21.6	23.9
<b>Efficiency</b>				
Receivables Days	73	100	120	120
Inventory Days	93	110	140	140
Payables Days	108	108	120	120
Opex/Net Sales (%)	8.1	10.0	9.8	10.0
<b>Profitability (%)</b>				
ROA	20.4	15.0	17.8	20.5
ROE	42.6	25.4	30.2	29.4
ROCE	50.5	27.6	31.0	33.2
<b>Leverage (x)</b>				
Asset/Equity	2.08	1.69	1.70	1.43
Net Debt/Equity	0.54	0.44	0.35	0.05
Net Debt/EBITDA	0.82	1.12	0.77	0.12

## Key Operating Indicators

	2020	2021E	2022E	2023E
Installed capacity (ths m2)	11,000	22,000	33,500	33,500
Utilisation	97%	60%	58%	65%
Production (ths m2)	10,621	13,200	19,430	21,775
Sales from production	10,849	13,200	19,430	21,775
Domestic sales	7,113	8,316	11,269	13,065
Export sales	3,736	4,884	8,161	8,710
Sales (TL mn)	703	992	1,549	1,937
Domestic	335	427	619	819
Exports	372	570	939	1,131
Discounts	-5	-6	-9	-12

## Key macro assumptions

	2020	2021E	2022E	2023E
GDP growth, real	1.8%	6.0%	3.0%	3.0%
CPI	14.6%	13.4%	11.0%	10.0%
EURTL, ave	8.04	9.90	11.37	12.79
EURTL, eop	9.12	10.67	12.06	13.51

## Valuation

We value QUA Granite with a DCF valuation utilising our free cash flows to firm (FCFF) estimates. The key valuation assumptions are as follows:

- 1) A blended risk-free rate of 15.5% which we base on Turkish 10 year bonds and developed market government bonds as more than half revenues are generated in the latter markets,
- 2) Equity risk premium of 7%, a higher rate compared to 5.5-6.0% we use to compensate for market volatility and perceived risks,
- 3) Stock beta of 1.0 based on the trading history starting from the IPO date, April 2021,
- 4) Terminal growth rate of 13.6% which is broadly in line with our nominal GDP growth assumption in the terminal year,
- 5) Maintenance capex of 2% of sales, and working capital at 25-30% of sales. The new capacity is estimated to cost TL 600m.
- 6) 5% tax rate in the initial years as the company will be utilising government incentives,
- 7) We expand the fair equity value by cost of equity to reach at our 12m PT.

### Exhibit 2. QUAGR DCF Valuation

TL mn	2020A	2021E	2022E	2023E	2024E	2025E	2026E
Revenues	703	992	1,549	1,937	2,299	2,604	2,984
<i>Growth rate</i>	74%	41%	56%	25%	19%	13%	15%
EBITDA	224	302	496	649	770	872	1,000
<i>EBITDA margin</i>	31.9%	30.5%	32.0%	33.5%	33.5%	33.5%	33.5%
EBIT	206	282	452	582	703	807	936
+ Depreciation & amortisation	19	20	43	67	68	65	64
- Capex	-17	-525	-75	-39	-46	-52	-60
<i>Capex/Revenues</i>	-2%	-53%	-5%	-2%	-2%	-2%	-2%
- Change in working capital	-201	-64	-311	-156	-146	-124	-154
- Taxes	-45	-14	-23	-29	-35	-186	-215
Free cash flow to firm (FCFF)	-39	-301	87	425	543	511	571
Discount factor		0.90	0.74	0.61	0.50	0.41	0.34
Discounted cash flow for projected period	722	-271	65	258	270	209	192
Discounted cash flow for perpetuity	2,645						
Enterprise value	3,367						
- Adjusted 2020A net debt	-54						
- Minority interest	0						
+ Participations	0						
Equity value	3,421						
Implied fair value (TL)	28.50						
COE	23%						
<b>12m Price Target (PT)</b>	<b>34.90</b>						
Potential upside	34%						
<b>WACC</b>							
Risk free rate	15.5%						
Beta	1.00						
Equity risk premium	7.0%						
Cost of equity	22.5%						
Cost of debt, after tax	18.0%						
Capitalisation rate	15.0%						
Weighted average cost of capital	21.8%						
Terminal growth rate	13.6%						

Source: Company data, INFO RESEARCH estimates

**Exhibit 3. QUA Granite Relative Valuation**

Company Name	Country	MCAP (USD mn)	P/E		EV/EBITDA		EV/SALES		Dividend Yield	
			2021E	2022E	2021E	2022E	2021E	2022E	2021E	2022E
Asian Granito India Ltd	India	76.9	8.3	6.3	5.6	4.6	0.6	0.5	0.3%	0.5%
Dynasty Ceramic Pcl	Thailand	890.2	16.1	15.7	10.6	10.2	3.3	3.2	5.9%	3.2%
Arwana Citramulia Tbk	Indonesia	92.2	13.2	10.8	1.3	1.1	0.3	0.3	3.9%	0.3%
Al Anwar Ceramic	Oman	263.2	20.9	23.0	10.8	12.0	3.3	3.5	3.3%	3.5%
Saudi Ceramic Co.	Saudi Arabia	1,252.3	22.7	17.3	16.3	14.2	3.3	3.0	0.8%	3.0%
Panariagroup Industrie Ceram Italy		107.7	-99.8	20.0	5.9	5.6	0.6	0.6	0.0%	0.6%
		Median	16.1	17.3	10.6	10.2	3.3	3.0	3.3%	3.0%

**Turkish peers**

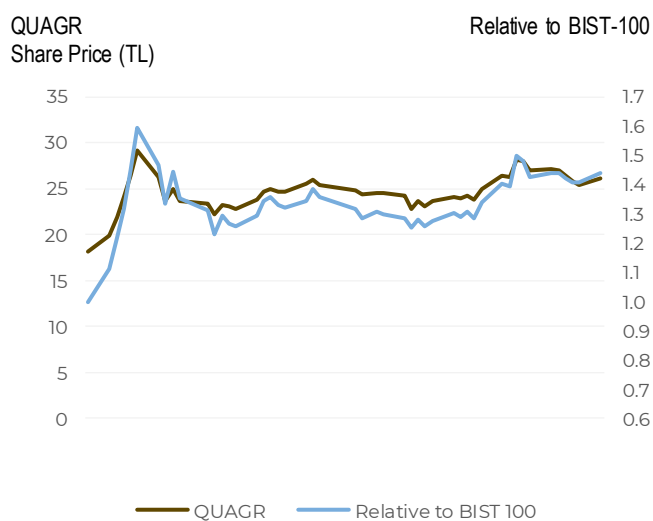
Usak Seramik*	Turkey	57.1	66.5	N.A	8.9	N.A	1.4	N.A	N.A	N.A
Ege Seramik*	Turkey	99.4	6.8	N.A	4.8	N.A	1.1	N.A	7.7%	N.A
Qua Granit Hayal Yapi	Turkey	358.5	16.0	9.4	10.2	6.2	3.1	2.0	0.0%	0.0%
		Median	16.0	N.M	8.9	N.M	1.4	N.M	3.8%	N.M

Source: FactSet estimates via EquityRT, INFO RESEARCH estimates for QUA Granite. Usak and Ege Seramik based on last twelve months

**Exhibit 4. Share price performance**

	Relative Return in Local Currency			
	YTD	1M	3M	12M
Asian Granito India Ltd	-36.3	1.8	9.7	5.9
Dynasty Ceramic Pcl	42.4	4.1	24.4	65.8
Arwana Citramulia Tbk	6.6	0.0	-2.7	89.8
Al Anwar Ceramic	53.5	7.3	26.2	185.0
Saudi Ceramic Co.	62.1	3.9	42.1	124.7
Panariagroup Industrie Ceramic	119.2	7.8	43.1	100.9
Usak Seramik	-12.8	-28.4	-16.4	36.0
Ege Seramik	21.5	-17.1	-6.4	150.2

Source: EquityRT

**Exhibit 5. Share price performance**


Source: EquityRT, INFO RESEARCH estimates

## Risks

The ceramic tile manufacturing demand is mainly driven by construction activity which tends to be highly cyclical — it can move grow or shrink by a multiple of the real GDP growth. That said, the construction activity has been weak in the past few years even when the rest of the economy grows, on what seems to be rebalancing after years of vibrant growth. On that basis, one could argue that some of the downside risks are addressed.

The company procures most of its raw materials locally, but c. 20% of its COGS is driven by natural gas and electricity prices. The government-set price changes are hard to predict and may result in margin erosion, especially if combined with a weak demand environment. However, those changes tend to be temporary as producers can usually pass the cost to customers.

QUA exports nearly half of its production mostly to developed countries. The company is currently ramping up its capacity to start exporting to the US. Any change in tax regime or political risks are a potential overhang on exports. That said, the company is exporting to more than 60 countries which somewhat reduces those concerns.

An important part of valuation and recommendation is based on the assumption that capacity will be completed on time. Potential delays in construction or significant cost outruns would have implication for our recommendation. Then again, QUA was able to finish its previous capacity investments on time, according to management.

## Industry Overview

**One of the largest globally.** Turkey enjoys a formidable place in world ceramic tile production helped by abundant natural resources. It ranks in top 3 in Europe and top 10 globally based on its 340m sqm average annual production and 550m sqm of installed capacity. In 2020, Turkey manufactured 383m sqm of ceramic tile products with an implied 70% capacity utilisation.

**Large domestic market with many players.** In 2020, total domestic sales was 255m sqm, up by 36% despite the pandemic, after Turkish economy shrank in 2019. By nature, the industry is highly cyclical in line with the rest of construction activity with annual demand in the 250-260m sqm range.

Industry associations do not disclose market share information because of competition reasons. However, we believe there are several small to mid-size players—one 2013 article puts the number of players in 20s. However, technical granite is produced by a limited number of players as it is targeted at the upper segments of the market. According to management, QUA is the largest manufacturer by a wide margin—the closest competitor has an installed capacity of 3.5m sqm vs 11m sqm for the company. QUA has a market share in low single digits in the overall market.

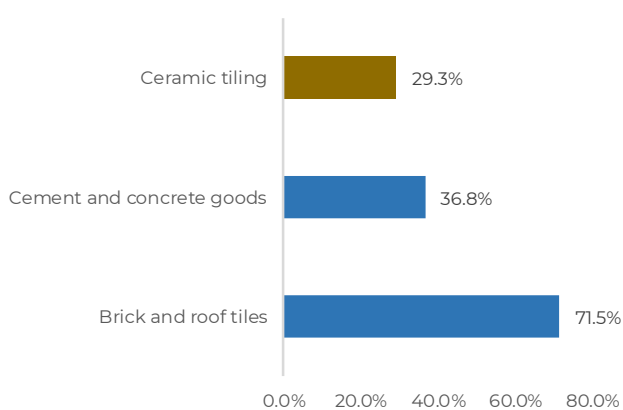
**Exports growing steadily.** Globally, Turkey ranks as the 6th biggest ceramic tile exporter after the likes of China, Italy and Spain. In 2020, Turkey exported 128m sqm of ceramic tiles, generating USD 777m in revenues, according to Ceramic Tile Manufacturers' Association (SERKAP). In general, the exports are on the rise, and have grown by a CAGR of 10% since 2015, perhaps also driven by weak domestic construction activity. Turkey exports to 100+ destinations, but the majority of its products end in the developed markets.

**US market presenting an opportunity as share of China declines.** Of late, the US market became the number one export destination for Turkish ceramic tiles as taxes on China increased by nearly 10 fold since 2017. In 2020, the share of the US market in exports were 17% followed by Germany (15%), the UK (10%) and Israel (10%).

**2021 had a good start with 35% yoy growth in export revenues.** According to SERKAP, Turkey exported 48m sqm of ceramic tiles in the first four months of 2021, implying a 31% yoy growth. In terms of revenues, the exports grew by 35% reaching USD 297m.

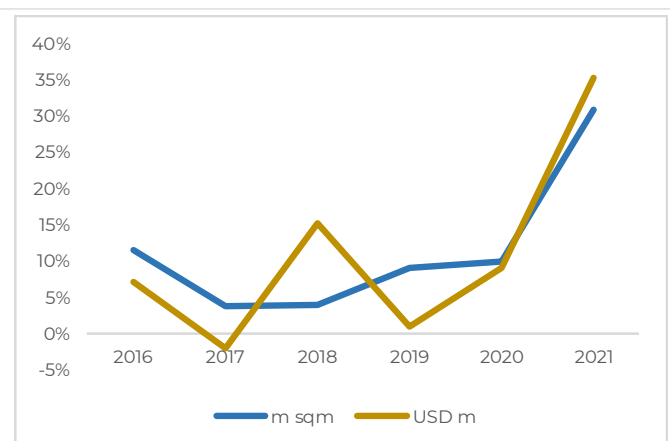
Meanwhile, domestic market for construction materials also had a good start. According to Association of Construction Materials IMSAD, the construction materials production increased by 17% yoy in the first quarter of 2021 posting a broad based recovery. 21 out of 22 sub-segments posted yoy growth, most in double-digits, driven by steady demand and export markets.

**Exhibit 6.** Turkey 1Q2021 production growth (yoy)



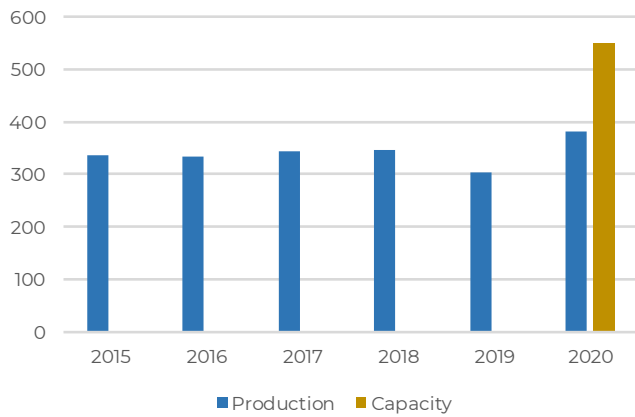
Source: IMSAD,

**Exhibit 7.** Ceramic tile export growth (Jan-Apr yoy)



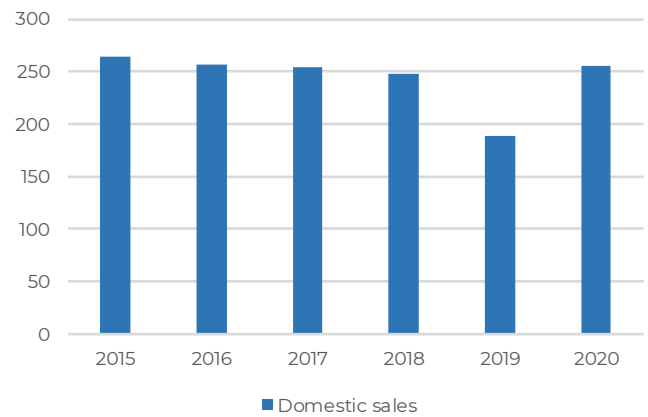
Source: Ceramic Tile Manufacturers Association

**Exhibit 8. Turkish ceramic tile manufacturing (m sqm)**



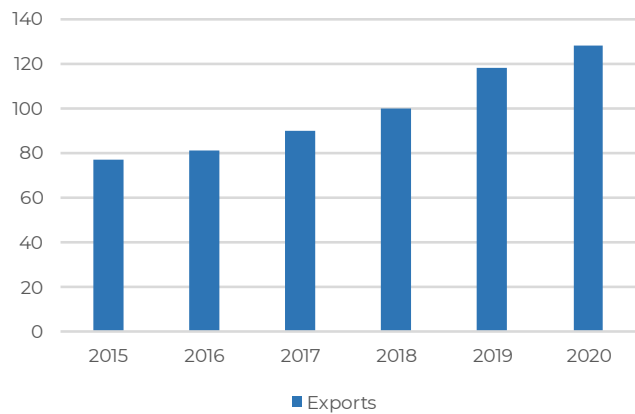
Source: Company presentation

**Exhibit 9. Domestic ceramic tile sales (m sqm)**



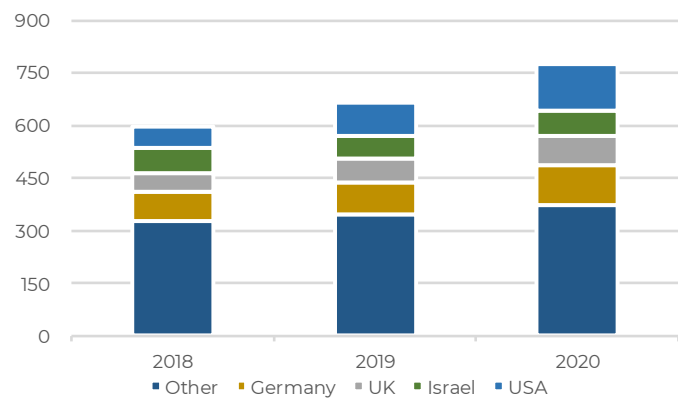
Source: Company presentation

**Exhibit 10. Turkish ceramic tile exports (m sqm)**



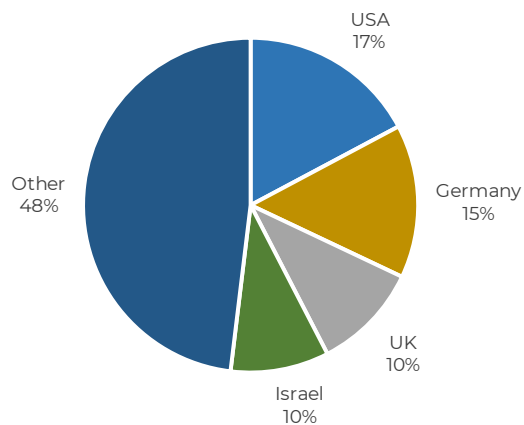
Source: Company presentation

**Exhibit 11. Turkish ceramic tile exports by destination (USD m)**



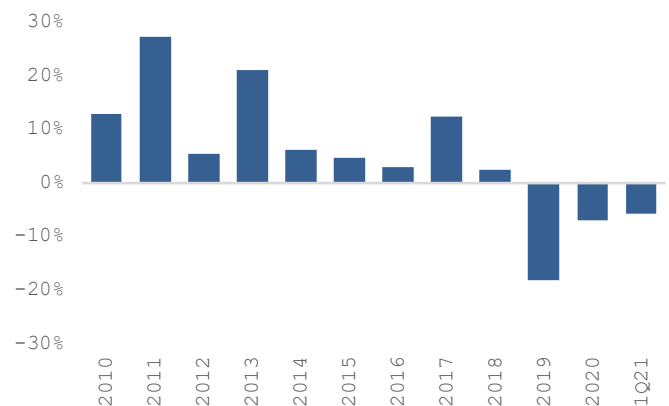
Source: Company presentation

**Exhibit 12. 2020A top 5 export destinations (USD m)**



Source: Company

**Exhibit 13. Gross capital formation (construction, yoy)**



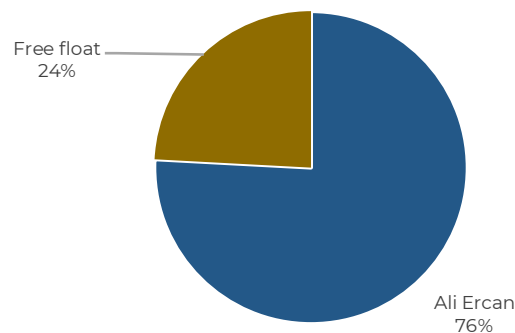
Source: TUIK

## QUA Granite Overview

QUA Granite was established in less than 10 years ago, in 2015, starting production in 2016 in Aydin Soke in western Turkey. With its 11m sqm installed capacity, it is currently the largest Turkish technical granite manufacturer with 29 distribution points nationally. QUA generates more than half of its revenues from international sales, exporting to more than 60+ countries globally. Located near its main raw material quarries and connected with railway to Izmir sea port and airport, the company employs 550 people.

While the company itself may be young, its market know-how rests on Bien Seramik, a ceramic tile manufacturer established by QUA-founder Ali Ercan's family in 2007. Having grown rapidly in both domestic and export markets, QUA went public in early April 2021 mainly to fund new capacity investments.

### Exhibit 14: QUA Granite shareholders



Source: Company financials

**Focus and scale drives cost competitiveness.** Utilising an advanced and highly efficient manufacturing process, QUA produces high quality technical granite which is used in building tiling, including facades. As part of the production process, the company mainly brings together domestically available clay and feldspar to form various designs, presses them into desired size and shape, and bakes to produce high specification tiling. Focusing only in technical granite production, QUA prides itself in its efficiency and scale which helps it to achieve low unit costs despite producing a high quality and value-added product.

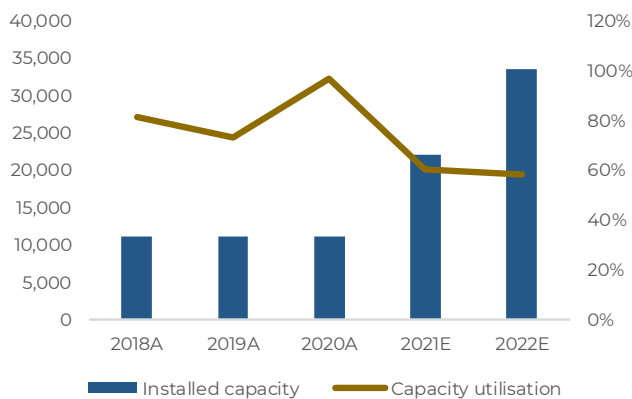
**Capacity to more than triple.** Operating at near full capacity by end of 2020, management has decided to more than triple the capacity to 33.5m sqm by early 2022. The first new capacity is expected to become online in September 2021. QUA will be spending TL600mn in capex, of which some will be funded via the IPO proceeds.

**Margin expansion likely on better product mix.** Given the competitive unit costs, QUA enjoys 40%+ gross margins on granite tile sales. The company also sells outsourced tiles (including granite, as demand has been strong) and other accessories which command lower margins—these constituted close to 30% of unit sales in 2020. As new capacity comes in, the company will be replacing outsourced granite sales with own production, helping to boost margins. That said, QUA will always maintain a level of trading activity on ceramic tiles and accessories as part of its marketing strategy.



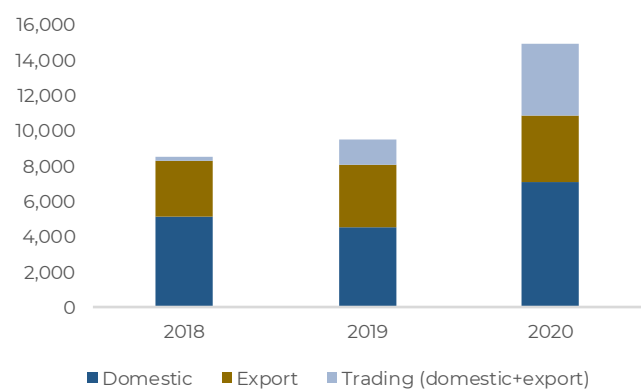
**Europe main export market, US will become feasible after new capacity.** In 2020, export markets accounted for more than half of QUA's sales. The company exports to more than 60+ countries, thanks to its wide product range according to management. Europe has been the main destination for QUA's products so far, but management is adamant that it will be growing strongly in the US market after its capacity expansion. Given that the US market is very big, the company believes a large production capacity is required to successfully meet market demand there. But more important is the 10 fold tax increase on Chinese goods entering the US since 2017, which has propelled this market to the top export destination in 2020.

**Exhibit 15: QUA installed capacity to triple**



Source: Company

**Exhibit 16: Sales breakdown (m sqm)**

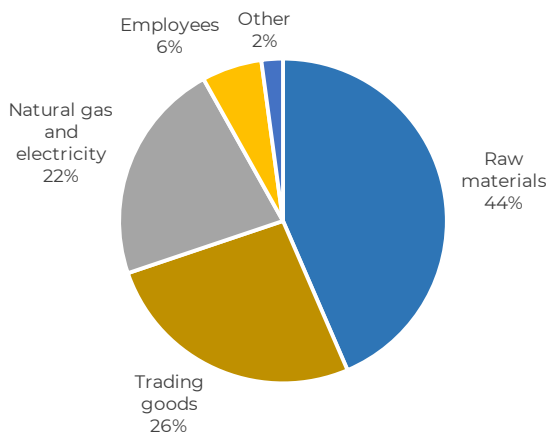


Source: Company

**Room for market share growth in domestic market.** Beyond new export markets, QUA expects to channel new capacity to the domestic market. According to ceramic tile manufacturers association SERKAP, Turkish market is sizable with 255m sqm of tiles sold in 2020. As QUA's market share is in low single digits, management believes it can comfortably increase sales which we find credible, especially with a potential pick up in economic activity driven by house renovations. Despite the pandemic, construction/renovation activity has been relatively buoyant in the upper segments.

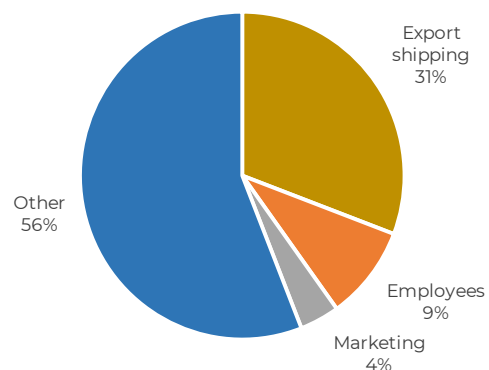
**Favourable FX position on operations.** As an exporter, QUA generates 50%+ of its revenues in hard currencies with strong exposure to the Euro region. On the other hand, nearly a quarter of COGS are in foreign currencies which include dyes and chemicals imported from Italy, Spain, China and Ukraine. Including the natural gas and electricity expenses which are denominated in TL but linked to USD, we can say that nearly half of COGS are hard currency linked. Given the nearly 40% gross margin, exports more than cover the FX costs proving a positive FX position against TL depreciation. Beyond operating costs, capital expenses relating to new capacity investments are FX based which has been partially hedged by management.

**Exhibit 17. 2020A Breakdown of COGS**



Source: Company financial, INFO Research estimates. \*Excluding depreciation

**Exhibit 18. 2020A Breakdown of opex**



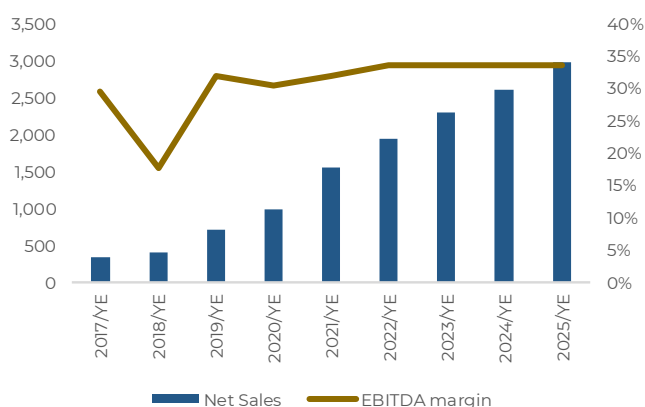
Source: Company financial, INFO Research estimates. \*Excluding depreciation

**Working capital needs may be sizable.** For QUA, maintenance capex may be insignificant in a normal year at 2-3% of sales. Working capital needs, on the other hand, can be a big outflow. In 2020, it amounted to 14% of sales according to our calculations. In fact, management earmarked a part of IPO proceeds for working capital funding needs. In the long term, we expect working capital needs continue to be a big component of sales growth needs.

**Better product mix may drive margin expansion.** As outsourced granite product sales are replaced by own production, QUA should normally see improvement in its operating margins. However, a potential increase in natural gas and electricity prices may negatively impact margins, especially if it coincides with poor demand conditions as in 2019. In normal times, QUA is usually able to pass cost increases to its customers.

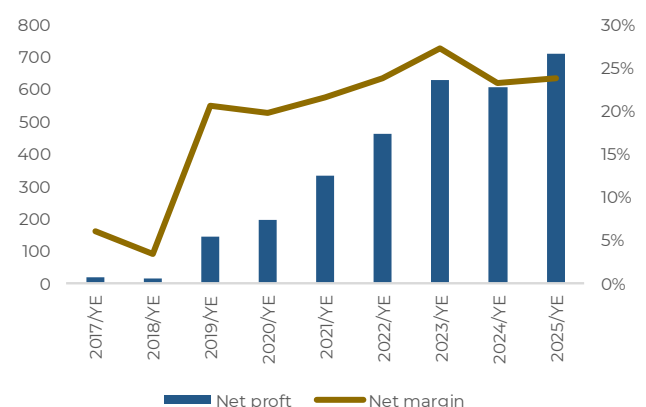
**Otherwise, a good overall outlook.** QUA is well-positioned for economic recovery both at home and abroad. Additionally, it is poised to benefit from opening of new export markets with its capacity addition. Encouraged also by strong 1Q21 results which saw QUA grow revenues by 64%, we expect the company to record strong sales and earnings growth in the coming years. Based on our model, we see the revenues more than double over two years and nearly triple by 2023-end. Despite a heavy capex schedule in 2021, we also expect its financial position to remain sound with Net debt/EBITDA hovering around 1x at the peak of investments.

**Exhibit 19. Sales and EBITDA margin**



Source: Company financial, INFO Research estimates.

**Exhibit 20. Net profit and net margin**



Source: Company financial, INFO Research estimates.

# DISCLAIMER & DISCLOSURES

## Analyst Certification

I, Oytun Altaşlı Widmer, hereby certify that the views expressed in this research report accurately reflect the personal views of the INFO Research team, regarding the securities and issuers referred to therein and that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

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## Rating Methodology:

We employ Discounted Cash Flow (DCF) model and peer multiple analysis to derive at our target prices. Our recommendation methodology is as follows:

**Buy:** If Target Price is 5 percentage points higher than the estimated Cost of Equity

**Hold:** If Target Price is within -5 and 5 percentage points of the estimated Cost of Equity

**Sell:** If Target Price is lower than 5 percentage points of the estimated Cost of Equity

Please note that the analyst's short-term view may occasionally diverge from the stock's longer-term fundamental rating.

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