



ALIGN
RESEARCH

Blue Star Capital

7th November 2019

Technology investor trading at a deep discount to NAV and poised to exploit growth in the burgeoning e-sports industry

Blue Star Capital is an investment company with a focus on new technologies, particularly in the areas of blockchain, media and gaming. The focus is on businesses that have the capacity for substantial growth and increase in value over the medium to long-term.

■ Expansion into e-sports diversifies the portfolio and provides significant growth opportunities

On 14th October 2019 Blue Star announced it had entered into an agreement to make investments of c.£150,000 each in six early stage e-sport companies operating across six different geographic markets. **E-sports, which sees players compete against each other on popular video games, is a rapidly growing industry, forecast to rise in value from \$1.1 billion in 2019 to \$1.79 billion by 2022.**

■ Placings completed to finance investments, with warrant issues providing the potential for further funding

Two placings of £0.45 million each have been completed to fund the e-sports investments. In addition, warrants to a total value of £1.37 million, at prices ranging from 0.1p to 0.25p per share, are being issued to incentivise directors and provide access to further funding.

■ SatoshiPay and Sthaler other stand out investments

Micropayments platform business SatoshiPay is Blue Star's main investment, currently valued at £4.6 million. The company is focusing on expanding its online payment service which allows digital content and service providers to monetise their products. Biometrics payments provider Sthaler meanwhile is advancing commercialisation of its Fingopay product.

■ Valuation suggests 35% upside, with the opportunity for further value creation in the medium to long-term

Taking into account recent events we estimate a NAV per share of 0.194p. With Blue Star shares currently trading at 0.115p they are therefore priced at a discount of 41%, which represents upside of 69% should they trade at parity to our estimated NAV. However, to add a degree of conservatism, we apply a 20% discount to our NAV estimate to set our target price of 0.155p per share, implying upside of 35% from current levels. **Conviction Buy.**

This investment may not be suitable for your personal circumstances. If you are in any doubt as to its suitability you should seek professional advice. This note does not constitute advice and your capital is at risk. This is a marketing communication and cannot be considered independent research.

CONVICTION BUY
Price target - 0.155p



Key data

EPIC	BLU
Share price	0.115p
52 week high/low	0.25p/0.075p
Listing	AIM
Shares in issue	3,142,582,852
Market Cap	£3.61m
Sector	Investment

12 month share price chart



Analyst details

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Corporate Background

Investment company **Blue Star Capital (BLU)** listed on AIM in October 2004 with the goal of providing initial seed capital for the development of early stage companies. The company has focused on a number of sectors during its time on the market but following a strategic review in October 2013, led by CEO Tony Fabrizi (appointed in July 2012), it narrowed its focus to seek potential investment opportunities in the media, technology and gaming sectors. **Since that time the company has also eliminated all debt from the balance sheet.**

Investment policy

Blue Star's current investment policy is broadly similar, with the remit being to focus on new technologies, particularly in the areas of blockchain, media and gaming. Like most venture capital style investors, the focus is on businesses that have the capacity for substantial growth and increase in value over the medium to long-term. To date, investments have mostly been made into equity but the policy also allows for debt, convertible or hybrid securities. Shareholder returns are anticipated to come from growth in the value of investee companies rather than from dividends received.

Blue Star's geographical focus is mainly on UK businesses but, as demonstrated by its recent investment in the e-sports companies, it also considers international opportunities and will actively co-invest in larger deals. Current investments are passive in nature but may be actively managed and board representation sought if deemed relevant. While the value of the company's investment in SatoshiPay has risen to dominate the current portfolio by value, it is Blue Star's intention not to invest more than 10% of gross assets in any individual company, calculated at the time of investment.



Current portfolio

As at the last reported balance sheet date (31st March 2019) Blue Star's investment portfolio was dominated by its stake in micropayment infrastructure provider SatoshiPay, with additional stakes held in biometrics payments technology business Sthaler and technology investor Disruptive Tech Limited. Since then, Blue Star has made investments of c.£150,000 each in six early stage companies operating in the e-sports industry. All of these investments are discussed in more detail below.

Investments

e-sports

On 14th October 2019 Blue Star announced it had entered into an agreement to make investments of c.£150,000 each in six early stage e-sport companies operating across six different geographic markets. The opportunity was presented by entrepreneur Jonathan Bixby (through his business Toro Consulting), with Bixby perhaps best known for being the founder of LSE listed cryptocurrency miner Argo Blockchain.

In order to finance the investments Blue Star has placed 900 million new shares at a price of 0.1p each to raise a gross £900,000 (£820,000 after expenses). Notably, the price was a 33% premium to the previous trading day's closing mid-price of 0.075p. As part of the placing CEO Tony Fabrizi invested £20,000, taking his stake to 2.3%, with new Chairman Derek Lew, investing £100,000. Blue Star has also secured the right to invest in future rounds of each company to allow it to maintain its holding percentage. The placing was completed in two equal parts, with the first 450 million shares having been admitted to trading on 18th October and the remainder expected to be admitted on 12th November following approval at a general meeting on 6th November.

The six companies and investment details are as follows:

Company	Investment	Instrument	Jurisdiction
The Lords E-sports plc	£150,000	11.1% equity	UK
Googly E-sports plc	£150,000	11.1% equity	India & UK
The Dibs E-sports Corp	US\$185,000	Loan note convertible into 13.7% equity	USA
Dynasty E-sports PTE Ltd	SGD\$255,000	13.7% equity	Singapore
The Cubs E-sports PTY Ltd	AUS\$250,000	13.3% equity	Australia
The Drops E-sports Inc	CAD\$250,000	13.3% equity	Canada

Warrant issue

In consideration for Jonathan Bixby's introduction, and to incentivise the directors, the following warrants, which we note all exercise at prices at or above the placing price, are being issued along with the financing. **Should all the warrants be exercised Blue Star will receive a total of £1.37 million in further funding.**

Name	Exercise price (p)	Term from grant date	Warrants	Value (£)
Toro Consulting Ltd	0.1	6 months	220,000,000	220,000
Tony Fabrizi	0.1	12 months	25,000,000	25,000
Derek Lew	0.1	12 months	55,000,000	55,000
Toro Consulting Ltd	0.175	12 months	220,000,000	385,000
Tony Fabrizi	0.175	18 months	25,000,000	43,750
Derek Lew	0.175	18 months	45,000,000	78,750
Toro Consulting Ltd	0.25	18 months	180,000,000	450,000
Tony Fabrizi	0.25	24 months	15,000,000	37,500
Derek Lew	0.25	24 months	30,000,000	75,000
TOTAL			815,000,000	1,370,000

e-sports market

e-sports, or electronic sports, are a form of competition which sees players, either individually or in teams, compete against each other on popular video games. While video game competitions have been around for as long as the games themselves, in the past decade or so professional competitions have sharply increased in both popularity and value, with players competing for ever increasing amounts of prize money.

The recent *Fortnite* World Cup 2019 for example, held by developer Epic Games, had a reported total prize pool of \$30 million, with the overall winner, 16 year old Kyle Giersdorf, receiving \$3 million. The sector has become established to the extent that in 2018 the International Olympic Committee recognised that competitive E-sports could be considered a sporting activity, with players considered to prepare and train with an intensity which may be comparable to athletes in traditional sports. Teams themselves act like traditional sports teams, attracting their own sponsorship, advertising, player contracts and media agreements.

Rising viewer figures

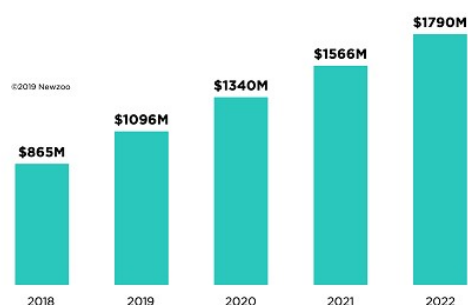
Alongside participation, there has also been a sharp increase in the number of people watching e-sport competitions, mainly via live internet streams on platforms such as Twitch, which was acquired by Amazon for \$970 million in August 2014. To give some idea of the industry's scale against other entertainment markets, it is estimated that in 2018 the *League of Legends* World Championships were watched by 99.6 million unique viewers. This is higher than the estimated 98.2 million US viewers who watched the 2019 Superbowl.

According to the 2019 Global E-sports Market Report from analysts at Newzoo, the total global e-sports audience is expected to grow to 453.8 million in 2019, up 15% compared to 2018. This is split into 201.2 million "e-sports enthusiasts" (those who watch at least one a month) and 252.6 million occasional viewers (those who watch less than once a month).

Rising revenues

More importantly, revenues generated through activities including ticket sales, sponsorships, advertising, merchandising, media rights and partnerships have also risen sharply in the e-sports industry. According to Newzoo, the market will exceed the billion-dollar revenue mark for the first time in 2019, growing by 26.7% year-on-year to \$1.1 billion. **Newzoo is looking for the market to rise to a value of \$1.79 billion by 2022, although in a more optimistic scenario sees revenues growing to \$3.2 billion that year.**

2018-2022 GLOBAL ESPORTS MARKET FORECAST PER SEGMENT TOWARD 2022



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Newzoo estimates that c.82% of the market (\$897.2 million) in 2019, will come from media rights, advertising, and sponsorship, with sponsorship being the highest individual revenue stream at \$456.7 million.

Sponsorship



Media Rights



Advertising



Merchandise & Tickets



Game Publisher Fees



e-sports revenue stream category forecasts 2019. Source: 2019 Global E-sports Market Report

It is under this backdrop that, according to a recent report by Deloitte and The E-sports Observer, *The Rise of E-sports Investments*, 2018 saw \$4.5 billion invested in the e-sports industry, up from \$490 million in 2017. Large investments have continued in 2019, with one recent notable example being NASDAQ listed Chinese technology company NetEase announcing plans to invest ¥5 billion (£545 million) to build an e-sports stadium in Shanghai.

Blue Star's strategy

It is Blue Star's intention to take advantage of growth in the e-sports market by investing in franchises and infrastructure investments targeting different regions globally. All six companies agreed to be invested in have recently been founded and it is their intention to create or acquire a competitive e-sports franchise to generate revenue from areas including tournament winnings, digital marketing opportunities, sponsorship, membership, merchandise and promotional tours and events. Each is targeting a different global region for financing and team building but all will attempt to become global brands.

SatoshiPay

Making up the vast majority of Blue Star's investment portfolio by value is its stake in micropayment infrastructure provider SatoshiPay. A total of £1.8 million had been invested by Blue Star as at 31st September 2018. Following a recent conversion of loan notes and considering recent equity fundraisings, Blue Star's current holding in the company is 27.9%, which has a carrying value of £4.6 million.



Founded in 2014, SatoshiPay is a fintech company which supplies micropayment infrastructure based on blockchain technology to digital industries. SatoshiPay's platform provides a login-free, one-click online payment service which allows digital content and service providers to monetise their products at a low cost across vendor platforms. The technology is offered both through in-house built products and as an application programming interface (API) upon which third party developers may build their own solutions, including with publisher Wordpress. The company takes its name from the "satoshi" the smallest unit of the bitcoin cryptocurrency which is equal to one hundred millionth of a bitcoin.

SatoshiPay's micropayment system is based on the Stellar blockchain network, a distributed ledger technology, and uses Stellar lumens (XLM) as the underlying settlement token. Using the SatoshiPay platform, online media companies are able to process payments of €0.05 (5 cents) or less with minimal transaction fees. This acts as a direct alternative to paywalls and subscriptions, enabling users to pay on a per article, per song or per download basis and for the content owners to earn an alternative revenues stream. Payments are instant and the user's wallet balance is available on each website that integrates the SatoshiPay software. SatoshiPay itself generates revenues by charging the payment recipient a 10% fee based on the value of the transaction, with no minimum charge.

The technology has been designed to overcome existing issues with online micropayments that have prevented them from achieving mainstream adoption. This mainly relates to high transaction costs driven by existing bank infrastructure which make such payments commercially unfeasible. **In contrast, SatoshiPay's blockchain based platform, amongst many other advantages, removes intermediaries, allowing transactions to be carried out faster and cheaper than traditional methods.**

SatoshiPay's technology can also process payments greater than 5c, but the company believes the real technical innovation is in relation to micropayments, in some cases being less than 1 cent. Management believe there are a wide range of potential applications for the platform, including for online video publishers, digital media, apps, gaming (for in-game purchases) and the Internet-of-Things.

Recent developments

In July 2018 Blue Star announced that it had signed heads of terms to acquire the entirety of SatoshiPay, subject to conditions and due diligence, with the deal amounting to a reverse takeover under the AIM rules. As a result Blue Star shares were subsequently suspended from trading. However, in late January 2019 it was announced that, due to difficult market conditions causing problems with fundraising, the two parties had agreed not to proceed with the proposed transaction. Blue Star was clear to point out that the decision was not related to any adverse findings from its due diligence on SatoshiPay and that it remains supportive of the company and confident in its management team.

Following the termination of the transaction, 2019 has been an eventful year for SatoshiPay, with the company continuing to develop its technology, raise further funding and continuing to sign up media partners to use its technology. Much of the year has been spent refining the product offering and developing a number of technical features including the Solar wallet, international VAT compliance tools for its publishers and a login-based cross-device wallet backup.

In addition to its offering for the publishing industry, SatoshiPay is broadening its reach into other verticals and intends to expand its services within cross-border B2B payments, a market currently estimated to be worth £160 billion. The company is said to be engaged in a number of customer conversations and while this sector is highly competitive it believes there is a strong opportunity to exploit its technology.

The first few months of 2019 saw SatoshiPay make a number of announcements concerning new partnership deals. In January the company entered into an agreement with Axel Springer, one of the largest digital publishing houses in Europe, to begin working on a joint offering, enabling users to pay for content with the digital SatoshiPay Wallet. As part of the project, the payment solution is to be integrated into Axel Springer products in order to gain experience in user acceptance and generate initial revenues. Further, in March the company agreed a partnership with 5% shareholder Börsenmedien, a specialist financial information company for the German-speaking region, to integrate its payment solution into Börsenmedien's news sites, enabling readers to pay for premium content.

Finally, in February and March this year SatoshiPay completed a private fundraise, raising a total of £1.7 million at a valuation of £15 million. The latest Companies House total exemption accounts, for the year to 31st December 2018, show an accumulated loss of €1.97 million, up from €0.94 million 12 months previously.

Disruptive Tech Limited

Blue Star acquired a holding in Disruptive Tech Limited (DTL) in November 2013 following the company's combination with investing business eSeekers, in which Blue Star had invested £300,000 in 2007. DTL is a Gibraltar based holding company which had a remit to own and manage investments in a number of technology enterprises. However, DTL has announced that it will not be making any more investments and it intends to exit all its existing positions when opportunities arise.



DTL currently has three investments: an 8% shareholding in the AIM listed international gaming technology and services provider **Nektan**; a 10% shareholding in "champion management" platform **Freeformers**; and a 1.8% shareholding in **Bookingbug**, which has developed a software platform to manage online bookings and appointments. When realised, the proceeds of the sales are expected to be returned to shareholders. Blue Star's holding in DTL is valued on the balance sheet at the cost price of £300,000.

Sthaler

In June 2015 Blue Star invested £50,000 in Sthaler, an early stage biometrics payments technology business. On the basis of the last fundraise Blue Star's holding, amounting to around 1% of the business, is currently valued at c.£300,000 – a six fold return.

FINGOPAY

Sthaler was founded in 2016 by music entrepreneur Nick Dryden to create a cashless experience for music festival goers. In partnership with Japanese conglomerate Hitachi the company has developed Fingopay, a product which enables a consumer to identify themselves and pay for products using just their finger at retail points of sale.

Fingopay works by using Hitachi's VeinID™ technology, which uses infrared light to map the unique vein pattern in a customer's finger, convert it into an individual 'digital ID' key and store it securely in the cloud. Users then register to link their vein pattern with their bank card, enabling them to scan their finger to pay, prove their age and earn rewards, with verification occurring in seconds. This approach is considered more secure than other biometrics, such as fingerprint and face recognition, as vein patterns leave no trace and can't be copied, making it ideal for high security authentication. Providing a significant barrier to entry, Sthaler has exclusive rights for the use of VeinID™ in retail transactions worldwide until 2035.

For consumers, the technology provides the opportunity to pay for things and prove identity faster than current methods, and reduces the need to carry cash, cards or ID documents. Businesses meanwhile can increase efficiency at the checkout, making for a better consumer experience, reduce fraud and obtain data to support CRM activities.



Fingopay biometric payment device. Source: Sthaler

Over the past two years Sthaler has been piloting Fingopay in a number of retail environments including convenience stores, restaurants, coffee shops and bars. To date it has successfully completed pilots at Festival Number 6, Proud bar Camden, Brunel University and Copenhagen Business School. Earlier in 2019 it launched in Manchester, with work space provider All Work & Social being the company's launch partner in the city. New launches in Manchester are scheduled for later in 2019, along with Copenhagen and Dublin, with the company focused on a city-hub strategy, working with both local retailers and authorities.

In August 2018 Sthaler raised just over £1.2 million on crowdfunding platform Crowdcube at a valuation of £33.6 million. The last total exemption accounts show an accumulated deficit of £4.79 million as at 31st December 2018, up from £2.53 million 12 months previously.

Financials

Blue Star's most recent set of accounts, covering the six months to 31st March 2019, reported an operating loss of £0.494 million, up slightly from a loss of £0.501 million posted for H1 2018. The most significant P&L items were a total of £0.35 million of non-cash fair value losses, along with administration costs of £0.17 million. Admin expenses rose from £0.1 million compared to H1 2018 as some additional costs were incurred relating to the aborted acquisition of SatoshiPay.

On the balance sheet, net assets at the period end stood at £5.15 million, down from £5.46 million at the year-end in September mainly due to the reduction in fair value of investments. This equated to a net asset value per share at the period end of 0.26p. The investment portfolio itself was valued at £5.17 million, down from £5.29 million six months previously. The only liabilities at the half year end were trade and other payables of £95,893,

Cash was £63,605 at the period end, with no debt, with the company commenting that the working capital position is dependent on new funds being made available. The net cash outflow from operations amounted to £0.15 million, lower than net losses mainly due to the adding back of the non-cash fair value reductions. The cash position was boosted during the period by a £200,000 placing completed at a price of 0.18p per share in January. Following the period end, in July 2019 Blue Star raised £250,000 (before expenses) through the issue of 250 million new shares at a price of 0.1p each. CEO Tony Fabrizi and Non-Exec Sean King each invested £12,000.

On the outlook, Blue Star commented at the time that it was confident the current portfolio has the potential for a significant improvement in net asset value and that management continues to monitor corporate opportunities to enhance shareholder value.

Management

Derek Lew – Chairman

Derek Lew has advised, started and invested in technology companies for over 20 years. An active member of the technology community in Vancouver, he is President & CEO of venture capital fund manager GrowthWorks Capital Ltd. Derek is a Partner with Initio Group, a Vancouver, BC-based early-stage angel investment firm. Derek started his technology career as a lawyer, advising both technology companies and investors in all areas, including life sciences, ITC and e-commerce.

Anthony (Tony) Fabrizi - Chief Executive Officer

Tony joined the board of Blue Star Capital in April 2011, initially as a non-executive director, before taking on the role of CEO in July 2012. He qualified as a chartered accountant with KPMG in 1986 and joined James Capel (later HSBC Investment Bank) in 1987. He worked in corporate finance and spent eight years undertaking UK transactions, becoming a director in 1993. During his last three years at HSBC he was responsible for the other financial and fund management activities within corporate broking. Tony joined RP&C, a US Investment Bank, as a partner in 1998 to help develop its UK business. In 2002 he established Ghaliston Limited as a corporate finance advisory business. Over the next 4 years Ghaliston acted as financial advisor to 10 companies listing on AIM and raised capital for a number of private companies. In May 2006, Ghaliston Limited acquired Merchant Securities Limited, a private client stockbroking business and the enlarged company listed on AIM in November 2006. Tony resigned as CEO of that company in June 2008.

Sean King - Non Executive Director

Sean King has over 20 years' experience in publishing and digital content, having set up Square One Group in 1994, which was one of the fastest growing independent content agencies in the UK. In 2007, Square One Group was acquired by rival Seven Publishing (backed by Guardian Media Group and Caledonia Investment Trust) with Sean acting as CEO for the enlarged group until stepping down in April 2018. Seven was in turn acquired by German content agency C3 (part of Hubert Burda Media) in 2016.

After stepping down as CEO of SevenC3, Sean now acts as an independent advisor to a number of brands including Captify, (a fast growing pioneer in Search Intelligence); Octaive (an ad:tech start-up based in London and New York); DADI (a blockchain-powered decentralised global cloud computing network); and Liberty AIM (a new blockchain-powered ethical search engine).

Key Risks

Exposure to early stage technology companies

Blue Star's focus on early stage technology companies exposes it to a range of risks including technology failure, the rapid pace of technological change, commercial failure and financing risks. Blue Star reduces this exposure by investing in companies which have proven their product and by applying strict due diligence before making investment decisions.

Portfolio concentration risk

As discussed, the company's stake in SatoshiPay currently makes up the vast majority of Blue Star's investment portfolio by value. The £4.6 million holding amounted to just under 90% of total investments as at the last reported balance sheet date. Following the conclusion of the recent placing we estimate that the SatoshiPay holding will fall to c.75% of the total portfolio value. While this reduces the exposure, the concentration remains high.

Liquidity risk

All of Blue Star's portfolio investments are in private companies which have no active market for their shares. Therefore, the company may find it difficult to liquidate its holdings in these companies unless a liquidity event such as an IPO or takeover occurs.

Funding risk

In order to take advantage of further investment opportunities, or to pay for corporate costs, Blue Star may undertake further equity funding raisings which will be dilutive to shareholders. These will however be offset by the value of investments entered into with the proceeds of funds raised.

Valuation

Following their return from suspension, pending the outcome of the potential reverse takeover, in January 2019, shares in Blue Star Capital have fallen from 0.25p to the current level of 0.115p. This is partly understandable, given that the shares weren't trading during the small cap malaise of Q4 2018. **At current levels however we believe that the valuation looks completely out of kilter with the company's net asset position, the primary quantitative metric by which investment companies are valued against.**

While Blue Star had a net asset value per share of c.0.26p as at 31st March 2019 we are making a number of adjustments to this figure to take into account events over the past seven months, namely the e-sports investments and related placings.

For our calculation, to net assets as at 31st March 2019 we add in the net proceeds of the July placing (assuming a 5% fee) and the estimated £820,000 net proceeds of the October/November placings. Based on historic numbers, we subtract £118,739 of corporate costs which we estimate have been incurred since the end of March. This gives us an estimated net asset value of £6.09 million. For the denominator we use the number of shares in issue (3,142,582,852) following admission of the second placing shares, expected on or around 12th November following the recent general meeting.

As at 12/11/2019	
Shares in issue	3,142,582,852
Current share price (p)	0.115
Market cap (£)	3,613,970
Net assets as at 31/03/2019 (£)	5,149,798
+ January placing (net)	237,500
+ Oct/Nov placings (net)	820,000
- corporate costs since March	118,739
Net assets estimate 12/11/2019 (£)	6,088,559
NAV per share (p)	0.1937438
Discount to NAV	40.64%
Upside	68.47%

Blue Star Capital net assets estimate as at 12/11/2019. Source: Align Research

As per the table above, we estimate a NAV per share as at 12th November 2019 of 0.194p. With Blue Star shares currently trading at 0.115p they are therefore priced at a discount of 40.64%, which represents upside of 68.47% should they trade at parity to estimated NAV.

However, to add a degree of conservatism, and to reflect a liquidity discount considering the nature and structure of the investments in the portfolio, we apply a 20% haircut to our NAV estimate to set our target price. This equates to 0.155p per share, implying upside of 35% from current levels.

Conclusion

Like most publicly listed venture capital style investors, we believe that shares in Blue Star Capital should trade at a modest discount to NAV to reflect the illiquid and long-term nature of the investments in the portfolio. **However, the current near 41% gap between our estimate of net assets and the current share price looks excessive in our opinion, even considering the large exposure to SatoshiPay and investor disappointment following the aborted reverse takeover.**

We believe that the current discount completely fails to reflect the opportunities for value creation across the portfolio, with SatoshiPay, Sthaler and the e-sports businesses all operating in rapidly growing industries which look ripe for disruptive growth. The current share price also doesn't reflect the fact that the valuation of SatoshiPay, which we estimate at c.0.146p per share post placing, is in itself c.27% higher than Blue Star's current valuation.

We initiate coverage of Blue Star Capital with a target price of 0.155p and a stance of **Conviction Buy**.

DISCLAIMER & RISK WARNING

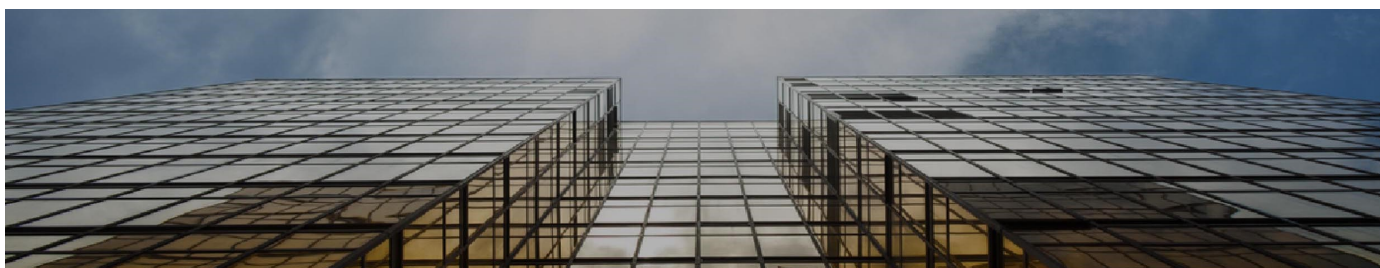
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