

Finders Resources

Wetar copper - good to go

Initiation of coverage

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Target price
A\$0.67

Price
A\$0.360

Short term (0-60 days)
n/a

FND111017

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	0.41	0.45	0.43
Absolute (%)	-13.3	-20.0	-16.3
Rel market (%)	-17.4	-14.6	-6.5
Rel sector (%)	-9.2	2.7	5.2



Market capitalisation

A\$100.63m (US\$104.08m)

Average (12M) daily turnover
A\$0.09m (US\$0.09m)

Sector: BBG AP Mining
RIC: FND.AX, FND AU
Priced A\$0.36 at close 13 Oct 2011.
Source: Bloomberg

Analyst

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With two years experience operating the Wetar (FND 95%) demonstration plant and 2,500t of copper cathode sold, the acquisition of the 18,000tpa Whim Creek SX-EW plant and a very robust DFS, Finders now needs to fund its US\$155m Wetar mine development. We initiate with a Buy.

Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA (A\$m)	-7.24	-4.83	-5.48	93.80	172.9
Reported net profit (A\$m)	-11.6	-7.37	-7.86	59.30	111.4
Normalised net profit (A\$m) ¹	-9.44	-7.37	-7.86	59.30	111.4
Normalised EPS (c) ¹	-3.51	-2.64	-2.71	20.44	38.37
Normalised EPS growth (%)	104.1	-24.8	2.59	n/a	87.80
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	-10.3	-13.6	-13.3	1.76	0.94
EV/EBITDA (x)	-12.1	-17.6	-17.0	0.25	-0.62
Price/net oper. CF (x)	-13.6	-13.6	-13.3	1.51	0.80
ROIC (%)	-24.4	-13.0	-5.27	80.90	168.7

1. Pre non-recurring items and post preference dividends
Accounting standard: IFRS
Source: Company data, RBS Morgans forecasts

year to Jun, fully diluted

Wetar Island, Indonesia – copper heap leach (FND 95%)

Finders Resources has operated a heap leach and SX-EW plant capable of producing five tonnes per day (1,650 tpa) of copper cathode since February 2009 on Wetar Island, Indonesia. The company completed the definitive feasibility study (DFS) into a development to produce up to 25,000tpa of cathode at a cash cost of US\$1.09/lb over the nine year mine life based on current reserves, and purchased the 18,000tpa Whim Creek SX-EW plant.

Wetar – the DFS

Reserves of 8.2mt at 2.5% copper within the Kula Kuning and Lerokis optimised pit shells contain 205,000t of copper, with a Waste:Ore ratio of 0.95:1. Exploration by prior tenement holders identified 1mt at 2.3% copper at Meron, not in compliance with Joint Ore Reserves Committee (JORC) Code criteria, and we believe there is potential for exploration success. The company projects metallurgical recovery at 75%. Given the low strip ratio and heap leach SX-EW process, we project a cash cost of US\$1.09/lb Cu. The Stage 1 development, at a capital cost of US\$41m, will expand production to 7,000tpa of copper cathode. We expect the Whim Creek plant to enable FND to increase production by 18,000tpa to 25,000tpa at a capital cost of US\$114m.

Corporate and financial

Finders reported net cash of A\$3.4m at 30 June 2011, with the DFS completed, and the Whim Creek plant crated ready for shipping to site. A banking syndicate is mandated to provide US\$138m of debt funding for Wetar mine development. Conversion of the forestry classification over the main mine area is a prerequisite to securing funding. Forestry permits will still be required over 4ha of the previously mined Lerokis pit, but this area is not scheduled for production until year three of the operation. We estimate the Wetar Island resource represents value of A\$1/FND share. In arriving at our target price A\$0.67, we have applied a 30% discount to allow for the risk associated with financing structure alternatives, hedging, the development schedule and commissioning risk.

The basics

Versus consensus

EPS	Ours	Cons	% diff
2011F	-2.64	-0.72	n/a
2012F	-2.71	0.00	n/a
2013F	20.44	10.06	103%

Source: Reuters, RBS forecasts

Catalysts for share price performance

The proposed mine site on Wetar island was originally a gold mine. When the gold was exhausted, the mine was closed. Zoning regulations in the area subsequently changed and the mine site was reclassified as forest. In order for copper mining operations to commence, the reclassification needs to be reversed. We expect achievement of this to be a significant catalyst for the share price.

Earnings momentum

We anticipate that the company will generate earnings when production starts in FY13.

Valuation and target price

In our simple DCF valuation of the Wetar project we have assumed a 25% tax rate. We calculate a value for Finder's equity of approximately US\$270m, using an 11.3% discount rate. This generates a valuation of A\$1/FND share. Our expectation is that while debt will be employed to fund development, further equity will also be required above the current 279.5m shares on issue. We have applied a discount of 30% to allow for the risk associated with the structure of the funding, construction and commissioning, resulting in a modelled a risked target price of A\$0.67 per FND share. Risks to our target price include weaker-than-forecast production, a deterioration in the copper price, further strengthening of the AUD relative to the USD and potential delays in receipt of the various permits and approvals required to operate. Successful evaluation of other prospects on Wetar Island could lead to an extension of the mine life.

Forced ranking*

Company	Rec	Upside / Downside
FND	BUY	70%
DML	HOLD	2%

* by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: RBS forecasts

How we differ from consensus

Finders Resources has only been covered by one to two analysts at a time, so consensus estimates are not statistically meaningful.

Risks to central scenario

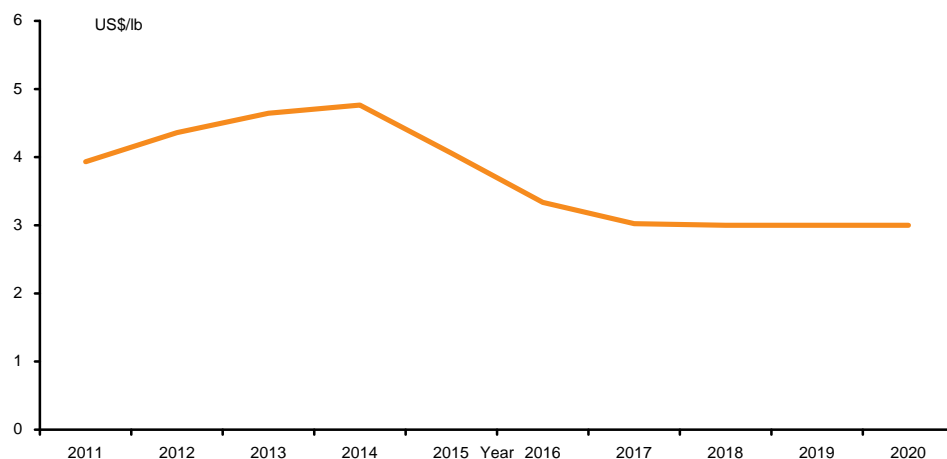
- A delay in zoning approval to begin mining could defer debt financing depleting the company's cash reserves.
- There is a risk that the company will not be able to raise sufficient funds through either debt or equity markets to progress the mine's development.
- Mine development may be subject to cost overruns and/or delays.

Key assumptions and sensitivities

The USD copper price and the strength of both the AUD and the Indonesian Rupiah against the USD impacts operating margins and profitability in AUD terms.

Our revenue forecasts are based on an assumed profile of future copper prices:

Figure 1 : Copper Price Forecasts



Source: RBS Morgans forecasts

Our base case copper price assumptions are \$4.65 in FY13F and \$4.77 in FY13F and FY14F respectively. Our base case assumptions for the AUD/USD exchange rate are \$1.10 and \$1.03 respectively. The sensitivity of the company's earnings to copper prices and exchange rates is explored in the table below:

Figure 2 : Earnings Sensitivities

Factor	Movement	FY13	FY14
Copper price	NPAT (A\$m)	59.3	111.4
	+10%	69.1	129.0
	-10%	49.5	93.9
AUD/USD	NPAT (A\$m)	59.3	111.4
	+10%	53.4	100.7
	-10%	66.3	124.5

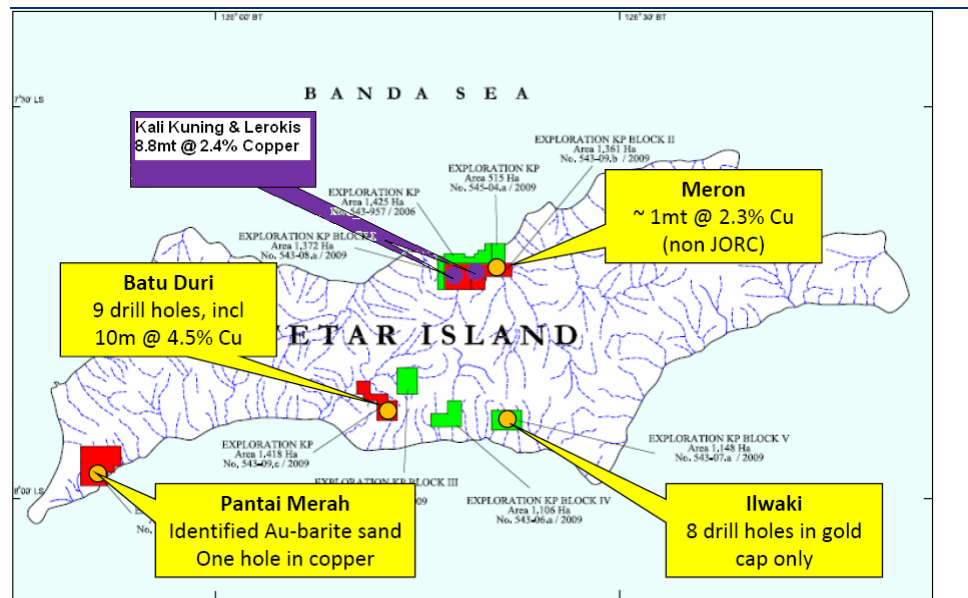
Source: RBS Morgans forecasts

Company Overview

FND has produced and sold 2,500t of copper cathode from a 5tpd SX-EW copper cathode demonstration plant on Wetar Island, Maluku province, Indonesia. It has completed a definitive feasibility study into development of the Wetar copper project, in which it has a 95% interest, based on reserves of 8.2mt at 2.5% copper in the Kali Kuning and Lerokis ore bodies, both amenable to open pit mining. The ore will be heap leached, with Stage 1 copper cathode production at a rate of 7,000tpa, increasing to 25,000tpa with the Stage 2 addition of the 18,000tpa Whim Creek plant which FND has purchased. The current focus is to build both Stages of the \$155m project in parallel, with Stage 1 coming on-stream approximately one year before Stage 2.

At the Ojolali gold-silver project, Sumatra, Indonesia, FND has an option to increase its interest from 72% to 100%. The current exploration program at Ojolali is designed to increase the resource base from 217,000oz of gold equivalent to above 300,000oz to support a 30-50,000oz pa open pit mine.

Figure 3 : Wetar Island - Resources and exploration targets



Source: Company data

The Wetar copper project – FND 95%

The Wetar Copper Project, Maluku, eastern Indonesia, is the site of a former gold mine, operated by Billiton plc until 1997, which mined and processed a gold-barite sand sitting above sulphide copper deposits at Kali Kuning and Lerokis, located approximately 3km from the northern coast of Wetar Island. Much of the infrastructure that remains in place, including the wharf, offices and accommodation, is being used and slowly refurbished by FND, which has a 95% interest in the project.

A resource of 8.8mt at a grade of 2.4% copper is reported at Kali Kuning and Lerokis, in satisfaction of the JORC Code standards. Based on the measured and indicated resources, a reserve of 8.18mt at 2.5% copper, containing 205,000t of copper is reported, a conversion factor of 94% (at Kali Kuning) and 97% (at Lerokis) from resource to reserve. As is evident from the map above, there is potential to increase both the resource base and reserves.

To evaluate the profitability of copper production, FND built and operated a fully permitted mine, heap leach and solvent extraction and electro-winning (SX-EW) plant with a nominal capacity of 5tpd of copper cathode (1,800tpa). It has confirmed the validity of the reserve, with a positive reconciliation in terms of contained copper in both sulphide ore and in transition/oxide ore, and has confirmed the suitability of the proposed heap design.

In terms of metallurgical recovery, laboratory testing over a two year period indicated recoveries up to 80% could be anticipated. Over two years up to December 2010 FND evaluated heap irrigation techniques, and leach and plant performance. Irrigation techniques were modified to achieve recovery rates from Heaps 3 and 4 which were in line with the company's modelling. Plant reliability issues, largely related to overheating of the generators and rectifier, were overcome to achieve 97.3% availability for the generators and rectifier.

FND completed a DFS based the current reserves at Kali Kuning and Lerokis, and in light of their operating experience. The projected C1 cash cost of US\$1.09/lb of copper cathode places it close to the median of its peer group.

Figure 4 : Wetar Project Economics – June 2011 DFS

Ore Reserves	8.2 mt
Strip Ratio	0.95
Initial Mine Life	9 years
Average Copper Grade	2.5%
Copper Cathode Production Capacity	25,000 tpa
LOM Copper Cathode Production	150,000 t
Average Copper Recovery	75%
Operating Cash Cost (LOM) ¹	US\$1.09/lb Cu
Capital Costs	US\$155m
NPV ₁₀	US\$304m

Notes:

1. Operating Cash Costs exclude royalties (4%), head office costs and marketing costs (expected to be zero after netting off sales premiums)
2. Key financial assumptions used in the financial analysis
 - Copper price for the base case used the Comex forward curve as at 16 June 2011 and then assumed a reversion to a real long-term price of US\$2.50/lb by 2017.
 - Discount rate 10% (approximates Company's weighted average cost of capital, WACC)
 - IDR/USD exchange rate 8,500
 - Diesel fuel price US\$1.13/litre, MFO fuel price US\$1.01/litre
 - Total power cost US\$0.226/kWh
 - Tax rate of 25%, royalty rate of 4%

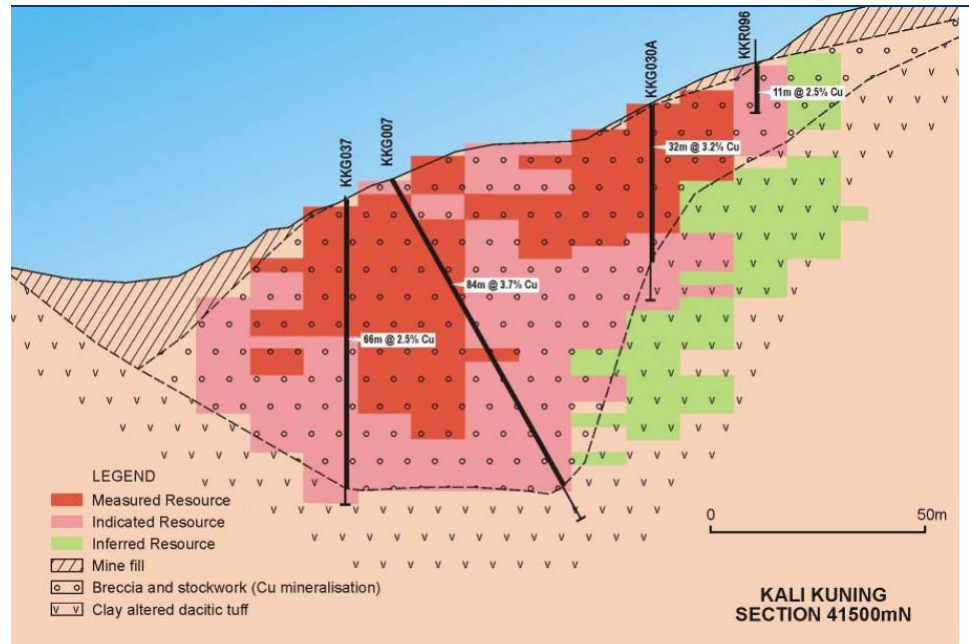
Source: Finders Resources – June 2011

The DFS evaluated a two-stage development, with Stage 1 involving building heaps within the footprint of the existing Billiton pit at Kali Kuning, and the expansion of the existing demonstration plant from its current nominal capacity of 5tpd (1,800 tonnes per year) of copper cathode to approximately 7,000tpa. The company estimates a capital cost of US\$41.3m (June 2011) for expanding the existing demonstration plant. Management expects that this scale of production would generate an operating profit.

The second stage also involves the continuation of mining beneath the existing Kali Kuning pit, but requires construction of a new heap and plant site, using waste rock from the Kali Kuning mining pit for the increased heap footprint. .

FND estimated in November 2009 that the capital cost for this second stage, exclusive of Stage 1 costs, would be US\$91m. It revised this estimate to US\$114.1m in June 2011. This includes the cost of relocating and commissioning the Whim Creek SX-EW plant. This plant, with annual capacity of 18,500t of copper cathode was acquired by FND, with the issue of shares to Straits Resources Limited (ASX:SRL), now the second largest shareholder in FND, with a 10.8% shareholding. Of the US\$114.1m cost, US\$44.1m is for the process facilities.

Figure 5 : Kali Kuning Pit Cross Section



Source: Finders Resources – July 2008

The Ojolali project

Finders Resources has a 72% interest in the Ojolali project, with the option to move to 100%. The project, located in southern Sumatra, covers:

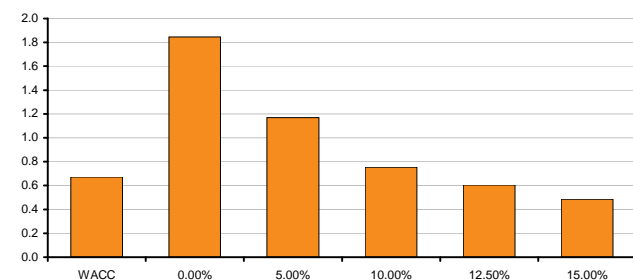
- the Jambi oxide gold deposit, with a resource defined in satisfaction of the JORC Code standards of 4.08mt at 1.05g/t gold and 7.6 g/t silver;
- the Tambang gold silver prospect, with a resource defined by previous operators (and not to JORC Code standards) of 7.9mt at 167 g/t silver and 0.7 g/t gold;
- the Way Neki prospect, where mapping and trenching has defined an area of high grade gold and silver mineralization hosted in quartz veins, geologically similar to Kingrose Minerals (ASX:KRM) Way Linngo prospect, 60km to the south and
- a number of other geologically and geochemically anomalous targets which require follow-up.

Finders has reported that its primary objective is to increase the Jambi resource to +300,000oz to support a small open cut gold-silver mine, with targeted production of 50,000oz of gold equivalent per year. Evaluation and exploration of other targets will continue. We believe this is highly prospective acreage; however the primary focus of the company is on the Wetar project.

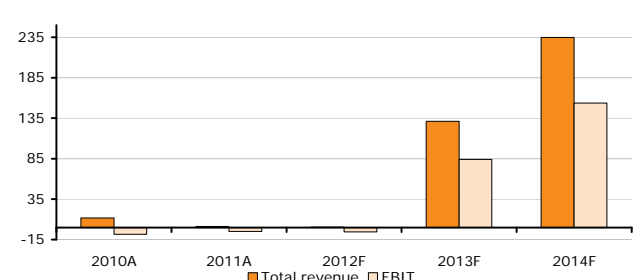
FND – financial summary

Year to 30 Jun (A\$m)	AIFRS 2010A	AIFRS 2011A	AIFRS 2012F	AIFRS 2013F	AIFRS 2014F	Price target (A\$)	0.67
Income statement						Val'n (A\$)	0.67
Divisional sales	11.3	0.8	0.0	130.6	233.9		
Total revenue	11.8	1.3	0.6	131.2	234.6		
EBITDA	-7.2	-4.8	-5.5	93.8	172.9	Valuation summary	A\$m A\$ps DCF valuation inputs
Depreciation & amortisation	-1.3	0.0	0.0	-9.7	-19.4	Wetar Copper Project	176.2 0.61 Rf 5.25%
EBIT	-8.5	-4.8	-5.5	84.1	153.6	Wetar Island Exploration	48.9 0.17 Rm-Rf 6.00%
Net interest expense	-0.1	-5.0	-5.0	-5.0	-5.0	Ojolali	5.0 0.02 Beta 1.54
Pre-tax profit	-8.6	-9.8	-10.5	79.1	148.6	Net cash	-10.0 -0.03 CAPM (Rf+Be) 14.5%
Income tax expense	0.0	2.5	2.6	-19.8	-37.1	Corporate & Other	-25.0 -0.09 Tax rate (t) 25.0%
After-tax profit	-8.6	-7.4	-7.9	59.3	111.4	Total Value \$m	195.0 0.67 WACC 11.18%
Minority interests	-0.8	0.0	0.0	0.0	0.0		Shares 290.3
NPAT	-9.4	-7.4	-7.9	59.3	111.4		
Significant items	-2.1	0.0	0.0	0.0	0.0	Production (Mt)	2011A 2012F 2013F 2014F
NPAT post abnormal	-11.6	-7.4	-7.9	59.3	111.4	Copper Production (mibs)	0.20 0.00 30.86 50.70
						Silver Production (moz)	0.00 0.00 0.00 0.00
Growth ratios	2010A	2011A	2012F	2013F	2014F	Key assumptions	2011A 2012F 2013F 2014F
Sales growth	n.m.	n.m.	n.m.	n.m.	n.m.	USD / AUD exchange rate	0.99 1.07 1.10 1.03
Operating cost growth	n.m.	n.m.	n.m.	n.m.	n.m.	Copper price (US\$/lb)	3.93 4.36 4.65 4.77
						Silver price (US\$/lb)	29.01 40.00 32.50 28.50
Cash flow statement	2010A	2011A	2012F	2013F	2014F	Per share data	2011A 2012F 2013F 2014F
EBITDA	-7.2	-4.8	-5.5	93.8	172.9	No. shares	279.5 290.3 290.3 290.3
Cash flow from ops (1)	-7.1	-7.4	-7.9	69.1	130.8	EPS (cps)	-2.6 -2.7 20.4 38.4
Capex (2)	-6.2	-50.0	0.0	0.0	0.0	EPS (normalised) (c)	-2.6 -2.7 20.4 38.4
Disposals/(acquisitions)	1.2	0.0	0.0	0.0	0.0	Dividend per share (c)	0.0 0.0 0.0 0.0
Cash flow from invest (3)	-5.8	-50.0	0.0	0.0	0.0	Dividend payout ratio (%)	0.0 0.0 0.0 0.0
Incr/(decr) in equity	20.5	60.0	0.0	0.0	0.0	Dividend yield (%)	0.0 0.0 0.0 0.0
Incr/(decr) in debt	0.0	30.0	0.0	0.0	0.0	Operating performance	2011A 2012F 2013F 2014F
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	EBIT growth	-43% 13% n.m. 83%
Other financing cash flow	-0.8	0.0	0.0	0.0	0.0	NPAT growth	n.m. n.m. n.m. n.m.
Cash flow from fin (5)	19.7	90.0	0.0	0.0	0.0	Normalised EPS growth	-25% 3% n.m. 88%
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Asset turnover (%)	0.2 0.0 21.8 24.9
Incr/(decr) cash (1+3+5+6)	6.9	32.6	-7.9	69.1	130.8	EBITDA margin (%)	n.m. n.m. n.m. n.m.
Equity FCF (1+2)	6.9	32.6	-7.9	69.1	130.8	EBIT margin (%)	n.m. n.m. n.m. n.m.
						Net profit margin (%)	n.m. n.m. n.m. n.m.
Balance sheet	2010A	2011A	2012F	2013F	2014F	Return on net assets (%)	-5.2 -6.4 58.0 59.9
Cash & deposits	14.5	47.1	39.2	108.3	239.1	Net debt (A\$m)	-15.6 -7.8 -76.8 -207.6
Trade debtors	0.8	0.8	0.8	0.8	0.8	Net debt/equity (%)	-16.7 -9.1 -53.0 -80.9
Inventory	1.0	1.0	1.0	1.0	1.0	Net interest/EBIT cover (x)	n.m. n.m. n.m. n.m.
Investments	0.3	0.3	0.3	0.3	0.3	ROIC (%)	-13.0 -5.3 80.9 168.7
Other intangible assets	0.0	0.0	0.0	0.0	0.0	Comparable multiples (x)	2012F 2013F 2014F
Fixed assets	0.0	0.0	0.0	0.0	0.0	Finders Resources	EV/EBITDA -17.0 0.3 n.m.
Other assets	28.9	78.9	78.9	69.2	49.8	Year to 30 Jun	PE -13.3 1.8 0.9
Total assets	45.5	128.1	120.2	179.6	291.0	Discovery Metals	EV/EBITDA -32.6 2.4 1.0
Short-term debt	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	PE -23.7 6.4 4.0
Trade payables	1.8	1.8	1.8	1.8	1.8		
Long-term borrowings	1.4	31.4	31.4	31.4	31.4		
Provisions	0.9	0.9	0.9	0.9	0.9		
Other liabilities	0.3	0.3	0.3	0.3	0.3		
Total liabilities	4.5	34.5	34.5	34.5	34.5		
Share capital	85.7	145.7	145.7	145.7	145.7		
Other reserves	-1.4	-1.4	-1.4	-1.4	-1.4		
Retained earnings	-42.2	-49.6	-57.5	1.9	113.3		
Total equity	42.0	94.7	86.8	146.1	257.5		
Minority interest	-1.0	-1.0	-1.0	-1.0	-1.0		
Total shareholders' equity	41.0	93.6	85.8	145.1	256.5		
Total liabilities & SE	45.5	128.1	120.2	179.6	291.0		

Valuation sensitivity to discount rate (A\$/share)



Total revenues and EBIT (A\$m)



Source: Company data, RBS Morgans forecasts

QUEENSLAND

BRISBANE – HEAD OFFICE	(07) 3334 4888
BRISBANE – EDWARD STREET	(07) 3121 5677
BUNDABERG	(07) 4153 1050
BURLEIGH HEADS	(07) 5520 8788
CAIRNS	(07) 4222 0555
CALOUNDRA	(07) 5491 5422
CAPALABA	(07) 3245 5466
CHERMSIDE	(07) 3350 9000
EMERALD	(07) 4988 2777
GLADSTONE	(07) 4972 8000
GOLD COAST	(07) 5592 5777
IPSWICH	(07) 3202 3995
MACKAY	(07) 4957 3033
MILTON	(07) 3114 8600
NOOSA	(07) 5449 9511
REDCLIFFE	(07) 3897 3999
ROCKHAMPTON	(07) 4922 5855
SPRING HILL	(07) 3833 9333
SUNSHINE COAST	(07) 5479 2757
TOOWOOMBA	(07) 4639 1277
TOWNSVILLE	(07) 4725 5787
YEPPON	(07) 4939 3021

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SYDNEY – MACQUARIE STREET	(02) 9125 1788
SYDNEY – PHILLIP STREET - LEVEL 33	(02) 8215 5111
SYDNEY – REYNOLDS EQUITIES	(02) 9373 4452
ARMIDALE	(02) 6770 3300
BALLINA	(02) 6686 4144
BALMAIN	(02) 8755 3333
CHATSWOOD	(02) 8116 1700
COFFS HARBOUR	(02) 6651 5700
GOSFORD	(02) 4325 0884
HURSTVILLE	(02) 9570 5755
MERIMBULA	(02) 6495 2869
NEUTRAL BAY	(02) 8969 7500

NEWCASTLE	(02) 4926 4044
NEWPORT	(02) 9998 4200
ORANGE	(02) 6361 9166
PARRAMATTA	(02) 9615 4500
PORT MACQUARIE	(02) 6583 1735
SCONE	(02) 6544 3144
WOLLONGONG	(02) 4227 3022

VICTORIA

MELBOURNE – HEAD OFFICE	(03) 9947 4111
MELBOURNE – FARRER HOUSE	(03) 8644 5488
BERWICK	(03) 9796 2676
BRIGHTON	(03) 9519 3555
CAMBERWELL	(03) 9813 2945
CARLTON	(03) 9066 3200
GEE LONG	(03) 5222 5128
RICHMOND	(03) 9916 4000
SOUTH YARRA	(03) 9098 8511
TRARALGON	(03) 5176 6055
WARRNAMBOOL	(03) 5559 1500

ACT

CANBERRA	(02) 6232 4999
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SOUTH AUSTRALIA

ADELAIDE	(08) 8464 5000
NORWOOD	(08) 8461 2800

WESTERN AUSTRALIA

PERTH	(08) 6462 1999
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DARWIN	(08) 8981 9555
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TASMANIA

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