

**Overweight**

|                      |                 |
|----------------------|-----------------|
| <b>Current Price</b> | <b>S\$0.260</b> |
| Fair Value           | S\$0.340        |
| Up / (downside)      | 30.8%           |

**Stock Statistics**

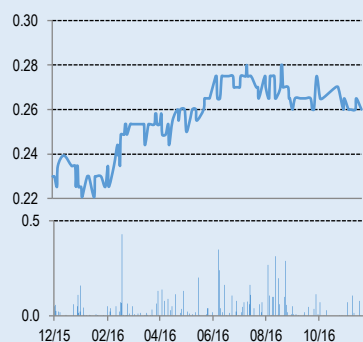
|                      |           |
|----------------------|-----------|
| <b>Market cap</b>    | S\$118.1m |
| <b>52-low</b>        | S\$0.230  |
| <b>52-high</b>       | S\$0.280  |
| <b>Avg daily vol</b> | 28,082    |
| <b>No of share</b>   | 454.4m    |
| <b>Free float</b>    | 24%       |

**Key Indicators**

|                    |          |
|--------------------|----------|
| <b>ROE 17F</b>     | 12.1%    |
| <b>ROA 17F</b>     | 4.8%     |
| <b>P/BV</b>        | 1.67     |
| <b>Net gearing</b> | Net cash |

**Major Shareholders**

|                               |       |
|-------------------------------|-------|
| <b>STT Communications Ltd</b> | 50.5% |
| <b>Leap International</b>     | 19.7% |

**Historical Chart**

Source: Bloomberg

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**Several Factors to Drive Higher Upside in 2017**

- New PCS joint venture.** TeleChoice has earlier incorporated a 51% owned subsidiary Planet Smart Services Pte. Ltd. as part of a joint venture to provide infrastructure engineering services and other information technology and computer service activities. This joint venture caught our attention as the joint venture partner D-Ron Singapore Pte. Ltd. is primarily involved in the provision of IP surveillance, networking solutions, storage requirements and video management software. This development suggests that TeleChoice may be rolling out a new service under its personal communications solutions (PCS) segment which typically operates under the "Planet" brand name.
- Moving from equipment distribution to services.** Our analysis of the PCS business has previously been focused on the distribution and sale of mobile handsets and the potential of new accessories such as VR headsets. However, these activities only form a part of the PCS division's business of distribution and supply chain management services for telecommunication companies. Given the capabilities of D-Ron Singapore, we reckon that PCS may be looking at extending beyond handsets to the potential provision of smart home system services, e.g. home set-top boxes. With TeleChoice's existing businesses with Starhub, the provision of additional services is synergistic and matches the bundling of end services e.g. internet, TV and mobile to consumers.
- Samsung Galaxy S8 may prove to be a hit.** In addition, the PCS division looks set to recover on its own in 2017 as Samsung will be releasing its new Galaxy S8 model in March or April next year. Hype over this product is increasing as Samsung is expected to roll out a killer product to mitigate the "exploding" Note 7 of this year. We reckon that the suite of new features in the S8 model will spur a higher rate of handset upgrades next year, translating to higher revenue for PCS.
- 3Q16 results show improvement over 2Q16.** During 3Q16, TeleChoice reported improved financial results with revenue growing by 2% quarter-on-quarter and PATMI rebounding to S\$2.0m from S\$0.5m in 2Q16. The improved profitability was driven by higher margins across all three segments and the reversal of a pre-tax loss of S\$1.0m in 2Q16 to a pre-tax profit of S\$0.3m in 3Q16 for the ICT segment. The profitability of the ICT segment in 3Q16 may not recur in 4Q16 due to the project based nature of this segment. In this update, we revised our FY16 PATMI forecast to S\$6.9m from S\$7.9m previously, implying year-on-year lower 4Q16 PATMI of S\$3.2m in line with the guidance provided by the company. Nonetheless, our forecast still suggests sequential profit growth from 3Q16.

| <b>Key Financial Data</b><br>(S\$ m, FYE Dec) | <b>2014</b> | <b>2015</b> | <b>2016F</b> | <b>2017F</b> | <b>2018F</b> |
|---|-------------|-------------|--------------|--------------|--------------|
| Sales   | 516.8       | 580.7       | 546.4        | 587.4        | 632.8        |
| Gross Profit                                  | 42.5        | 43.1        | 38.8         | 42.3         | 46.8         |
| Net Profit                                    | 9.4         | 10.3        | 6.9          | 9.2          | 10.9         |
| EPS (cents)                                   | 2.1         | 2.3         | 1.5          | 2.0          | 2.4          |
| EPS growth (%)                                | (3.1)       | 9.5         | (32.5)       | 32.3         | 19.0         |
| PER (x)                                       | 13.3        | 12.2        | 18.1         | 13.6         | 11.5         |
| NTA/share (cents)                             | 12.8        | 13.5        | 13.5         | 14.1         | 15.0         |
| DPS (cents)                                   | 1.6         | 1.6         | 1.6          | 1.6          | 1.6          |
| Div Yield (%)                                 | 5.8         | 5.8         | 5.8          | 5.8          | 5.8          |

Source: Company, NRA Capital forecasts

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## Results Comparison

| FYE Dec (S\$ m)      | 3Q16       | 3Q15       | yoy %<br>chg | 2Q16       | qoq %<br>chg | Prev.<br>3Q16F |
|----------------------|------------|------------|--------------|------------|--------------|----------------|
| Revenue              | 127.4      | 145.2      | -12          | 124.6      | 2            | 157.2          |
| Operating costs      | (123.8)    | (142.0)    | -13          | (122.6)    | 1            | (153.4)        |
| EBITDA               | 3.6        | 3.2        | 14           | 1.9        | 87           | 3.8            |
| EBITDA margin (%)    | 2.8        | 2.2        | 29           | 1.5        | 82           | 2.4            |
| Depn & amort.        | (0.7)      | (0.7)      | -8           | (0.7)      | 3            | (0.6)          |
| EBIT                 | 2.9        | 2.4        | 20           | 1.3        | 131          | 3.2            |
| Interest expense     | (0.2)      | (0.1)      | 125          | (0.2)      | 9            | (0.2)          |
| Interest & invt inc  | 0.0        | (0.2)      | 126          | (0.0)      | 213          | 0.0            |
| Associates' contrib  | 0.0        | 0.0        | Nm           | 0.1        | -54          | 0.0            |
| Exceptionals         | 0.0        | 0.0        | Nm           | 0.0        | nm           | 0.0            |
| <b>Pretax profit</b> | <b>2.8</b> | <b>2.1</b> | <b>29</b>    | <b>1.1</b> | <b>156</b>   | <b>3.0</b>     |
| Tax                  | (0.7)      | (0.7)      | 7            | (0.6)      | 26           | (0.2)          |
| Tax rate (%)         | (26.2)     | (31.6)     | -17          | (53.2)     | -51          | (7.8)          |
| Minority interests   | 0.0        | 0.1        | -97          | 0.0        | -33          | 0.1            |
| <b>Net profit</b>    | <b>2.0</b> | <b>1.5</b> | <b>33</b>    | <b>0.5</b> | <b>301</b>   | <b>2.8</b>     |
| EPS (cts)            | 0.45       | 0.34       | 32           | 0.11       | 309          | 0.63           |

Source: Company, NRA Capital

**Lower revenue, but higher margin in 3Q16.** 3Q16 revenue was generally lower than expected due to the recall by Samsung for the Note 7 phones. As a result, PCS revenue fell by S\$18.1m or 16% year-on-year to S\$91.6m. ICT and network engineering revenue were flat at S\$20.6m and S\$15.2m respectively. The silver lining is that profit before tax margins for the respective segments improved during 3Q16. Hence, EBITDA margin was higher than expected, indicating tight cost control and, in the case of the ICT segment, improved project margins upon completion.

**What to expect for 4Q16?** In 4Q15, TeleChoice made S\$5.8m of PATMI. Of the operating pre-tax profit of S\$6.3m, the PCS, ICT and network engineering segments made S\$2.0m, S\$2.7m and S\$1.6m respectively. In particular, the ICT segment experienced a spike in revenue in 4Q15 of S\$41.6m. Looking ahead, we do not expect the ICT segment to generate such high revenue and profitability in 4Q16. Moreover, TeleChoice has also indicated that its operating performance for 4Q16 and full year 2016 is expected to be lower than the corresponding periods of 2015.

**Resilient share price performance.** In spite of the performance of TeleChoice in 2016, its share price has remained relatively stable. Based on TeleChoice's share price of S\$0.260, it trades at 17.3x and 13.0x our updated FY16 and FY17 earnings per share forecasts. However, we remind that TeleChoice is actually in a net cash position with S\$25.8m or 5.67 cents per share of net cash on its balance sheet as of 30 September 2016. Subtracting the cash from TeleChoice's share price, it actually trades at a much more conservative multiple of 13.55x FY16 EPS and 10.16x FY17 EPS.

**PCS division may expand into new services.** We believe that the higher margin business of the PCS division is actually its retail and supply chain management business. Lower reliance on equipment distribution will actually raise margins over time. In this aspect, we hold the view that the PCS segment will be able to grow its management service business by seeking out new businesses from Starhub and from other clients in the region. The PCS division is in a position to replicate these services given its existing client base of both Starhub and U Mobile.

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**But the outlook for handset sales in 2017 is actually positive.** Samsung will be launching its Galaxy S8 next year in March or April. Given the Note 7 recall, we reckon that Samsung will double down on efforts to make the Galaxy launch a success and to recapture market share. Initial reviews have been positive.<sup>1</sup> Improvements will include the removal of the physical home button so that the screen will cover the front of the entire phone. Like Apple's iPhone, the Galaxy S8 will also go wireless, dropping the headphone jack. Other new features may include for instance foldable or bendable screens.<sup>2</sup> Moreover, Samsung users who have skipped on upgrading in 2016 may choose to replace their handsets in 2017.

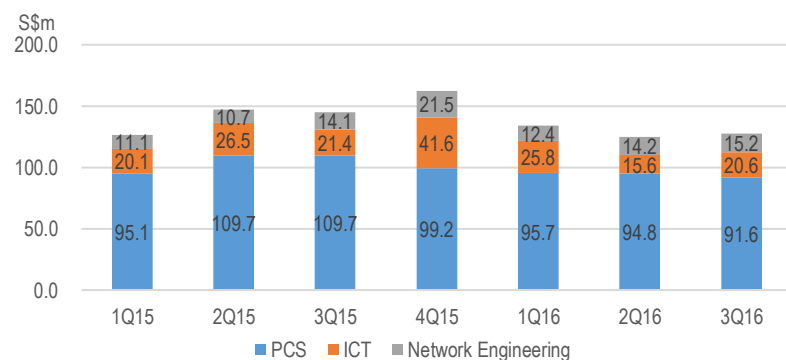
On balance, our view is that PCS revenue should rebound in 2017 based on its existing businesses alone. While we project that PCS revenue may drop by 5% in 2016 to S\$393m, it will likely rebound back to S\$413m in 2017 which is similar to that of 2015.

Figure 1: Potential Galaxy S8 Concept



Source: <http://www.businessinsider.sg/apple-iphone-8-vs-samsung-galaxy-s8-same-features-2016-12/?r=US&IR=T#ASFwImFzz4oD5pdL.97>

Figure 2: Samsung Galaxy S8 May Give PCS Revenue a Boost in 2017



Source: Company, NRA Capital

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**ICT Segment won several new government projects lately.** Our review of the GeBiz portal showed that S&I has secured a S\$5.48m contract to supply and support a commercial off-the-shelf integrated assessment system for the Ministry of Education (tender reference - ITE000ETT16000004). Other contracts awarded include the provision of IT application development and maintenance services for government ministries/departments and statutory boards (tender reference - IDA000ETT16000030 / IDA(T)-1432-G). However, the value of this contract is not available. TeleChoice's broader strategy for the ICT segment remains unchanged. While it will continue to bid for government contracts, the focus remains on the private sector. For instance, the hospitality sector is a target market where TeleChoice can work with its associated company MVI Systems to offer converged telephony and entertainment solutions.

**Any fourth telco will benefit the network engineering business the most.** The IMDA has shortlisted My Republic Limited (MR) and TPG Telecom Pte Ltd to participate in the spectrum auction. If MR is selected, local services providers such as TeleChoice are likely to benefit as the new telco will have to roll out its own network within 15 months. The risks are if a decision is made not to have a fourth telco or if TPG Telecom is selected. TPG Telecom is an Australian company and may have its own choice of service providers.

**Recommendation and valuation.** Overall, we continue to like TeleChoice for its full fledge of capabilities to support telco companies, e.g. retail and supply chain management services, ICT services and network engineering services. These capabilities can be marketed to other telcos in the region. The key risk is if TeleChoice decides to cut its dividend for FY16, especially when profit has dropped. However, any reduction in dividends will likely be reversed and repaid when profits recover in 2017 or later.

In fact, TeleChoice comes across as even more undervalued once the EV/EBIDA measure is applied. TeleChoice currently trades at 8.1x FY16 EV/EBITDA, which is already a low year, versus the current peer average of 13.3x. Applying a multiple of 13.3x, we yielded an enterprise value of S\$155.3m. Adding back the cash, the implied market capitalisation works out to S\$178.8m or S\$0.393 per share. Hence, our valuation of S\$0.340 is reasonable.

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<sup>1</sup> <http://www.independent.co.uk/life-style/gadgets-and-tech/news/samsung-s8-galaxy-iphone-8-rumours-leaks-specs-screen-home-button-a7463996.html>

<sup>2</sup> <http://www.techtimes.com/articles/188577/20161212/samsung-galaxy-s8-and-galaxy-note-8-to-rock-foldable-screens-in-2017-what-else-to-expect.htm>

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Figure 3: Peer Comparison

| Company Name                                 | Mkt Cap (\$m)   | T12M Sales (\$m) | ROE         | Debt to Equity | P/E         | P/B        | EV/EBITDA   |
|--|-----------------|------------------|-------------|----------------|-------------|------------|-------------|
| CSE Global Ltd                               | 239.97          | 338.2            | 9.89        | 23.0           | 10.38       | 1.03       | 4.75        |
| Nera Telecommunications Ltd                  | 153.81          | 179.6            | 85.78       | 29.1           | 21.84       | 1.29       | 11.67       |
| Declout Ltd                                  | 112.77          | 290.2            | 6.50        | 70.1           | 15.95       | 1.16       | 9.56        |
| Hengxin Technology Ltd                       | 118.34          | 325.6            | 9.13        | 9.1            | 4.93        | 0.43       | 0.91        |
| Polaris Ltd                                  | 85.27           | 116.5            | -184.25     | 70.9           | NA          | 8.10       | NA          |
| Addvalue Technologies Ltd                    | 58.58           | 19.0             | -21.00      | 59.3           | NA          | 2.42       | 62.15       |
| Global Invacom Group Ltd                     | 45.64           | 193.7            | 2.42        | 9.8            | 24.51       | 0.59       | 2.93        |
| Next-Generation Satellite Communications Ltd | 12.82           | 0.0              | 59.46       | 0.0            | 0.53        | 0.25       | NA          |
| Captii Ltd                                   | 15.82           | 17.4             | 5.63        | 0.0            | 8.67        | 0.48       | 1.36        |
| CMC Infocomm Ltd                             | 5.32            | NA               | NA          | 17.6           | NA          | 0.44       | NA          |
| <b>Average</b>                               | <b>84.8</b>     | <b>164.5</b>     | <b>-2.9</b> | <b>28.9</b>    | <b>12.4</b> | <b>1.6</b> | <b>13.3</b> |
| <b>TeleChoice International Ltd</b>          | <b>118.1</b>    | <b>548.2</b>     | <b>13.8</b> | <b>26.2</b>    | <b>12.4</b> | <b>1.7</b> | <b>6.1</b>  |
| <b>Telecommunication Companies</b>           |                 |                  |             |                |             |            |             |
| Singapore Telecommunications Ltd             | 61,887.5        | 16,562.5         | 15.4        | 39.8           | 15.8        | 2.4        | 15.0        |
| StarHub Ltd                                  | 5,096.9         | 2,395.7          | 175.0       | 366.5          | 13.8        | 22.2       | 9.2         |
| M1 Ltd/Singapore                             | 1,878.6         | 1,055.0          | 43.6        | 85.6           | 11.7        | 5.0        | 7.9         |
| <b>Average</b>                               | <b>22,954.3</b> | <b>6,671.1</b>   | <b>78.0</b> | <b>164.0</b>   | <b>13.8</b> | <b>9.9</b> | <b>10.7</b> |

Source: Bloomberg, NRA Capital

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| <b>Profit &amp; Loss</b> (S\$ m, FYE Dec)   | <b>2014</b>   | <b>2015</b>  | <b>2016F</b>  | <b>2017F</b> | <b>2018F</b> |
|---|---------------|--------------|---------------|--------------|--------------|
| Revenue                                     | 516.8         | 580.7        | 546.4         | 587.4        | 632.8        |
| Operating expenses                          | (501.8)       | (565.1)      | (534.7)       | (574.4)      | (617.7)      |
| EBITDA                                      | 15.0          | 15.5         | 11.7          | 13.0         | 15.1         |
| Depreciation & amortisation                 | (3.4)         | (2.9)        | (2.6)         | (2.6)        | (2.6)        |
| EBIT  | 11.6          | 12.6         | 9.1           | 10.4         | 12.5         |
| Net interest & invt income                  | (0.2)         | 0.2          | (0.2)         | 0.5          | 0.5          |
| Associates' contribution                    | 0.0           | 0.0          | 0.0           | 0.0          | 0.0          |
| Exceptional items                           | 0.0           | (0.6)        | 0.0           | 0.0          | 0.0          |
| <b>Pretax profit</b>                        | <b>11.4</b>   | <b>12.2</b>  | <b>8.9</b>    | <b>10.9</b>  | <b>13.0</b>  |
| Tax   | (2.2)         | (2.1)        | (2.2)         | (2.0)        | (2.3)        |
| Minority interests                          | 0.2           | 0.2          | 0.2           | 0.2          | 0.2          |
| <b>Net profit</b>                           | <b>9.4</b>    | <b>10.3</b>  | <b>6.9</b>    | <b>9.2</b>   | <b>10.9</b>  |
| Shares at year-end (m)                      | 454.4         | 454.4        | 454.4         | 454.4        | 454.4        |
| <b>Balance Sheet</b> (S\$ m, as at Dec)     | <b>2014</b>   | <b>2015</b>  | <b>2016F</b>  | <b>2017F</b> | <b>2018F</b> |
| Fixed assets                                | 3.3           | 3.7          | 4.2           | 4.6          | 5.1          |
| Intangible assets                           | 14.0          | 13.0         | 12.3          | 11.7         | 11.1         |
| Other long-term assets                      | 7.0           | 7.7          | 8.2           | 8.6          | 9.2          |
| <b>Total non-current assets</b>             | <b>24.3</b>   | <b>24.4</b>  | <b>24.7</b>   | <b>25.0</b>  | <b>25.4</b>  |
| Cash and equivalents                        | 38.0          | 44.6         | 43.0          | 42.5         | 44.1         |
| Stocks                                      | 32.7          | 51.3         | 48.5          | 52.1         | 56.0         |
| Trade debtors                               | 91.7          | 73.6         | 69.3          | 74.5         | 80.2         |
| Other current assets                        | 0.0           | 0.0          | 0.0           | 0.0          | 0.0          |
| <b>Total current assets</b>                 | <b>162.4</b>  | <b>169.5</b> | <b>160.8</b>  | <b>169.0</b> | <b>180.2</b> |
| Trade creditors                             | 85.6          | 89.3         | 86.3          | 92.7         | 99.6         |
| Short-term borrowings                       | 20.0          | 14.5         | 8.2           | 8.8          | 9.5          |
| Other current liabilities                   | 5.8           | 5.8          | 7.0           | 6.8          | 7.2          |
| <b>Total current liabilities</b>            | <b>111.4</b>  | <b>109.6</b> | <b>101.5</b>  | <b>108.3</b> | <b>116.3</b> |
| Long-term borrowings                        | 0.0           | 5.0          | 5.5           | 5.9          | 6.3          |
| Other long-term liabilities                 | 3.1           | 5.1          | 4.9           | 4.6          | 4.4          |
| <b>Total long-term liabilities</b>          | <b>3.1</b>    | <b>10.1</b>  | <b>10.3</b>   | <b>10.5</b>  | <b>10.7</b>  |
| <b>Shareholders' funds</b>                  | <b>72.1</b>   | <b>74.2</b>  | <b>73.8</b>   | <b>75.7</b>  | <b>79.3</b>  |
| Minority interests                          | 0.2           | 0.0          | (0.2)         | (0.5)        | (0.7)        |
| NTA/share (S\$)                             | 0.13          | 0.13         | 0.14          | 0.14         | 0.15         |
| <b>Total Assets</b>                         | <b>186.7</b>  | <b>193.9</b> | <b>185.4</b>  | <b>194.0</b> | <b>205.6</b> |
| <b>Total Liabilities + S'holders' funds</b> | <b>186.7</b>  | <b>193.9</b> | <b>185.4</b>  | <b>194.0</b> | <b>205.6</b> |
| <b>Cash Flow</b> (S\$ m, FYE Dec)           | <b>2014</b>   | <b>2015</b>  | <b>2016F</b>  | <b>2017F</b> | <b>2018F</b> |
| Pretax profit                               | 11.4          | 12.2         | 8.9           | 10.9         | 13.0         |
| Depreciation & non-cash adjustments         | 1.9           | 10.2         | 3.7           | 3.7          | 3.8          |
| Working capital changes                     | (10.0)        | 3.7          | 5.1           | (2.2)        | (2.5)        |
| Cash tax paid                               | (1.9)         | (1.3)        | (1.0)         | (2.2)        | (2.0)        |
| <b>Cash flow from operations</b>            | <b>1.4</b>    | <b>24.7</b>  | <b>16.6</b>   | <b>10.2</b>  | <b>12.4</b>  |
| Capex                                       | (3.0)         | (2.3)        | (3.1)         | (3.1)        | (3.1)        |
| Net investments & sale of FA                | 0.0           | (5.9)        | 0.0           | 0.0          | 0.0          |
| Others                                      | (1.3)         | (0.3)        | (0.5)         | (0.6)        | (0.6)        |
| <b>Cash flow from investing</b>             | <b>(4.3)</b>  | <b>(8.4)</b> | <b>(3.6)</b>  | <b>(3.7)</b> | <b>(3.7)</b> |
| Debt raised/(repaid)                        | 0.1           | (0.5)        | (5.8)         | 1.0          | 1.1          |
| Equity raised/(repaid)                      | (0.2)         | 0.0          | 0.0           | 0.0          | 0.0          |
| Dividends paid                              | (7.3)         | (7.3)        | (7.3)         | (7.3)        | (7.3)        |
| Cash interest & others                      | (0.6)         | (1.9)        | (1.4)         | (0.9)        | (0.9)        |
| <b>Cash flow from financing</b>             | <b>(8.0)</b>  | <b>(9.7)</b> | <b>(14.5)</b> | <b>(7.1)</b> | <b>(7.1)</b> |
| <b>Change in cash</b>                       | <b>(10.9)</b> | <b>6.6</b>   | <b>(1.5)</b>  | <b>(0.6)</b> | <b>1.6</b>   |
| <b>Change in net cash/(debt)</b>            | <b>(11.0)</b> | <b>7.1</b>   | <b>4.3</b>    | <b>(1.6)</b> | <b>0.5</b>   |
| <b>Ending net cash/(debt)</b>               | <b>18.0</b>   | <b>25.1</b>  | <b>29.4</b>   | <b>27.8</b>  | <b>28.3</b>  |
| <b>KEY RATIOS</b> (FYE Dec)                 | <b>2014</b>   | <b>2015</b>  | <b>2016F</b>  | <b>2017F</b> | <b>2018F</b> |
| Revenue growth (%)                          | (7.1)         | 12.4         | (5.9)         | 7.5          | 7.7          |
| EBITDA growth (%)                           | 2.2           | 3.7          | (24.8)        | 11.2         | 16.3         |
| Pretax margins (%)                          | 2.2           | 2.1          | 1.6           | 1.9          | 2.1          |
| Net profit margins (%)                      | 1.8           | 1.8          | 1.3           | 1.6          | 1.7          |
| Effective tax rates (%)                     | 19.3          | 17.6         | 25.0          | 18.0         | 18.0         |
| Net dividend payout (%)                     | 77.6          | 70.9         | 105.1         | 79.4         | 66.7         |
| ROE (%)                                     | 13.0          | 13.8         | 9.4           | 12.1         | 13.7         |
| Free cash flow yield (%)                    | (1.4)         | 19.0         | 11.4          | 6.0          | 7.9          |

Source: Company, NRA Capital forecasts

# TeleChoice International Limited

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