

# Foresight Solar Fund

Solar energy – the future is here

Initiation of coverage

Investment trusts  
Renewable energy equities

18 February 2021

**Price** 102.0p  
**Market cap** £619.9m  
**AUM** £569.8m

NAV\* 93.9p  
Premium to NAV 8.7%  
NAV\*\* 95.6p  
Premium to NAV 6.7%

\*Excluding income. \*\*Including income. At 30 September 2020.

Yield 6.7%

Launch date 29 October 2013

Ordinary shares in issue 607.7m

Benchmark MSCI World High Div Yield Index

Code/ISIN FSFL/JE00BD3QJR55

Primary exchange LSE

AIC sector Renewable Energy Infrastructure

52-week high/low 118.0p 91.0p

NAV\* high/low 103.6p 95.6p

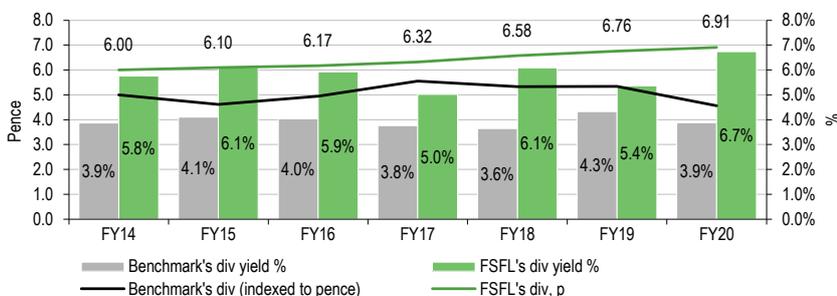
\*Including income

Net gearing\* 175%

\*At 31 January 2021, (GAV less cash)/NAV

Foresight Solar Fund (FSFL) has consistently delivered on its investment objective from its launch in October 2013. It is the largest UK solar player and provides investors with a covered, sustainable and growing dividend, underpinned by subsidised assets in the UK and high-return growth opportunities globally. This continued during the fund's arguably most challenging few years, amid declining power prices and the COVID-19-triggered economic shock. The solar industry's growth potential remains huge. The IEA estimates that solar capacity needs to quadruple in the next decade globally (a 20% CAGR) to limit global warming to 1.5°C. The UK's solar capacity is forecast to more than double within the next 10 years.

FSFL's dividend growth and yield (31 December each FY) vs the benchmark\*



Source: FSFL, Bloomberg, Edison Investment Research. Note: \*MSCI World High Dividend Yield Index.

## Why invest in FSFL?

FSFL pays consistently growing income (6–7% dividend yield) from operating solar plants and selling generated electricity to grids. Net shareholders' TR target is 7–8% per year. FSFL is the largest, most diversified and conservatively capitalised solar operator among three UK-focused peers. Even during 2020, the toughest year since launch and amid depressed contract prices, the cash coverage margin was sufficient to pay the higher dividend. With energy prices recovering, we are confident the dividend remains covered and the progressive dividend policy stands.

## The analyst's view

FSFL has a high degree of protection against power price fluctuations. Long-term revenue volatility is reduced, as the high share of the revenues (74% in H120) is fixed. All UK assets (83% of GAV) are subsidised and inflation linked. Around 60% of each UK asset's annual total revenues is subsidy fixed and 14% is PPA fixed. FSFL's strategy includes maintaining a proportion of short-term energy sales (26% in H120) uncontracted, aiming to benefit from the increases in electricity prices.

## Valuation: A revaluation opportunity

FSFL's lower premium to NAV than the peer group average (6.7% vs 8.7%) could be attributed to weaker NAV growth, as valuation methodologies differ. As power prices recover, we expect FSFL to surprise on the upside. The trust's opportunity to revalue is underpinned by a higher energy yield due to a wider geographic mix (Australia and Spain) and valuation assumptions that appear more conservative.

## Fund objective

Foresight Solar Fund's (FSFL's) investment objective is to provide investors with a sustainable and progressive quarterly dividend underpinned by investments in a geographically diverse portfolio of assets. FSFL aims to preserve and, where possible, enhance capital value through reinvesting excess cash flows not required for the payment of dividends. FSFL acquires large-scale solar power plants, identifying solar opportunities in the UK and overseas markets (to 25% of the gross asset value).

## Bull points

- Solid track record as illustrated by fully cash-covered and growing dividends to date.
- Foresight is a 'one-stop shop' with a wealth of expertise in the solar and renewables sector.
- Our analysis suggests FSFL's valuation assumptions are more conservative than those of peers.

## Bear points

- Power price volatility.
- High NAV sensitivity to power price, inflation and discount rates.
- FSFL has reported lower NAV growth due to its conservative valuation methodology.

## Analysts

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**Foresight Solar Fund is a research client of Edison Investment Research Limited**

## Fund profile: UK and global (to 25% GAV) solar fund

FSFL is a London Stock Exchange-listed investment trust focused on solar investments, launched on 29 October 2013. The investment objective is to pay sustainable and progressive quarterly dividends. FSFL aims to preserve and, where possible, grow capital through reinvesting excess cash flows not required for paying dividends.

FSFL's investment strategy is to acquire large-scale solar power plants, principally in the UK. Up to 25% of the GAV of FSFL and subsidiaries, calculated at the time of investment, can be invested outside the UK. Up to 25% of GAV can be invested in construction assets. FSFL does not take development risk. The company buys assets once operational or during construction, funding the construction by paying in stages, subject to construction progress.

The company targets total return (TR) to investors equivalent to an unlevered IRR of 7–8% after having accounted for fees and expenses. It seeks to achieve these returns through active management of its solar power plants in accordance with its investment policy and will look to grow its investment portfolio through additional asset acquisitions throughout its life.

FSFL does not use an investment performance benchmark and has a total-return focus.

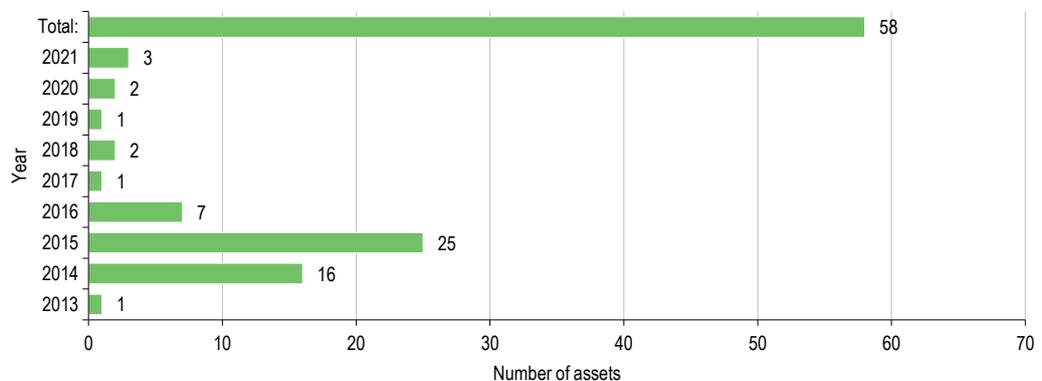
### FSFL's evolution

FSFL launched with seven contracted assets (136MW in total). The portfolio currently consists of 58 assets, including 50 in the UK, four in Australia and four in Spain. In 2017 it acquired the four assets in Australia, which account for 146MW of total installed capacity. Connection issues delayed them becoming operational but have now been largely resolved. Of the four Spanish assets, one is expected to become operational in Q3 21 and three in June 2022. The total installed capacity is 994MW, once fully operational.

Having raised £150m of equity from both institutional and private investors at launch, FSFL has evolved into a mature and diversified solar asset manager with £1,016.8m GAV and £580.6m net asset value (NAV) at 30 September 2020 (30 June 2020: £1,022.5m and £582.1m, respectively).

The portfolio evolution is presented in Exhibit 1, by commissioning date. The heaviest years were 2014 and 2015, when FSFL commissioned 16 and 25 solar assets, respectively. The UK-subsidised assets receive subsidies for 20 years if they were commissioned before 2016.

**Exhibit 1: FSFL's portfolio evolution**



Source: FSFL, Edison Investment Research at 20 January 2021

FSFL's growth and geographic expansion has been financed with both equity and debt capital, which is a combination of long-term debt and revolving credit facilities (RCF). The company has

raised £666.2m equity since launch (bought back £27.3m). FSFL had £400.4m of long-term debt at 30 June 2020. The use of RCF allows FSFL to use low-cost capital funding and avoid cash drag.

## The fund manager: Foresight Group

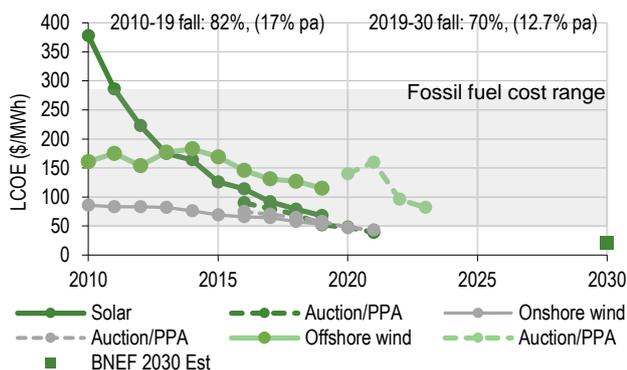
### The manager's view: Excited about solar industry prospects

The portfolio manager Ricardo Pineiro believes solar energy will grow considerably as a proportion of global energy generation from current levels, having become the cheapest source of renewable energy (see Exhibit 2). He points out that generating c 13GW of energy from solar, the UK is expected to more than double this to 30–35GW in 10 years' time. This resonates with National Grid's estimates for UK solar capacity to double by 2030 (at 9% CAGR, see Exhibit 3), if the UK remains on track to reach its net zero carbon emissions commitment by 2050.

Considering the opportunities for further investment in the UK are limited, FSFL is diversifying geographically, using power purchase agreements (PPAs) (Australia, Spain). The renewable obligation (RO) mechanism, whereby the UK government subsidised solar assets at fixed rates, was closed for all assets built after 1 April 2016. This led to the rate of solar installation in the UK to slow sharply in recent years. In addition, assets in the secondary market (particularly those backed by government subsidies) demand higher valuations. Some Australian assets within FSFL's portfolio also benefit from subsidies, although the proportion of annual subsidised revenues is significantly lower than in the UK. All Spanish assets are subsidy free.

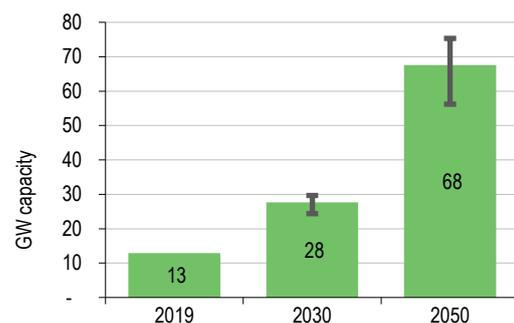
As renewable energy sources replace carbons, power prices are likely to continue to fluctuate, depending on whether this process is slower or faster than the market expects. Declining costs in the solar energy industry attract more players building more capacity, which puts further deflationary pressure on power prices. This is called 'cannibalisation' and is another factor that contributes to power price volatility.

**Exhibit 2: Falling solar costs make it the cheapest form of electricity. Further cost reductions are expected**



Source: Adapted from IRENA. Note: LCOE, levelised cost of electricity, is designed to incorporate the different mix of capex, operating and system cost by generation type. BNEF expects solar LCOE to fall to c \$20 by 2030.

**Exhibit 3: UK solar capacity expected to double by 2030 and grow fivefold by 2050 in a net zero scenario**



Source: Based on National Grid FES 2020 net zero scenarios (Consumer/System Transformation and Leading the Way). Note: The chart implies 1.3 GW of capacity added every year until 2030 and 2.0 GW added every year between 2030 and 2050

### Manager and team

FSFL's investment manager is Foresight Group (Foresight). FSFL's investment management team is led by the experienced team of UK-based managers. Ricardo Pineiro, FSFL's portfolio manager, is a partner at Foresight and the head of the UK solar team. Since joining Foresight in 2011, he has led or overseen the acquisition of over 70 solar power plants representing more than 1GW in the

UK and internationally. Pineiro has been part of FSFL's management team since FSFL listed. Gary Fraser is a partner, CFO and COO.

The managers are supported by the portfolio management team at Foresight. FSFL's corporate structure includes the listed vehicle, project vehicles, the asset manager (Foresight Group), the engineering company and intermediate holdings companies, among others.

FSFL uses resources of Foresight, which has 97 team members, including 10 partners and 41 investment professionals, all with renewables' backgrounds and an average of 12 years' industry experience. There are team members overseeing portfolio and asset management and a seven-strong investor relations team. This allows Foresight to use in-house teams for most activities to service and manage FSFL's business, including engineers implementing a number of technologies, and it outsources only a few services to contractors.

## Foresight

Founded in 1984, Foresight is a leading independent infrastructure and private equity group. It manages c £6.8bn (at 30 September 2020) on behalf of institutions and retail clients, which is c 3–6x of the assets under management (AUM) of the two closest UK solar peers. FSFL (c £1.1bn GAV) is the largest UK-based solar fund and its management is an integral part of Foresight's infrastructure team.

Foresight's infrastructure team invests for the long term and focuses on new and replacement power infrastructure. The team originates, executes and provides ongoing asset management services to institutional and retail investors. To date, the team has made 277 clean energy investments, having invested c £1bn of private capital in bioenergy assets. It reviews over 500 clean energy deals each year. Foresight is headquartered in London with regional offices across the UK and international offices in Sydney, Rome, Madrid and Luxembourg. It employs close to 250 individuals globally, including more than 70 investment professionals.

## Strategy and asset allocation

### Business model

As Exhibit 4 illustrates, FSFL generates revenues through the sale of electricity to the markets, typically, via two means: the subsidies provided under different subsidy regimes, such as RO certificates (ROCs) and feed-in-tariffs (FITs); and PPAs, which can be fixed or merchant.

1. Government-backed payments either FITs or ROCs, which guarantee fixed prices over the project lifetime (typically 20-25 years).
- 2a. Fixed PPAs typically pay a fixed price to take a certain level of generation over a shorter period.
- 2b. Merchant income, the remaining non-contracted solar generation is sold in the electricity market at the prevailing price (which can be hedged to improve visibility further).

The revenue streams are underpinned by two main factors:

- the energy output (measured as energy generated in KWh), which is mainly driven by the solar irradiation, technical performance and availability of the plant; and
- the actual price at which the energy generated is sold to the markets and the subsidies received for the same generation.

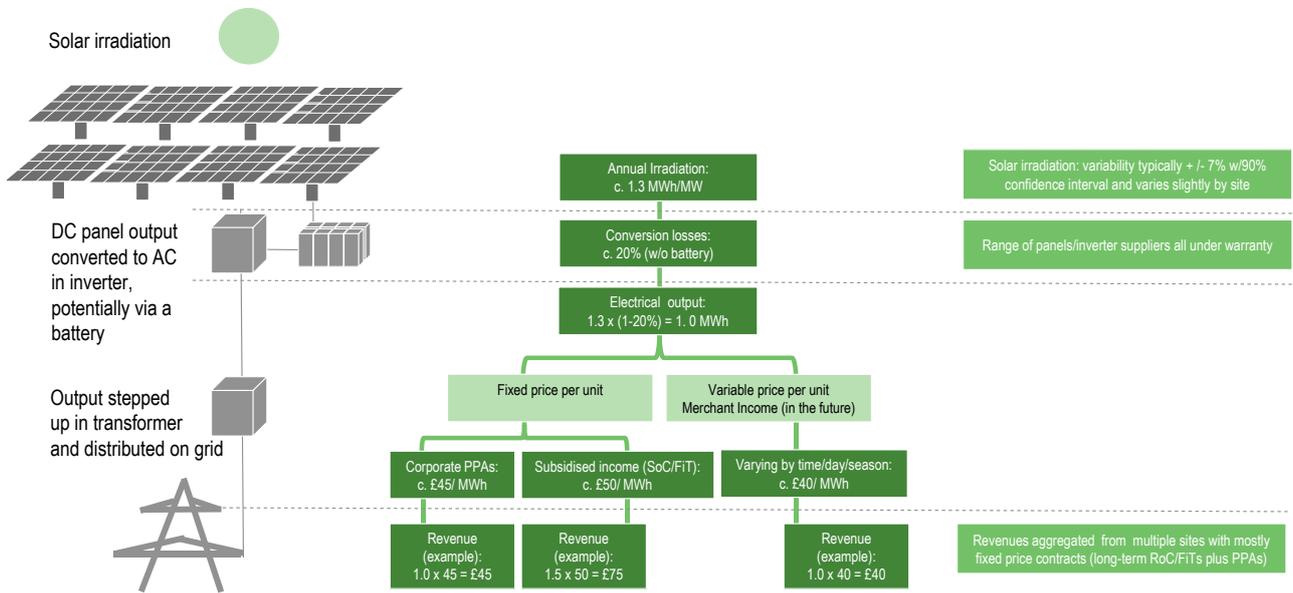
Solar energy generation is predictable, as solar irradiation displays little regional volatility. The expected variability is  $\pm 10\%$  based on 90% confidence interval, according to FSFL's estimates. The technical or operational performance is principally measured by a conversion factor (the ratio captures the solar plant performance ratio and its availability, reflecting all system shutdowns for

maintenance or one-off events such as outages), which is c 83% for solar plants, but can be improved using various efficiency measures.

The performance of a plant in terms of revenues is a product of the operational performance and the commercial terms of the subsidies and PPAs in place. Realised prices of subsidies differ for solar operators. The price of one ROC will be the same across all funds and technologies; however, the realised price will depend on portfolio-weighted ROC banding, allocated by the government to various renewable assets. Hence it is a function of technology, in this case, solar photovoltaic (PV), age and so on of the assets in the portfolio. FITs also have their pricing rules, for example, they progressively depreciate as the energy output of an operator increases.

Before taking into account tax payments and financing considerations, the cash-flow generation of solar assets is influenced by operating expenses, which are usually governed by contracts of more than five years and characterised by low volatility over the long term.

**Exhibit 4: The solar revenue model**



Source: Edison Investment Research

## Investment process

FSFL's management team pursue active power price strategy management to ensure the targeted proportion of the next year's revenue (typically around 60%) comes at fixed prices from government subsidies. Most of the UK portfolio was acquired over 2015–18 and has 20 years of the contracted subsidised revenue from the time of commissioning. The acquired assets typically stay with FSFL until the end of their useful life, when they are dismantled (the expected costs are incorporated in the valuation models). The land where assets are based is leased by FSFL, typically over the corresponding term. The average remaining subsidy life for the UK portfolio is 15 years. These subsidies are 100% inflation linked.

Although it is some time until subsidies on its UK assets expire, the FSFL team uses the rolling approach to deliver in the future, implementing different strategies. FSFL books merchant revenue on a rolling basis. This approach allows the company to time and book contracts at higher prices, when energy prices rise.

FSFL implements other mechanisms or fixed-price agreements in all three current markets. It negotiates the balance of energy for sale on the market with various energy buyers. This PPA and/or merchant revenue also becomes 'fixed', typically when the contract is signed. For example, Iberian and Australian assets have longer-term PPA agreements.

FSFL enters PPAs between each of the individual solar power plant special purpose vehicles (SPVs) in its portfolio and creditworthy off-takers in the UK. Under the PPAs, the SPVs will sell solar generated electricity and green benefits to the designated off-taker. The company may retain exposure to fluctuations in UK power prices through PPAs. Reducing the risk of such exposure, the team targets securing the bulk of its contracted future revenue via fixed-price mechanisms and long-term contracts.

The company seeks to diversify risk by ensuring a significant proportion of its expected income stream (c 60%) is derived from subsidies – government-sponsored green benefits, such as ROCs and FITs. A single asset is limited to 30% of the GAV post acquisition.

While PPAs are typically shorter-term contracts (one to four years) and provide less protection to falls in long-term power price assumptions, FSFL is also working to secure longer-term PPAs, particularly in its international assets. As the number of companies seeking to decarbonise their electricity demand rises, the market for PPA commitments is likely to grow.

FSFL diversifies exposure by having a portfolio diversified by assets and geographies. FSFL uses a number of different third-party providers such as developers, which reduces the business risk. When sourcing new deals, FSFL's team leverages the depth of expertise of the management team and local presence in relevant geographies.

ESG principles are embedded in FSFL's business and culture. The UK portfolio generated enough clean energy to power 173,000 homes for a year during the first half of 2020. As a signatory to the internationally recognised ESG standards Principles for Responsible Investment in its 2020 assessment, Foresight Group maintained its A+ rating for strategy and governance and improved its infrastructure score from A to A+, the highest grade, demonstrating the investment manager's ongoing commitment to sustainability.

Battery storage is the recent evolution of FSFL's strategy added to future solar projects. In February 2021, shareholders supported FSFL board's proposal to allow 10% of GAV to be invested into utility-scale battery storage system opportunities, principally located adjacent to FSFL's existing PV solar sites. For an incremental cost, battery storage can reduce some of the volatility of solar generation, enabling greater flexibility over when it is sold to the grid. In the context of income streams moving away from fixed-price subsidies towards more volatile merchant revenue, this could help maximise the value of the energy produced.

## Valuation assumptions and sensitivities

FSFL's management team values the company and its forecast cash flow revenue streams, building a discounted cash flow (DCF) model. NAV is derived from DCF and is based on a wide range of assumptions and current operational metrics.

The assumptions of FSFL's team are based on observable market and technical data. FSFL set out the inputs which it has ascertained would have a material effect on the NAV. All sensitivities are calculated independently of each other. FSFL publish these sensitivities in the company's regular reporting.

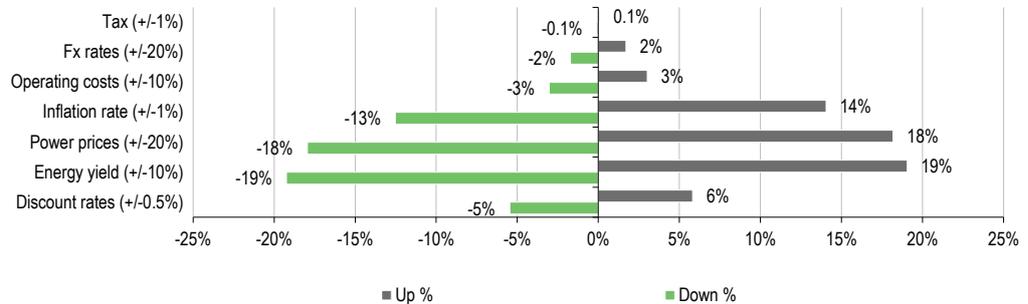
As Exhibit 5 presents, NAV is sensitive to five factors (most sensitive at the top):

- Energy yield: the proportion of operational time that an asset produces energy.
- Power prices: the blended average of forecasts provided by third-party consultants.
- Inflation rate: FSFL's long-term assumption is the 2.75% long term for the UK and 2% for both Australia and Spain.
- Discount rates: FSFL publishes its discount rates in its reporting, the latest being 6.75% at 30 June 2020 (reduced by 0.25% to 6.75% during the six months to end-June 2020). The discount rate used for UK asset cash flows which have received lease extensions beyond the initial

investment period of 25 years is 7.75% for subsequent years, reflecting the merchant risk of expected cash flows beyond the initial 25-year period.

- Operating costs: the costs of running a solar park.

**Exhibit 5: FSFL's valuation sensitivities\***



Source: FSFL, Edison Investment Research. Note: \*Based on the NAV of £582.1m at 30 June 2020.

The expected weighted average life of the UK portfolio at 30 June 2020 is 30.6 years from the date of commissioning. This represents a remaining useful economic life of the portfolio of 25.3 years when the historical operational periods are taken into consideration.

FSFL has modelled operating costs in its DCF and these are c 25–28% of revenues. All FSFL's UK assets are subsidised. The average remaining subsidy life for the UK portfolio is 15 years. Assets located in Australia currently assume a useful economic life of 25 years. Spanish assets currently assume a useful economic life of 35 years.

The company's assumptions are revised quarterly, based on a blended average of the forecasts provided by three third-party consultants (undisclosed) and updated on a quarterly basis for each market. Power price curves are published in FSFL's reports twice a year.

## Market outlook: Power prices and UK solar industry

### Power price forecasts: The greatest risk

We believe that in a 'subsidy-free world', as long as power prices remain above solar costs with a gradually widening margin over the long term, solar businesses could continue distributing growing income to investors, and be able to sustain cash covered by progressively growing dividends.

Power price forecasts feed into the DCF assumptions for solar assets; lower forecasts reduce solar valuations. Over the last 18 months, all UK solar investors have seen impacts on the value of their assets as these forecasts have fallen. Nevertheless, power price forecasts (by three major industry consultants whose forecasts are used by UK solar businesses) for 2021 and beyond are set to increase. This has enabled solar companies to secure higher contract prices for 2021, compared to 2020.

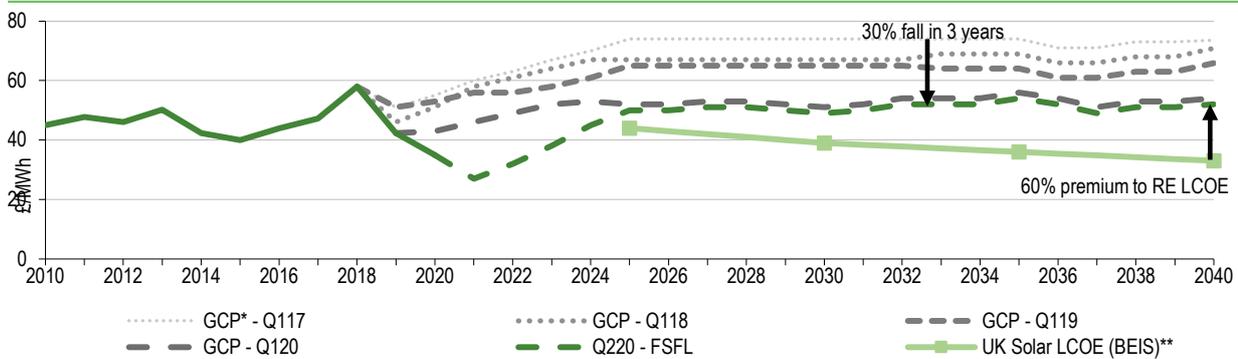
Solar technology is expected to lead the transition to low-carbon energy. This is underpinned by cost declines in the solar industry, and the fact that in many markets solar is already the cheapest form of electricity. Over the course of the last decade, average power generation costs have fallen c 80% (17% per year, source: IRENA), largely driven by improvements in module efficiency and economies of scale. These factors, combined with the policy-driven imperative to decarbonise, mean deployment is likely to accelerate at an increasing scale, pushing costs down further.

The UK government's Department for Business, Energy & Industrial Strategy (BEIS) forecasts the levelized cost of energy (LCOE) of £44/MWh by 2025. This compares with the 2016 forecast, which placed solar at £68/MWh. The LCOE is the present value of the total cost of building and operating

a power plant over an assumed lifetime. These cost reductions have resulted in the effective withdrawal of explicit policy support in the UK (subsidised prices) and are arguably also beginning to contribute to recent deflationary trends in power prices. The UK Power Price Spot Index is the APX Base Index (current price £54.7 MWh). Notably, the three major UK solar companies including FSFL only incur operating costs, which form part of LCOE, as they buy and operate built assets. Hence, their operating costs per MW are lower than the LCOE numbers.

Historically, power prices have been set by the marginal cost of natural gas, the form of generation typically used to plug the gap between demand and supply once renewable and nuclear supply is accounted for. Despite higher carbon prices, the price of gas (driven by oversupply of LNG in particular) has been under pressure for several years now. Moreover, increasingly cheap, intermittent renewables (wind is also an important factor, particularly in the UK) running at zero marginal cost, and the impact of COVID-19, have exacerbated the pressure on prices. As Exhibit 6 highlights, power price forecasts in the UK have fallen by c 30% over the last three years, but arguably, might have bottomed out. Economic recovery from the COVID-19 crisis would also underpin power prices.

**Exhibit 6: UK wholesale electricity prices 2010–40 vs solar LCOE forecasts**



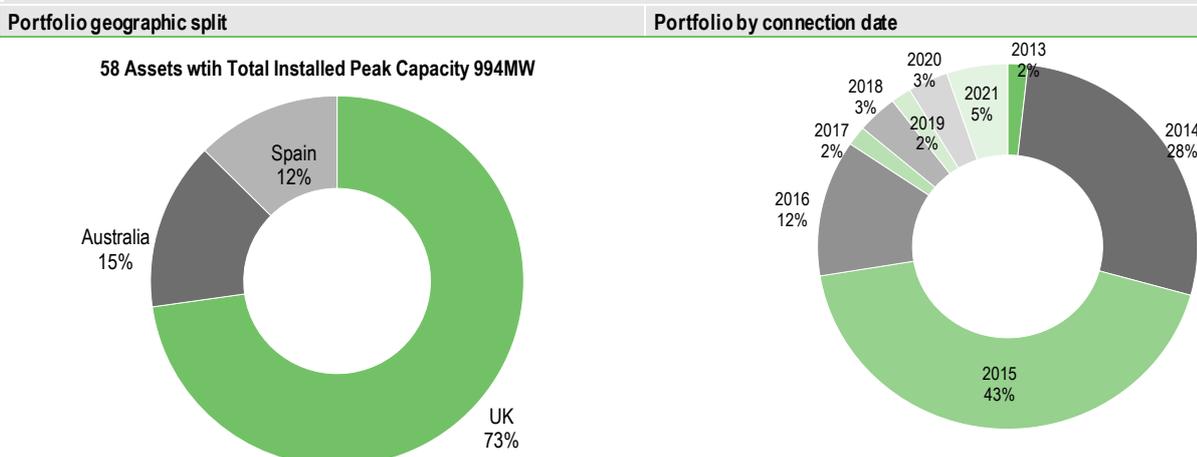
Source: Various. Note: \*GCP Infrastructure fund presentation (May 2020). \*\*BEIS – Electricity Generation Costs 2020. \*\*\*OFGEM – Wholesale electricity costs charts and indicators

## Portfolio

### Current portfolio positioning

Exhibits 7 and 8 present FSFL's portfolio comprising 58 assets.

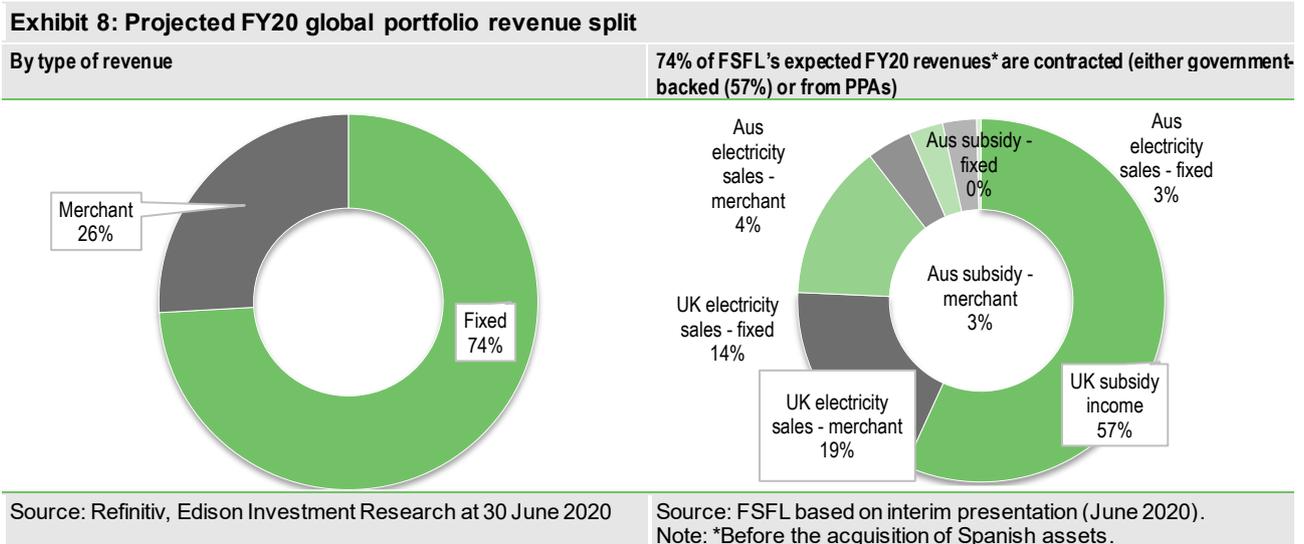
**Exhibit 7: Portfolio at 31 January 2021**



Source: Refinitiv, Edison Investment Research

The portfolio assets are based in the UK, Australia and Spain, with an installed capacity of 994MW, once fully operational. The company's investments outside the UK represent c 17% of gross asset value (GAV).

Implementing the combination of subsidised revenues and rolling contract policy each financial year, FSFL's team has fixed 74% of the projected FY20 revenue and c 30% of FY21 revenue (at 30 June 2020, see Exhibit 8, LHS). As costs have fallen, the level of government-backed income for new solar assets has also fallen. As an early entrant to the market, FSFL has 57% of its revenue covered by subsidies (see Exhibit 8, RHS).



In the UK, FSFL retains the option to fix the PPAs for its assets at any time. Three of the four assets in the Australian portfolio benefit from long-term PPAs (17 and 20 years) that offer protection against power price volatility for the next few years. The average power price achieved across the Australian portfolio during the period, including fixed price arrangements, was A\$56.11/MWh at end-June 2020. The weighted average spot prices during H120 were A\$43.9/MWh and A\$59.7/MWh in Queensland and Victoria, respectively.

## Mitigating power price volatility risks: Focus on quality and diversification

The Spanish 2020–21 acquisitions represent FSFL's first investments in subsidy-free solar. Long-term investment projects requiring significant upfront investment that are not backed by subsidies are potentially more risky. Nevertheless, management believes the prospects for returns justify the additional risk in this case. FSFL targets higher long-term shareholder TR from the new assets outside the UK, compared to existing UK solar farms. With the cost of panels and inverters (a type of electrical converter), largely similar across different markets, Spain's higher irradiation levels should enable it to generate substantially higher output for each MW deployed. Management has mitigated some of the risk by securing a PPA with Shell Energy Europe until 2030.

## Peer group comparison

### Business comparison

Exhibit 9 below compares three major UK solar peers, their assumptions implemented in DCF models to arrive at a NAV and their key business characteristics.

We note that while the inflation assumption and average length of portfolio assets is very similar, and the weighted average cost (WAC) of debt is comparable – across all three, the discount rate varies considerably. Both FSFL and NextEnergy Solar Fund (NESF) use the more conservative latest discount rate of 6.75% and 6.8%, respectively. The WACC is undisclosed by Bluefield Solar Income Fund (BSIF), and is fairly comparable for FSFL and NESF at 5.1% and 5.4%, respectively, with FSFL having a marginal advantage with a lower cost of capital.

**Exhibit 9: UK solar peers' business characteristics and major DCF assumptions**

Parameter	FSFL	BSIF	NESF
	30-Jun-20 (H120)	30-Jun-20 (FY20)	30-Sep-20 (H121)
Discount rate (latest)	UK: 6.75% (7.75% post 25 years); Australia: 8%	6.00%	6.80%
Inflation rate	2.75% long term	2020–24 of 3.00% and from 2025 onwards of 2.75%	3% long-term, 1.1% short-term
WAC of debt	2.70%	2.60%	3.1% (excl. pref. shares); a pref. div. of 4.75% p.a. until March 2036.
WACC	5.10%	Undisclosed	5.40%
No portfolio assets	58 (994MW)	90 (479MW)	91 (763MW)
Revenue split: subsidies/PPA %	57/43	59/41	65/35
UK % GAV	83%	100%	88%
Other % GAV	Australia (146MW); Spain (125MW)	N/A	Italy 12%, £116m, 34.5MW
Investment policy	Up to 25% GAV outside the UK (since launch)	Up to 10% GAV outside the UK (from 6- Jul-20)	Up to 30% GAV outside the UK (from Sept-20)
Weighted average portfolio life, years	27.4	27.4	27.1
Average energy yield	14% est. (12% for the UK portfolio)	12% est. (not disclosed)	12.5% est. (not disclosed)
OCR (% NAV)	1.14%	1.10%	1.10%
Team, no of people in the group	250	50	190
Group AUM	£6.8bn	\$1bn	£2.3bn
Launch	Oct-13	Jul-13	Apr-14
GAV £m	1022.5	656.1	994
Dividend policy	From FY20 progressive (changed from linked to RPI since launch)	From July 2020 progressive (changed from linked to RPI since launch)	From 1-Apr-21 progressive (changed from linked to RPI since launch)
Dividend policy - distribution	<100%	100%	<100%
Scrip div, % take up	7-8%	No	8.5% (£1.6m & £18.7m cash div)
Leverage % of GAV	39% (c 43% GAV including drawn down part of RCF, 49% including RCF)	34% (44% GAV including drawn down RCF post Aug 20 acquisition, 50% GAV when also include £50m RCF (£44m drawn), 52% when also incl. £11m project level debt)	41% (LTD & pref. shares), 49% GAV when incl. RCF)
Long-term debt £m	£400m, fully amortising	£222m, fully amortising	of £194m: fully amortising
RCF	£105m RCF, drawn £40m; maturity Mar & Aug'22	£110m RCF (three years), fully drawn post August 2020 acq & £50m (£44m drawn), maturity September 2021 with a one-year extension option.	£90m (£70m & £20m, July and February 2022 maturity)
Leverage description	40% GAV targeted by the board; LTD & RCF (40-50% permitted)	40-50% GAV targeted by the board; LTD & RCF	(21% LTD & 20% pref shares at 30 Sept'20); up to max 50% permitted
Project level debt	No	£11m, fully amortising 2029	No (call the drawn portion of RCF a 'project level debt')

Source: Company reports

FSFL is the most diversified geographically, with 17% of GAV outside the UK, while NESF has 12%. BSIF has all its assets in the UK. While FSFL has had 25% outside the UK asset limit since launch, both its peers introduced this policy in 2020, with 10% and 30% for BSIF and NESF, respectively. The highest ex-UK share of assets gives FSFL an advantage over its peers. The warmer climates of Australia and Spain have higher irradiation levels, and allow FSFL to generate more energy in weighted terms across the portfolio, and enjoy a higher energy yield than its two peers currently have at c 14%, versus an estimated 12.5% and 12% for BSIF and NESF, respectively.

Foresight Group is the largest of the three renewable UK groups that have a large solar division, with 250 people and AUM of £6.8bn. FSFL is the largest solar entity of the three UK peers, with over £1bn GAV and energy generating capacity of 1.5–2x of its two peers. All three trusts were launched within 12 months during 2013–14.

The proportion of subsidised and PPA revenues are fairly equal across all three at c 60%/40%, respectively. FSFL has the smallest number of assets (58), and they are almost twice the size of BSIF's and about 1.5x the size of NESF's (when comparing generation capacity in MW). FSFL has the largest energy generation capacity of 994MW, compared with 479MW for BSIF and 763MW for NESF.

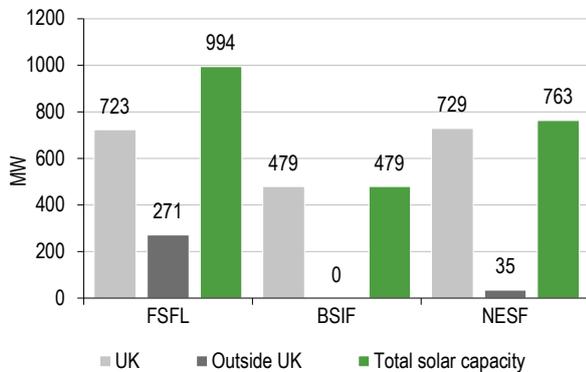
The dividend policy was changed to progressive and de-linked from RPI during 2020 at all three companies. The dividend policies of FSFL and NESF are similar: they distribute the target dividend and reinvest the excess cash flow into the business, while BSIF distributes 100%, at times putting aside reserves (for a dividend history comparison, see the Dividend cover section). We believe BSIF's 100% distribution policy has attracted investors, as they could see BSIF consistently exceeding its dividend targets, while FSFL's and NESF's reinvestments into the business were not obviously visible to investors.

Leverage comparison is less straightforward, as NESF has preference shares in its capital structure, accounting for about half of its leverage. FSFL is less leveraged on a look-through basis, when accounting for the revolving credit facility (RCF) and project debt: 49% versus 52% for BSIF. While leverage limits at 40–50% are comparable among the three trusts, FSFL has the most conservative target of 40% of GAV.

## Portfolio

FSFL has the largest portfolio of solar assets by capacity among the three peers, both in the UK and internationally (Exhibit 10). FSFL's 'higher quality' portfolio means it would likely see a lower impact on its valuation from a further cut to power price forecasts (see Exhibit 11).

**Exhibit 10: Installed solar capacity of FSFL vs its nearest UK peers**



Source: Company reports

**Exhibit 11: The impact of potential power price cuts on FSFL's PV is marginally less than its nearest peers**



Source: Company reports, Edison Investment Research's calculation. Note: FSFL analysis is based on halving the impact of a 20% cut to prices (GAV).

## Revenue and realised prices

In short, the NAV of a solar investor and asset manager is most highly dependent on the outcome of the DCF and its assumptions, primarily the power price curve. As assumptions change, the NAV will change as well. Arguably, annual cash revenues, observed over a few years, give a fuller picture of the fundamental health of a solar asset manager. Yearly revenues fluctuate and are primarily derived from the realised power price mix (both fixed and merchant) during each reporting period. Hence an investor should look at the cash revenue history of each solar operator in conjunction with their reported NAVs.

Exhibit 12 shows the average secured contract prices for all three UK solar companies and their revenue mix for the last reporting period, as well as prices secured for the next period (2021).

Making direct comparisons across three peers is difficult, as disclosure varies across the companies and not all information was publicly available. Although FSFL secured a £33.6MWh (PPA + merchant) weighted average price in H120, as power prices fell rapidly over six months due to the lockdowns triggered by COVID-19, its 2021 fixed price of 45.7MWh is competitive. The relatively high price secured by BSIF in 2020 is unlikely to be repeated in 2021, as BSIF benefited from fixing a large proportion of its prices in October 2018 (when prices were high) for 27 months. Negotiated PPAs and merchant prices, as well as subsidy levels are disclosed differently at all three portfolios. FSFL discloses the price per ROC, NESF – includes its indexed band's price, which comes after indexing at c 1.5x ROC's price). We also note the higher prices reported by NESF at March 2020 reporting period, before power prices plummeted during 2020, following the lockdown imposed in March across the UK, which impacted FSFL's June reporting.

#### Exhibit 12: Revenue and realised prices of FSFL and peers

	MWh	Realised price (£)		%		Realised price (£)	% revenues
		PPA + Merchant	Subs	PPA	Subs	2021 PPA weighted average price	Fixed for 2021
<b>FSFL</b>							
6m revenues (£m)		<b>6m to 30-Jun-20</b>					
68.9	503	33.6	50.1 (per ROC)	43%	57%	45.7	30%
<b>BSIF</b>							
12m revenues (£m)		<b>12m to 30-Jun-20</b>					
69.7	495	47.8	Not disclosed	41%	59%	N/A	N/A
<b>NESF</b>							
12m revenues (£m)		<b>12m to 31-Mar-20</b>					
132	1073	48.6	74.4 (indexed)	35%	65%	46.8	50%

Source: Company reports

## Cash flow dividend cover

Exhibit 13 illustrates that all three companies covered their dividend over the last reporting period.

#### Exhibit 13: Cash dividend cover

	12m	12m	12m	6m
Period end, £m	30-Jun-20	30-Jun-20	31-Mar-20	30-Sep-20
	<b>FSFL</b>	<b>BSIF</b>	<b>NESF</b>	<b>NESF</b>
Cash revenues	68.9	65.9	61.2	32.5
Operating expenses (cash reported)	-13.4	-21.3	-15.1	-3.3
Debt repayment	-14.6	-9.2		
Pref shares div	N/A	N/A	-7.8	-4.8
Brought forward revenue reserves	Not disclosed	2.3	Not disclosed	Not disclosed
CFO	40.9	37.7	38.3	24.5
Cash div	37.1	29.3	39.7	20.3
<b>Cash div cover, x</b>	<b>1.1</b>	<b>1.3</b>	<b>1.0</b>	<b>1.2</b>
CFO - as reported	N/A	N/A	46.1	N/A
Cash div - as reported	N/A	N/A	39.7	N/A
Cash div cover - as reported	N/A	N/A	1.2	N/A

Source: Company reports

Despite the headroom for cash dividend cover having shrunk from 30–40% at launch to c 10% (for FSFL) due to the power price decline, we estimate that all three companies have extra cash after paying their dividends (Exhibit 14). The current upward trend of power prices and operating efficiency measures provide support for the progressive covered dividend, going forward.

**Exhibit 14: Dividends, dividend growth, cash cover and cash reserves after paying dividends**

	Foresight Solar (FSFL)				Bluefield Solar (BSIF)				NextEnergy Solar (NESF)				
	Div, pps***	Div growth %	Cash div cover, x	Div reserves (est. as EPS - DPS), pps	Div target, pps	Div, pps	Div growth %	Cash div cover, x	Div reserves (reported), pps	Div, pps***	Div growth %	Cash div cover, x	Div reserves (est. as EPS - DPS), pps
FY14	6.00	N/A		-0.10	4.00	4.00	N/A	1.75	N/A				
FY15	6.10	2%	1.22	-0.19	7.00	7.25	81%	1.06	0.41	5.25	N/A	N/A	3.88
FY16	6.17	1%	1.10	4.21	7.07	7.25	0%	1.04	0.26	6.25	19%	1.2	-5.47
FY17	6.32	2%	1.10	2.48	7.18	7.25	0%	1.04	0.30	6.31	1%	1.1	7.50
FY18	6.58	4%	1.20	5.02	7.43	7.43	2%	1.04	0.30	6.42	2%	1.1	-0.54
FY19	6.76	3%	1.12	-8.65	7.63	8.31	12%	1.07	0.60	6.65	4%	1.3	5.28
H120*	6.91	2%	1.10		7.90	7.90	-5%	1.28	2.23	6.87	3%	1.2	-9.86
FY21**					8.00					7.05	3%	1.2	
<b>Cumulative:</b>				<b>2.77</b>					<b>2.23</b>				<b>0.79</b>

Source: Company accounts, Edison Investment Research. Note: pps = pence per share, \*HY = half year, H120 used for FSFL. \*\*H121 for NESF are targets/expectations; \*\*\*Dividend paid equals the dividend target for FSFL and NESF.

## Relative performance and fund characteristics

The peer ranking table in Exhibit 15 illustrate the high and growing income strategy of FSFL relative to the two UK peers and one US solar peer listed on the LSE.

Within its solar peers FSFL retains the highest yield, and trades at a slightly higher premium than NESF, but on lower than BSIF. Its one-year NAV TR of -3.0% is almost in line with NESF, but lags BSIF (1.4% TR). FSFL lags its peers over three and five years, and also lags BSIF since FSFL's launch, on an NAV TR basis.

We believe that a few factors have contributed to FSFL's underperformance to peers. Firstly, the 100% dividend distribution policy by BSIF might have attracted more investors since launch, relative to FSFL and NESF. This policy has resulted in BSIF typically exceeding its dividend targets, and the market has rewarded it.

Secondly, FSFL's disclosure in the reports, accounts and investor presentations was poorer than that of peers, but this has now been addressed. Investor understanding of solar businesses and relevant investment funds is relatively inadequate and, all else being equal, those companies that present information in a more digestible way would have advantage. We believe that FSFL's H120 interim report disclosure is more transparent, relative to the previous periods since launch and in parts is now better than that of peers. We welcome such a development from FSFL, which stated that it will keep disclosure in its H120 format.

**Exhibit 15: Solar funds peer group at 31 January 2021\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR si FSFL**	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
<b>Foresight Solar</b>	616.8	(3.0)	7.9	30.0	43.7	10.2	1.1	No	175	<b>6.74</b>
Bluefield Solar Income Fund	545.4	1.4	23.0	51.3	81.5	21.3	1.1	No	151	5.90
NextEnergy Solar	609.1	(2.8)	13.3	35.7		6.1	1.2	No	168	6.71
US Solar Fund	194.7	(3.1)				12.5	0.9	No	253	2.10
<b>Simple average</b>	<b>491.5</b>	<b>(1.9)</b>	<b>14.8</b>	<b>39.0</b>	<b>62.6</b>	<b>12.5</b>	<b>1.1</b>		<b>91</b>	<b>5.3</b>
<b>FSFL rank in peer group</b>	<b>1</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>2</b>	<b>3</b>	<b>2</b>		<b>2</b>	<b>1</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance at 31 January 2021 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. \*\*si = since inception 29 October 2013.

Lastly, BSIF signed a large PPA contract agreement to fix its contract prices for 27 months in October 2018, when the prices were high, and this, boosting its cash dividend reserves, most likely, attracted investors to the fund from its peers, and was positively reflected in BSIF's higher premium.

FSFL with 175% gearing is higher geared than BSIF (151%) and NESF (168%), but this is within a reasonable margin: gearing will fluctuate between reporting periods, as companies use their RCFs.

## Performance: Steady long-term TR

As Exhibits 16 and 17 illustrate, FSFL has performed very competitively with the MSCI World High Div Yield Index. Its NAV has outperformed the index over one, three years and since launch by 3.0%, 5.6% and 5.9%, respectively (to end-January 2021), and as the chart on the front page illustrates, has generated a higher yield.

### Exhibit 16: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	Benchmark* (%)	MSCI AC World (%)	CBOE UK All Companies (%)
31/01/17	19.8	10.5	25.5	33.7	20.9
31/01/18	2.8	8.8	4.0	13.4	10.8
31/01/19	13.0	10.3	(1.3)	0.6	(2.8)
31/01/20	9.7	0.6	9.6	16.4	10.4
31/01/21	(8.2)	(2.7)	(5.5)	12.9	(8.3)

Source: Refinitiv. Note: All % on a TR basis in pounds sterling. \*Benchmark is a MSCI World High Dividend Yield Index.

### Exhibit 17: Share price and NAV TR performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	Since launch
Price relative to MSCI World High Div Yield Index	1.5	(5.7)	(7.8)	(2.8)	11.4	5.1	10.1
NAV relative to MSCI World High Div Yield Index	2.0	(6.2)	(3.1)	3.0	5.6	(2.6)	5.9
Price relative to MSCI AC World	0.6	(13.7)	(13.6)	0.5	17.4	7.4	17.7
NAV relative to MSCI AC World	1.0	(14.2)	(9.3)	6.4	11.2	(0.5)	13.2
Price relative to Global Core Infra Index	1.4	0.1	(4.5)	0.7	(10.7)	(16.7)	(20.6)
NAV relative to Global Core Infra Index	1.9	(0.4)	0.3	6.6	(15.3)	(22.8)	(23.6)

Source: Refinitiv, Edison Investment Research. Note: Data to end-January 2021. Geometric calculation.

## Dividends

FSFL follows a progressive dividend policy aiming to grow its dividend over time. The company has met all target dividends since IPO. From FY14 to FY19 the compound annual growth rate (CAGR) of the dividend payments was 2.4%.

In FY20 the company moved from an inflation-linked annual dividend growth target (effective from launch on 29 October 2013) to a progressive dividend policy, reflecting the divergence of power prices and inflation since the company's inception.

Total dividends of 3.45p per share (comprising the two interim dividends of 1.72p and 1.73p per share) were paid during the period for FY20 to 31 December 2020 (6.76p per share in FY19). The company is targeting a full year dividend for the year ending 31 December 2020 of 6.91p per share, representing a 2.20% increase against the dividend declared for FY19.

FSFL also offers a scrip dividend alternative, effective for three years from 25 June 2019, when the resolution granting authority for the board to offer a scrip dividend alternative was approved. The scrip share price is calculated using the average of the middle market ordinary share quotations for the five dealing days from and including the ex-dividend date of the relevant dividend.

### Dividend cover

As reported by FSFL, the two interim dividends' cash flow cover for FY20 was 1.10 times (30 June 2019: 1.12 times). This coverage ratio is compared with the relevant net cash flows from operations of FSFL and underlying investments of £40.9m.

Based on the most recent power price forecasts from consultants, the managers believe they have c 10% dividend cover headroom over the next few years. This is expected to increase up to c 15% for the rest of the ROC period as power prices are forecast to grow in real terms.

In Exhibit 18, we present the dividend cover based on reported net income. In its H120 report, FSFL began to disclose the relevant net cash flows from operations (OCF) of £40.9m and the underlying OCF dividend cover of 1.1x. Since launch, FSFL has covered its dividend (based on the interest income and FSFL's quoted relevant net OCF dividend cover measures).

**Exhibit 18: FSFL's dividend cover (£m)**

Measure	FY14	FY15	FY16	FY17	FY18	FY19	HY20
Interest income	7.2	25.1	29.5	35.4	36.8	39.2	19.7
Gross dividends - common stock	0.0	19.1	18.7	27.2	31.3	36.0	19.2
Div cover (x)	N/A	1.3	1.6	1.3	1.2	1.1	1.0
CF div cover quoted by FSFL*	N/A	1.2	1.1	1.1	1.2	1.1	1.1

Source: Company reports, Edison Investment Research. Note: \*As reported in the investment managers report in company's reports, adjusted by FSFL and excluding dividends paid to recently issued equity.

FSFL's reported dividend cover remained above 1.0x even as power prices dived to a multi-year low in 2020. Prices began recovering and the team expects dividend cover to increase from here over time. Australian cash flows should start to improve and contribute to the increase in dividend cover.

## Capital structure and discount

FSFL has an annually renewed resolution to buy back, in the market, up to 14.99% per year of its ordinary shares in issue. At 31 December 2020 the company had 607.7m ordinary shares in issue. During FY20 FSFL issued 2.5m shares for a total consideration of £2.6m (FY19 56.3m for £66.9m). No shares were bought back in FY20.

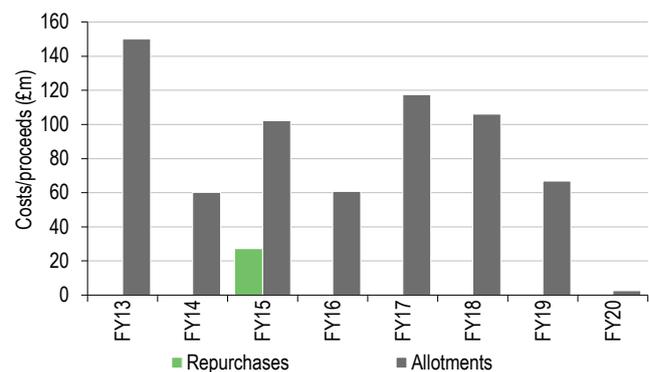
The trust currently trades at a 6.7% premium to cum-income NAV, almost in line with its three-year average of 7.0%. During FY20 the trust traded primarily at a premium, with the exception of a deep dive in March when the market and all closed-ended funds sharply corrected in response to the storm of negative news about the COVID-19 pandemic and consecutive lockdown measures. The fund recovered back to a premium within a few weeks.

**Exhibit 19: Premium/discount over three years**



Source: Refinitiv, Edison Investment Research

**Exhibit 20: Buybacks and issuance**

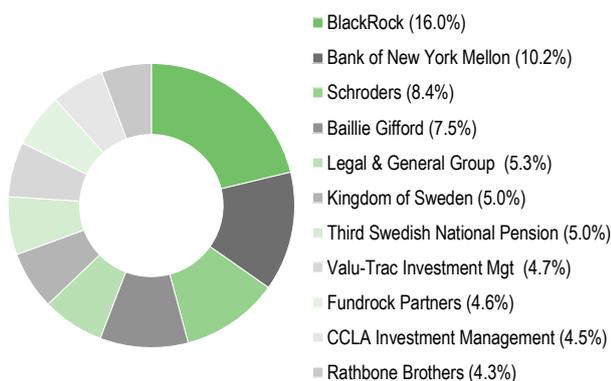


Source: Morningstar, Edison Investment Research

There is no continuation vote. There is a discount control mechanism, when a shareholders' vote is triggered if the average discount to the NAV (published by the company) is wider than 10% during any financial year. If this is the case, the board will propose a special resolution at the company's next annual general meeting that the company ceases to continue in its present form. If such a special resolution is passed (requiring the approval of at least 75% of the votes cast in respect of it), the board will be required to put forward proposals to shareholders at a general meeting of the company, to be held within four months of the resolution being passed, to wind up or otherwise reconstruct the company, bearing in mind the illiquid nature of the company's underlying assets.

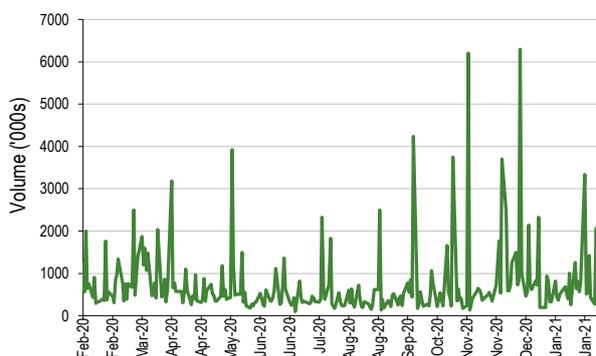
There is no difference between the weighted average ordinary or diluted number of shares.

**Exhibit 21: Major shareholders**



Source: Bloomberg, at end-December 2020.

**Exhibit 22: Average daily volume 12m 31 January 2021**



Source: Refinitiv.

## Leverage

At 30 June 2020, the total outstanding debt of the company and its subsidiaries, including RCFs, amounted to £440.4m (31 December 2019: £443.5m), with long-term debt representing £400.4m (December 2019: £403.5m). Total debt represented 43.1% of GAV (December 2019: 41%). Long-term structural debt represented 39.2% of GAV (December 2019: 38%), within the 40% of GAV long-term debt target set by the board (40–50% permitted). All long-term debt is secured by solar assets and has agreed to covenants as to its operation and financial position.

## Fees and charges

The investment manager receives an annual fee of 1% of the NAV of the company up to £500m and NAV in excess to this is charged at 0.9% per annum. This is payable quarterly in arrears and is calculated based on the published quarterly NAV. The ongoing charges ratio (OCR) for FY19 was 1.14%.

## The board

**Exhibit 23: FSFL's board of directors**

Board member	Date of appointment	Remuneration in FY19	Shareholdings at end-FY19
Alex Ohlsson (chairman)	16 August 2013	£70,000	25,000
Chris Ambler	16 August 2013	£55,000	26,524
Peter Dicks	16 August 2013	£45,000	65,034
Monique O'Keefe	1 June 2019	£45,000*	N/A
Ann Markey	4 September 2020	N/A	N/A

Source: Company reports. Note: \*Anticipated fees for FY20.

During 2020, Ann Markey was appointed to join the board as a fifth non-executive director, with her appointment effective from 4 September 2020.

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