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# Ukraine 2012 Politics Preview

It's already all about the October parliamentary election

- The Party of Regions is already positioned to dominate Ukrainian politics for at least the next few years after stacking the rules for the October parliamentary election in its favor and with the opposition so far failing to offer a unified alternative.
- Ukraine enters 2012 losing friends in both the West and the East. EU relations have been soured over concern for the rule of law and democratic backsliding, slowing progress on the landmark Association Agreement. At the same time, Russia has taken a tough, pragmatic position on Ukraine's requests for a gas price break: no free handouts.
- The NBU's mandate ahead of the October election appears to be hryvnya stability, having drawn a line-in-the-sand at 8.0 UAH/USD. The government is eager to prove to the electorate it can handle economic pressure better than its predecessors in 2008-2009 when the hryvnya fell 40% vs. the US dollar. So far it has been successful - the hryvnya has been flat vs. the US dollar since late 2009 unlike most other regional currencies.
- We are on the lookout for several politically unpopular decisions *early in the year* including (1) a gas deal that could give Russia partial control of Ukraine's gas transit system and underground gas storage facilities and (2) a household gas tariff hike (necessary to unlock Ukraine's frozen USD 15.5 bln IMF loan). The Party of Regions will be banking on the feel-good effect from co-hosting UEFA Euro-2012 Football Championship next summer to mitigate some of the fallout before the autumn election.
- The campaign of political pressure on opposition politicians and opposition-friendly businessmen is likely to continue in 2012.
- The population remains extremely politically disenchanted and apathetic, and we believe that barring a nasty surprise from the government, there is a low risk of unrest and widespread protests.

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**Political party tracker**

| Party                 | Support | Chg, yoy |   |
|-----------------------|---------|----------|---|
| Party of Regions      | 12.5%   | -16.0 pp | ↓ |
| Yulia Tymoshenko Bloc | 10.2%   | -0.3 pp  | ↔ |
| Communist Party       | 5.1%    | +1.7 pp  | ↑ |
| Udar Party            | 4.4%    | +2.1 pp  | ↑ |
| Strong Ukraine        | 3.2%    | -4.9 pp  | ↓ |
| Svoboda Party         | 2.3%    | -0.3 pp  | ↔ |

*Note: Arrows indicate comparison to popular support in November 2011 vs. October 2010*

*Source: Kyiv International Institute of Sociology survey*

**Politics watch list**

|   |               |
|---|---------------|
| EU-Ukraine Summit in Kyiv                 | Dec. 19, 2011 |
| Opening Match of Euro-2012                | June 8, 2012  |
| Final Match of Euro-2012                  | July 1, 2012  |
| Parliamentary Election Campaigning Begins | July 30, 2012 |
| Parliamentary Election                    | Oct. 28, 2012 |

## A look ahead: Political agenda for 2012

### **Parliamentary election (October 28, 2012): Regions already has it under control**

The main event in Ukrainian politics in 2012 is sure to be the October parliamentary election, which is already shaping up to be hotly contested. Though campaigning officially begins in July, it is already clearly the #1 consideration in political decision-making. The Party of Regions saw its popularity plummet last year, but no opposition party has yet been able to capitalize. Several new and young faces including professional boxer Vitaliy Klitschko (Udar Party) and politicians such as Arseniy Yatseniuk (Front of Changes) and Natalia Korolevska (Tymoshenko Bloc) are on the scene, but will truly have to break the mold at this point to sway voters.

The government has so far successfully headed off momentum from the opposition and various civil and political groups' protest movements over the last two years. We believe there will be few challenges to their stranglehold next year - the new law on parliamentary elections reinstates a mixed-mandate system (history has shown that independent constituency-voted lawmakers have drifted to the party in power) and increases the threshold for entry from 3% to 5%. The population remains extremely politically disenchanted and apathetic, and we believe that barring a nasty surprise from the government, there is a low risk of unrest and widespread protests, even if there is vote-rigging and other fraud in the election.

### **Foreign policy: Neither West... nor East**

Ukraine's eternal foreign policy question – West or East? – became more clouded in 2011. President Viktor Yanukovich's notable progress in both directions in 2010 ground to a halt this year, albeit for different reasons. In summer, it looked as if Ukraine would finally bag a long-awaited landmark Association Agreement with the EU this year. However, EU concerns over the prosecution of opposition political figures and democratic backsliding have derailed more progress on the deal. There should be some token progress on the pact next week at the annual EU-Ukraine Summit in the name of keeping Ukraine "engaged". The bigger issue is ratification of the agreement in EU member parliaments – this is where the EU will make its stand against concerns over Ukraine's democratic path and rule of law.

To the east, Ukrainian officials' dialogue with their Russian counterparts visibly cooled this year – and will get further politicized in 2012 with presidential election in Russia in March and parliamentary election in Ukraine in October. What is clear is

that Ukraine has no interest in Russia's overtures to join its tripartite Customs Union and Common Economic Space with Belarus and Kazakhstan. The wildcard that could change everything is Ukraine's begging for a discount on imported gas. Depending on what Ukraine gives up (the prevailing thought being at least a sizable stake in the gas transportation system), it could play right into Russia's hand and firmly put the country back into the orbit of its larger eastern neighbor.

### **Gas: Lower prices for the nation, higher prices for the people?**

It is now clear negotiations on Ukraine's request for a price break on imported gas will drag into early 2012. An article on Zerkalo Nedeli last week suggested Ukraine might give up a stake in Naftogaz' transportation and distribution units as well as underground storage facilities. Though a boon to big business interests behind the Party of Regions and the overall economy, in our view, any arrangement like that would entail a significant political toll domestically.

Aside from a discount from Russia, an IMF-mandated increase in household gas tariffs could also go a long way toward shoring up the chronic budgetary black hole that is Naftogaz of Ukraine (NAFTO). However, the government is waiting until after it concludes talks with Russia before determining the necessity and magnitude of any tariff hike.

### **Hryvnya stability: Political line-in-the-sand issue until election**

Hryvnya stability will continue to be a major issue until the election. In spite of devaluation pressure, the government has drawn a line-in-the-sand at 8.0 UAH/USD. Officials' mandate ahead of the October election appears to be to prove their mettle by holding their ground, compared to their predecessors, which devalued the hryvnya 40% in 2008-2009 against the US dollar. So far they have been successful - the hryvnya has been flat vs. the US dollar throughout 2011 unlike other regional currencies (Polish zloty -17%, Russian ruble -4%). With the Eurozone debt crisis dragging, downside pressure is likely to persist, especially until Ukraine strikes a new gas deal with Russia and/or renews its USD 15.5 bln IMF loan.

**Euro-2012: feel-good event of the year**

Preparation for co-hosting the UEFA European Football Championships accelerated when the current government took power in 2010. A successful event will go a long way toward mitigating the electoral impact of unpopular political decisions, particularly with the final match in Kyiv less than a month before the official beginning of parliamentary election campaigns.

**Land reform: tradable market still at least a year away**

In the coming weeks, Ukraine's parliament could pass the Law on Land Market. The bill is the final hurdle required to cancel the moratorium on agricultural land sales. However, as cancellation is politically unpopular and technical normative acts have yet to be adopted, extension of the moratorium until 2013 looks almost certain.

## A look back: Key political events of 2011

**Political party consolidation: Regions narrows choices**

The Party of Regions has been a driver of party consolidation with a view to folding in competition in next October's parliamentary election. The process started back in August when Prime Minister Mykola Azarov and Deputy Prime Minister Sergiy Tigipko (#3 place in the first round of the 2010 presidential election), respectively heads of the Party of Regions and Strong Ukraine parties, announced they were planning a merger. Various opposition parties have publicly said they were exploring alliances too, but there has been little concrete action so far.

**Privatization: Ukrtelecom finally hit the auction block**

The government finally unloaded its 92.8% stake in incumbent telecom operator Ukrtelecom (UTLM UK) early this year. The sale helped the government meet its annual budget target for privatization proceeds for the first time in recent memory. It has now also sold off 25% of Kyivenergo (KIEN UK) and is pressing ahead with the sales of 25-50% stakes in Zakhidenergo, Dniproenergo and several power distribution companies (Oblenergos).

**Pressure on opposition moves into business sphere**

Reports of corporate raiding have been persistent and alarming in scope. Notably, companies controlled by businessman Konstantin Zhevago, a member of the Yulia Tymoshenko Bloc in parliament, were the subject of raids by the Security Service, and intrusive tax inspections.

**Prosecution of Tymoshenko & other opposition figures**

What began in 2010 as a series of arrests of government officials that served under former Prime Minister Yulia Tymoshenko (2005, 2007-2010) escalated considerably in 2011. Tymoshenko herself has now spent more than four months in jail and has been handed a seven-year jail term. A further 10 cases have been opened against her. The handing of her case has become a major issue in EU-Ukraine relations. Former Interior Minister Yuriy Lutsenko is also standing trial and the prosecutor general has also gone after several other lesser known former government figures.

**IMF's USD 15.5 bln loan program remains frozen**

Despite two visits from IMF delegations and numerous statements by Ukrainian politicians, Ukraine's USD 15.5 bln standby loan agreement remained frozen. The government met two conditions, increasing central bank independence and enacting pension reform, but has been reluctant to raise household gas tariffs. The last IMF mission left Kyiv in early November and took a pause for technical work.

## Appendices

### Appendix 1: Political party tracker

| ↑/↓ | Polling support*<br>Nov. 2011 (vs. Oct. 2010) | Political party              | Overview   | Notes  |
|-----|---|------------------------------|--|--|
| ↓   | 12.5% (-16.0 pp)                              | <b>Party of Regions</b>      | Leader: Prime Minister Mykola Azarov. Electoral base: East and Southeast Ukraine. Ideology: Pro-Russia, Center-left. Currently controls Cabinet of Ministers and leads a majority in the Verkhovna Rada. | Took over control of all key levers of power since Yanukovich's election in 2010. Experienced heavy backlash over 2010-2011 even in key constituencies due to heavy-handed tactics in pushing through its agenda and persecution of opposition figures.  |
| ↔   | 10.2% (-0.3 pp)                               | <b>Yulia Tymoshenko Bloc</b> | Leader: Former Prime Minister Yulia Tymoshenko. Electoral base: Western and Central Ukraine. Ideology: Pro-Europe, Center-right.   | Tymoshenko once again became a consistent news-maker since criminal proceedings were launched against her. She is a divisive national figure, which has limited widespread domestic support, but her bloc remains the most influential opposition party.   |
| ↑   | 7.0% (+1.7 pp)                                | <b>Front of Changes</b>      | Leader: MP Arseniy Yatseniuk. Electoral base: Western and Central Ukraine. Ideology: Center-right. Opposition party.   | Yatseniuk's popularity has resurged somewhat over 2011 as he became increasingly critical of democratic backsliding by the government and supportive of Tymoshenko. Despite holding a range of positions in previous governments, he is still a relatively untainted "fresh face" in Ukrainian politics. |
| ↑   | 5.1% (+1.7 pp)                                | <b>Communist Party</b>       | Leader: MP Petro Symonenko. Electoral base: Eastern Ukraine. Ideology: Pro-Russia, Left.   | The Communist Party's popularity has been in a secular downtrend. It still remains an influential force in certain quarters and will likely linger on the national scene.  |
| ↑   | 4.4% (+2.1 pp)                                | <b>Udar Party</b>            | Leader: professional boxer Vitaliy Klitschko. Electoral base: Western and Central Ukraine. Ideology: Pro-Europe, Center-right. Opposition party.   | Klitschko emerged as a key critic of the government in 2011 and champion of Ukraine's European trajectory. His household name in Ukraine and the rest of the world has helped put him on the political map. He could be a key political force in 2012.   |
| ↓   | 3.2% (-4.9 pp)                                | <b>Strong Ukraine</b>        | Leader: Vice Prime Minister Sergiy Tigipko. Electoral base: Central and Eastern Ukraine. Ideology: Centrist. Allied with Party of Regions.   | Strong Ukraine established itself as a national party in 2010 following Tigipko's presidential bid. Tigipko joined the Party of Regions led government in March and announced in August said he was in talks to merge Strong Ukraine with Regions.   |
| ↔   | 2.3% (-0.3 pp)                                | <b>Svoboda Party</b>         | Leader: MP Oleh Tyahnybok. Electoral base: Western Ukraine. Ideology: Right, Nationalism. Opposition party.  | Tyahnybok's radical nationalist party increased its standing significantly over 2010-2011 as a reaction to perceived pro-Russian slant of the Yanukovich presidency. It had an impressive showing in Western Ukraine in the October 2010 local elections.  |

\* According to Kyiv International Institute of Sociology: 2011 survey conducted November 4-15, 2,037 participants, margin of error: ±3.3 pp. 2010 survey conducted October 8-17, 2,038 participants, margin of error: ±2.3 pp. Source: Kyiv International Institute of Sociology, political party websites, Concorde Capital research

## Appendix 2: Ukraine global development ratings

| ↑/↓ | Recent rating (vs. previous) | Rating name & sponsor  | Excerpt from rating report   | Rating components   |
|-----|------------------------------|--|--|---|
| ↓   | 105/134 (98/128)             | <b>Best Countries for Business Index by Forbes (October 2011)</b>                            | Ukrainian Government officials eliminated most tax and customs privileges in a March 2005 budget law, bringing more economic activity out of Ukraine's large shadow economy, but more improvements are needed, including fighting corruption, developing capital markets, and improving the legislative framework... External conditions are likely to hamper efforts for economic recovery in 2011.   | Trade freedom, monetary freedom, property rights, innovation, technology, red tape, investor protection, corruption, personal freedom, tax burden, market performance. ( <a href="http://www.forbes.com/bestbizcountries/">www.forbes.com/bestbizcountries/</a> )   |
| ↑   | 82/142 (89/139)              | <b>Global Competitiveness Index by World Economic Forum (September 2011)</b>                 | After falling 16 places over the last two years—one of the steepest declines of all countries, which reflects the many economic and political challenges the country has faced in recent years—Ukraine reverses the trend and moves up 7 positions this year... Despite its impressive reform agenda, no real improvements have been measured in the country's weak institutional framework (131st) or in its highly inefficient markets for goods and services (129th), which stifle competition and prevent entrepreneurship from flourishing. | Institutions, infrastructure, macroeconomic stability, health & primary education, higher education & training, goods market efficiency, labor market efficiency, financial market sophistication, technological readiness, market size, business sophistication, innovation. ( <a href="http://www.weforum.org/issues/global-competitiveness">http://www.weforum.org/issues/global-competitiveness</a> ) |
| ↓   | 152/183 (149/183)            | <b>Doing Business Index by World Bank / International Finance Corporation (October 2011)</b> | Paying taxes: Ukraine made paying taxes easier and less costly for firms by revising and unifying tax legislation, reducing corporate income tax rates and unifying social security contributions. Trading across borders: Ukraine made trading across borders more difficult by introducing additional inspections for customs clearance of imports. Enforcing contracts: Ukraine amended legislation to streamline commercial dispute resolution and increase the efficiency of enforcement procedures.  | Starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business. ( <a href="http://www.doingbusiness.org">www.doingbusiness.org</a> )  |
| ↓   | 164/179 (162/179)            | <b>Index of Economic Freedom by the Heritage Foundation (January 2011)</b>                   | Structural constraints and political instability continue to undermine private-sector development. State intervention and the ongoing threat of expropriation limit dynamic economic activity. Ukraine's underdeveloped financial sector struggles to provide the necessary credit for private-sector development, while the regulatory environment remains opaque and burdensome.   | Business freedom, trade freedom, fiscal freedom, government size, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption, labor freedom. ( <a href="http://www.heritage.org">www.heritage.org</a> )  |
| ↓   | Partly Free (Free)           | <b>Freedom in the World Index by Freedom House (January 2011)</b>                            | Viktor Yanukovych, whose fraudulent electoral victory in 2004 had been overturned by the Orange Revolution, won the presidency on his second attempt in early 2010. He then oversaw a deterioration in press freedom, state efforts to curb student activism, intimidation of NGOs, local elections that were almost universally derided as neither free nor fair, and indications of increased executive influence over the judiciary.  | Electoral process, political pluralism and participation, functioning of government, freedom of expression and belief, associational and organizational rights, rule of law, personal autonomy and individual rights. ( <a href="http://www.freedomhouse.org">www.freedomhouse.org</a> )  |
| ↓   | 131/178 (89/175)             | <b>Press Freedom Index by Reporters without Borders (October 2010)</b>                       | The Philippines, Ukraine, Greece and Kyrgyzstan all fell sharply in this year's index. In the Philippines this was due to the massacre of around 30 journalists by a local baron, in Ukraine to the slow and steady deterioration in press freedom since Viktor Yanukovych's election as president in February, in Greece to political unrest and physical attacks on several journalists, and in Kyrgyzstan to the ethnic hatred campaign that accompanied the political turmoil.   | Physical attacks, imprisonment and direct threats; indirect threats, pressures and access to information; censorship and self-censorship; public media; economic, legal and administrative pressure; internet and new media; number of journalists murdered, detained, attacked or threatened and government role in this; country data. ( <a href="http://www.rsf.org">www.rsf.org</a> )                 |

## Appendix 3: Ukraine's political system

Ukraine is a semi-presidential republic. It declared independence from the Soviet Union on August 24, 1991. Ukraine has 24 oblasts (regions), one autonomous republic and two cities with special status (see map right). Ukraine's capital is Kyiv. Ukraine's current constitution was adopted June 28, 1996; amendments made in 2004 were annulled in 2010.



**President of Ukraine.** Ukraine's president is the head of state. The Ukrainian president is elected by popular vote for a five-year term. The president has the power to determine foreign policy, act as commander-in-chief of the Ukrainian Army, and limited authority to disband parliament. The current president, Viktor Yanukovich, was inaugurated on February 25, 2010.

**Verkhovna Rada of Ukraine.** Ukraine's Verkhovna Rada is a unicameral parliament with 450 seats. It has the power to amend the Constitution of Ukraine (requires 300 votes), adopt laws (with 226 votes), approve the state budget, ratify and denounce international treaties, declare war and peace, and appoint select officials and judges. The Verkhovna Rada can override a presidential veto with 300 votes. MPs are elected for a five-year term via a dual mandate voting (as of the next parliamentary election in October 2012): 50% of MPs will be elected from party lists and 50% from constituencies.

**Cabinet of Ministers of Ukraine.** Ukraine's Cabinet of Ministers is the highest body of executive power. Ukraine has 13 ministries and there are 17 positions in the Cabinet (including the Prime Minister and Vice Prime Ministers). The Prime Minister is the head of the executive and presides over the Cabinet of Ministers. The Prime Minister is appointed by the Verkhovna Rada, following submission of the candidate by the President of Ukraine, and can be fired by the President or by the Verkhovna Rada. The current prime minister, Mykola Azarov, was confirmed on March 11, 2010.

**Constitutional Court of Ukraine.** Ukraine's Constitutional Court is charged with interpreting the Constitution of Ukraine and decides whether laws and legal acts are constitutional. The court is composed of 18 judges, appointed in equal shares by the president, Verkhovna Rada and the Congress of Judges. Judges are appointed for a single nine-year term.

**Court system in Ukraine.** The judicial system in Ukraine has four levels of courts of general jurisdiction: local courts, appeals courts, high courts and the Supreme Court. High courts include the High Administrative Court of Ukraine, which rules on administrative cases, and the High Economic Court of Ukraine, which rules on commercial cases. The highest level is the Supreme Court of Ukraine. Supreme Court appointments are made by parliament and have no term limits.

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