
PE REVIEW ISSUE IV



Exporting the Chinese Model to BRI Countries: Cambodia as a Case Study

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Executive Summary

This paper examines how China and Cambodia, a key Southeast Asian BRI country, have collaborated in almost textbook fashion to implement a small scale version of the Chinese economic growth model. Within a decade, Cambodia now has sufficient energy to support an already growing economy as well as sufficient infrastructure to begin to attract corporate investments, initially from China and then across a number of other countries and sectors.

This paper initially analyses 16 Phase 1 projects (defined below) including 6 renewable energy projects and 10 infrastructure projects, during the period of 2011-2017, all funded by Chinese partners. We then analyse the Chinese Government related funding used by in these projects through which we conclude that Cambodia's debt to GDP increased from circa 28% in 2008 to circa 35% in 2015, via a carefully managed mixture of G2G loans and grants, Mekong Delta regional fund pledges, policy bank loans and Chinese corporate investments.

The combination of efficiently managed Chinese infrastructure spend to further lift an economy already ranked 6th globally in average growth and possessing a stable government has produced an even more attractive environment for corporate investors across countries and industries. FDI increased by 25% during 2016; momentum which continued into 2017. While China has represented the lead FDI investor (we analyse Chinese corporate investments by sector and by specific investments over \$1 billion) there has also been increased investment from major corporates based in Japan, Korea, Hong Kong, Singapore and France.

Predictably, this recent surge in FDI has now moved beyond (Cambodia's garment) manufacturing, but into construction and real estate (which has led to credit expansion), consumer and tourism, sectors which can meet private equity return thresholds.

Our analysis is disaggregated into two phases:

Phase 1 – Energy, Infrastructure

1. Starts with sufficient energy to power the country, with some % of renewable energy
2. Portable water
3. Infrastructure (roads, bridges, rail, ports and logistics)

All of which needed and to be built and funded (ideally) without harming country's balance sheet.

Phase 2 – Commercial Equity Investments

1. Once infrastructure is sufficiently operational, the initial sector investment play is real estate
2. Followed by manufacturing increases (garment industry in Cambodia)
3. Special Economic Zones (SEZ) are added to help fuel SME growth
4. Leading to increases in the consumer segment
5. GDP growth also powered by increases in FDI, not just by Chinese companies but across a number of countries and industries

Energy Component

In the early 2000s, Cambodia had total electric power capacity of 790 MWs, of which Cambodia bought 196 MW from Vietnam, 95 MW from Thailand and 2 MW from Laos. Less than 50% of Cambodia households had access to reliable electricity and electricity demand had been increasing each year. Cambodia then signed 12 agreements on the development of electricity with total generation capacity of 2,123 MWs with China. By 2016, the 928 MW annually generated from the six operational hydroelectric plants set out below, five of which were 100% funded by China, currently represents about 47% of available electricity in Cambodia.

Table 1. Chinese Investments in Cambodia Hydroelectric Power (2011-2017)

Project/Description	Size/Metrics			Dates		On time
	Power (MW)	Amount (\$m)	Debt/Equity (%)	Start	Operational	Y/N
(1) Kamchai Dam	193	280	100%/0%	2007	2011	Y
(2) Kirirom III Hydro Power Plant	30	47	0%/100%	2010	2013	Y
(3) (Stung) Atay River Hydro Power Plant	120	558	0%/100%	2008	2014	N
(4) Russei Chrum Kram River Hydroelectric Dam	338	493	0%/100%	2010	2015	Y
(5) Tatay River Hydro Power Plant	248	540	100%/0%	2010	2015	Y
(6) Lower Se Sam II Dam	400	781	70%/30%	2014	2018	N
Total	1,329	2,699				

Footnotes:

- 1) In December 2011, the hydropower facility constructed by Sinohydro Corporation for a cost of US\$280 million under a 44-year BOT contract became operational. Under terms of the agreement, Sinohydro will sell power to the Electricity of Cambodia. Loan was provided by CEXIM.
- 2) In February 2013, the Kirirom III Hydro Power Plant was inaugurated. It has a capacity of 18 megawatts and can produce 78 million KWH/year. State Grid Corporation of China invested and was responsible for building the plant, which cost US\$47.1 million. Electricity from the plant will be sold to Electricity of Cambodia (Kirirom I producing 12 MW, became operational in 2002). Tariff: US\$0.0791/KWH.
- 3) In March 2014, the (Stung) Atay River 120 MW hydropower dam was inaugurated. Construction was started in 2008 and was to have been completed in May 2013, but there was an incident (accident) in late 2012. The \$255 million project was undertaken by China Datang Corporation under a 34-year BOT arrangement.
- 4) In January 2015, the 338-MW Russei Chrum Krom hydropower plant was inaugurated. The US\$500 million plant, located in western part of Koh Kong province, is Cambodia's largest hydroelectric project, and was developed by China Huadian Corp. under a 35-year BOT contract. The power generated by Russei Chrum Krom will be sold to Electricity of Cambodia. Tariff: US\$0.0735/KWH, generates \$12.5 million/yr in tax.
- 5) In December 2015, the \$540 million 246 MW Tatay River hydropower plant, located across the Tatay River in Koh Kong Province, about 300 km to the west of Phnom Penh., was inaugurated. The Tatay project was constructed under a BOT contract by China National Heavy Machinery Corp (CNMC) and Cambodian Tatay Hydropower Ltd. Electricity generated from the dam sold to Electricity of Cambodia. CEXIM provided a \$540 million loan to Cambodia for the construction. Tariff: US\$ 0.0745/KWH, generates \$12 million/yr tax.
- 6) In progress (2017) The Lower Se San 2, located on the Se San River, with a cost of \$781 million, is a JV involving Chinese, Cambodian and Vietnamese companies; China's Lancang Hydropower International Energy owns 51%, Cambodia's Royal Group 39% and Vietnam's EVN International 10%. By October 2016, construction was 70% complete.

Infrastructure Component

Table 2 sets out a number of Cambodian infrastructure projects built by and funded by China during the years 2012-2017. The table also sets out the type of financing deployed for each project. Total Chinese financing allocated to Cambodia for such projects was \$6.7 billion, although \$2.3 billion was our calculation of Cambodia's allocation for Mekong Basin countries. As seen, uses of the funds were varied across a number of infrastructure projects.

In July 2017, with only 40% of the country's roads being tarmacked, the Cambodian Government said that construction and improvement of about 910 km of national and provincial roads are under way with financial aid from China, Japan, South Korea and the Asian Development Bank. Infrastructure remains particularly bad in rural areas. According to the country's transport secretary, the priority for the government's infrastructure development program would be roads, bridges, railways, ports and airports.

Table 2. Chinese Loans/Grants Cambodia Infrastructure (2012-2017)

	Date	Amount (\$m)	Lender/Investor	Use	Comments
(1)	04/17	160	Chinese Government	Grants for 2023 SEA Games	To build a stadium
(2)	10/16	2,000	Chinese Government	Multiple uses: \$90m plus debt forgiveness for 2015 interest charges	National Road 11: \$157m; Sihnaoukville Road \$1.6bn
(3)	06/16	800	Chinese Government	Grants to Cambodia	2016-2018 aid to support election infrastructure, health and education
(4)	08/14	3	Chinese Government	Closed circuit TV	Public Security Ministry
(5)	03/14	2,300	Chinese Government	Mekong Basin countries	\$10bn line of credit plus \$1.5 preferential loans
(6)	10/13	121	CEXIM	Irrigation system, electrical transmission line	Infrastructure, energy
(7)	10/13	1	Chinese Government	Flood aid	Purchase 2,000 tons of milled rice/relief kits
(8)	04/13	548	Chinese Government	Infrastructure/Roads	\$500m soft loans, \$48m grant
(9)	06/12	430	Chinese Government	National Road 6: \$250m; plus two other projects	National Road 6 completed early 2017-on schedule
(10)	02/12	302	CEXIM	National Road 124, National Road 76, Viaco irrigation system	Three infrastructure projects
Total		6,665			

Footnotes:

- 1) In April 2017, China committed US\$160 million (as a grant) to build a stadium for Cambodia to host the 2023 Southeast Asian (SEA) Games. The stadium will be built by China IPPR International Engineering Company and is expected to be completed by 2020.
- 2) During President Xi's visit to Cambodia in October 2016, Beijing forgave US \$90 million debt Cambodia incurred in 2015, loaned Hun Sen's Government another \$60 million, provided an incremental \$237 million in direct aid-and 2 days later-announced it would build a \$16m National Assembly hall in Phnom Penh. It is thought that some of this grant was to be allocated to Cambodian SMEs.
- 3) In 2006, China provided a similar \$600 million aid and loan package to Cambodia for infrastructure development.
- 4) The Chinese Government donated \$3 million to Cambodia to set up a closed-circuit television (CCTV) surveillance system across Phnom Penh for the study, research and monitoring of traffic and security in Phnom Penh.
- 5) Total of \$11.5bn for all 5 countries; Grisons Peak number represents 20% of total.
- 6) In October, 2013 CEXIM signed two agreements to provide a total of \$121 million in loans to Cambodia to develop the A Chang irrigation system in Kompong Chhnang province and the project to build the 115 kilovolt electrical transmission line from Phnom Penh to Bavet City.

- 7) *The Cambodia floods in autumn 2013 saw 113,260 hectares of rice paddies, or 4.4 % of the total rice fields completely destroyed while some 440 km of national roads and 3,693 km of gravel roads were damaged. In late October 2013 China donated \$1 million to Cambodia for the relief of the flood- affected people. In early December 2013, China's Yunnan province provided 200 agricultural engines to Cambodia's Banteay Meanchey province for post-flood rehabilitation*
- 8) *Agreements covering \$500 million in soft loans and \$48 million in grants which will be used to improve infrastructure as well as help build 400 km (250 miles) of new roads/year over several years.*
- 9) *In June 2012, Cambodia signed agreements for US\$430 million in loans from CEXIM. The bulk of the loans are for two national road projects and a multipurpose dam in Battambang. An extension on the rehabilitation of National Road 6 alone was set to cost about \$250 million, constructed by Shanghai Construction Group.*
- 10) *Cost of Phase 1 of the Viaco Irrigation Development Project, thought to be the biggest water resources irrigation project under the cooperation of Cambodia and China, is \$99 million. It will be constructed by two phases; total cost of both phases US\$200 million. Total cost for project of 178 km extension National Road 76 was \$89 million.*

Chinese Government Related Funding

The initial two sections of this analysis involved Chinese involved energy and infrastructure projects during this period (only), including:

- 6 hydroelectric power plants (most completed on or ahead of schedule)
- 7 national roads (including numerous bridges)
- 1 oil refinery (1st ever in Cambodia)
- 1 port (funding for 1st phase)
- 1 suburb of Phnom Penh (see below).

All were funded by the following sources:

- \$1 billion actual Government Loans
- \$0.6 billion actual Government Grants
- \$4.3 billion Government Pledges (including pro rata portion of the Mekong Delta \$11.5 billion fund)
- \$2.7 billion Policy Bank loans
- \$2.4 billion corporate investments

Such finance packaging is important as Cambodia's debt to GDP rose only from 27.8% in 2008 to circa 35% in 2015 via the mixing of the components of the packages. While these are low relative to western standards, the share of bilateral debt in Cambodia's total external public debt rose from 50% in 2009 to 70% by year end 2015; China accounted for 90% of all new bilateral loan disbursements over the past 3 years ending 2016.

Major Corporate Chinese Investments – By Sector

In this section, we set out Chinese investment in 5 key sectors. Not surprisingly, China's interests are aligned with Cambodia's in that the Cambodian economy has been driven by garment exports and tourism (Table 1 sets out energy investment). Agriculture, mining and real estate are also no real surprises. The Sihanoukville SEZ is somewhat surprising in light of the number of existing SEZs in Cambodia (discussed later).

- **Energy** - China is the largest foreign investor in the energy sector in Cambodia, with accumulated capital of more than \$7.5 billion in hydropower plants and about \$4 billion in coal power plants. Chinese companies invested in nine electricity power stations with a capacity of 1,733 megawatts – there are seven hydropower projects with a capacity of 1,328 megawatts and two coal energy projects with a capacity of 405 megawatts.
- **Garment and textile sector** - a leading source of Cambodian exports. The garment industry is essentially dominated by foreign owned firms, mainly from the neighbouring countries such as China, Hong Kong, Singapore, Malaysia and Korea. Over 60% of Cambodia's garment factories are located in or near Phnom Penh. The finished products are transported from the factories by train to the sea.
- **Agriculture** - By 2016 there were about 30 Chinese investment projects relating to agriculture and the agro-industry, covering about 237,406 hectares of land, in which 21 projects are in operation on 173,904 hectares. So far, only about 42,081 hectares have been cultivated and rubber plantations consume most of the cultivated land. In addition, there are seven Chinese investment projects in rice mills with a production capacity of 669,816 tonnes per year.
- **Tourism** - China has invested in five main projects – an international resort complex in Koh Kong province (discussed later) and a resort complex and five-star hotel in Preah Sihanouk province.
- **Mining** - Of the 23 companies investing in the mining industry including iron ore and gold, 10 are from China. In 2016, there were two Chinese investment projects in granite mining in Kratie province.
- **Real Estate** - 2015 and 2016 saw very positive investment returns on residential real estate. For 2017, it was thought that foreign investment would move towards entertainment, hotels, condo-hotels, (pre China outbound constraints). From a geographical perspective, the next real estate boom could be in Sihanoukville which is known for its beaches and the rapid growth in tourism numbers. While Phnom Penh and Sihanoukville could continue as the primary beneficiaries of real estate development, mid-tier cities like Poipet and Battambang could also see increased interest.

- **The Sihanoukville Special Economic Zone (SEZ)** - the first special economic zone funded by the Chinese government in Asia. The Cambodia International Investment Development Group and Jiangsu Taihu Cambodia International Economic Cooperation Investment co-manage the project. There are 108 enterprises and companies located in the zone with a total investment capital of more than \$3 billion.

Specific Major Chinese Equity Investments (2016-2017)

We now highlight 5 major Chinese investments over \$1 billion which are equity related. Again, they are aligned to key sectors of future development: energy, infrastructure/ tourism, manufacturing/ agriculture and a new suburb situated close to the country's capital. Most of these have local partners/ investors – and are long term in nature. Due to the recent timing of these investments, it is too early to calculate returns to the investors.

- In 2016, Tianjin Union Development Group (UDG), a subsidiary of Chinese developer Wanlong Group, has committed to an investment of \$3.8 billion to build a deep water port, an airport and the largest resort in Cambodia as well as Southeast Asia . As of January 2017, the deep water port was nearly finished (JICA purchased a stake in the existing largest port in August). The international airport to be built for the Dara Sakor Seashore Resort is expected to be built in three phases, with phase one commencing in January 2018 at a projected cost of between \$300-\$350 million (total cost of circa \$500 million). The airport would be able to receive medium-sized airplanes once phase one was completed over the course of the next two and a half years. A casino, hotels, restaurants and a golf course have been erected, along with an artificial lake to supply water but little has happened on guest numbers.
- Heng Fu Sugar is one of China's largest sugar producers. In 2016, it opened its new Cambodian sugar production facility, the largest Chinese sugar facility in Cambodia, via an investment of more than \$360 million. In the second and third stages of the project, the company has planned to invest more than \$1 billion to construct a modern agricultural development zone.
- In December 2016, Cambodian conglomerate LYP Group and the China Minsheng Investment Group (CMIG) signed an MoU to develop a 550-hectare "Cambodia-Chinese Friendship City". The \$ 1.5 billion joint venture deal allows for CMIG, China's largest investment company, to develop the residential area within the 2,000 hectare Garden City satellite city being built by LYP Group 10km north of Phnom Penh. Construction on the "Cambodia-Chinese Friendship City" is expected to start in 2017 with the project including a convention centre, logistics centres, schools and other facilities.
- In May 2017, after years of delays and setbacks, the Cambodian private firm set to operate the Kinlandmark oil refinery, Cambodia Petrochemical Company (CPC), finally broke ground on a

\$1.62 billion project with an updated completion date set for mid 2019. The oil refinery, was first expected to be completed in 2014 after securing a 100% committed loan from EXIM in December 2013. However, the refinery plans did not move forward until May of 2016 when CPC granted a \$620 million first phase construction contract to CNPC. Construction was then outsourced to China's Sino Great Wall International Engineering Group. Upon completion, the facility is expected to have an annual refining capacity of 5 million tonnes of crude oil.

- In December 2016, a consortium led by Sino Great Wall Intl won a \$2.7 billion contract to build 133-story twin commercial skyscrapers in Phnom Penh, a five-year project that would make them among the world's tallest buildings. The Phnom Penh contract will come into effect once the consortium, which includes Sino Great Wall and Wuchang Shipbuilding Industry, finalizes the funding. In a filing to the Chinese stock exchange in Shenzhen, Sino Great Wall said construction was expected to take about 60 months.
- In August 2017, Worldbridge Land (Cambodia) and China's Sino Great Wall International Engineering signed an agreement focused on further developing Cambodia's public infrastructure. Under the agreement, Sino Great Wall would own 60% while and Worldbridge would own 40%. The JV would look to invest \$3 billion in terms for public infrastructure projects.

GDP Growth/Economic Conditions

Over the past two decades (1994-2015), the Cambodian economy grew at an average annual growth rate of 7.6%, ranking it #6 in the world. Through such growth, Cambodia attained the lower middle-income status as of 2015, with gross national income (GNI) per capita reaching \$1,070. Economic growth is expected to remain strong over the next two years (6.8% in 2017 and 6.9% in 2018). Keys to future growth include political stability and security, open policies for investment, and a young labour force, 72% of which is under the age of 35.

Overall FDI into Cambodia

Foreign direct investment in Cambodia increased from an average of \$644 million a year from 2005 to 2008 to an average of \$1.5 billion annually from 2009 to 2014, according to data from the United Nations Conference on Trade and Development.

Since 2005, Cambodia has approved more than 30 SEZs, although only around a dozen are in operation at this time. The SEZs are being created along a corridor than runs from the Vietnamese border in the southeast to the capital Phnom Penh and northwest toward Thailand.

Whereas Chinese investment has been centered on energy, infrastructure and the garment industry, Japan is leading a shift to investment in manufacturing. A small number of Japanese automotive parts

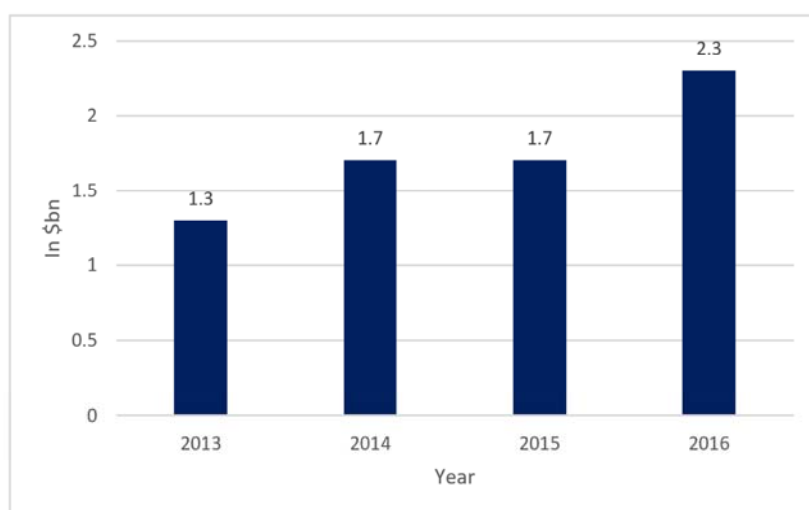
makers are operating at the Phnom Penh Special Economic Zone, including Denso, a wiring unit of Japan's Sumitomo Corp. and Minebea, a producer of machinery components and electronic devices which is now Cambodia's second-largest private sector employer, behind ACLEDA Bank.

Japan has also been investing in Cambodian real estate. Aeon built a sizeable mall, at a cost of \$250 million, which opened in Phnom Penh in 2014 and announced plans to build a 2nd mall by 2018. A 23-floor, \$14 million Toyoko Inn hotel opened last year in Phnom Penh. It is the city's first Japanese hotel.

By 2015, China led with 1,055 firms operating in Cambodia, South Korea followed with 278, while Japan was 3rd with 250. The 250 Japanese companies registered with Cambodia's Ministry of Commerce in 2015 is a major increase from 19 in 2010 and 179 in 2013.

South Korea replaced the UK as the largest investor in Cambodia in 2011, but has seen its ranking in inbound investment decline over the past several years due to series of poor returns on ill-timed real estate investment, nearly a decade ago.

Figure 1. Cambodian FDI (2013-2016)



2016

According to the National Bank of Cambodia Foreign direct investment (FDI) into Cambodia increased by 25 percent in 2016 amounting to \$2.15 billion; \$539 million into the banking sector, \$390 million to the manufacturing sector, \$370 million to real estate, \$232 million to agriculture and \$228 million for food and accommodation. China was the largest foreign investor, with an inflow of

\$511 million, followed by Hong Kong at \$237 million, Vietnam at \$192 million, Japan at \$185 million and \$169 million from Singapore.

In addition, Japan also announced two grants/loans (one of which was not signed until 2017): a \$35 million grant from Japan to implement the fourth phase of a JICA-sponsored flood-protection project in Phnom Penh and a concessional loan from JICA of approximately \$209 million to implement a container terminal project at Cambodia's principal deep sea port in Sihanoukville.

H1 2017

FDI into the banking sector amounted to \$439 million during H1 2017, an 89 percent increase compared to the same period one year earlier. (BRED) Banque Populaire – France – officially launched operations in Cambodia in March, while Mizuho Bank, one of Japan's largest financial institutions, entered in April.

In August 2017, the JICA \$209 million concessional loan was signed. In addition, Japan signed an agreement offering a \$800 million concessional loan to complete the skytrain to link central Phnom Penh to the airport. During his state visit to Japan, Mr Hun Sen pointed to expanding operations by Aeon Mall and Minebea, a Japanese electronics subsidiary, reflects strong confidence in the Cambodian government. "In the last five years, big Japanese companies that invested in Cambodia's neighbouring countries have stepped in for investment in our country, establishing factories to produce electronic, automotive, and other technical materials for export. Mr Hun Sen added that the investment of these companies would make other Japanese companies in other sectors, including banking, hotels, and airlines, decide to invest in Cambodia.

Meanwhile, Chinese investment during the first nine months 2017 grew 80% compared to the same period last year.

Conclusions

Cambodia and China signed a Memorandum of Understanding on strengthening cooperation and investment on industries in 2015. As recently as October 2017, Cambodia was labelled as "an integral constituent of President Xi Jinping's Belt and Road Initiative (BRI)".

While there is no panacea of exporting the Chinese economic miracle to BRI countries, we believe that this analysis represents an excellent example of how China can be helpful to its BRI friends in transforming their economies and positioning them for additional future growth. We also believe that by China spending vast sums to fund Phase 1 projects at yields of 10% or less on most of those projects, China is actually helping the recipient country unlock investment from other countries/corporates on projects with much higher financial return potential.



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Henry Tillman has an international business career of nearly 35 years. The initial decade was spent based in New York with major investment banks, focused mostly on advising on US organizations on M&A and capital raising. Since 1992, he has been based in London, including a senior management role at Barclays Group, with a focus on Europe and Southeast Asia and at ABN AMRO, where he was a Wholesale Banking Board Member, managing a global business with a focus on Emerging Markets, in particular Asia.

In 2003, Mr. Tillman founded Grisons Peak, a London based, Asian focused merchant bank which has completed over €25 billion in advisory assignments since inception. The firm focusses on advising UK/European companies with unique technologies to partner with China based businesses in China and on Asian organizations interested in international expansion.

In 2008, he founded China Outbound Investments, which tracks and analyses G2G agreements, Chinese Government related loans and M&A/equity investments in a single quarterly report, all of which have been reconciled with original source documents whenever possible. This database also includes bespoke capabilities which measure Chinese Government related loans linked to individual infrastructure/renewable energy projects since 2013. Our research has been cited by many major press including The Financial Times, The Wall Street Journal, Thompson Reuters, IFR and several others. This database has also been used by major universities for academic research regarding Chinese outbound investment in the UK (Cass Business School) and the US (New York University).

Mr Tillman previously served as a Non Executive Director of Wells Fargo Securities (Europe). In 2016, Mr Tillman represented the 48 Group (UK) at the launch of the Maritime Silk Route in Xiamen. In 2017, has led workshops for European Executives and Board members on the BRI at Cambridge University, on Funding the BRI at the Intermodal Global Industry Leaders Conference (Shanghai) and was interviewed in a podcast by The Financial Times on Chinese capital controls.

He is currently Chairman and Co- Founder of Music for Autism International, the international arm of the UK based charity Music for Autism. MFAI collaborates with leading ASD schools based in countries committed to developing musical, artistic and dance/movement talent for their gifted ASD students and sustainable music programmes for other ASD students (Autistic Performance.com). He is also Chairman and Co-Founder of The Autistic Adult Choir, the world's 1st all autistic, all adult choir, based in London.

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