Sustainable International Leaders Strategy

Brown ADVISORY
Thoughtful Investing.

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We believe companies with strong competitive advantages and moats from a fundamental and sustainability perspective, that have reinvestment opportunities at high returns on invested capital (ROIC), capable and rightly incentivized management teams and are undervalued over a long-term investment horizon have the ability to compound returns and generate attractive risk-adjusted excess returns throughout the economic cycle.

Priyanka Agnihotri
Portfolio Manager

Dear fellow investors,

2022 was no doubt an exciting and challenging year for the financial markets. Not only did the year offer a myriad of geopolitical and economic challenges impacting our investments, but with interest rates rising faster than at any time since the 1980s[1] to combat rising inflation, valuation models for equities had to recalibrate for these new inputs. In particular, companies with long-dated cash flow streams, often grouped as growth and hyper growth stocks, have corrected as the new costs of capital are being priced in by the market. Whilst the bulk of the portfolio is not over-indexed to such areas, we did see a correction in the long-duration stocks that we own. We believe that the Sustainable International Leaders strategy has held up well against this backdrop. With absolute performance net of fees of -17.1%[2] for 2022, the strategy modestly underperformed its benchmark the MSCI AC World ex U.S. Index which returned -16.0%.

We are long-term investors and, as such, one calendar year or even the 16 months since inception of the Sustainable International Leaders strategy (launch August 31, 2021) is a fairly short time period in the context of our 5 to 10-year investment horizon. Nevertheless, we are cognisant of the changes we have seen over the last year and want to use this opportunity to reflect on lessons learnt.

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[1] Source: Bloomberg, Federal Fund Rate changes since 1970 to December 14, 2022

[2] The composite performance shown reflects the Sustainable International Leaders Composite, managed by Brown Advisory Institutional. Brown Advisory Institutional is a GIPS Compliant firm and is a division of Brown Advisory LLC. Please see the Brown Advisory Sustainable International Leaders disclosure statement at the end of this letter for a GIPS compliant presentation.

What a Difference a Year Makes

The strategy's core belief is that competitively advantaged businesses that can invest at high returns on invested capital (ROIC), are run by capable management teams and are attractively valued, can generate attractive risk-adjusted returns over the course of a full business cycle. We therefore expect these companies to generate shareholder returns ahead of the market in the long term, and we expect them to outperform their peers.

Over the last year, market inflation expectations, policy rates and implied cost of capital assumptions in many of our key markets have meaningfully corrected upwards[3]. While the Federal Reserve led interest rate tightening, many international markets followed. Within our core geographic allocations of U.K., Europe, Switzerland, Japan and India, interest rates have moved from no change in Japan to a hike of 325 basis points in the U.K.[4] since the beginning of 2021, all in response to fast-rising inflation in everything from raw materials and logistics to labour costs. Furthermore, not all of these cost increases are expected to be purely cyclical. While the operating environment for a lot of our businesses has once again changed in a short period of time, in less than two years from the severe disruption of the COVID-19 pandemic, we believe that our time-tested principles of investing in attractive businesses and talented management teams at the right valuation will allow us to perform well in the current environment.

So, how do we think about valuation and the long-term cost of capital for our investments today? Sustainable International Leaders employs a free cash flow-based valuation approach and a standardized weighted average cost of capital (WACC) of 10% for developed markets and a higher rate for developing markets when valuing companies. Our assumptions for cost of capital are based on our best long-term estimates, keeping in mind historical long-term interest rates and equity returns. We think that despite the changes in interest rates over the last 12 months, our assumptions continue to remain conservatively above implied markets rates[5]. Thus, we feel comfortable that we will be able to identify attractive entry and exit points within our existing framework as we enter 2023.

As regards inflationary pressures, in the short term, we believe companies will need to be tactical in increasing prices while not damaging their relationship with their customers. Not every business will be in a position to do so. We believe that competitively advantaged businesses should be somewhat protected due to their ability to pass on most, if not all, of the inflationary pressures that they face. As an example, European consumer goods company Unilever was fast in grasping the implications of higher inflation in Europe, having drawn upon its extensive experience of operating in emerging markets. The company was quick to raise prices, which not only allowed them to take price in one of their most competitive markets but protected their margins with limited impact on volumes. In our view, this speaks to the strength of Unilever's competitive advantages in its brands and long-standing relationships with its retailer customers.

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[3] Source: Bloomberg, Quest – global average share price implied cost of capital, as of December 12, 2022

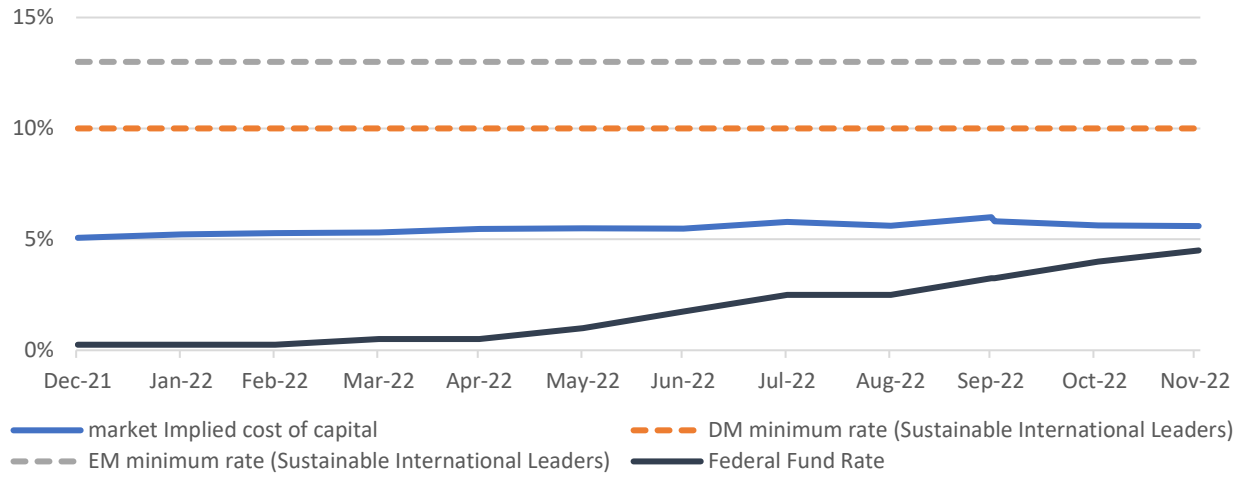
[4] Source: Bloomberg, as of December 12, 2022

[5] Source: Quest – global average share price implied cost of capital, as of December 31, 2022

We expect that the best-run businesses will clearly outperform their industries in an operating environment that has radically changed over the last eighteen months. The U.K. outsourced food services provider, Compass Group, is one example that comes to mind. We believe the company finds itself well positioned to execute on its game plan of reducing complexity for its customers – a strategy that has been in place since before the pandemic began. We are starting to see an inflection in new customer wins and market share increases against the backdrop of a host of issues faced by their customers: wage inflation, rising health and safety risks and regulations, increasing demand for sustainability and ongoing supply chain issues. Longer term, we believe that policies put in place by thoughtful management teams to make supply chains more reliable and to use resources more efficiently will deliver the best results and strengthen companies' competitive positions.

Conservative valuations in a rising rate environment

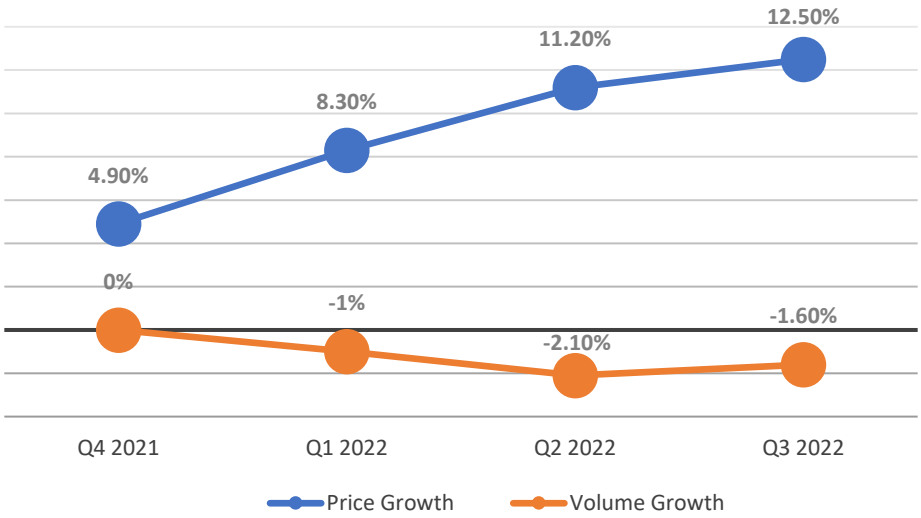
Interest rate and WACC assumptions from December 31, 2021 to December 31, 2022



Source: Quest, Bloomberg and Brown Advisory

Unilever's revenue resilience and pricing power

Price Growth and Volume Growth from Q4 2021 to Q3 2022



Source: Unilever company reports: https://www.unilever.com/files/15b3ac9d-329b-4e15-b480-3ce0a9b0a1fc/unilever-q3-22-presentation.pdf
Strategy composite performance can be found on page one of this report.

Lessons learnt

It is almost always a difficult time to invest and looking back at our experience as a relatively new strategy, we thought it would be useful to consolidate some of the lessons we've learned over the last year, namely: 1. Invest in good businesses; 2. Management quality matters; 3. Don't compromise on valuation

Invest in good businesses

The market can be viewed as an ever-changing pendulum oscillating between extreme optimism and extreme pessimism, spanning everything in between. Ultimately, we don't expect our view of the portfolio to change very much based on these gyrations – we can only hang our hat on robust fundamentals, strong competitive advantages and our conviction on free cash flow generation for our investments. The strategy's success doesn't depend on us tactically positioning for any style, market, or macro-driven opportunity. While there is more than one way to skin a cat, we focus on resilient businesses with a specific set of characteristics that we believe will provide us the best opportunity for outperforming the market. We therefore feel comfortable to have little or no exposure to certain segments of the universe such as energy companies or hyper growth companies, where it has been harder to find the types of business models in which we would typically invest. For energy companies, a significant dependence on the price of a commodity, such as crude oil, limits our ability to predict future returns and cash flows with any reliability. Additionally, given the energy transition that is underway globally, it is difficult to gain

comfort around incremental returns on capital for energy companies, a key driver of future cash flows. By continuing to remain on the side-lines in the energy sector last year we experienced some pain in terms of the strategy's relative performance, but for now our view is aligned with our assessment of opportunities in the sector to date. When looking at what are viewed as faster growth companies, we would only selectively consider investments that already have validated business models and a high likelihood of producing meaningful cash flow streams over the next five to ten years. We do not believe that we need to be invested in every part of the international universe or benchmark and are happy to own a diversified set of businesses that we believe will reliably provide us the best chance of generating strong shareholder returns over the course of a full market cycle. With a broad and diversified universe – taking our benchmark the MSCI All Country World ex USA Index as a proxy – of 2,261 constituent companies across 46 countries,[6] we are confident that our bottom-up, fundamental stock-picking approach can lead us to uncover high-quality companies that bring long-term growth opportunities at attractive valuations.

Management quality matters (hugely)

Management is responsible for allocating the vast majority of the capital generated by a firm over a five to ten-year period. The importance of high-quality management teams cannot be overstated. While this might sound obvious at first glance, the implications of ignoring warning signs of questionable management practices can be very severe over time, ranging from long-term underperformance due to misallocation of capital to complete permanent loss of capital due to outright fraud. At this early stage in our journey, this specific lesson was apparent when looking at our investment in the U.K. industrial software company Aveva which we exited in 2022. At Aveva, following some top executive changes, we became increasingly uncertain about new management's ability to execute on a challenging revenue model transition at the same time as undertaking the integration of data historian OSISoft, one of its largest acquisitions. In the course of our ongoing research into new developments at the firm, these concerns became insurmountable leading to a thesis break. Our thesis centred around the company strengthening its competitive position after merging with OSISoft. From management's perspective, this would lead to meaningful expansion into markets with long-term, structural growth trends. The execution risk we identified eventually changed the risk profile of the investment. We exited the position well before our average expected holding period.

A company that we think exemplifies an excellent management team and that is currently held in the portfolio is luxury brand company LVMH. LVMH has been part of the portfolio since inception (albeit only a 16-month period) and we view it as an exceptionally well-run business. Management has a deep understanding of what works in luxury and has had a consistent strategy which has been executed nearly flawlessly year after year. They understand how to build brands for the long-term and we believe they are masters of striking the right balance between exclusivity and accessibility, where many other brands (such as Prada, Versace and Pierre Cardin) have historically floundered. In addition to the focus on organic

[6] Source: MSCI as of December 30, 2022

growth, CEO Bernard Arnault has a reputation as a shrewd deal-maker in the luxury industry. LVMH has acquired iconic brands such as Bulgari, Dior and more recently Tiffany. These heritage brands are at least 75 years old, would be virtually impossible to recreate today and have flourished under LVMH's ownership. Arnault owns approximately 48% of LVMH's share capital and 64% of the voting rights[7] giving him significant skin in the game. This, in our opinion, been a strong driving force in aligning the interests of management with long-term shareholders.

Don't compromise on valuation

One of the surest ways to underperform the market, in our opinion, would be to ignore valuation in our consideration of primary drivers of investment returns. We believe that it is important to carefully consider valuation levels and what they mean for five year expected returns—in terms of adding new positions as well as for position sizing and maintaining a good sell discipline. At the same time, our experience of investing in high-quality businesses shows that exceptionally strong businesses, which may appear expensive on one-year forward metrics typically employed in the market, can continue to compound their intrinsic value at high rates far beyond the time horizon of most investors. As we entered 2022, Waste Connections, one of our top contributors for the year, traded at a higher one-year forward multiple compared to the benchmark, as did HDFC Bank, when compared to many of its global banking peers. However, in our analysis, both companies were attractively valued over the medium term and we believe this contributed to their strong performance in a relatively tumultuous period for the markets. Thus, we view valuation analysis as more nuanced than merely looking at short-term heuristics and with conservative assumptions, we hope to strike the right balance between realistic cash flow estimates and keeping a margin of safety in estimating the intrinsic value of a business.

Not all investments have fared as well. We invested in Shopify, the leading e-commerce platform for small and medium sized merchants in the U.S. and Canada, at the end of January, when it was off 48% from its peak less than 3 months earlier. Shopify's competitive advantages of scale and switching fit our qualitative criteria well. Our primary research indicates that they are positioned to continue to outgrow the overall e-commerce market in the medium term through the sale of their core platform solution as well as from their payment and fulfilment businesses. From a valuation perspective, what appeared to be an attractive entry point proved to be a relatively expensive price for what we still regard as a high-quality business. With hindsight, we underestimated how difficult it is to get valuation right for companies with high embedded growth expectations. Following our initial investment, Shopify announced increased investment in its merchant solutions business, particularly its fulfilment services, which contributed to the decline in the company's market valuation. We fundamentally disagree with the market's interpretation of this move. While the risk of short-term free cash flow (FCF) dilution increased, we believe Shopify is investing in long-term value creation by improving the outcome for their customers. We would expect to see meaningful FCF expansion as this business scales over five years and beyond. As a relatively early stage business with high growth prospects, we are aware that the distribution of outcomes for this business is

[7] Source: LVMH company reports

wider than for more mature businesses. This was reflected in a lower position size at inception which has remained small through the year despite our faith in the strength of the business model. That said, our experience has underscored the importance of valuation once again and highlighted how hard it can be to get it right in situations with a wider probability distribution of outcomes.

Our general approach to investing in attractive businesses is to be patient and wait for market dislocations that we believe can offer attractive opportunities for long-term investors. One company that we have waited to own for a few years is ASML, the Netherlands-headquartered leader in advanced lithography equipment for the semiconductor industry. ASML's extreme ultra violet or EUV technology is virtually impossible for peers to replicate over the medium term. We believe it is well positioned to benefit from greater digitalization across the economy and continued scaling in semiconductors, both of which should drive greater lithographic intensity over time. We believe the drive for technological sovereignty will create manufacturing inefficiency and further add to demand for lithography tools from new semiconductor fabs being built around the world. Having followed the company for many years, we saw an attractive base case internal rate of return (IRR) in March, when a combination of rising rates and the beginning of the Ukraine-Russia conflict offered an attractive entry point.

What role does environmental, social and governance (ESG) research play in our decision making?

Brown Advisory has more than a decade of experience in sustainable investing and the strategy works closely with our dedicated, internal ESG research team. We aim to identify investments that add value for shareholders through thoughtful mitigation of ESG risks and active pursuit of sustainable opportunities. Our ultimate goal is to invest in businesses that are part of the ESG solution as opposed to part of the problem. We are aware of the complexity of investing in international and emerging markets where companies as well as countries are at a different stage of development on ESG standards compared to developed markets. That said, our concentration means that we can afford to be selective and do not need to compromise on globally accepted best practices. At our teams' annual offsite, one question that came up was how to define parameters that can track a company's progress on its ESG journey. For companies that fall behind this goal, we seek continued engagement and improvement over our holding period. One of our investments in Indonesia, the microfinance lender Bank Rakyat, highlights this process. The company flagged as not having set science-based targets which led us to a conversation with them to understand their climate strategy and Science Based Targets initiative (SBTi) adoption plans. This was an engagement conversation specifically dedicated to SBTi adoption whereby the company laid out their timeline for SBTi adoption and publication of their goals.

Other ESG risks and opportunities can be very idiosyncratic, like in the case of our investment in Chinese internet company Tencent. By the time we exited in October, we felt that our ability to analyse this company had become permanently impaired due to increasing regulatory risk. The trigger for our decision to exit was the consolidation of Xi Jinping's power at the 20th National Congress in October. We viewed

this development as negative and believe there is a greater likelihood than ever of increased government intervention in Tencent's business. Our original thesis for Tencent centred around its exceptional position to drive the monetization of exclusive content in a Chinese economy that continues to digitize. From a sustainability perspective, Tencent's social platform facilitates low cost communication. Their services such as payments and mini programs have helped launch some of the most successful consumer internet businesses in China. This has reduced barriers to entrepreneurship and ultimately promotes economic equality. Tencent also provides environmentally sustainable profits through its cloud products and efficient data centres. Tencent is a good example of the importance governance risk – in this case the risk emanated from the government and not company management – plays in international investing.

Today's portfolio and outlook

We view the strategy as a collection of strong business models which we believe are well positioned to increase their intrinsic value over time and in a wide range of macroeconomic scenarios. The portfolio is broadly diversified across all international markets with 30% geographic revenue exposure to Europe, 28% in Asia ex Japan, 4% to Japan and 36% to the reset of the world of which 28% is allocated to the Americas (U.S., Canada and Brazil)[8]. We also see attractive portfolio characteristics that are reflected in a 19% ROIC, 7% three-year sales growth and a 4% FCF yield as of December 31, 2022.

Thank you for your support.

Priyanka and the Sustainable International Leaders Team

[8] As of 31st December 2022

Disclosures

Past performance may not be a reliable guide to future performance and investors may not get back the amount invested. All investments involve risk. The value of the investment and the income from it will vary. There is no guarantee that the initial investment will be returned.

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ESG considerations are one of multiple informational inputs into the investment process, alongside data on traditional financial factors, and so are not the sole driver of decision-making. ESG analysis may not be performed for every holding in the strategy. ESG considerations that are material will vary by investment style, sector/industry, market trends and client objectives. The strategy seeks to identify companies that it believes may have desirable ESG outcomes, but investors may differ in their views of what constitutes positive or negative ESG outcomes. As a result, the strategy may invest in companies that do not reflect the beliefs and values of any particular investor. The strategy may also invest in companies that would otherwise be screened out of other ESG oriented funds. Security selection will be impacted by the combined focus on ESG assessments and forecasts of return and risk. The strategy intends to invest in companies with measurable ESG outcomes, as determined by Brown Advisory, and seeks to screen out particular companies and industries. Brown Advisory relies on third parties to provide data and screening tools. There is no assurance that this information will be accurate or complete or that it will properly exclude all applicable securities. Investments selected using these tools may perform differently than as forecasted due to the factors incorporated into the screening process, changes from historical trends, and issues in the construction and implementation of the screens (including, but not limited to, software issues and other technological issues). There is no guarantee that Brown Advisory's use of these tools will result in effective investment decisions. This piece is intended solely for our clients and prospective clients, is for informational purposes only, and is not individually tailored for or directed to any particular client or prospective client.

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The MSCI ACWI (All Country World Index) ex USA Index captures large and mid cap representation across Developed Markets (DM) countries (excluding the US) and Emerging Markets (EM) countries. The index covers approximately 85% of the global equity opportunity set outside the US. All MSCI indexes and products are trademarks and service marks of MSCI or its subsidiaries.

ROIC is a measure of determining a company's financial performance. ROIC = NOPAT / IC. NOPAT = EBIT + Amortization of acquired intangibles - Cash tax paid. IC = Total Debt + Total Equity + Total unfunded pension liabilities - Excess Cash.

The internal rate of return (IRR) is a measure of an investment's rate of return. The internal rate of return is a discount rate that makes the net present value (NPV) of all cash flows from a particular project equal to zero. It is also called the discounted cash flow rate of return.

Weighted Average Cost of Capital (WACC) presents a firm's average after-tax cost of capital from all sources, including common stock, preferred stock, bonds, and other forms of debt. WACC is the average rate a company expects to pay to finance its assets.

The forward multiple refers to the multiple applied to a company's next twelve months Earnings before interest, taxes, depreciation and amortization (EBITDA) or Earnings before interest and taxes (EBIT). It is based on a company's predicted earnings for the next year, and therefore more subject to error than the trailing twelve months (TTM) multiple.

Free cash flow (FCF) represents the cash a company generates after cash outflows to support operations and maintain its capital assets. Unlike earnings or net income, free cash flow is a measure of profitability that excludes the non-cash expenses of the income statement and includes spending on equipment and assets as well as changes in working capital.

Sales growth rate is based on reported company revenue for the past three years at the end of the current quarter, provided as a historical average.

Sustainable International Leaders Composite

Year	Composite Total Gross Returns (%)	Composite Total Net Returns (%)	Benchmark Returns (%)	Composite 3-Yr Annualized Standard Deviation (%)	Benchmark 3-Yr Annualized Standard Deviation (%)	Portfolios in Composite at End of Year	Composite Dispersion (%)	Composite Assets ($USD Millions)*	GIPS Firm Assets ($USD Millions)*
2021**	-1.6	-1.7	-1.4	N/A	N/A	Five or fewer	N/A	1	79,715

**Return is for period September 1, 2021 through December 31, 2021.

Brown Advisory Institutional claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Brown Advisory Institutional has been independently verified for the periods from January 1, 1993 through December 31, 2021. The Verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

1. *For the purpose of complying with the GIPS standards, the firm is defined as Brown Advisory Institutional, the Institutional and Balanced Institutional asset management divisions of Brown Advisory. As of July 1, 2016, the firm was redefined to exclude the Brown Advisory Private Client division, due to an evolution of the three distinct business lines.
2. The Sustainable International Leaders Composite (the Composite) includes all discretionary portfolios invested in the Sustainable International Leaders strategy. The Sustainable International Leaders strategy aims to achieve capital appreciation by investing primarily in international equities. The strategy intends to invest in equity securities of companies that the portfolio manager believes are leaders within their industry or country, as demonstrated by an ability to deliver high relative return on invested capital over time.
3. ESG considerations that are material will vary by investment style, sector/industry, market trends and client objectives. The strategy seeks to identify companies that it believes may have desirable ESG outcomes, but investors may differ in their views of what constitutes positive or negative ESG outcomes. As a result, the strategy may invest in companies that do not reflect the beliefs and values of any particular investor. The strategy may also invest in companies that would otherwise be screened out of other ESG oriented funds. Security selection will be impacted by the combined focus on ESG assessments and forecasts of return and risk. The strategy intends to invest in companies with measurable ESG outcomes, as determined by Brown Advisory, and seeks to screen out particular companies and industries. Brown Advisory relies on third parties to provide data and screening tools. There is no assurance that this information will be accurate or complete or that it will properly exclude all applicable securities. Investments selected using these tools may perform differently than as forecasted due to the factors incorporated into the screening process, changes from historical trends, and issues in the construction and implementation of the screens (including, but not limited to, software issues and other technological issues). There is no guarantee that Brown Advisory's use of these tools will result in effective investment decisions.
4. The Composite creation date is October 6, 2021. The Composite inception date is September 1, 2021.
5. The benchmark is the MSCI ACWI ex U.S. Net Index. The MSCI ACWI ex U.S. Net Index captures large and mid cap representation across Developed Markets (DM) countries (excluding the U.S.) and Emerging Markets (EM) countries. The Index covers approximately 85% of the global equity opportunity set outside the U.S. All MSCI indexes and products are trademarks and service marks of MSCI or its subsidiaries. An investor cannot invest directly into an index. Benchmark returns are not covered by the report of the independent verifiers.
6. As of September 1, 2022, the Composite benchmark was changed from the FTSE All-World ex-U.S. Net Index to the MSCI ACWI ex U.S. Net Index. The change was applied retroactively from the Composite inception date. The Advisor determined that MSCI indices are more widely used for global products, and thereby provide more relevant data to shareholders and prospects as well as comparisons to competitors.
7. Composite dispersion is an equal-weighted standard deviation of portfolio gross returns calculated for the accounts in the Composite for the entire calendar year period. The composite dispersion is not applicable (N/A) for periods where there were five or fewer accounts in the Composite for the entire period.
8. Gross-of-fees performance returns are presented before management fees but after all trading commissions, and gross of foreign withholding taxes (if applicable). The strategy seed account net-of-fees returns are calculated by deducting a model management fee of 0.2%, 1/4th of the highest management fee of 0.80%, from the quarterly gross portfolio return. Net-of-fee performance returns for all other accounts within the composite reflect the deduction of actual management fees and all trading commissions. Other expenses can reduce returns to investors. The standard management fee schedule is as follows: 0.80% on the first $50 million; 0.55% on the next $50 million; 0.45% on the next $50 million; and 0.40% on the balance over $150 million. Further information regarding investment

advisory fees is described in Part II A of the firm's form ADV. Actual fees paid by accounts in the Composite may differ from the current fee schedule.

9. The investment management fee for the Investor Shares of the Brown Advisory Sustainable International Leaders Fund (the Fund), which is included in the Composite, is 0.75%, and represents the highest fee charged excluding Advisor Shares. The total expense ratio for the Investor Shares of the Fund is 1.44%. Further information regarding investment management fees and expenses is described in the fund prospectus and annual report.
10. The three-year annualized ex-post standard deviation measures the variability of the Composite (using gross returns) and the benchmark for the 36-month period ended on December 31. The 3 year annualized standard deviation is not presented as of December 31, 2021 because 36 month returns for the Composite were not available (N/A).
11. Valuations and performance returns are computed and stated in U.S. Dollars. All returns reflect the reinvestment of income and other earnings.
12. A complete list of composite descriptions and broad distribution and limited distribution pooled funds is available upon request.
13. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.
14. Past performance is not indicative of future results.
15. This is not an offer to sell securities. That may only be accomplished by the issuance of a private offering memorandum/subscription documents.
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