

CareCapital*

Real Estate Holding & Development
CARE.L(AIM)

Oversold.

Earnings and asset quality alone justify a significant readjustment in share price.

Investment Case

- CareCapital has seen its SP fall 60% YTD. This is totally unjustified.
- CARE should be viewed in terms of the quality and visibility of its earnings and should be afforded a premium as a result. Over 80% of its UK rent roll is effectively government-backed and very long term in nature.
- For FY'08 we are expecting an Adj. EPS of 0.9p rising in 09 to 3.2p. This leaves CARE trading on a PER of 9.2x falling to 2.6x and in terms of valuation it trades at a near 50% discount to 08e NAV, compared to sector comparables of c.30%. Strong BUY.

Year End Update

Buy Upside
136%

What's Changed

2008E EPS	0.9p
2009E EPS	3.2p
Rating	BUY
Price Target	19.5p

Price 8.25p
Target Price 19.5p



Source: Proquote

Shares in issue	78.9m
Market Cap	£5.4m
NAV/Share	18.9p
Next Event	Interims – Sept '08

* Daniel Stewart acts as broker and nomad to CareCapital

Forecasts	12/06A	12/07A	12/08E	12/09E
Turnover (£000)	1,336	2,115	2,640	3,584
DSC Op Profit (£'000)	2,923	2,740	3,070	6,303
DSC PBT(£M)	2,051	1,653	1,371	3,526
Tax (%)	70.5	10.0	47.0	29.0
DSC EPS (p)	1.4	1.7	0.9	3.2
DPS (p)	0.0	0.0	0.0	0.0

Ratios	12/06A	12/07A	12/08E	12/09E
NAV (p)	18.1	18.9	19.5	22.3
P/E (x)	5.9	4.9	9.2	2.6
Yield	0	0	0	0
Price/NAV	0.54	0.52	0.50	0.44

Company Description

Development and ownership of health related properties for the long term.



Investment Case: income visibility and security

- 100 percent of CareCapital's UK income stream is effectively guaranteed for 10 years and over 90% of it is guaranteed for 15 years. This is secured on the fact that over 80% of CARE's UK income is ultimately guaranteed by the UK government via various Primary Care Trusts.
- Regular rent reviews take place which have historically resulted in c.15% uplifts in rental income, but have been as high as 20%. Whilst it might be reasonable to assume that increases of this magnitude may fall back over the next 18 months or so, we nevertheless expect these reviews to be a significant driver of earnings growth. In FY'08 there is scheduled to be £541k of annual rent subject to review.
- CareCapital does not develop speculatively. It is either approached or enters into a competitive tendering process. Minimal sunk costs are incurred at the initial stages, and no substantial spending takes place before a heads of terms agreement is signed.
- There is strong momentum behind the idea of moving towards GP led polyclinics in the UK reflecting the model adopted in France and Germany. We view this as a positive direction for CareCapital since polyclinics involve larger, higher margin developments.
- Notwithstanding the previous point, we believe that there is very significant demand for high quality new PCT stock at the GP level and that the demand for the renewal of services alone would account for significant growth. Indeed, we believe c.60% of GP's consider their existing premises to be inadequate for their *current* needs, not to mention future needs. Moreover, with a rapidly ageing population, it is easily conceivable that the UK will need many thousands more GP's in the medium to long term.
- CareCapital has 20 projects that are currently under development (providing a projected uplift to NAV of £26.5m), 2 of these projects are due to complete in FY'08 and 18 in FY'09/10. Once completed, these developments will virtually double the Group's portfolio to 45 centres.

100% of CareCapital's UK revenue is effectively guaranteed for 10 years and 90% for 15 years

Regular rent reviews have historically resulted in c.15% uplifts in rental income

There is no speculative development and very nominal sunk costs

There is a lot of momentum building behind the implementation of polyclinics

Demand for high quality, new PCT stock is growing rapidly. Many existing Medical Centres are inadequate or inappropriate

CARE has 20 projects currently under development which will provide a projected uplift to NAV of c.£26.5m

Financial Analysis & Valuation

CareCapital's income comes from the following:

- Rental Stream from existing UK and German developments

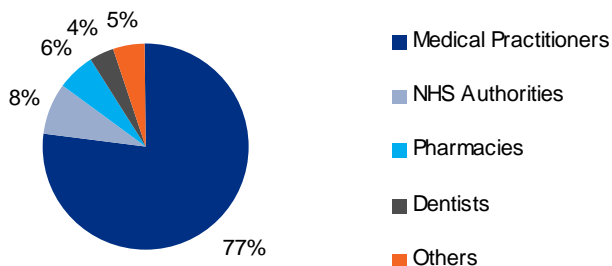
It also receives

- Development margin recovery from the construction of projects; And
- Pharmacy incentives

Rental Stream

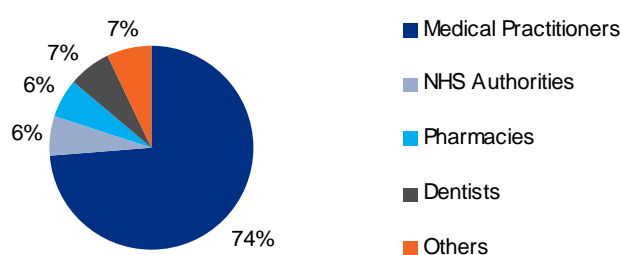
The Group's rent roll is its main source of income and is predominantly (over 80%) backed by the UK Government. Charts 1 and 2 below show the percentage of rent coming from each type of tenant in '06 and '07. It is clear that Medical Practitioners and NHS authorities are still by far the largest tenants in terms of rent roll with 74% of the stream coming from them. That said there has been some further diversification of rental income towards Dental and Pharmacy occupancy.

Chart 1: Rent roll by tenancy, 2006



Source: CareCapital/Daniel Stewart

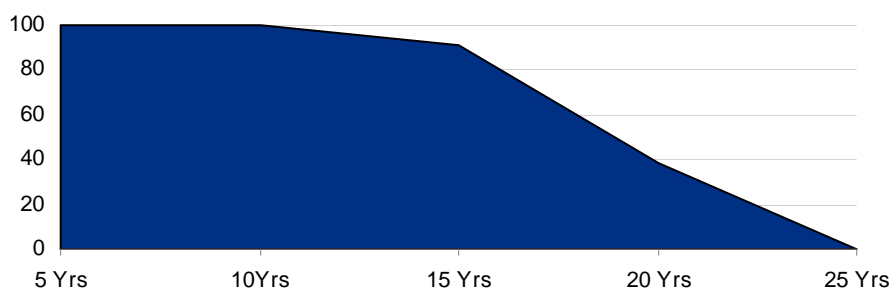
Chart 2: Rent roll by tenancy, 2007



Source: Daniel Stewart

The robustness of CARE's income stream is clear, but its visibility is also a credential worthy of comment. If we consider chart 3, we can see that 100% of the Group's UK rental income is secured for up to 10 years. Moreover, 90% of income is secured for 15 years and nearly 40% is secure for 20 years and over.

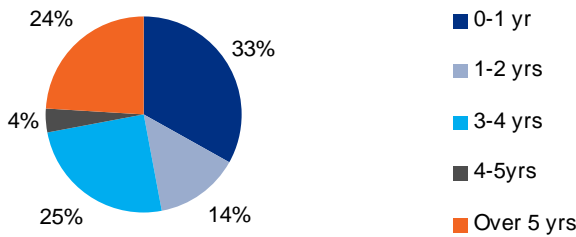
Chart 3: Security of income by lease term, 2007



Source: CareCapital/Daniel Stewart

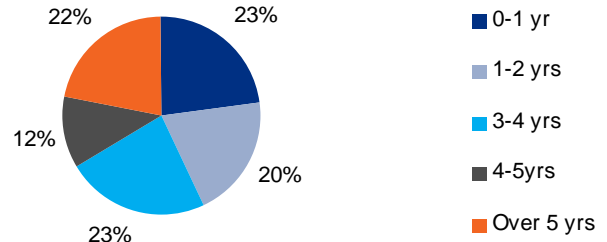
Charts 4 and 5 below show the schedule of rent reviews by annual rent. As can be seen, 23% of the rent roll is due to be reviewed in the current financial year. Historically, it has been the case that rental reviews have resulted in average uplifts of c.15%. Whilst we might expect this figure to come back over the next 18 months or so, we nevertheless fully expect these rental reviews to result in uplifts. Within the next 1-5 years, 78% of the existing rent roll will come under review.

Chart 4: Future rent review pattern by annual rent, 2006



Source: Daniel Stewart

Chart 5: Future rent review pattern by annual rent, 2007



Source: Daniel Stewart

Development Margin Recovery

Costs that are associated with a project which are billed on a time-basis fall under development margin recovery. It comprises c.7.5% of the total build cost of a project and is accrued on an internal time-sheet basis with the exception of the profit element which is booked on completion.

DMR is c.7.5% of the total development cost of a project

Pharmacy Incentives

Whilst there has been no contribution from pharmacy incentives as yet, we anticipate that they will start to flow through in FY'09. Essentially these payments are a reflection of the value added benefits to be reaped from operating a pharmacy within a healthcare centre.

We anticipate high value receipts for pharmacy incentives will start to flow through in FY'09

Revaluation Surplus

Properties are independently valued upon completion. In FY'08, we anticipate revaluations will result in uplifts of up to 30%; these are booked to the income statement in the year of completion of the development. We have forecast this based on the respective yields of the UK (5.5%) and German markets (6.5%) and have used a prospective rental income figure for each of the properties. We are able to estimate prospective rents fairly accurately since they are agreed as part of the contract prior to the commencement of the development process proper.

We are expecting revaluation uplifts of c.30% on developments completing in FY'08

Valuation

Based on the quality of CARE's income stream and the robustness of its asset class, we believe that it is unjustified for it to trade at anything less than its projected '08 NAV of 19.5p. There is exceptional growth potential in this stock over the next few years as over twenty new medical centres (all of which are pre-let to medical practitioners) will be completed resulting in significant rent roll and capital appreciation. CARE trades at a 28% valuation discount to peer PHP. Strong BUY.

CARE trades at a 50% discount to '08e NAV and a significant discount to PHP.

Table 1: CARE trades at a significant discount to PHP

	NAV '08e	Price/NAV '08e	NAV '09e	Price/NAV '09e
Care Capital	19.5	0.50	22.3	0.44
PHP	371.6	0.69	388.3	0.66

Source: Daniel Stewart

Existing & Development Portfolio.

Existing Portfolio

Table 2: Existing portfolio

	Usage	Leasehold or Freehold	Constructed	Most recent rent	Valuation
UK (£)					
Chafford Hundred	Medical centre	Freehold	Jul-99	77,465	1,408,000
Chalford	Medical centre	Freehold	Jul-95	47,620	866,000
Consett	Medical centre	Freehold	Dec-98	123,500	2,245,000
Darlington	Medical centre	Freehold	Mar-02	98,000	1,781,000
Hinckley - Medical Centre	Medical centre	Freehold	Jun-03	155,000	2,819,000
Hinckley - Pharmacy	Pharmacy		Jun-03	29,440	535,000
Hornchurch	Medical centre	Freehold	Jun-97	164,209	2,985,000
Ipswich	Medical centre	Leasehold	Dec-97	57,227	1,040,000
Leamington Spa	Medical centre	Freehold	Jun-01	90,000	1,636,500
Leith	Medical centre	Freehold	Nov-99	107,300	1,950,000
Watlington	Medical centre	Freehold	Jun-97	63,048	1,146,000
Wingate - Medical Centre	Medical centre	Freehold	Jul-00	52,500	955,000
Wingate - Pharmacy	Pharmacy	Freehold	Jun-00	11,273	205,000
Burnley	Medical centre	Leasehold	Aug-03	121,428	2,208,000
Lydney	Medical centre	Freehold	May-02	50,000	909,000
Hornchurch Dental	Dental	Freehold	Dec-01	18,200	330,000
Darlington Pharmacy	Pharmacy	Freehold	Feb-02	11,225	204,000
Leamington HPU	Health Promotion Unit	Freehold	Feb-05	35,500	645,000
Leamington Pharmacy	Medical centre	Freehold	Jan-01	11,225	204,000
Consett Pharmacy	Pharmacy	Freehold	Feb-98	22,500	409,000
Germany (€)					
			Purchased		
Adlershof	Mixed Medical	Freehold	Dec-06	626,000	9,639,000
Konigs Wusterhausen	Mixed Medical	Freehold	May-07	357,000	5,069,000
Neukolln	Mixed Medical	Freehold	Oct-07	426,000	6,270,000

Source: Daniel Stewart

Development Portfolio

CareCapital currently has 20 projects under development:

- **FY'08:** 2 projects – Folkestone in August and Markredwitz in December - are due to complete. Together they will bring an estimated developed value of £8.7m which translates into a c.£2.5m uplift in NAV.
- **FY'09/10:** the further 18 projects under development will complete over the course of these two years – we are anticipating 8 completions in FY'09. Together these projects have an estimated developed value of c.£85m (excluding receipts from capital sales of developed properties) and this will translate into an estimated £24m uplift in NAV.

Projects completing in FY'08 are expected to contribute a c.£2.5m uplift to NAV

Projects completing in FY'09/10 are expected to contribute a c.£24m uplift in NAV

Market Developments

What are polyclinics?

Very large clinics, sometimes including the amalgamation of several GP practices, but also offering complementary as well as hospital services alongside those of a normal medical centre. These may include homeopathy, GUM clinics, physiotherapy, mental health services and healthy living advice.

What is the rationale behind introducing them?

- Ostensibly, they will provide more services in one location at more convenient times.
- It will also provide a conduit for improved communications between the various health care professionals
- Improved provision of care for those with complex or chronic illness
- A shift from hospital based secondary care towards a panacea polyclinic.

Who's in favour?

- Whilst as yet, there are no firm government plans for the implementation process, Lord Darzi who is in the process of producing an all-encompassing review looking to modernise the NHS has comedown firmly in favour of polyclinics.

Criticisms?

- There are a number of criticisms of polyclinics, some of which have been outlined by the King's Fund.
- They believe a polyclinic will certainly make it no easier and in many cases will make it more difficult for those who live in rural areas.
- Putting health professionals under the same roof will not necessarily lead to improved cooperation.
- Many of the opportunities for offering joined-up care and time synergies are often lost in projects like these.

What are the benefits for CareCapital?

- The Group is a provider of medical real estate not clinical services and as such is well placed to develop the necessary centres evidenced by what it currently does in Germany.
- CARE has already started to develop healthcare centres with integrated facilities, i.e. with GP, dental and pharmacy services all under one roof.
- An extension towards providing multiple services as happens in CARE's German properties would provide the Group with an even higher quality of income since it would see many PCT backed professionals operating within one building all with lengthy leases and guaranteed rents.
- The existing stock of GPs surgeries in the UK would be inappropriate for polyclinics almost without exception. Polyclinics will require far greater space than most existing premises and it is likely that in most cases, they will need to be specifically designed.

Disclosure Checklist

Company	Code	Disclosure
CareCapital	CARE.L	2,3,6
Primary Health Properties	PHP.L	3,6

Source: Daniel Stewart

1. Within the past twelve months Daniel Stewart & Co plc and/or its affiliates has managed or co-managed a public offering for this Company, for which it received fees or the promise of fees
2. Daniel Stewart & Co plc and/or its affiliates act as corporate broker or nominated advisor to this Company
3. Daniel Stewart & Co plc and/or its affiliates regularly hold/may hold in future trading positions (which may include options) in this Company
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5. The Company holds more than 5% of the securities of Daniel Stewart & Co plc and/or its affiliates
6. Daniel Stewart & Co plc and/or its affiliates may currently be providing, expects to provide within the next three months or may have provided within the previous twelve months, investment banking services to this Company, which have given rise to payment or the promise of payment
7. The author and/or an individual responsible for production of this report has direct ownership of stock in this Company
8. The author responsible for the production of this report received or purchased shares in the issuer, prior to a public offering of the shares.
9. Daniel Stewart and Company is party to an agreement with this company for the publication of research on it
10. This research note has been disclosed to the Company, with resulting amendments, prior to its dissemination

The Daniel Stewart recommendation structure is based on relative upside/downside to target price. The target price is set on a rolling 12 month view. Upside or downside of 10% or more is categorised as Buy or Sell respectively, and less than 10% a Hold.

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Distribution of Ratings

	All Companies	Of which are Investment Banking Clients in the last 12 months
Buy	72%	40%
Hold	20%	9%
Sell	8%	0%

data as of 31 March 2008

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Authorised and Regulated by the Financial Services Authority. April08

Key Assumptions

- Yield assumptions of 5.5% in the UK and 6.5% in Germany.
- 2 properties completing in '08 and 8 in '09.

Income (£'000)	12/06A	12/07A	12/08E	12/09E
Revenue	1,336	2,115	2,640	3,584
Gross Profit	1,287	1,952	2,409	3,270
Development Margin Recovery	0	573	943	1,618
Pharmacy Incentives	0	0	0	630
Revaluation Surplus	3,528	2,507	2,379	4,024
Op. Profit pre exceptional	2,923	2,740	3,070	6,303
Op. Profit post exceptional	2,334	2,740	2,807	6,303
Finance Income	186	258	316	47
Finance Expense	1,089	1,551	2,016	2,824
PBT (DSC)	2,051	1,653	1,371	3,526
EPS (DSC) (p)	1.4	1.7	0.9	3.2
DPS(p)	0.0	0.0	0.0	0.0

Valuation	12/06A	12/07A	12/08E	12/09E
P/E (x)	5.9	4.9	9.2	2.6
NAV (p)	18.1	18.9	19.5	22.3
P/NAV (x)	0.54	0.52	0.50	0.44

Cash Flows (£m)	12/06A	12/07A	12/08E	12/09E
Op. CF (£m)	(0.8)	0.2	0.6	2.4
FCF (£m)	(7.2)	(11.0)	(19.6)	(39.7)
FCFPS (p)	(9.7)	(14.0)	(24.9)	(50.3)

Balance Sheet (£m)	12/06A	12/07A	12/08E	12/09E
Fixed Assets	31.8	44.9	66.7	112.2
Current Assets	2.9	0.7	3.9	0.5
Current Liabilities	(1.5)	(3.3)	(3.2)	(5.4)
Long-term Liabilities	(20.6)	(27.4)	(52.0)	(88.7)
Net Assets	13.4	14.9	15.3	17.6
Net Debt (Cash)	21.0	27.3	52.2	83.5

Recent News / Events

10/07/08 – Selected with JV Partner to develop Primary Care Centre in Swansea. Completion of acquisition of health centre in Berlin.

30/06/08 - £4m of refinancing is secured on competitive terms, if additional £4m cannot be then management will underwrite a loan.

08/04/08 – Final Results

01/02/08 – JV with Gauffron to develop £3m Primary Care Centre.

17/01/08 – Selected as preferred developer for the provision of a £4.1m medical centre in Hewall and a £5m centre in West Wirral.

16/01/08 – Acquisition of the shell structure for a £3.5m dental facility.

Management Team

Chairman – Dr. Michael Sinclair
Chief Executive – Paul Stacey
Finance Director – Steve Wilden
NED – Keith Gibbs
NED – Lord Evans
NED – Baroness McDonagh

Major Shareholders

	%
Sinclair Montrose Trust	27.6
Credo Capital	12.1
Framlington	8.7
Solera Holdings	7.3
Canada Life	3.7