EQUITY DEVELOPMENT

CareCapital Group

September 2007

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Index: **Aim**

Sector: **Property**

Key points

- Established developer and investor of healthcare properties
- Focus on UK and Germany
- Healthy flow of projects already under way and solid longer term pipeline
- New equity finance likely in 2008
- Valuation ratios modest, particularly on medium-long term forecast numbers

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CareCapital Group

Company Description: CareCapital is an investor in, and developer of, healthcare property. It listed on AIM in August 2006, but the nucleus of the company's activities was originally founded by Dr Michael Sinclair and Paul Stacey (the present chairman and chief executive) in 1994.

CareCapital Group

CARE

Date:	**26/09/2007**
Share price p	**27.5**
52 week high/Low p	39.0 / 25.5
Market cap £m	20.9

EVOLUTION OF THE BUSINESS

The company acts as a property developer and investor. It develops healthcare properties, and then lets them to tenants on long term leases. In so doing it captures both the development profit and the long term revenue stream deriving from leasing what then becomes an investment property. This distinguishes it from a company like Primary Health Properties, for example, which solely acts as an investor, only buying completed developments. CareCapital buys completed properties occasionally in circumstances where there are development opportunities but its main focus is development and then investment.

The properties in question are primarily health centres let to GP practices, dental surgeries, and pharmacies. Most of these properties are intended for the broad NHS sector. The group is also seeking opportunities to develop intermediate care facilities, such as community hospitals, within the primary care sector.

The table on the next page shows the way in which the group's portfolio has developed since the company's inception and also demonstrates the geographical spread within the UK, the substantial nature of many of the buildings, and the steady, methodical way in which it has developed and invested in these properties since 1995. In its early years much of the finance was provided by banks and by loans from directors.

Figure 1: Price Performance

ADVFN

CareCapital is quoted on AIM and investors should be aware that shares traded on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

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Table 1: CareCapital Group - Evolution of UK Property Portfolio*

Property location	Type	Lease (yrs)	From	Annual rent (£000's)	Mkt. Value (£000's)
Chalford, Gloucs	Health centre	25	1996	43	700
Hornchurch, Essex	Surgery/cons.rooms	30	1997	164	2665
Maylands,Essex	Dental surgery	24	1997	18	255
Ipswich	Surgery	25	1997	57	930
Kings Lynn	Health centre	30	1997	63	1025
Consett, Co. Durham	Health centre	30	1998	124	2000
Consett, Co. Durham	Pharmacy	25	1998	23	325
Southampton**	Patient hotel	25	1999	148	1500
Chafford, Essex	Surgery/dentist	25	1999	59	960
Edinburgh	Health centre	25	1999	107	1745
Wingate, Co Durham	Surgery	30	2000	52	850
Wingate, Co Durham	Pharmacy	30	2000	11	145
Leamington Spa	Pharmacy	30	2001	11	145
Leamington Spa	Health centre	30	2001	76	1245
Darlington	Pharmacy	20	2002	10	145
Lydney, Gloucs	Health centre	30	2002	50	815
Darlington	Health centre	30	2002	74	1200
Burnley	Health centre	21	2003	112	1820
Hinkley, Leics.	Health centre	20	2003	142	2300
Hinkley, Leics.	Pharmacy	25	2003	15	220
Leamington Spa	Office	15	2005	36	535

* As at AIM listing August 2006

** Recently sold for £1.675m

Company

The company was created in its present form in 2004 following investment by two entities, Asgard and Valhalla. These are Luxembourg based private equity companies managed by AXA Real Estate Investment Managers. Together they injected £10m into the business. Further properties were developed by CareCapital after this refinancing. The listing on AIM, in August 2006, came about partly to allow Asgard and Valhalla to realise their investment.

At that time the company listed just short of 20m existing ordinary shares and 5m new shares. After the listing Asgard retained a stake of 29.9%, with Sinclair Montrose Trust (jointly owned 80/20 by Michael Sinclair and Paul Stacey) holding 34%.

Also in 2006 the group completed the extension of the medical centre in Hinkley (see table), and began construction on a new dental surgery in Folkestone. This is expected to be completed in November 2007. By the year-end, rent reviews on four properties had led to an uplift in the valuation of the property portfolio by some £700,000, while a hardening in yields on medical properties also contributed to Colliers CRE, the group’s property advisers, arriving at an overall valuation for the group’s UK portfolio of some £23.5m.

Perhaps more significantly, however, shortly before the year-end the group acquired a large medical centre in Adlershof, on the south east outskirts of Berlin. This property, which has 4100 sq metres of space, cost some £6m. It is, however, located in the largest science and technology park in Germany. The group sees Germany as a nucleus for further expansion because of the particular

characteristics of the market (see later section). In March 2007 it acquired, for around £4m, a 2850 sq. metre health centre in Konigswusterhausen, another suburb south east of the City.

The company has subsequently announced it has exchanged contracts on the purchase of a third property in the Berlin area, this time on Karl Marx Strasse in Neukoln on the eastern edge of the city centre, immediately to the east of Templehof airport. This property cost €5m (around £3.4m) and is a 2865 sq metre medical centre housing 13 tenants, including a large dental centre operated by Medeco – one of the premier dental chains in Germany. The property has been purchased on a rental yield of 7.6%, expected to increase to close to 8% following the implementation of agreed rent increases

These properties follow the 'polyclinic' style of operation common in Germany, where a number of specialists are gathered under one roof. In situations like this, cross referrals of patients are common, and the doctors prepared to pay higher rents in order to be part of a stimulating and profitable medical environment and to share access to on-site ancillary services they could not afford individually. Further acquisitions and development of properties of this type are expected in Germany.

By April 2007, Asgard's stake in CareCapital was down to 21.5%. Then on 2nd May CareCapital announced that the **entire** Asgard stake had been placed and that Sinclair Montrose Trust had also reduced its stake slightly from 34.1% to 27.6%. This has removed the overhang of the Asgard holding, which has been a steady tap since the listing in August 2006. It also improved liquidity in the shares.

MANAGEMENT TEAM

The following are some brief notes on the executive directors of the group and the senior operating management team at CareCapital.

Michael Sinclair: Dr Sinclair is 63 and executive chairman. He qualified in medicine from the Middlesex Hospital in London in 1967 and subsequently held a number of appointments at teaching hospitals in London. He was Registrar in Psychiatry at the Maudsley Hospital and Institute of Psychiatry of London University before leaving the medical profession to take up a business career in 1971.

He founded Nestor Healthcare in 1971 and between 1971 and 1977 held a number of board appointments at Allied Investments, which had interests in nursing homes, nursing agencies, locum services, medical equipment distribution and other similar businesses. In 1979 he founded Sinclair Montrose Trust, a private investment vehicle for him and his family.

Dr Sinclair has been an active investor in and developer of healthcare related businesses throughout his business life. Sinclair Montrose Healthcare, an earlier venture formed from the merging of Match Healthcare Services and GP Deputising Services, joined AIM in June 1996 with the additional goal of developing a chain of walk-in GP centres, under the Medicentre brand name, initially in London. The company soon branched out into other medical areas.

While still expanding its Medicentre concept, it acquired Premiere Group, a healthcare recruitment business in November 1997 for £10.7m and ASA Locums,

a similar business, for £11m in July 1998. SMH was eventually taken private in a £30m management buyout deal with Mercury and Natwest in mid-1999.

Dr Sinclair's outside business interests include spells as chairman of Lifetime Corporation, a NYSE listed healthcare company, and of Atlantic Medical Management LLP, a US based healthcare related venture capital fund. He is currently on the board of Tufts University School of Medicine and chairman of the AIM-listed YooMedia plc and Totally plc.

Paul Stacey: Mr Stacey is chief executive of CareCapital and is 58. He qualified as a chartered secretary in 1971 and was admitted as a fellow of the Institute of Chartered Secretaries in 1980. Following management training at the construction group Acrow, he worked for almost 20 years at Nuffield Hospitals, initially in a company secretarial role but latterly as executive director of Nuffield Healthcare.

He joined Sinclair Montrose Trust in 1992 and is now its managing director and a director of a number of its subsidiary and associate companies. He has been actively involved throughout in the development of the group's primary care properties and was instrumental in the establishment of walk-in GP centres in the UK for Sinclair Montrose Healthcare. He was appointed MD of CareCapital in August 2004 and chief executive in 2006.

Steve Wilden: Mr Wilden qualified as a chartered accountant with Josolyne Layton Bennett in 1975, and gained experience with TI Group and Rockwell International before joining Courtaulds in 1982. He has held senior jobs in a number of businesses and business sectors in the UK, USA and Italy. From 1997 he was finance director of Sinclair Montrose Healthcare, which was listed on AIM in 1996 before being taken to a main listing in 1998 and then taken private in 1999 (see above).

Mr Wilden left SMH in 2000 to help set up and become finance director of Staffing Ventures plc, since renamed as Supporta plc. He left that business and joined CareCapital as finance director in 2004.

Allan Weiner: Mr Weiner (aged 41) is executive director of CareCapital Limited, the main operating subsidiary, a position he took up in 2006. He began his business career in 1990 as a management consultant with Roland Berger & Partners. He subsequently gained additional experience in private equity, as an investment director, in London and Stockholm, with Speed Ventures. Prior to joining CareCapital he set up a London based healthcare service operation, Euro Clinics, offering cardiovascular screening and echocardiography. He has an MBA from the Stockholm School of Economics. Mr Weiner has responsibility, inter alia, for the group's activities in Germany.

Kenn Dalley: Mr Dalley, aged 64, is director of Estates and Development of CareCapital Limited and has lengthy experience in architecture and design, particularly of public service buildings in healthcare and education. He joined CareCapital in 2004 and is responsible for new project design and development and for overseeing the existing portfolio.

Graham Gardner: Mr Gardner is aged 49 and is director of medical centre developments. He has worked in various commercial property positions, joining Ashley House (a listed competitor of CareCapital) in 2000 and moving to Sapphire Primary Care Developments in 2003, before joining CareCapital in 2005. He is

responsible for expanding the group's primary care portfolio by optimising the commercial viability of the schemes.

Rick Hayes: Mr Hayes is also director of medical centre developments for CareCapital Limited. Aged 43, he has a background in construction and had a similar career path to Graham Gardner in recent years, working both with Ashley House and Sapphire Primary Care Developments. He joined CareCapital in 2005 and is primarily responsible for business development, liaison with GPs, site finding and planning matters.

CARECAPITAL'S OPERATING METHODS

The basic way the group operates is to identify a site, acquire land, build a healthcare property on it, and then let the completed building on a long term lease to a healthcare provider, while retaining the freehold. Leases usually provide for the lessee to be required to maintain the condition of the interior and exterior of the property. CareCapital does not develop speculatively. It enters into binding contracts with tenants prior to committing to land purchases and construction costs.

In doing this CareCapital is something of a hybrid between pure developers, who develop property and then sell it to an investor to realise their profit, and investors, who buy properties from developers and essentially invest passively in them. Primary Health Properties is an example of the latter. Ashley House, which recently listed on AIM, is nominally an example of the former, although most of its properties are sold to an investment fund in which it has a controlling interest and it styles itself more as a project management and consulting firm.

This process, of developing and then either selling or investing, does not proceed in isolation. For the most part properties are let to NHS practitioners, and therefore the group is essentially in a position of competitive bidding for contracts to develop new healthcare properties.

Competition for new projects can be intense. CareCapital (21 properties with a further nine under development in the UK and three in Germany) believes it main competitors in this area to be Apollo Medical Partners (formerly Primary Medical Properties – 50 developments in 11 years and a current portfolio of 32), General Practice Investment Corporation (largest in the industry with 142 properties completed in 10 years), Assura Property (formerly Medical Property Investment Fund - 112 properties), and Primary Health Properties (investment portfolio of 75 properties assembled over 12 years, but not a developer).

A typical scenario is where the NHS, or a group of GPs themselves, has identified the need to relocate to modern, more appropriate premises. This may entail, for example, the merging of a number of small practices in the same area under one roof. In a case like this, the process of procuring an appropriate property is often fronted by the local Primary Care Trust. CareCapital assesses the feasibility of the proposed project in planning and financial terms; identifies a suitable and viable site; progresses the design and planning stages; reaches legal agreement with the tenants; and then manages the construction process through to completion and occupation. The NHS, through Primary Care Trusts, is on record as wanting to improve both the number and quality of health centre type operations within the GP sector.

In competing for contracts, CareCapital has, in addition to its own experienced in-house team, an established set of relationships with construction companies, facilities management providers, planners and designers. All of these can be brought on board to work on a successful bid. Contracts are typically gained through recommendations and referrals, or through reviewing and responding to invitations to tender advertised by Primary Health Trusts.

The bidding and contract process is a lengthy one, and can take up to three years or more to complete. At any one time the company will be in the position of having a number of possible opportunities in various stages of progress. At the time of the listing, for example, the company noted it had a development pipeline of 18 projects. Of these, five have since moved on to the development programme and, over the same period, the pipeline has now increased to 20 projects.

This pipeline is distinct from those projects already under way but not completed, and is a list of those where the company has been successful in tendering for the project and has exclusivity, but where the process of site finding, obtaining planning permission, and other related legal work has yet to be completed. The process of tendering for projects is an ongoing one, and as projects move from the pipeline into the list of projects where work has begun, the company would hope to add new projects to keep its active pipeline growing.

Despite the convoluted nature of the process, there are several aspects of this that are of particular interest to investors. One is that once contracts are awarded, there is an element of predictability in both the timing and financial characteristics of the development pipeline. Capital cost, likely rent, development profit, any capital receipts, capital value once completed and let, and funding structure can all be determined with a reasonable degree of certainty more or less from the outset.

Unlike some other property developers and investors, the business is not dominated by one high profile project, but by a stream of smaller ones. It is also worth noting that, although there are several established competitors, there are also barriers to entry for outsiders at several levels within this process, not least the need for anyone contemplating working in this market to have knowledge of and a track record in the tendering process and specialist knowledge of the needs of the healthcare market.

Established relationships with Primary Care Trusts, healthcare providers, specialist contractors and lenders are also all required, although the latter would be capable of being accessed by any competent property developer. Nonetheless healthcare properties are specialist buildings, and specialist architectural and design input is required.

Details of the properties so far developed by the group, current developments in progress and the longer term pipeline of possible developments are given in a later section of the report.

While most of the developments are either multi-GP health centres, sometimes with a pharmacy attached, the company has also developed or acquired other types of facilities. The 'polyclinic' properties in Germany are one example of this.

Outside the UK and the NHS environment, the company has already made three initial investments in Germany and expects to acquire and develop more

properties in due course. As already noted, these take the form of the 'polyclinic' style of operation, housing a broad range of medical specialists, a model which management believes could come to the UK in time, in which the experience garnered in Germany should prove extremely worthwhile. Indeed recent announcements from the Department of Health would seem to support this view.

The company sees the opportunities in Germany, an attractive market for health related properties in its own right, as providing a springboard for expansion in the long term into other markets in Eastern Europe, perhaps beginning with Poland. CareCapital has already developed financing relationships with Deutsche Apotheker und Artzebank (Apo Bank for short), a cooperative bank serving the medical profession in Germany. It also has a German partner, Schuetzbau GmbH, managing the properties on a day to day basis, dealing with tenants and collecting rents.

THE UK HEALTHCARE PROPERTY MARKET

The growth opportunity identified by the group, and one or two other similar companies in the UK, essentially rests on government plans for NHS properties. At present 90% of all treatments and appointments in the NHS are conducted through primary care facilities. Since 1992, following the creation of Primary Care Trusts, decision-making has become less centralised.

Currently, according to Department of Health Statistics, primary healthcare is provided by 36000 GPs operating through 11000 surgeries across the UK, but projections suggest that a further 10000 GPs may be required in future to cope with population increases and the increasing emphasis the NHS is now placing on patients receiving a greater range of treatment at primary care level.

This being so, are current primary care properties broadly suitable to take on this role? According to BMA data, the answer is 'no'. Some 60% of GPs consider their current properties unsuitable for current needs, and 75% consider their current properties unsuitable for projected future needs.

After several years spent channelling money into the refurbishing of existing properties, with a particular focus on hospitals and existing NHS buildings, a 2006 Health White Paper proposed the transfer of a modest proportion of funding from secondary healthcare to primary healthcare, presumably on the grounds that doing more at primary level would alleviate pressure on the hospital sector.

In particular, one priority was said to be so-called 'super-surgeries', large health centres offering, in addition to GP, pharmacy and dental services, opticians, nurses, physiotherapists, social carers. Properties like this would also allow for minor surgical procedures and the management of long term conditions such as diabetes and asthma, traditionally only available in hospitals. While it is tempting to view this simply as another political initiative designed to be eye-catching and little more, this type of approach in broad terms does seem to be the current way the NHS is thinking.

Accepting this as the way things are moving, the real point for companies such as CareCapital is that GP practices, even when banding together, are unlikely to be able to finance the outright purchase of a property of the sort described.

This is not necessarily because finance is not available, but more because of the age structure of GP partnerships, and the fact that younger GPs may either not want to undertake the sort of financial commitments required, or be unable to find the wherewithal to do so, while older partners may be considering retirement and be unsure what mechanism may exist for their younger colleagues to buy out their interests when they do cease practicing. For these reasons, it has become common for GPs to band together, move to purpose built properties, and simply rent them from a developer/investor under a long term lease agreement.

One option the group is exploring is to put in place a structure whereby a GP practice can retain a minority equity stake in a property, partly to guarantee good relationships with tenants and a constructive approach to maintain the fabric of the building.

Current Portfolio

The company's current portfolio consists of 20 properties at 13 sites spread around the UK, plus two owned properties in Germany and a further one in process of being acquired.

Properties

Basic details on the properties are outlined in the next table:

Table 2: Basic data on existing sites

Site	Location	Completed	Size (sqm)	No. of GPs or tenants	Ancillary facilities
Frithwood	Chalford, Gloucs.	1996	351	4	
Maylands	Hornchurch	1997	764	7	Dental surgery
Watlington	Kings Lynn	1998	396	3	
Birches	Ipswich	1998	441	4	
Chafford Hundred	Essex	1999	580	5	
Waterside	Leamington Spa	2000	646	5	Office building for PCT, Pharmacy
Restalrig	Edinburgh	2000	552	6	
Caradoc	Wingate, Co Durham	2000	400	3	Pharmacy
Lydney	Gloucestershire	2002	416	4	
Clifton Court	Darlington	2002	746	6	Pharmacy
Parkside	Burnley	2003	771	7	
Consett	Co Durham	2004	981	9	Pharmacy
Station View	Hinkley	2005	675	6	Pharmacy
Konigs Wusterhausen 1	Berlin	2007	2850	25	Orthopaedic unit, pharmacy, optician
Adlershof 1	Berlin	2007	4100	34	Radiography unit, dental lab, pharmacy, optician
Neukoln	Berlin	2007	2865	13	Large dental centre included

Company

As can be seen from this table most of the properties in the UK portfolio are relatively small, as befits the structure of the GP profession in this country. Increasingly, however, properties are being developed with additional facilities, not mentioned in the table, such as minor surgery facilities to reflect the new trend for minor surgical procedures to be conducted at primary care level rather

than at hospitals. Pharmacies are sometimes an integral part of the development, and sometimes added later.

The properties in Germany acquired recently are of a different scope and scale with many more physicians operating in a polyclinic type of environment. The healthcare regime in Germany is funded through a regulated insurance based system.

Federal and state governments underwrite health insurance provision for most citizens, and some can take out top-up insurance to cover the cost of additional services beyond the basic provision. Many individuals get healthcare insurance provided through their employers. The self employed have to take out insurance privately.

Patients can, however, refer themselves to a specialist practitioner rather than the GP referral system that operates in the UK. Germany has an above average number of doctors of all types per head of population. Most are self employed, hence the demand for high quality office space.

Rental structure

The crucial component of value in any property related business is rental levels, the yield basis on which value is assessed, and the timing of rent reviews. In the UK the group's total rent roll is currently in the region of £1.3m, and the current average rent is £138 per sq. metre (c. £13 per sq. foot). This level of rental is approximately that paid by medical practitioners, who represent over three quarters of the groups tenants by rent roll and floor area.

NHS authorities typically pay around £160 per sq. metre and pharmacies around £180 per sq. metre, essentially reflecting differences in the nature of the property and the function of the space provided. Rents for dental practitioners are typically somewhat lower than those for doctors. Rental levels in Germany equate to around £102 per sq. metre, reflecting lower property values and construction costs.

The table 3 shows the pattern of rents, property values, lease terms and rent review dates on the UK portfolio. Data is arranged in descending order according to the timing of the next rent review. Most leases stipulate three yearly upward-only rent reviews, with some linked to the RPI. The obligations on tenants are shown in the table and are largely self explanatory.

Table 3: Rental Characteristics of UK Portfolio

Property	Type	Lease term	From	Rent	Value	Implied Yield (%)	Next review	Obligations on lessee
Darlington	Pharmacy	20	2002	10	145	6.90	Mar-07	Internal/external repairs and decoration
Chalford, Gloucs	Health centre	25	1996	43	700	6.14	Jul-07	Internal/external repairs and decoration
Consett, Co. Durham	Health centre	30	1998	124	2000	6.20	Dec-07	Internal/external repairs and decoration
Leamington Spa	Health centre	30	2001	76	1245	6.10	Dec-07	Repairs and insurance
Lydney, Gloucs	Health centre	30	2002	50	815	6.13	May-08	Repairs and insurance
Consett, Co. Durham	Pharmacy	25	1998	23	325	7.08	Dec-08	Internal/external repairs and decoration
Maylands, Essex	Surgery/cons.rooms	30	1997	164	2665	6.15	Jun-09	Internal/external repairs and decoration
Kings Lynn	Health centre	30	1997	63	1025	6.15	Jun-09	Internal/external repairs and decoration
Chafford, Essex	Surgery/dentist	25	1999	59	960	6.15	Jul-09	Internal/external repairs and decoration
Hinkley, Leics.	Health centre	20	2003	142	2300	6.17	Jul-09	Full repairing and insuring
Hinkley, Leics.	Pharmacy	25	2003	15	220	6.82	Jul-09	Full repairing and insuring
Burnley	Health centre	21	2003	112	1820	6.15	Aug-09	Full repairing and insuring
Maylands,Essex	Dental surgery	24	1997	18	255	7.06	Dec-09	Repairs and insurance
Ipswich	Surgery	25	1997	57	930	6.13	Dec-09	Internal/external repairs and decoration
Edinburgh	Health centre	25	1999	107	1745	6.13	Dec-09	Internal/external repairs and decoration
Leamington Spa	Office	15	2005	36	535	6.73	Feb-10	Repairs and insurance
Darlington	Health centre	30	2002	74	1200	6.17	Mar-10	Repairs and insurance
Wingate, Co Durham	Surgery	30	2000	52	850	6.12	Jul-10	Internal/external repairs and decoration
Wingate, Co Durham	Pharmacy	30	2000	11	145	7.59	Dec-10	Repairs and insurance
Leamington Spa	Pharmacy	30	2001	11	145	7.59	Jan-11	Repairs and insurance

Company

Since the official circular produced at the time of the group's listing on AIM last year, a number of overdue rent reviews have been implemented. The six reviews agreed during the course of last year produced an increase in the passing rent of around 14.8% and further two relating to 2006 are still under negotiation. In the table we have assumed that all outstanding rent reviews have been concluded.

As can be observed from the table, there is a relatively even pattern of rent reviews with some 33% due within one year, 14% 1-2 years out, 25% 3-4 years out, 4% 4-5 years out and 24% over five years out.

The two German properties already in the portfolio together produce rental income of £650,000 - an implied yield basis, based on acquisition cost, of 5.5% when adjusted to reflect UK type lease stipulations. Underlying yields are higher in Germany because lease provisions are less generous to the landlord. Leases in Germany are typically much shorter than those in the UK (10 years rather than 20-25 years) and there is usually no stipulation for periodic rent reviews, which need to be renegotiated periodically, usually to reflect the change in the RPI. The property acquisition recently announced in Berlin city centre, for example, which is nominally on an approximate 8% yield basis, might for example translate to a 6% yield adjusted to the UK basis.

New Developments

One key to the way the company evolves is the flow of new developments that it is already undertaking, as well as the pipeline of projects that it expects to come to fruition in the longer term.

Developments in progress

At present the company has nine schemes under way in the UK and three in Germany. The financial characteristics of these are shown in the table.

Table 4: UK Developments in Progress (£000's)

Property	Type	Cap. Cost*	Expected Rent	Projected Market Value	Implied yield on: (%) PMV	Cost	Expected completion
Folkestone	Dental centre	3500	272	4900	5.55	7.77	Nov-07
Coventry	Health centre/pharmacy	1950	144	2600	5.54	7.38	May-08
Holmer Green	Health centre	1400	95	1700	5.59	6.79	Oct-08
Bishops Stortford	Health centre/pharmacy	3220	235	4300	5.47	7.30	Nov-08
Radlett	Health centre	2300	155	2800	5.54	6.74	Jan-09
South Oxhey	Health centre	2200	144	2600	5.54	6.55	Mar-09
Buckley (50% JV)	Health centre/ dentist/pharmacy	11000	823	15000	5.49	7.48	Apr-09
Epsom	Health centre/pharmacy	2500	187	3400	5.50	7.48	Apr-09
Southampton	Health centre/various others	3100	312	5600	5.57	10.06	Jul-09

*Net of expected capital receipts

Company

This table needs a little elaboration. CareCapital's priority is not to extract as much as it possibly can in the form of development profits, but to have the building enter the portfolio as an investment at a cost that reflects a fair and sustainable market value so that rents and capital value are in line with the appropriate yield basis. The percentage development margin that the group takes therefore varies according to circumstances, but might typically be in the range of 4% to 8%.

In addition, in the case of some projects in the list, the company expects to receive significant capital receipts.

The Southampton project is a large 10 storey building which will house a health centre, a retail pharmacy, other medical space, retailing, a residential element, community offices (for the local authority) and other services. Selling on the residential part of the development is what accounts for the high level of capital receipts from the project. There are expected to be 100 private residential units and 25 social housing units in the development. The social housing units are expected to be sold to a housing association, while the private residential units will probably be marketed through local agents, who currently report high demand for this type of property in the area.

The aggregate gross capital cost of the developments in the list is some £51.6m, but a total of £20.4m is expected to be received in the form of capital receipts and an aggregate development margin of £3.4m. The addition to NAV from completion of these projects is some £10.5m.

The Buckley, Flint project – a large health centre with a floor area of 4500 sqm housing 20 GPs - is being developed as a 50/50 joint venture with Gaufron Healthcare. Figures in the table relate to 100% of the venture.

Aside from the Buckley development, the remaining properties in the list house relatively small numbers of GPs typical of the group's existing portfolio, ranging from three in the case of Holmer Green to six in the case of Radlett.

In reality, the market value attributable to CareCapital in this case will be £7.5m on the assumed yield basis, and the addition to NAV arising from this property in the region of £2.5m. CareCapital typically structures the financing of its development projects on the basis of a debt to equity ratio in the region of 3:1, with debt representing approximately 75% of the anticipated market value of the property on completion and letting.

In Germany, the group currently has three developments in train. These include a €5.9m expansion of the Adlershof facility to provide space for 15 additional tenants in a separate building alongside the existing one and expected to be completed in December 2008, and a second building at Konigs Wusterhausen, to be built at a cost of €1.7m and expected to be completed in June 2008.

The company also has a planned project in Marktredwitz in Northern Bavaria for a 3000 sq metre facility alongside an existing hospital that will provide 12 offices and space for a renal unit, as well as a parking garage for the hospital, at a total cost of €6.7m. These two projects are expected to be completed in August 2008. In both the Adlershof and Bavarian development, the group's local German partners, Shuetzbau GmbH, have a minority equity share of the order of 10%.

Longer term pipeline

What the company describes as its pipeline of developments, as distinct from projects where development is already in progress, are those which are longer term in nature but which are highly likely to proceed. In the UK, projects enter this category once the group has an exclusive agreement in place with the GP practices in question and/or with the Primary Care Trust, where the nature of the facilities required has been identified and a suitable site found, and where the company has a reasonable expectation of securing planning consent.

In Germany, the definition of a project in the pipeline is simpler, essentially that site acquisitions are under way. Hence the properties described above would, in UK terms, fall somewhere between the UK definition of 'current' projects and 'pipeline' ones.

At present the situation in the UK is that the group has 20 projects in this category, all 100% owned, with a projected aggregate annual rental income of £3.7m, a capital value of £59.2m and an expected addition to NAV of £8.9m. Around one half to two-thirds of these projects currently look reasonably likely to progress to fruition, with costs and timescale broadly fixed. In a number of other cases the group is at earlier stages of the tendering process and the outcome cannot yet be determined with any certainty. The company does, however, have a consistently good record in converting pipeline projects into developments which can be progressed to completion, and should also be able to capture significant additional opportunities that may come along.

While the incidence of these projects coming on stream is not entirely certain at this stage, a reasonable assumption is that they will feed in to results in the course of the 2009-2010 period, with three German properties completed in the course of 2008. What this suggests is that even at this stage the group can expect a considerably larger addition to NAV in these two years as is likely to accrue in 2007 and 2008, particularly bearing in mind the likelihood of significant capital receipts, and a significantly greater increase in rent roll.

Longer Term Strategy

The longer term ambitions of the group appear to centre on three main areas.

- As has already been mentioned, the group expects to continue its push into Germany, where rental yields on healthcare properties are typically higher than those in the UK, but gradually coming down. Eventually this may entail the group employing staff locally, although for the moment the developments that are likely over the next few years can be handled under present arrangement with a locally employed property management partner dealing with tenants and collecting rents and on occasion taking an equity stake in new developments.
- It is likely that the group will seek to use Germany as a springboard into other areas where property yields offer attractive opportunities and where good infrastructure and a solid legal system is in place to assure ownership of properties that might be bought or developed. This probably means, in the first instance, countries like Poland and Hungary. There are also possible opportunities in countries such as Spain, where the specialist development of medical offices is largely unknown.
- As the group gets larger, it is quite possible that it will be offered portfolios of medical properties. Like many businesses linked indirectly to public sector spending, healthcare property ownership is relatively fragmented, with a few large operators (already mentioned earlier) and a long 'tail' of typically private companies, often local developers, owning a handful of properties each. It is conceivable that the group may at some stage move to acquire businesses of this type, to enlarge its portfolio and rent roll, if purchases can be made on terms that are satisfactory to shareholders.
- Finally, bearing in mind Michael Sinclair's international experience in the healthcare field, it is also possible that the group may seek to be a little more

imaginative in the way in which some of the properties are financed, bringing in techniques from elsewhere in the property market or from other healthcare property markets. There are a number of different models that could be tried. One example might be for larger properties to be 'condominiumised' with CareCapital retaining the primary ownership of a building but giving individual medical specialists, who are currently tenants, the opportunity to buy an equity stake in their own consulting rooms, with CareCapital arranging financing for this on a fee basis.

FINANCES AND FORECASTS

With its development programme ramping up over the next few years, it is clear that CareCapital is likely to be cash hungry for the next few years, given the facts currently known regarding the group's current development programme and likely pipeline.

We estimate the likely outflow to be in the region of £10m, with heavy expenditure on development somewhat attenuated by the receipt of capital inflows from some of the larger developments, notably the Southampton Gateway project.

This number should however be seen in the context of existing shareholders equity of £13.4m with an underlying property valuation of £30m and a projected NAV in 2010 of around £45m and property assets of around £160m. Current gearing levels show net borrowings of £21.2m comparing with equity of £13.4m and properties of £30m. At the end of the period in 2010 net borrowings are likely to be around £115m versus property assets of around £160m.

We also expect the group to raise some £8-10m in fresh equity in the first half of calendar 2008. As the company expands it is likely to be able to negotiate better terms from its lenders, perhaps shaving as much as 25 basis points off its cost of funds. A further equity raising in 2010 cannot be ruled out, given the scale of the company's ambitions.

The present development programme follows the pattern of many other development companies, expansion being accomplished without undue financial strain, provided that property values continue to rise modestly.

The table below shows how we expect rental income from completed developments on the one hand, and the cost of keeping the development programme on track on the other, to intersect in P&L account terms. The assumptions underlying the forecasting model are shown in the footnotes.

Table 5: Forecasts

£000's	**2006**	**2007**	**2008**	**2009**	**2010**
Rental Income	1832	2050	2850	5000	7700
Development Profit/Other Income	251	826	2400	2750	2500
Cost of Sales	-83	-150	-230	-250	-250
Gross Profit	2000	2726	5020	7500	9950
Administrative Expenses	-2352	-2250	-2300	-2450	-2500
Surplus on property revaluation	3528	2100	3300	3750	3750
Exceptional costs	-590	0	0	0	0
Operating profit	2586	2576	6020	8800	11200
Interest income	187	177	0	0	0
Interest paid	-1065	-1350	-1800	-3600	-5000
Profit before tax	1708	1403	4220	5200	6200
Taxation	-1030	-421	-1266	-1560	-1860
Rate (%)	60.3	30	30	30	30
Profit after tax	678	982	2954	3640	4340
Earnings per share (p)	**0.92**	**1.28**	**2.98**	**3.41**	**4.07**
Weighted average shares in issue*	73544	76754	99254	106754	106754
Property assets	30022	48500	86000	120000	160000
Net borrowing	-16555	-31600	-61000	-80000	-115000
Other net liabilities	-89	-100	-125	-150	-150
Net assets	**13378**	**16800**	**24875**	**39850**	**44850**
NAV per share (p)	**18.2**	**21.9**	**25.1**	**37.3**	**42.0**

ED

**Assumes issue of 30m shares at 30p at end of Q1 2008*

The model shows a reasonably steady progression of rental income, earnings per share and NAV. These numbers are, however, to some extent academic because it is likely that the company will announce further acquisitions in the intervening period, such as the one shortly to be completed in central Berlin. We have tried to factor in an element of this in the 2009 and 2010 forecasts, but it is necessarily imprecise. The main touchstones however and the steady demand for the type of the property the company is developing, the blue chip nature of the tenants, the fact that properties like this will be 75% geared on completion and the rental yields should be modestly above cost of funds.

Large purchases of completed buildings, either in Germany or through the purchase of a ready-made portfolio in the UK, are also a possibility. If so, these are likely to require equity finance for around a quarter of the purchase consideration, with debt making up the remainder, but the advantage would be that already completed properties could make a contribution to the rental and profits stream almost from day one. It may be that management chooses to go this route in the first instance, simply to jack up the critical mass of the business in order to get onto the radar of small company fund managers.

Either way for the group as presently constituted, **earnings of around 2.98p a share in 2008 and 4.1p in 2010 provide a basis for valuation, as does NAV of 25.1p in 2008 and 42p a share in 2010.**

VALUATION

Rental income comparison basis

Despite the fact that it acts solely as an investor rather than a developer and investor, Primary Health Properties remains about the best comparator to use to get a handle on an accurate valuation for the group.

Since there are sharp differences in tax rates and, in the case of CareCapital, the incidence of development gains, it is probably best to compare the two companies on the basis of rental income. Here, on a proforma basis including the three German properties recently acquired and the existing properties in the group, the annualised rent roll is £2.2m and the multiple of rental income currently nine times, similar to that of PHP.

However, while this might suggest CareCapital is fairly valued on this measure, its rental stream is likely to grow significantly faster than PHP's in the next few years. By mid-2009, we estimate the company's annualised rent roll will be running at approaching £5m, while PHP's, assuming growth continues at the 13% annual rate seen in the last full year, will be of the order of £16.3m. The prospective multiples on these numbers become four times in the case of CareCapital, and approximately seven times in the case of PHP.

While PHP has the advantage of a longer track record as a public company, which might account for the difference in valuation, it should perhaps be remembered that CareCapital, in its previous incarnation, has been developing properties since 1995. On this basis it looks as though there is scope for CareCapital's market rating to improve relative to PHP's.

Premium/Discount to NAV comparison

Net Asset Value is, however, a more normal measure to use when comparing property companies. In this case, PHP's net asset value for the year to June 2008 was forecast at 540p per share by the company's brokers in September 2006, although current consensus forecast suggests that a figure around 375p per share might be more appropriate. At the current price of 343p, PHP is at an 8.5% discount to this number.

On the basis of the mid point of our forecast for the 2007 and 2008 calendar years, a comparable NAV number for CareCapital would be in the region of 23.5p, and with the shares at 27.5p this suggest a premium to NAV of 17%. However, this disregards the fact that rather more of the growth in NAV, on our forecasts, looks **likely to come through in 2009**, so the midpoint NAV for 2009 could be around 31.2p, which makes CareCapital's current valuation look much more modest.

PV of Future NAV

Given that much of the company's NAV growth, on our forecasts, is further in the future than the normal forecasting period, one solution to the valuation conundrum is to take the forecast NAV at the end of the period and discount back at an appropriate rate.

A 10% discount rate over the three and a half year period until the end of 2010, based on the end 2010 forecast NAV of 42p, produces a present value of **30.8p** a share. An 11.5% discount would give a present value of 2010 NAV of **29.5p**. To

equate to the current share price of 27.5p, the discount rate back from the estimated 2010 NAV would need to be around **16%**.

If our forecasts of future NAV are correct, this suggests that the company's shares are undervalued at their current price. A 16% discount rate would be excessive even for a relatively small company such as this. The value on a 10.5% discount rate, a five percentage point risk premium to current base rate, suggests the in the short term that the 'correct' value for the shares is in the region on this basis is **around 30p**. However this is a substantial discount to the likely NAV levels seen in 2009 and 2010. We would expect the shares to sell in due course at a small discount to the NAV at that time, suggesting a medium term target price closer to the **35p a share** mark, equivalent to a multiple of rental income of around seven times the 2009 number.

I certify that this report represents my own opinions
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