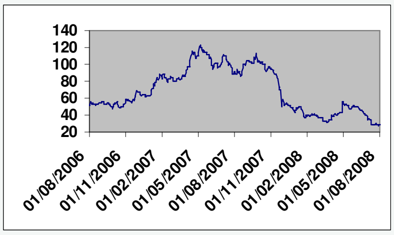
Speymill

27 August 2008

finnCap

Code	SYG.L
Price	30p
Market Cap	£17.4m
Year End	31 December
Net Cash	£0.5m (e)
Shares in Issue	57.9m
Next Results	Interims Sept 08

Share price Performance



Source: datastream

Company Description

International property investment management and specialist contractor

Institutional Contacts

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Initiating Coverage

BUY

Speymill plc is a multi-national property services group. Speymill's subsidiary, Speymill Property Group, undertakes property investment management services, principally through its management of two AIM quoted residential vehicles focusing on Macau and Germany. Speymill's UK based subsidiary, Speymill Contracts, is a specialist contractor with a focus on the budget hotel and leisure sector. Longer term Speymill is keen to develop in the UK and European retirement market in conjunction with a well-established US partner who has a strong and successful operating history in that sector. Negative sector sentiment has depressed the share price. We initiate coverage with a target price of 50p, governed by the prospect of underlying earnings per share advancing 50% over the next two years.

- **Profit generation in 2007/8.** Speymill derives the greater part of its profits from fund management contracts. Fees have grown sharply to £10m. Slow progress making investments in Germany during the latter part of 2007, delays in government planning approvals in Macau and exceptional corporate costs impacted 2007 results whilst 2008 forecasts have been hit by delays in the contracting business. Although tough property market conditions look likely to remain for the near future, the increased size of assets under management during 2008 and the scope to secure new mandates means that earnings have the capacity to move forward.
- **Business development.** Speymill's skill in putting together large deals is an obvious attraction for investors as is its track record of identifying growth areas (overseas property, hotels and retirement property in the UK). Large scale property deals remain possible through targeting private equity and institutional property portfolios on an investment management basis.
- **Rating.** Property and finance related share valuations have been hit hard during the credit crunch. However, facilities and fund managers remain attractive market sectors. The shares stand on a forward 09 PER of 6.0x.

Forecasts

Year end	2006	2007	2008(e)	2009(e)
Data				
Sales	22.3	52.7	65.0	73.0
EBITDA	(0.5)	2.3	3.9	4.8
PTP	(0.5)	2.2	3.5	4.7
Tax Rate	cr	7	28	28
EPS	(0.55)	3.28	3.7	5.0
DPS	0	0.5	1.0	1.5
Ratios				
EV/sales	0.7	0.3	0.3	0.2
EV/EBITDA	n/a	6.8	4.6	2.9
P/e	n/a	9.1	8.1	6.0
Yield	n/a	1.6	3.3	5.0
EPS growth	n/a	n/a	21.9	25.0

Recent Sector News

- Property sector valuations have taken a hit as firstly liquidity and then economic worries grow. Asset manager valuations have also suffered.
- Prime office/commercial property yields led the asset re-pricing, quickly moving out 100bp and more. Sentiment remains very weak
- Despite low market valuations, property fund management income streams tend to remain intact, a point in favour of Speymill, reinforcing the merits of high income visibility and a low capital risk business model (no principal positions).

Speymill : 2007

Despite the foregoing positive points, there have been set-backs on the way:

Profit Warning-November 2007

Profit warning hit the shares but the underlying structure is sound and the shares are performing in line with the sector

The profit warning on 26 November 2007 suggested that full year pre-tax profitability would be broadly consistent with H1 profitability. H1 PBT was £1.4m, thus the inference from the statement was that H2 profit would emerge at a similar level before exceptional costs of £0.4m relating to changing the Group's tax domicile and £0.4m for bonus payments due to staff. At the time this was regarded as a disappointment. The eventual outcome of £3m before share based payments, was therefore in range and the share price recovered.

Final results to 30 December 2007

- Turnover £52.7m (2006 £22.3m).
- Profit from operations before share based payments £3.09m (2006 £0.39m).
- Operational cash inflow of £1.93m (2006 outflow £0.06).
- Cash resources £1.5m (£0.6m).
- EPS 5.01p before share based payments, 3.3p diluted.
- Maiden Dividend of 0.5p.

$3bn of projected gross assets under management

Overall, 2007 saw the group incurring heavy infrastructure build out costs which will not be repeated to the same degree in 2008. The group also ended the year debt free and with net cash of £1.5m.

Speymill 2008:

Purchase of 49% of GOAL

The group announced on 02 June 08 that it had purchased the outstanding 49% shareholding of GOAL Service, a German property management company responsible for managing residential assets, for £0.8m. Gross assets acquired were £3.4m. GOAL therefore becomes wholly owned by Speymill plc, with the consequent effect on operating expenses. GOAL both manages assets and undertakes the management of refurbishment work. The acquisition will ensure that Speymill can direct the growth of GOAL as it seeks to secure additional management remits. Speymill thus gains the full financial benefit from refurbishment work and management fees. GOAL currently employs over 260 staff with full year sales in the region of £12m, dependent on the timing of refurbishment work. Revenue is H2 weighted (reflecting management fees) although the rental stream for which GOAL is responsible is expected to rise in line with inflation or slightly better. New management will seek to broaden the reach of the business.

Key Points

Low risk fund manager

Fund Manager. Speymill derives its income based on a fixed percentage value of assets or equity under management. Thus Speymill offers defensive earnings attributes in spite of property transactions becoming more difficult to achieve. The change in investor sentiment towards property will influence the size of funds Speymill will be able to launch, but the potential exists for the business to expand through winning new management mandates and joining forces with other parties.

Not a Retail Fund Manager. Speymill's two main quoted market funds are both well capitalised, closed end funds. Consequently Speymill's revenue stream is not at risk from equity fund outflows nor is it directly at risk from capital performance, other than as it affects future incentive payments.

Scope to expand

Flexible Model. Scaleable and flexible. Aside from growth in assets under management, Speymill Contracts provides longer term revenue upside through growth in retirement village construction. However, upside to earnings most likely will come from additional asset management fees on larger scale residential and other property-related funds.

Portfolio Risk. The group is expected to retain a bias towards property investment and can demonstrate a diversified and clear set of skills in that area. However, in the short term risk remains as far as the group is reliant on two public funds and one private fund is concerned.

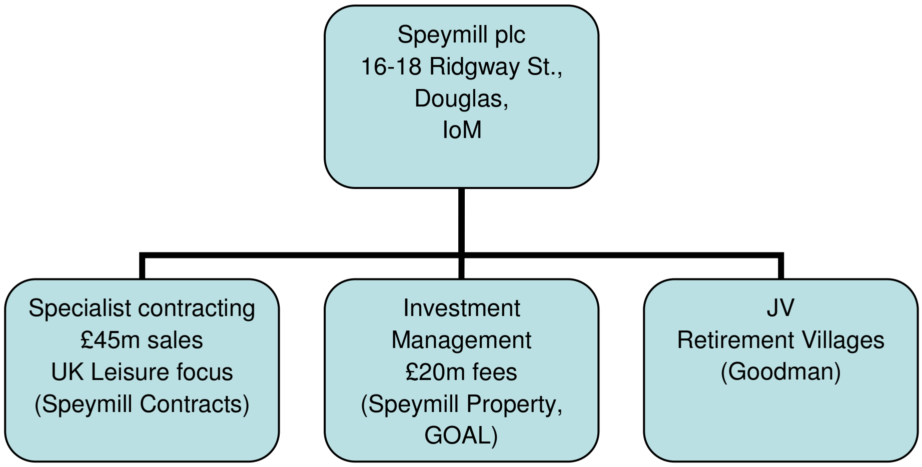
Growth through FUM. The acquisition of Teesland by Australian based Valad indicates that there is interest in the asset management route over the direct property investment route, and on a global scale. The potential for REIT structures domestically and overseas to deliver specific investor benefits also provides a funds stimulus to the market.

Incentive fee prospects longer term

Performance Fees Whilst at the turn of the year 3 yr IPD pooled funds returns suggested a median 3 yr industry performance of 10.2% pa, a changed sector outlook for 2008-11 anticipating lower capital returns will reduce the prospect of performance fees in general. The German fund performance (principally Speymill Deutsche Immobilien Company – SDIC) is being measured over a three year period, so an early incentive payment is unlikely. However, longer term the size and gearing of SDIC holds some promise for a performance fee in the second period. The situation in Macau is different as the performance fee is assessed annually and is related to asset realisations.

Dividends. The maiden 0.5p dividend is an important step. In the medium term a high return on capital and a potentially low tax charge should prove helpful for earnings. The directors seek to follow a progressive dividend policy.

Speymill Group Structure



Background

Speymill in its present form emerged from a restructuring of the Wigmore Group through its acquisition by Burnbrae, an Isle of Man investment group owned by Jim Mellon. New management was introduced, non core activities were sold (Blanchards, First National Property Maintenance) and a new focus on investment management put in place. Whilst Speymill retains its interest in construction, the launch of three large property funds changed the nature of the business considerably. The core group expertise now lies in capital raising and property fund management.

Speymill, registered in the Isle of Man, is effectively controlled by Jim Mellon and Burnbrae, who between them account for 45.0% of the equity.

Burnbrae has interests in a range of sectors, in particular the financial sector through its investments in Charlemagne Capital (emerging market investment management) and Regent Pacific (Chinese and Global Mining and Resources).

Management

The management team comprises:

Jim Mellon (non-exec Chairman)
Bob MacDonald (CEO)
Andrew Latham (MD)
Keith Lees (FD)
Paul Smith (CFO -Funds)
Denham Eke (non-exec)
Sir James Mellon (non-exec)

Group Operations

Construction (£45m sales 2008e)

Order book strong

The largest group operating business in revenue terms is the Huntingdon based construction business, Speymill Contracts. The business was part of the original Wigmore Group and turned over £41m in 2007 (2006 £18m). In common with a number of smaller contractors, the order book for 2008 remains promising. The overall order pipeline standS at over £150m. Speymill Contracts currently employs 85 staff.

Speymill Contracts				
£m	**2006**	**2007**	**2008e**	**2009e**
Revenue	18.1	41.3	45.0	51.0
Operating Profit	0.2	0.9	-0.5	1.0
Net Assets	-0.4	1.3	2.0	2.7

Source: Speymill/Finncap estimates

Leisure sector focus

The leisure sector (mainly budget hotels) accounts for the bulk of sales. Clients include Holiday Inn, Premier Inn, Travelodge, Accor Hotels, Ramada Encore. The major relationship is with Whitbread (Premier Inn), where 3,400 rooms were added in 2007 bringing the total to 36,000. Speymill Contracts also undertakes residential apartment construction but is not involved in industrial work.

According to Melvin Gold Consulting (Estates Gazette 15/12/07), the UK budget hotel sector is forecast to double the number of rooms it has to 225,400 by 2027, the increase being driven in the main by Travelodge and Premier Inn. This would give the sector a 27% share of rooms in the UK but the rate of growth is expected to slow after 2012.

Net construction margins are an industry average of 2% on sales but 2008 is proving a challenging year as projects have been prone to delay. Positively, the order book continues to grow. A combination of project delays with one customer going into administration will result in a loss for the division although a profit recovery is anticipated for 2009. Margins are under pressure. Raw material costs have risen but labour costs are expected to hold as a consequence of cooling in the property sector. As Speymill Contracts has grown quickly, we suspect the group will have to address its infrastructure before moving forward. In addition working capital has grown during H1 which will be reflected in the group's interim cash position.

Planned expansion within the retirement sector through the joint venture with Goodman has the scope to provide a source of contract work for Speymill Contracts once the growth in the budget hotel sector abates.

Germany the main source of income

Fund Management (£10m sales 2008e)

- Speymill manages three residential investment funds at present, two in Germany and one in Macau.
- The bulk of management income is derived from Germany.
- 15 staff employed (excluding GOAL).

Germany

The German residential market is seen as attractive by overseas investors for the following reasons:

- Low cost of housing relative to other countries in Europe.
- Low acquisition costs relative to the actual cost of new build.
- Low level of owner-occupation.
- High level of state ownership (currently being reversed).
- High yields (relative to the UK residential market).

The macro-dynamics for asset growth are provided by an improving economy, rising wages, a liberalised mortgage market under Mifid since November 2007, a 16 year low in unemployment and a view that house prices have bottomed. At a fund-level, asset valuations are influenced by rent negotiations and a refurbishment programme to upgrade properties. In contrast to the large institutional buyers of residential property in Germany who transact with the State Authorities, SDIC seeks to contract with private landlords selling smaller properties at lower prices and as a consequence now has a large number of properties in its ownership.

Underlying rental growth is estimated by SDIC to be in the region of 2.5% pa.

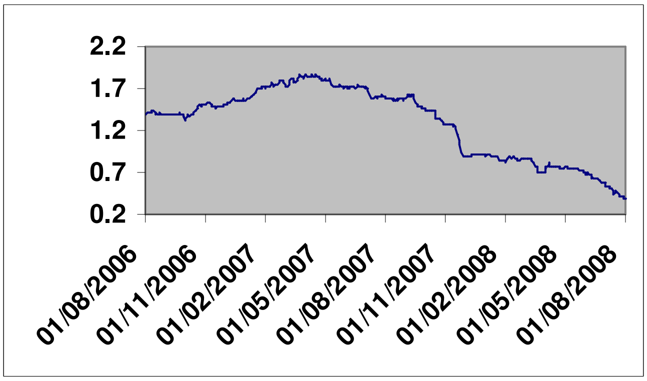
The Epicure Berlin Property Fund

This is a private fund which raised 127m euros when launched in October 2005 and now has around 7,000 properties under management. Assets under management stand at 380m euros. In line with the German residential property market, rents are increased as a result of improvements to the property (*rents for properties in a particular condition/location are set with reference to accepted market averages, the reference price known as Mietspiegel*) and a programme of refurbishment is an important aspect of active portfolio management (and sometimes also a condition of bank finance). Speymill owns GOAL Service GmbH (51% up to 02/06/08), which in turn owns GOAL Construction GmbH, which is contracted to manage the refurbishment of the properties.

FinnCap estimates that the management contract allows for a 1.5% charge on gross assets which is split between the fund manager and the investment manager. For Speymill this equates to 0.75% (2.8m euros, £2.2m p.a.). This is paid quarterly in arrears. The fund is fully invested. In addition GOAL GmbH participates in the property management fees which stand at 6.5% of monthly rent roll.

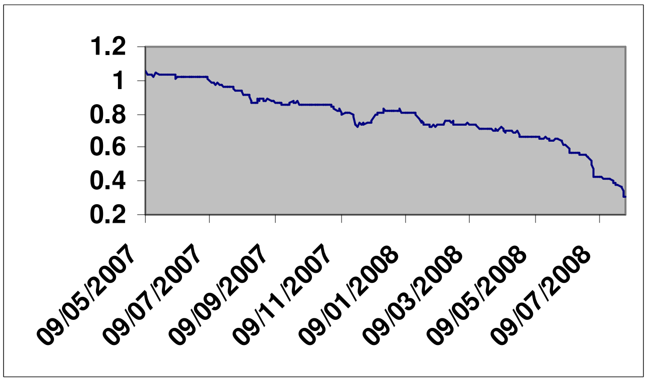
Speymill Deutsche Immobilien Company (SDIC)

SDIC : Ordinary shares



Source: datastream

SDIC : C shares



Source: datastream

Ord	40 cents	NAV 134c	(discount 70%)	Mkt Cap 68m EUR
C shares	29 cents	NAV 94c	(discount 69%)	Mkt Cap 72m EUR

- German residential property specialist company.
- Publicly quoted with two classes of equity (due to be converted into one class by 31/10/08).
- Ordinary share portfolio now fully invested and valued at 980m euros.
- C share portfolio worth 570m euros. Changing credit market conditions mean that it will not reach the same size as the Ordinary share portfolio.

SDIC is Speymill's largest fund. The company has a June year end and reports in September. The shares are quoted on AIM. SDIC was launched in March 2006 when it raised £170m. A subsequent issue of C shares in May 2007 raised a further 250m euros.

The **Ordinary share** portfolio is now fully invested and valued at 980m euros. This figure equates to 16,960 units (average price euros 49,600). The rental yield is 6.8% on purchase values (allowing for a 12.7% vacancy rate) and registered a 5.8% uplift on purchase values during 2007 to 980m euros. Rents are slightly lower than forecast but rental growth is evident. The fund NAV at the interim stage stood at 134 euro cents.

The **C share portfolio** now stands at 570m euros (incl notarised deals awaiting completion) (373m euros as at 31/12/07). In October 2007 3,954 units were contracted to purchase (av. price 50,600 euros). The total number of apartments stands at 10,473 units. The indicated rental yield is 6.7%, rising to 7.1% on completion of refurbishment works. The NAV on the C shares was 94c at the year-end. Whilst the intention had been to replicate the size of the ordinary share portfolio, funding conditions have influenced what can be achieved and therefore the fund can now be regarded as fully invested.

In common with the property sector, the share price for each class stands at a discount to NAV in the market, reflecting sector rotation away from the property sector in general, concern over highly leveraged vehicles and caution over rental yields.

SDIC has an impressive list of institutional shareholders which reflects interest in the market dynamics outlined earlier:

SDIC : C shares - Major Shareholders

	%
Invesco AM	30.1
QVT Financial	11.3
Standard Life	10.3
Majedie AM	7.8
Deutsche	4.7
Midas Capital	4.5
Artemis	4.1
Credit Suisse	3.7

Source: Argus Vickers

Management

Speymill is the fund manager and GOAL is the investment adviser. The fund properties are under the management of GOAL Service GmbH, and the refurbishment programme (basically a cost plus arrangement) under GOAL Construction GmbH. GOAL is now 100% owned by Speymill. The rental management agreement allows for a charge of 6.5% of rents to be paid to GOAL monthly in arrears. A sum of 26m euros has been allocated to the initial Ordinary share investment for refurbishment with further sum of 32m euros for the C share portfolio. Speymill therefore benefits from the fund management fees and participation in the rent collecting and property refurbishment management.

For Speymill, the funds raised through the initial issue of ordinary shares attract a 0.85% management fee calculated on gross invested assets. Of this fee, 45% is paid to Helvetica under terms similar to those which apply to the Epicure fund. The C shares attract a 0.65% fee but without any pay-away. The intention is that the basic management charge will be standardised at 0.65% of gross invested assets once the two share classes (ordinary and C share) merge. This will happen when the full year report and accounts are announced before the end of October 2008.

Performance fees are set at 20% of the excess over an agreed 10% compound growth rate for a 3 year performance period (2006/9 and repeated thereafter). This return involves adding back dividends (set at 6% of the original subscribed capital) and implies that at above a growth rate of 4% for the underlying assets, assuming full investment, the manager will be entitled to a performance fee. This was an attractive proposition at the time it was put in place but we have not allowed for any payments in our forecasts.

Equity classes to combine in due course

SDIC has been using market weakness to acquire C shares at prices between 74 and 82 cents/share (NAV 94c). In total SDIC has re-purchased and cancelled 7.7m shares (3%) since mid-December 2007. SDIC has announced that it plans to convert the C shares into Ordinary shares. The calculation date is 30 June 2008 with conversion to take place no later than 31 October 2008.

Rental yield of 7%

The rental yield is forecast to rise to 7.5% for the ordinary shares after property refurbishment and higher occupancy levels. The forecast rental yield for the C shares is slightly lower reflecting a later entry into the market. The yield differential also reflects a higher vacancy rate on the later portfolio acquisition, where on the initial purchase of 16960 flats it was 7.5% whilst for the C share purchase of 7248 flats, the figure was 11.9% The current vacancy rate in the ordinary portfolio is 12.7% (6.0% natural vacancies and 6.7% related to refurbishment). The target occupancy rate is 95%. 8.4% of the portfolio is currently subject to rental restrictions which should reduce to 2.6% by 2012.

Management fees growing

The accounts for SDIC revealed Manager's fees for the year to June 2007 of £3.8m. However subsequent investment will increase that figure sharply. SDIC accounts for the bulk of the group's asset management revenue and this is likely to remain the case for some time. SDIC has now invested approx 1.5bn euros in the German market.

The size of the C share portfolio will not match that of the ordinary

An adequate spread between rents and finance cost still exists. The finance cost after hedging was set at 4.6% for the ordinary shares (capped at 4.8%) and somewhat higher for the C shares at 4.8% but capped at 5%. These terms extend to SDIC Ordinary for 5 more years. For the C shares the funding availability is more restricted and with an LTV we believe now being employed of less than 75%. Although the C share issue of 250m euros could in theory fund asset purchases totalling 1bn euros, the cost of finance will prevent that from being achieved with 0.57bn euros proving more likely.

SDIC: Gross Assets/Fee Income profile				
Euros m	**2006**	**2007**	**2008(e)** **H1 31/12/07**	**2009(e)**
Assets		861.8	1125.0	1495.0
Cash	139.9	244.2	132.7	100.0
Other	22.1	94.9		
Gross assets	**162.0**	**1201.0**	**1355.7**	**1595.0**
Loans		678.6	843.0	1150.0
Net assets	**162.0**	**483.3**	**461.0**	**445.0**
Fees				
annual	1.4	5.5	9.0	9.8
perform				
Yield				
Ord	-	7.1%	7.3%	7.5%
C shares	-	-	6.7%	7.1%
Finance				
Ord	-	4.6%	4.6%	4.8%
C	-	-	5.0%	5.0%

Source : FinnCap estimates

Purchase of 49% of GOAL

An important revenue stream within the German asset management division

The group announced on 02 June 08 that it had purchased the outstanding 49% shareholding of GOAL Service, a German property management company responsible for managing residential assets, for £0.8m. Gross assets acquired were £3.4m. GOAL therefore becomes wholly owned by Speymill plc, with the consequent effect on operating expenses. GOAL both manages assets and undertakes the management of refurbishment work. The acquisition will ensure that Speymill can direct the growth of GOAL as it seeks to secure additional management remits. Speymill thus gains the full financial benefit from refurbishment work and management fees. GOAL currently employs over 260 staff with full year sales in the region of £12m, dependent on the timing of refurbishment work. Revenue is H2 weighted (reflecting management fees) although the rental stream for which GOAL is responsible is expected to rise in line with inflation or slightly better. New management will seek to broaden the reach of the business.

Macau

Macau represents a very different market to Germany. The Asian and Far Eastern regions are developing rapidly and Macau has enjoyed double digit growth rates for a number of years. Macau in particular has developed a strong position in the leisure/gambling market. Therefore with a constrained property supply and an influx of Chinese wealth, demand for high end residential property has increased sharply. From Speymill's perspective, in contrast to focusing on the income generating potential of a mature German residential property market, investment in residential property in Macau is about accessing the scope for capital appreciation in new developments.

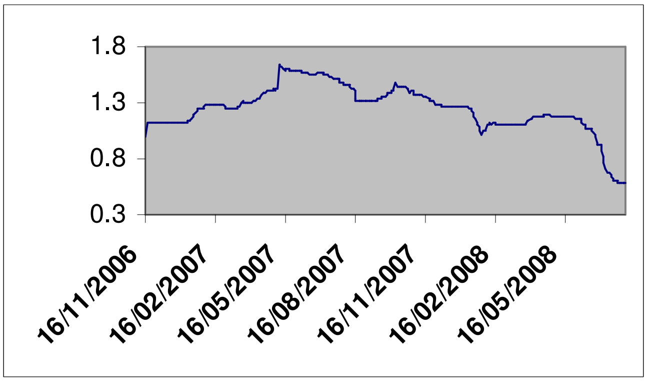
Speymill Macau Property Company (SMPC)

Ord $0.47 NAV $1.41 (discount 66%) Mkt Cap $58m

SMPC was formed in 2006 to invest in high end residential properties in Macau but not exclusively so. The local market demographics imply good prospects for a strong residential housing market and despite Asian growth rates slowing, forecasts from JLL suggest double digit price growth is still in prospect for 2008-9.

The first fund raised $80m ($1.00 per share) in October 2006 and was followed by a further funding round in May 2007 raising $70m at $1.40. SMPC is positioned to provide joint venture, institutional or expansion funds to local developers. At the year end there were 130m shares in issue and NAV was $1.41.

SMPC :



Source: datastream

Sale of Lot U in 2007 and withdrawal from Bel-lago left SMPC invested mainly in cash

In 2007 SMPC had participation in three projects. The largest was a development of 243 up-market apartments on the Macau peninsula (Lot U). This development was sold prior to completion with SMPC having paid only the initial deposit. A second development (Nam Van peninsula) comprises 24 up-market apartments in a shell state, where fitting-out is ongoing. These apartments are valued at $1.5m each and the units will be sold on individually. The third development was to have been 166 luxury units (Bel-Lago – Lot C9), but SMPC chose to withdraw from the project owing to planning problems with the deposit being returned.

2008 has therefore seen SMPC with a significant proportion of its assets in cash for the early part of the year.

New projects

SMPC recently announced the formation of a $10m joint venture to focus on affordable housing developments in Macau into which SMPC is investing up to $8.7m. Funding will be on a project by project basis with a targeted LTV of 75%. The venture has an initial life of three years.

Repeating Lot U

In addition, SMPC has announced a forward funding arrangement with a local Macau developer (Ho Chun) to finance the development of a high end residential building in the inner harbour area on the southwest of the Macau Peninsular. SMPC has committed to purchase 259 residential units (comprising 2 & 3 bedroom apartments) with the intention of selling before completion and handover in 2010. The consideration is $132m, 30% to be paid immediately, with the remainder payable on completion.

The transaction is similar in principle to the Lot U transaction (243 apartments), where a 2007 year end valuation of $160m sat alongside a contracted acquisition price (post completion) of $116m. SMPC never acquired any direct property rights and the transaction was held on the balance sheet at the initial capital invested along with a fair value adjustment when it became likely that the asset would be sold. The eventual gross profit was £44m. Property prices increased during the period of SMPC's involvement, but in adopting the same deal structure, the current transaction combined with the deferred settlement period suggests there is a justifiable upside still in the transaction.

Management fees for Speymill

The reporting year end is December. SMPC incurs two sets of asset related charges – one being a management charge, the other being an incentive fee, and both flow back to Speymill. The management fee of 2% per annum on the net asset value is paid monthly in arrears. The Manager pays 40% of the management fee to Avila Capital. Performance fees are set at 20% of the increase in NAV over 10% compound annual growth on a yearly basis but are only to be paid from realisation events. By way of illustration, the incentive fee related to the Lot U realisation is reserved in the 2007 accounts ($5.0m) but as Speymill effectively halves its fee with Avila Capital (a locally based property agent), only £1.2m is due to the Speymill Managers in 2008.

Need to step carefully in local markets

SMPC will continue to examine the market for opportunities (it reviewed development projects in total exceeding $2bn in 2007). Despite the growth prospects for Macau (population growth, GDP growth, relative affordability against peers like HK, imbalances in property supply) there are considerable practical risks (planning approvals, zoning, inflating land values etc) which is why the company works closely with established local agents and developers.

In terms of gearing, SMPC is able to debt finance around 65-70% of the cost of a project. This implies a maximum completed gross development value exposure for SMPC of $400m although current project levels are set somewhat lower.

SMPC: Major Shareholders

	(%)
Invesco AM	30.2
Insight	13.0
Wedd Jefferson	10.9
New Star	8.1
ABN AMRO	4.4
Bank Sarasin & Cie	3.6
Deutsche	3.3

Source Argus Vickers

SMPC therefore offers lower underlying asset management revenue opportunities relative to SDIC but greater scope for incentive fees.

In general, performance fees are compelling in high growth scenarios such as SMPC but should not be relied upon as a regular income source. By way of example, assuming $150m of net assets, a 20% increase in value would amount to $30m. Taking an in budget growth of 10% ($15m) would result in a performance payment of $3m (ie 20% on the out-performance of $15m) – assuming these assets were sold. Thus the performance incentive income stream to Speymill will be lumpy despite the fact that the manager is geared to realisation profits. 2009 will be quiet by comparison and we do not expect significant performance fees realistically until 2010 at the earliest.

SMPC: Asset Profile

$m	**2007**	**2008(e)**	**2009(e)**
Assets	**114.6**	**86.0**	**86.0**
Cash	36.7	123.0	123.0
Other	57.7		
Gross assets	**209.0**	**209.0**	**209.0**
Loans	15.4	15.0	15.0
Other	9.5	5.0	5.0
Net assets	**183.5**	**189.0**	**189.0**
Fees			
annual	1.8	2.1	2.4
perform	5.0		

Source FinnCap estimates

Interest income should cover costs in 2008

The key to 2009, however, depends on whether a fair valuation estimate can be brought into account on the development with Ho Chun and whether any disposals come through from Van Nam. For SMPC interest income should cover the majority of management costs in 2008. In 2007 these fees amounted to $3m. Incentive fees are dependent on realisations and $5m was reserved in the 2007 accounts.

Summary of existing funds

Speymill plc : Illustrative Income on Funds Managed (2009)

Speymill (excl perf fees)	currency	Fund Size	Fees Net	Income	**£m**
EBPF	euro	380m	0.75%	2.8	2.2
SDIC	euro	1570m	0.65%	9.8*	7.9*
SMPC	$	180m	1.2%	2.1	1.0
Total	**£**				**11.1**

* The Helvetica income share on the Ordinary shares reduces this number to 8.1m euros (£6.5m)
(Euro 0.78/£; $2.0/£)
Source : FinnCap estimates

Retirement Villages

New long term growth opportunities

As a function of demographics, the retirement market in the developed world is obviously of interest to developers, particularly when considering that existing property provision is in many cases unsuitable. The existence of an affluent and active elderly population, when viewed against the backdrop of dispersed family life and smaller family homes, means that markets are developing for more clearly defined retirement property provision.

Speymill has established a JV with the Minnesota based Goodman Group to develop retirement villages in the UK and Europe. The JV has been registered in the Isle of Man. Goodman was founded in 1965 and has experience across commercial and residential construction and more particularly, senior living and healthcare. Goodman believes in the concept of community living to underpin its projects (Memory Centers, Assisted Living).

Goodman will be responsible for site selection, facility design, marketing and operation of the schemes, whilst Speymill Contracts will manage the development and construction of the premises. Speymill Property Group will organise the capital raising and fund management aspects of the project. The strategy is to develop 10 retirement villages across the UK and Europe, with 150+ apartments in each. £25m has been budgeted for each village, which implies a mid range property solution. The intention is to adopt a rental model, rather than outright sale, with investors underwriting the development phase.

Group financial profile

Speymill plc: Group Profit Split – Summary						
(£m)		**2005**	**2006**	**2007**	**2008e**	**2009e**
Revenue	*Invest funds*		2.7	6.4	11.0	10.0
	GOAL~		1.4	4.9	9.0	12.0
	Contracts		18.1	41.3	45.0	51.0
			22.2	52.6	65.0	73.0
Op Profit	*Invest Funds**	0	0.7	2.6	5.4	4.5
	GOAL			0.8	1.0	1.3
	Contracts	-0.6	0.2	0.9	-0.5	1.0
EBIT		**(0.6)**	**0.9**	**4.3**	**5.9**	**6.8**
Shares			-0.9	-0.8	-1.1	-0.8
Central		*-1*	*-0.6*	*-0.9*	*-1.3*	*-1.3*
Excep				-0.4		
PBT		**-1.6**	**-0.6**	**2.2**	**3.5**	**4.7**
Tax^		0	0.2	-0.2	-1.0	-1.3
PAT		-1.6		2.0	2.5	3.4
Shares	Dil (m)	55.9	57.1	63.7	67.5	67.5
EPS	(p)	-4.25	-0.65	3.3	3.7	5.0

~ GOAL has a number of revenue streams (refurb fees, rent roll management fees, acquisition fees etc) which as GOAL is now wholly owned. become reflected in intra-group trading
*after cash bonus payment but before the share element of the bonus entitlement
^ taken at 27% but ultimately cash tax levels could be lower as a function of tax domicile
Source: Group accounts; FinnCap estimates

High margins on fund management activities support earnings

Under the present group structure, the construction business will account for the bulk of group revenue. The inclusion of a full revenue contribution from GOAL in 2008 for H2 will have an impact this year especially on administration costs. The fund management activities, however, provide the bulk of group profits, as supplemented by performance payment receipts in 2008. Whilst in contracting, average construction margins are around 2-3%, fund management margins can exceed 40% (30% after bonus payments). 2008 will benefit in particular from the receipt of performance fees (SMPC) although problems at Speymill Contracts will counter much of the uplift. Nevertheless, we anticipate a recovery in contribution in 2009 from Speymill Contracts.

Bonus arrangements are a little complicated

A practical concern for shareholders is that the annual staff bonus payment has become more onerous, particularly as it affects fund management activities. Speymill has committed to pay out 20% of profits up to £1m and up to 35% of profits over £1m by way of annual bonus. The awards are payable one half in cash and one half in deferred share entitlements issued over 2-3 years. The cash cost impact for half the bonus payment will be reflected in the P&L, which we have attempted to reflect in the divisional operating profit break-down. The other half is to be satisfied in shares, and is reflected as a charge in the accounts. To meet the ongoing rising obligation, the EBT will have to buy in shares, which can affect liquidity around period ends. The effect is akin to a progressive share buy-back with the cost spread over 2-3 years.

Speymill plc : Fund Management Division (Bonus split)

(£m)	**2006**	***2007***			**2008**	**2009**
	FY	*H1*	*H2*	FY	FY	FY
Invest Man						
Fees	2.7	*2.6*	*3.8*	6.4	9.2	10.0
Perf bonus*					1.8	
Total					**11.0**	**10.0**
Costs		*1.6*	*1.8*	3.4	4.5	4.6
Operating Profit	0.3	*1.0*	*2.0*	3.0	6.5	5.4
Bonus ^	1.1	*0.4*	*0.5*	0.9	2.1	1.7
Operating Profit (net)	**-0.7**	**0.6**	**1.5**	**2.1**	**4.4**	**3.7**

*performance bonuses are due from SDIC and SMPC dependent on terms. 80% of incentives fess are to be invested in underlying stock
^staff bonuses are 50% in cash and 50% in shares (ultimately purchased in the market)
Source; Finncap estimates

As far as performance fees are concerned, 50% of the payment due to the group is to be applied to buying shares in the underlying fund at NAV or better.

Tax charge to come down?

The Isle of Man tax residency in theory reduces the corporation tax charge to nil but the new tax structure has yet to become established in practice. Therefore we have factored in an unchanged tax charge of 28% for the time being. The group is also structuring its affairs in Germany post the GOAL stake purchase so as to avoid double taxation.

Balance sheet is good shape

The group had net cash of £0.7m at the interim stage and £1.5m by the year end. £0.8m has since been spent acquiring shares in GOAL. Increased working capital requirements will absorb the balance.

As at 31 December 2007, Speymill had 57.9m shares in issue with options outstanding over a further 9.6m shares, 5.6m of which are exercisable after July 2008 at 22p (which would raise £1.2m for the group).

Valuation

A feature of the current market collapse is that valuations have been reduced almost without reference to the different underlying business models. Consequently property investment groups have been marked down in price terms by the same percentage as agents and fund managers (up to 60% from 2007 peaks). Speymill is no exception in this regard.

The share values of the group's largest client exposure, SDIC, have also declined sharply. The difference in performance between Ordinary and C shares in SDIC reflects the net asset discounts applicable to each class of share. The ordinary shares are more highly geared as a function of becoming fully invested earlier in the cycle and investors' risk lies in the refinancing of debt in 4-5 years time. The C share portfolio is less geared. The decision to convert the C shares into Ordinary should be beneficial in terms of overall gearing levels for SDIC. Improvements to the estate and rental growth should go some way, however, towards reducing any potential refinancing risks.

In terms of current valuation, Speymill shares stand on a current year PER of 8.1x, dropping to 6.0x for 2009. SDIC stands on a discount of over 70%, and SMPC on a discount of 56%%. For SPG, EBT buy backs may correct some of the undervaluation related to sentiment and illiquidity, but the dominant stake held by Jim Mellon may influence the extent of any re-rating by restricting liquidity.

Looking forward, the acquisition of the minority stake in GOAL will have an impact on the group's working capital for the current year as will problems at Speymill Contracts. This situation should improve in 2009, and Speymill Group is forecast to generate a healthy cash surplus. The group had a modest cash position at the year end, which has been drawn upon to fund the GOAL minority position. Looking forward, the modest level of existing dividend (0.5p) also provides scope for above average dividend growth from 2009.

Major Shareholders

Jim Mellon 26.1m shares
Bob MacDonald 2.0m shares

Arhold & Bleichroeder LLC 5.12%

Speymill: Summary Financial Forecasts					
£m	2005(a)	2006(a)	2007(a)	2008(e)	2009(e)
Profit & Loss					
Revenue	15.3	22.3	52.7	65.0	73.0
Gross Profit	1.6	5.5	12.8	21.0	23.0
Op Expenses	2.6	5.1	9.2	15.1	16.2
Op Profit	**-1.0**	**0.4**	**3.4**	**5.9**	**6.8**
Goodwill/ Option Costs		-0.9	-0.8	-1.1	-0.8
Central costs				-1.3	-1.3
Exceptionals	-0.5		-0.4		
Net Interest	-0.1				
PTP	**-1.6**	**-0.5**	**2.2**	**3.5**	**4.7**
Tax		0.2	-0.1	-1.0	-1.3
Post Tax Profit	-1.6	-0.3	2.1	2.5	3.4
Av Shares	38.8	56.3	57.9	57.9	57.9
EPS (basic)	**-4.25**	**-0.55**	**3.6**	**4.3**	**5.8**
EPS (norm) dil		**-0.55**	**3.2**	**3.7**	**5.0**
DPS			**0.5**	**1.0**	**1.5**
Balance Sheet					
Fixed Assets	**1.0**	**1.0**	**2.1**	**2.7**	**2.7**
Intangibles	0.9	0.8	0.9	0.9	0.9
Tangibles	0.1	0.2	0.5	0.6	0.6
Other			0.7	1.2	1.2
Current Assets	**4.4**	**8.3**	**19.4**	**23.0**	**28.4**
Debtors	3.3	7.7	17.9	23.0	25.0
Cash	1.1	0.6	1.5	0.5	3.4
Current Liabilities	**3.6**	**7.2**	**16.5**	**18.5**	**19.5**
Creditors		7.2	16.5	18.5	19.5
Debt >1yr	-0.2				
Other	-				
Net Assets	**1.6**	**2.1**	**5.0**	**7.2**	**11.6**
NAV (p)					
Cash Flow					
EBIT	-1.6	-0.6	2.2	3.8	4.7
Depn/Options	0.3	1.1	0.9	1.0	1.1
W/C	-1.0	-0.5	-1.3	-3.1	-1.0
OP c/f	**-2.3**	**0.0**	**1.8**	**1.7**	**4.8**
Net Int	-0.1		-0.1	0.1	0.2
Tax				-1.1	-1.3
Capex		-0.2	-0.4	-0.3	-0.2
Acq/Disp	0.5		-0.6	-0.8	
Dividends				-0.3	-0.6
Net C/F	**-1.9**	**-0.2**	**0.7**	**-0.7**	**2.9**

Source : Group accounts; FinnCap estimates

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The recommendation system used for this research is as follows. We expect the indicated target price relative to the FT All Share Index to be achieved within 12 months of the date of this publication. A 'Hold' indicates expected performance relative to this index of +/-10%, a 'Buy' indicates expected outperformance >10% and a 'Sell' indicates expected underperformance of >10%.

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