

Welcome to Objective's Small & Mid-Cap Review

2005 was in many ways a surprisingly strong year for equities. The FTSE All-World index rose by over 9% in dollar terms despite soaring energy prices, growth rates slowing, interest rate uncertainties and major natural disasters.

The league tables of regional and sectoral performances bore many of the hallmarks of an early cyclical recovery. But that general observation conceals wide variations and we continue to believe that, on a secular basis, growth opportunities are more likely to be found outside the major developed economies.

For 2006 we expect a more balanced, not to say muted outcome with some changes in emphasis. The recent upward trend in the dollar should continue as interest rate differentials win out against concerns over deficits – but the respite will be temporary. US equities are likely to play catch up after missing out on the party last year and sectoral themes are likely to reflect a growing conviction that consumers are simply being canny, not playing dead in terms of spending. Rate increases should top-out this year except in the UK where we expect a further cut.

But risks remain. Pressure on corporate profitability and on disposable income are likely to persist despite expected falls in energy prices – someone has to pay for the pensions deficits in the UK and elsewhere. Suggestions that China may diversify its reserves away from the US dollar may spoil any revival in dollar-assets and the end of Mr Sharon's political life in Israel has the potential to reignite Middle East tensions in the forthcoming Palestinian and Israeli elections.

Our sector focus this month is on UK housebuilding. We believe that demographics and low interest rates are conspiring to drive a possible surge in private sector activity to levels not seen since Mary Quant first slashed hemlines!

Andy Hartwill
Research Director

Contents

In our review of the month

- » 2005 was surprisingly good with the 2006 outlook more benign than positive at this stage

Read more on pages 2-7

Upcoming flotations

- » Recently announced flotations

See our table on page 9

In our sector comment

- » Demographics and low interest rates may continue to drive UK residential property

Read more on pages 10-11

Companies to watch

- » **CSS Stellar** (CSS) 13
- » **Capital & Regional** (CAL) 14
- » **Superscape** (SPS) 15

Newcomer of the month

- » This month we welcome the Cypriot company **Charalambides Diary** (CHD)

Read more on page 16

Speculation on future flotations

- » Press speculation of possible future flotations

See our table on page 17

Companies in the news

- » **Shed Productions** (SHDP) 18
- » **Halfords** (HFD) 18
- » **Debtatters** (DEBT) 18
- » **Fountains** (FNT) 19
- » **PayPoint** (PAY) 19

Recent flotation data

- » The numbers from recent flotations on the markets

See our table on page 20

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Month in Review

Market Commentary

2005 proved to be a surprisingly good year for equity investors. The 9% dollar return from the FTSE All-World Index was respectable in itself and it encompassed a remarkable range of returns of up to 45%. What was remarkable was that the returns were delivered despite growth rates slowing, energy prices soaring, interest rates in most major developed economies rising and several major natural disasters.

Overall the growth was robust. Even the two major hurricanes in the USA produced in the end only a minor disturbance in the path of US GDP growth. The consequent spike in the oil price has proved to be short-lived and estimates for the price of oil suggest further falls to produce a 2006 average for Brent crude of around US\$50 per barrel. As the oil price falls so inflationary expectations should fall with it (there is little to fear in any case from the consumer). That in turn should allow policy makers to take a more relaxed view of monetary policy – although they will be in no hurry.

The outlook for equities in 2006 appears to be benign rather than positive. Growth rates moderating slowly, inflation fears abating and interest rate cycles topping out in most places, falling in others (notably in the UK). But we do not believe in a simple re-run of the 2005 themes. Commodity plays and emerging market growth stories are likely to compete for investor attention with more traditional consumer cyclicals, albeit later this year as yield curves flatten or steepen further.

But risks remain and last year's apparently high risk appetite is likely to be more sated in 2006. Renewed uncertainty in the Middle East following Prime Minister Sharon's illness, Russian sabre-rattling at the Ukraine and fears over Iran's nuclear capabilities and intentions are likely sources of global unease. Recent suggestions that China will diversify its reserves away from the USD may unsettle the dollar's recent recovery.

In 2005, global equity markets appear to have been driven by early cyclical. As we said at the start of 2005, one of the turning points from the 2004 doldrums would be in the USD. That duly took place and the scene was set for an apparent relaxation in demanded risk premium. Indeed the sector behaviour at the global level bears some of the characteristics of increased risk tolerance and of early cyclical behaviour.

The accompanying chart of relative performance shows that the global winners in 2005 included Mining, Oil and Gas, Construction, Steel, Engineering and Investment Companies. That is a classic combination of sectors for investors investing in early stage growth. But a look at the regional performances shows the need for greater sophistication than simply to bet on growth.

About Objective Capital:

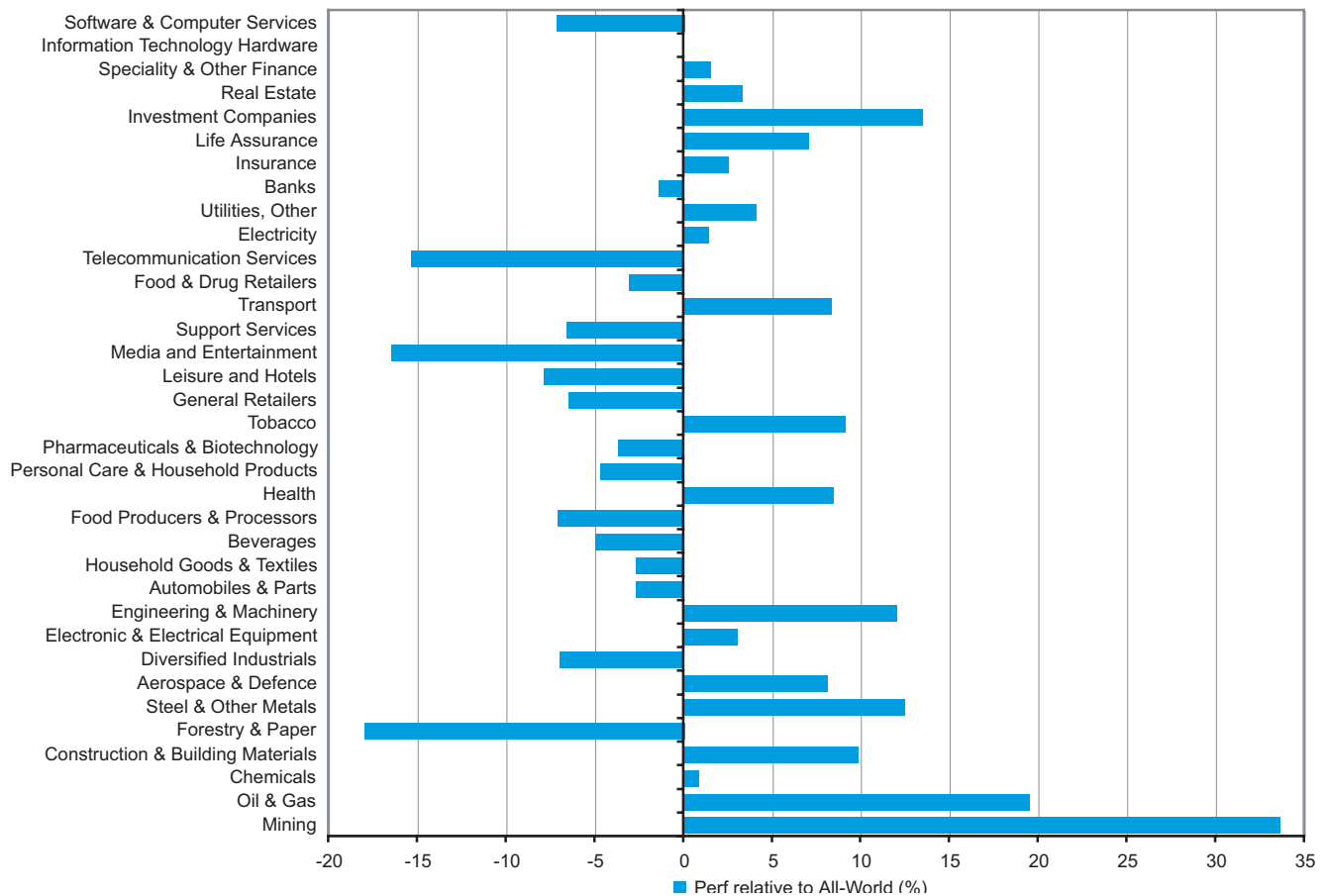
Objective is a leading UK provider of objective corporate research.

We offer investors two levels of insight – a regular survey of the complete small and mid-cap segment, highlighting those stocks where attention should be focused, and our detailed institutional-quality, sponsored research coverage. As always, our research doesn't offer trading recommendations or advice but an objective up-to-date assessment of the prospects, and risks, of the companies we cover.

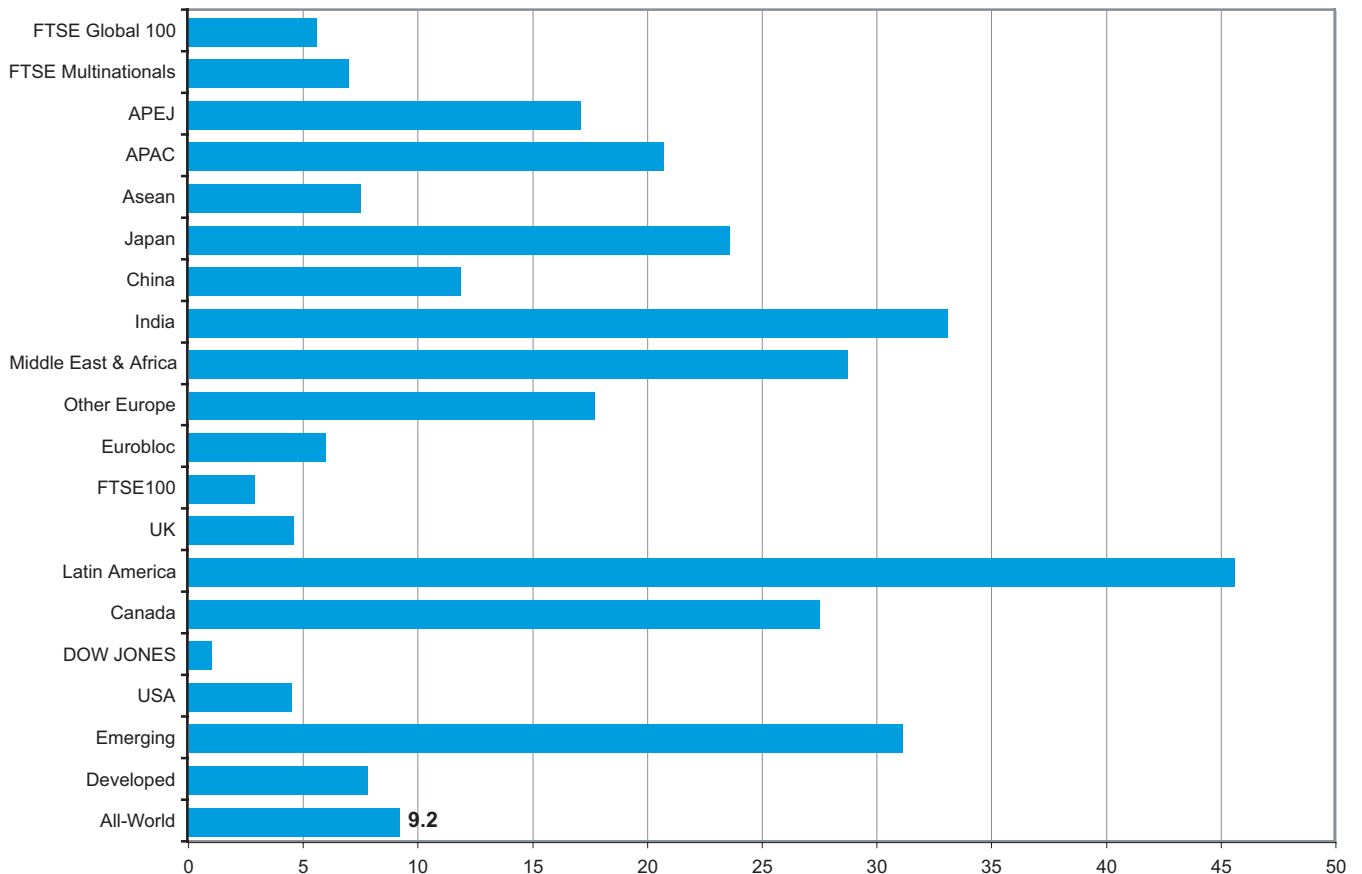
While the companies we cover sponsor our research, it is always written on behalf of our readers. It is of the essence of our research that it be **independent** — that is opinions, estimates and valuations be solely those of Objective's analyst; **objective** — that is based upon verifiable data; and **transparent** — that is based upon explicit assumptions.

Our research complies with all FSA recommendations as may arise out of CP172 and CP176, i.e., that it be independent of any broking or trading interests; and CP205, i.e., that it comply with standards for objectivity.

Performance relative to All-World (%)



All-World Regional Performance (%)



The league table of regional performances (in USD) is dominated by a combination of emerging countries and those with a particular exposure to mining and/ or oil. The picture confirms our long-held view that growth investors will increasingly look outside the developed economies. The implied shift in investor focus is probably secular.

The challenge for 2006 will be to see how underlying performance holds up as growth rates slow further. The good news of course is that slower growth in the end means lower interest rates and we expect the UK to be the first out of that gate in 2006, following its first cut of this cycle last year. At the very least the peaks of the current rate cycle are likely to be lower than worst fears as consumers, where they have a choice, continue to demonstrate their reluctance to help retailers out of their disinflationary discomfort. Of course they have no choice in dealing with regulated monopolies – but that is another story and one likely to haunt UK growth rates in particular.

Ordinarily, rate cuts bring a flattening and then steepening yield curve which in turn heralds a period of outperformance for later/ consumer cyclicals. But any such typical behaviour is likely this year to be tempered by a series of features which may yet conspire to decrease the risk appetite of investors, in other words any cyclical rally is likely to be modest.

In the UK, for example, the outlook for equities is clouded by concerns over corporate profitability and further pressures on disposable income. In the first week of the new year both Arcadia and the Co-operative group announced plans to shut their final-salary schemes to new members. At the end of last year Rentokil announced its intention to shut the existing scheme also for current members making it the first FTSE100 company to go so far. The problem runs deep. Actuarial firm Mercer has estimated that the aggregate deficit of FTSE350 companies widened by some 25% last year to £93bn – some 5% of total market capitalisation. In the end the consumer has to make up the shortfall.

Of the deficit, according to consultants Deloitte, some £75bn arises in the FTSE100 companies – a rise over 2004 of around 15%. The implication for the FTSE250 is more disturbing: on these numbers the implied rise in the deficit for FTSE250 companies was some 80% to around £18bn. The situation for smaller companies (below the threshold for the FTSE250) is more opaque. On the one hand their ability to anticipate and withstand such pressures may be more limited than for larger companies. On the other hand they tend to be newer and thus less likely to have final salary schemes in the first place.

Evidently the decision to scrap defined benefit pensions schemes removes a source of potentially rising costs; corporate P&L's should benefit at least to the ex-

tent that those will not have to be factored in to estimates. The flip-side however is that the deficit, or a proportion of it, will have to be funded instead by employees. They are, in turn, consumers and the consequence is likely to be a further dampening of consumer demand. Respite for the retailers seems always to be over the horizon.

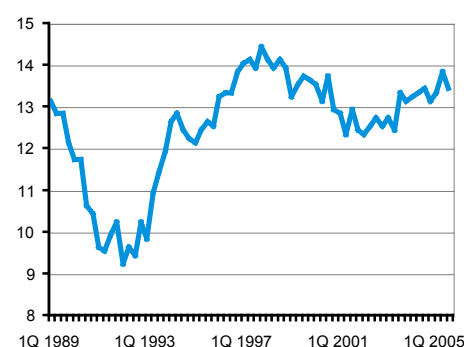
Corporations will not escape entirely scot-free. They are being obliged to make payment into the newly established Pension Protection Fund which sets out to provide some protection to workplace pensioners in schemes being restructured. Mercer estimates that 2005 additional contributions should be around £5bn, a similar level to that in 2004. Investors with long memories will recall the apparently halcyon days when companies were able to write-back to their P&L any actuarial surplus in their pension funds. They will remember also the current UK chancellor's wizard wheeze to raid pension funds to the tune of £80bn (1997 present value) when he abolished the dividend tax credit. Today's pensioners would not be suffering so greatly were it not for the combination of those two events.

Any further pressure on the corporate sector from the pensions quarter will come on top of the pain already being reported. JJB Sports has become the latest company to issue a profits warning citing margin pressure despite a late pickup in pre-Christmas trading i.e., another retailer paying the price of sales volume in a disinflationary environment. Meanwhile corporate failures have risen to their highest level for three years. Analysis by Experian showed that over 18,000 businesses "failed" in 2005, an 11% increase on the number in 2004. Rate rises, a slowdown in consumer spending and sharp rises in energy prices all took their toll. Against that background there is little surprise that UK profitability (as measured by net return on capital) fell in Q3 2005 (latest date available) to 13.4%.

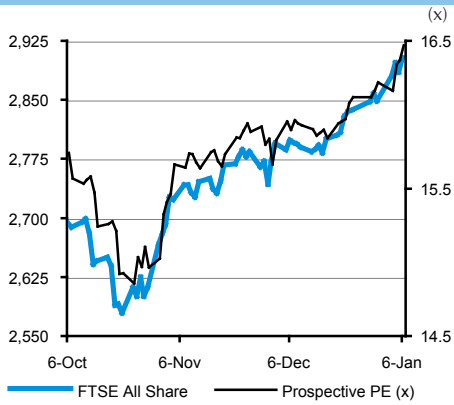
The accompanying chart shows that level to be still above the 2001 lows of around 12.5%. Nonetheless it begs a more worrying question for the outlook: if this (or indeed 14+% high in 1998) is the best that can be achieved in a period of unprecedentedly long growth, what happens as that growth slows further?

Of the reasons cited for the fall in 2005, interest rates provide perhaps the most hopeful answer – we expect consumer activity to slow further and energy prices to remain high, if not to spike higher through the wholesale gas market (see elsewhere). We have argued for some time that the top of the rate cycle in the UK (as in the USA) was likely to be lower than worst fears. After the rate cut last year, the UK's MPC appears to be content to wait and see for the now – and certainly will be in no hurry to cut again following the latest and stronger than expected CIPS survey of the service sector. But we believe that with dis-inflationary forces still at work outside the energy sector, the next move will be downwards. When that

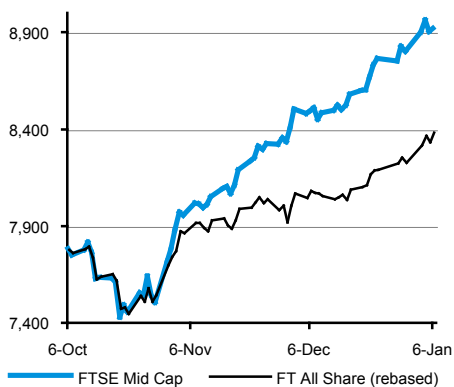
Net return on capital



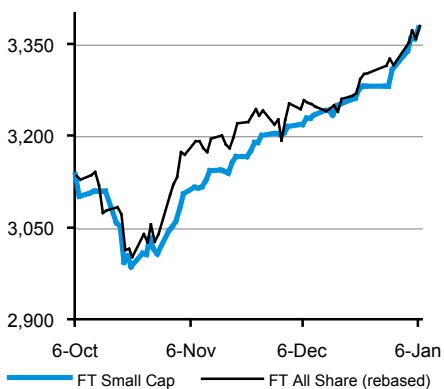
FTSE last 3 months



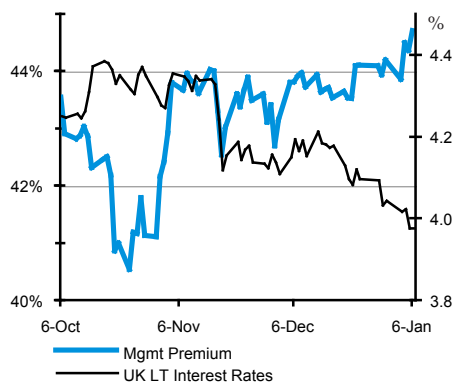
FT Mid Cap last 3 months



FT Small Cap last 3 months



Management premium in the FTSE¹



¹ management premium is the % of the FTSE that the market is paying for the "value" management is expected to generate. See page 12 for details.

happens (and don't hold your breath) it should come as a relief to, rather than salvation for, equity bulls. We are pretty sure that, one way or another, the total UK tax burden is likely to rise further.

Elsewhere the growth story looks more robust. In the USA the housing market shows signs of peaking but not of crashing. If so the wealth effect from earlier gains is likely to be maintained. Income growth appears to have peaked at 8% y/y and looks set to fall back to some 6% in 2006. That would be consistent with GDP growth of over 3%. We expect the Fed to remain on hold at 4.75% for most of 2006.

In the eurozone, 2006 looks like the year when corporates reap the benefits of the 5% fall in the (trade-weighted) euro during 2005. If the current level can be maintained then the decline could be expected to feed through to an annual growth in export volumes of up to 15% compared to only 5% as recently as the autumn of 2005. GDP forecasts have been edging upwards as have expectations for corporate profitability, hence capex and employment. We expect the ECB to increase rates by up to 50bp (to 2.75%) during the first half of 2006 and then go on hold.

In aggregate global growth is estimated to show only a modest reduction on the 4.4% achieved in 2005. We continue to believe that the risk to interest rate forecasts is on the downside.

Among the possible risk factors two are worthy of elaboration here: China and Israel.

Chinese foreign exchange policy appears again to be on the move. As the new year stumbled into life, a brief statement from the government's foreign exchange regulator (Safe) said that one of its targets for 2006 was to "improve the operation and management of foreign exchange reserves..... and to continue to expand the investment area of reserves."

Chinese reserves are estimated to exceed US\$1,000bn in 2006, a possible 25% rise over 2005. Consensus estimates suggest that some 70% of Chinese reserves are invested in US assets, helping to support the recent large US deficits. Monthly flows are estimated to be in the region of US\$15bn and some Chinese government economists are thought to have argued for reserves to be invested in domestic infrastructure rather than funding the US deficits. Evidently any major change in Chinese strategy could have significant effect on US assets.

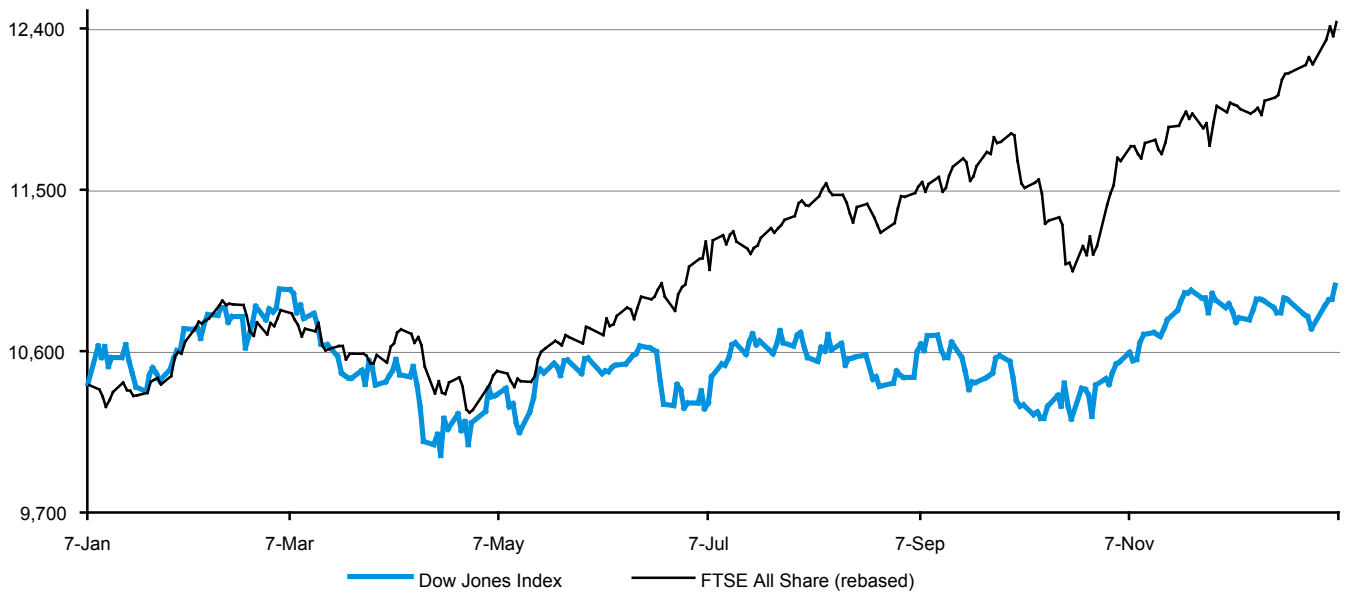
Inscrutable as ever, SAFE simultaneously announced its intention to end quotas on the amount of foreign currency Chinese companies can acquire to invest in overseas assets. Any bad news for the US deficit appears thus to be assuaged by the increased likelihood of Chinese-funded international M&A. And if that is not enough to square the circle of G7/8 opinion, there is the continuing possibility of a further revaluation of the Renminbi following the 2% (!!) move last July after the shift from the dollar-peg to a trade-weighted basket.

In Israel, the end of Mr Sharon's political life comes at a dangerous time. In the last two years Mr Sharon has made a most remarkable transformation to become apparently the best hope for a settlement with the Palestinians. The vacuum created by his enforced departure from politics is open to exploitation in forthcoming elections. Palestinians go to the polls at the end of January, Israelis at the end of March.

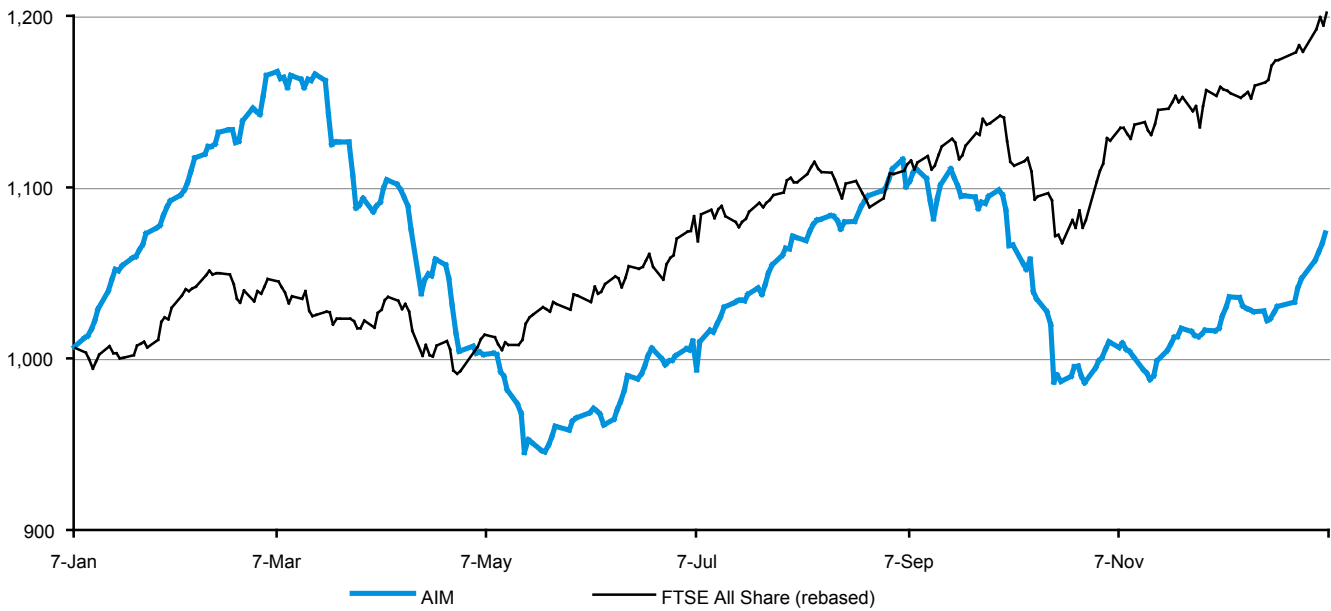
A straw poll taken immediately after Mr Sharon's stroke showed almost 50% of the seats in the Knesset as undecided and the three contesting parties within a few seats of each other. In other words it is an open race where before it had been assumed that Mr Sharon's Kadima party would emerge as the single largest winner.

In the Palestinian elections, polling before Mr Sharon's stroke had suggested that Hamas could win up to 30% of the 132 seats. One risk scenario is that Hamas does even better. If the right wing Likud party is seen to be in with a chance to fill the vacuum left by Mr Sharon, that may encourage a more hard-line reaction in the Palestinian election. If Hamas does better than expected at the end of January then it would encourage a hard-line reaction in the March Israeli election. By Easter, what is left of the peace process could be in tatters and extremists/insurgents throughout the Middle East could be emboldened. The second quarter would start with a significantly lowered risk appetite as the prices of oil and gold rise.

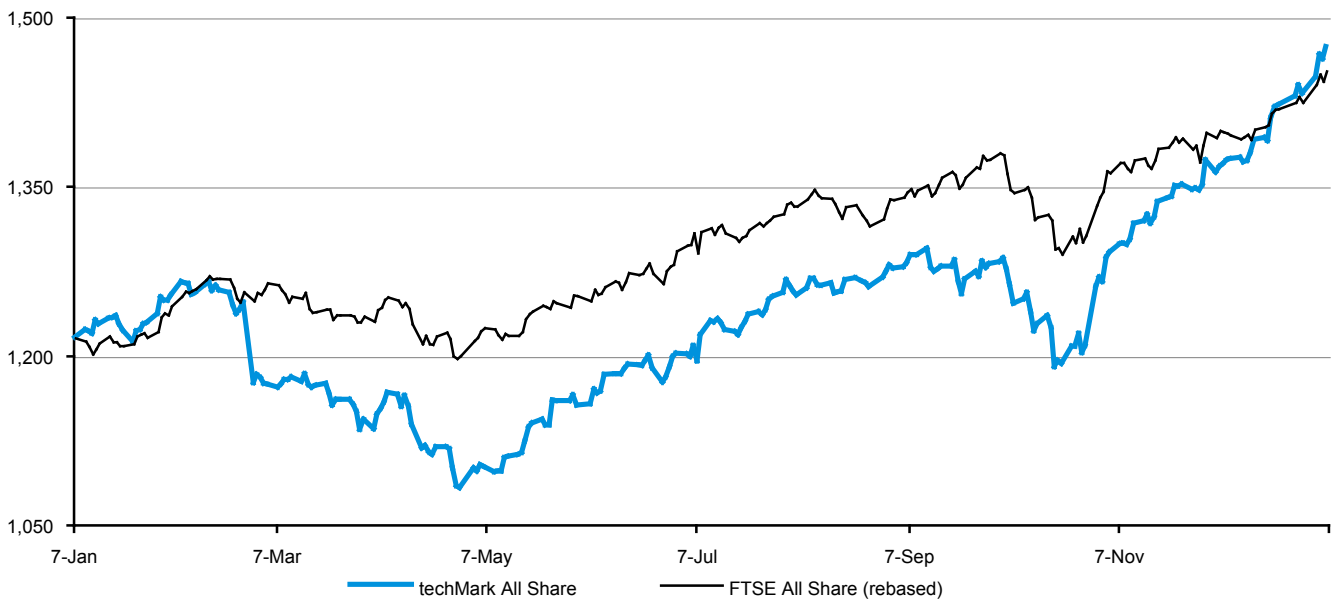
Dow Jones v. FTSE All Shares (rebased), 12-mth



AIM Index v. FTSE All Shares (rebased), 12-mth



techMark Index v. FTSE All Shares (rebased), 12-mth



Recently announced flotations

Company	Market	Type	Mkt Cap/ Amnt Raise	Issue Date	Description
Radiancy	Main	Placing	£65.0m / £30.0m	2006	Cosmetic treatment company
IVT Wireless Technology	Aim	Placing	TBC / £2.0m	2006	Bluetooth products
Plasma Warehouse Group	Aim	Public Offer	£2.0m / TBC	2006	Specialist audio visual systems
Betcorp	Aim	Placing	£20.0m / TBC	2006	Internet gambling
Gameaccount	Aim	Placing	£100.0m / £10.0m	2006	Internet gaming
Aqua Bounty Technologies	Aim	Placing	TBC / TBC	2006	Aquaculture biotechnology
Windsave	Aim	Placing	£50.0m / TBC	2006	Wind turbines
Euphony	TBA	Introduction	TBC / n/a	2006	Telecom services
Elitel Telecom	Aim	Placing	TBC / TBC	31-Jan-2006	Telecommunications
Allura	Ofex	Introduction	TBC / n/a	19-Jan-2006	Cash shell
Amteus	Aim	Placing	TBC / TBC	18-Jan-2006	Internet voice and data services
Asian Growth Prop. Ltd	Aim	Introduction	£80.0m / n/a	16-Jan-2006	Property
The Greenhouse Fund Ltd	Aim	Placing	TBC / £9.8m	12-Jan-2006	Environmental technology
Trident	Aim	Placing	£100.0m / £30.0m	2006	Internet gambling
Ashingo	Aim	Placing / Offer	TBC / TBC	TBC	Digital media advertising
Carlton Clubs	Aim	Placing	£40.0m / TBC	TBC	Bingo club owner
Isle of Man Int. Broadcstng	Aim	Placing	£75.0m / £13.0m	TBC	Radio broadcaster
Planet Conservatories	Aim	Placing	£70.0m / £10.0m	TBC	Bespoke conservatories
Miras Imaging	Aim	Public Offer	£6.4m / £1.0m	TBC	Medical devices specialist
TNX Television	Aim	Placing	£50.0m / £15.0m	TBC	Commuter train television
BCM Capital	Aim	Introduction	TBC / n/a	TBC	Construction
Barracuda	Aim		£300.0m / TBC	TBC	Pubs and bars
Petrosearch International	Aim	Introduction	TBC / n/a	TBC	Resource sector investments
Nyati Resources	Aim	Placing	£1.7m / £1.1m	TBC	Oil and gas exploration
AM2	Aim	Placing	£15.0m / £15.0m	TBC	Investment company
Medco Energi	Main	Placing	£800.0m / £214.0m	TBC	Indonesian oil and gas company
Talia Technology	Aim	Placing	£30.0m / £10.0m	TBC	Eye screening equipment
Afcan Mining Corporation	Aim	Placing	TBC / £10.0m	TBC	China-focused miner
Greenkote	Aim	Placing	£6.2m / £2.0m	TBC	Coatings company
First Croatia Properties	Aim	Placing	£46.5m / £46.5m	TBC	Commercial property
Lamont Property	Aim	Placing	TBC / TBC	TBC	Commercial property
Concept Group	Aim	Placing	TBC / £6.0m	TBC	Manufacturing consultancy
D-Pharm	Aim	Placing	£15.0m / TBC	TBC	Israeli biotech
Templin Airport Corp.	Aim	Placing	TBC / £13.9m	TBC	Airport development
Glennstars Investments	Aim	Placing	TBC / TBC	TBC	Investment company
Zone 4 Play	Aim	Placing	TBC / £7.0m	TBC	Online casino software
Mandarin Merchant Capital	Aim	Placing	£22.2m / £22.1m	TBC	Investment company
All African Resources	Aim	Placing	TBC / £0.8m	TBC	Mineral exploration
Uranco	Aim	Placing	£300.0m / £150.0m	TBC	Uranium miner
Ex Libris	Aim	Placing	£60.0m / £20.0m	TBC	Library software
PSG Franchising	Aim	Placing	£18.0m / TBC	TBC	Personal property searches
Marishal Thompson	Aim	Placing	£12.2m / TBC	TBC	Ecological risk management
OISE	Aim	Placing	TBC / £3.0m	TBC	Language teaching
Liberty Copper Corp.	Aim	Introduction	TBC / n/a	TBC	Copper mine investments
Deep Blue Holdings	Aim	Placing	TBC / TBC	TBC	Property development
Crystal Gaming	Aim	Placing	TBC / TBC	TBC	Online gaming
Penton International	Ofex	Introduction	TBC / n/a	TBC	Coal mines and marble quarry
Direct Petroleum	Aim	Placing	£150.0m / £43.0m	TBC	Oil and gas explorer
New Media Lottery Services	Aim	Placing	TBC / TBC	TBC	Electronic lottery games
MicroFuze International	Aim	Placing	TBC / TBC	TBC	Metal surface treatment
Gold Frost	Aim	Placing	£24.0m / £5.9m	TBC	Kosher food products
Marketingfile	Aim	Placing	TBC / TBC	TBC	Mailing lists
Personal Screening	Aim	Placing	TBC / TBC	TBC	Self-test medical kits
Erebus	Aim	Placing	TBC / TBC	TBC	Mining activities
St James's Mining	Aim	Placing	TBC / £3.0m	TBC	Mining investments
Nardina Resources	Aim	Placing	TBC / £3.0m	TBC	Metals and minerals investments

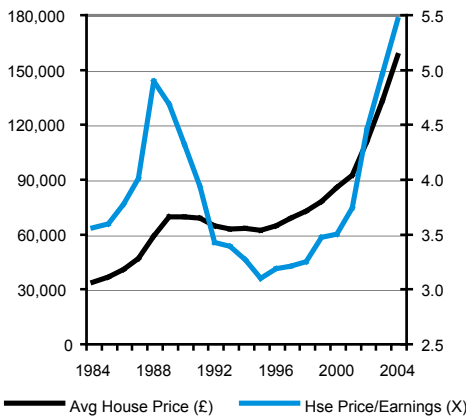
Sector in Focus

UK residential property

The latest data for UK housing shows that the “worst” may be over. The Halifax index of all prices showed a 5.7% YoY rise to November 2005 (latest data). The increase was the highest since April 2004 and, unsurprisingly, came after the first rate cut of this cycle. The index now stands at its highest level and has more than doubled during the “noughties”.

The immediate question is the extent to which such gains are sustainable. If not, there are profound implications for domestic demand through both the “wealth effect” and direct spending via equity release schemes. If it is sustainable then the effect on consumer demand should at least be neutral. In this brief article we attempt to throw some light on this crucial debate – not least for the housebuilders.

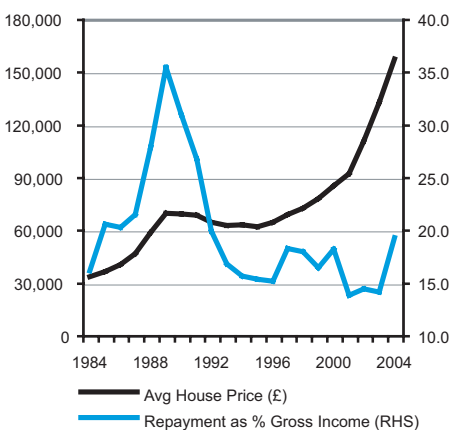
Rising house prices v. earnings



Much has been written on the affordability of housing as prices have risen. The chart to the left shows the scale of the apparent problem between 1984 and 2002.

House prices have risen considerably faster than average earnings and the multiple between the two now stands at an eye-watering 5.5x. On this basis there seems little opportunity to believe in sustainability of current house price trends. But we believe that the measure is misleading.

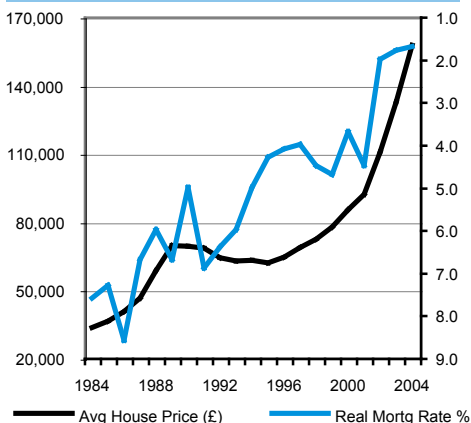
Mortgage repayments v. gross income



Looked at in terms of cashflow the situation is not so vertiginous. The monthly mortgage repayments as a percentage of gross household income are little more than they were in the early/ mid-1990s. At below 20% the ratio is way below the 35% extremes of the late 1980s – the onset of the deep recession in housing and elsewhere.

That of course reflects the intervening drop in real mortgage rates as shown in the next chart. If anything the chart suggests that the price trend in housing should have been more smoothly upwards through the second half of the 1990s.

Falling real mortgage rate



The picture which emerges is at the heart of the policy dilemma for the MPC. If you want to avoid a property price collapse, keep rates low – especially those at the shorter end of the yield curve.

But the data do not of themselves suggest any opportunity for further rampant price gains. The best of the dis-inflationary effects on falling interest rates are largely history and moves from here are likely only to be modest in comparison. That would leave house price growth driven increasingly by income growth – healthy if unspectacular.

UK House builders

		Price (p)	Mkt Cap (£m)	PER	52 Week Range
Barratt	BDEV	988.5	2,368.0	8.89	560.00 - 1,060.50
Bellway	BWY	1,157.0	1,289.0	8.93	750.00 - 1,156.00
Ben Bailey	BBC	466.0	53.3	4.64	342.00 - 516.50
Berkeley	BKG	1,087.0	1,306.0	8.45	760.00 - 1,138.00
Bovis	BVS	785.5	923.9	9.12	551.338 - 804.50
Crest Nicholson	CRST	455.0	506.6	9.39	350.00 - 475.50
McCarthy & Stone	MCTY	675.5	701.1	6.79	510.50 - 709.00
Persimmon	PSN	1,279.0	3,677.0	11.58	629.52 - 1,321.00
Raven Mount	RAV	76.0	80.8	n/a	57.00 - 85.00
Redrow	RDW	519.0	819.0	9.49	337.00 - 541.00
Telford Homes	TEF	167.0	49.4	8.99	133.00 - 170.00
Westbury	WBY	558.0	636.3	7.69	409.00 - 566.50
Wilson Bowden	WLB	1,460.0	1,368.0	7.75	1,037.00 - 1,492.00
Average				7.8	

However to the affordability picture can be added something for demand. Total housing completions have fallen in the UK from peaks of over 600,000 annually in the mid/ late 1960s to an estimated 250,000 in 2005 (Source: Office of the Deputy Prime Minister, ODPM). Of those totals Social Housing has fallen from over 250,000 to about 25,000. Private sector housing has remained fairly static at around 200,000 since the early 1990s.

The government commissioned the Barker Review to examine the UK housing market in general with a view to informing policy on how to solve the problems of supply shortage and rising prices. Barker suggested that to achieve a real rate of increase in average house prices of only 1.8% per annum, then a total of 70,000 additional homes each year would have to be built. To get the real price increase down to 1.1% (the EU average) would require an additional 120,00 private homes to be built annually – an increase of more than 50% over recent levels.

Two features become abundantly clear; that somewhere below 5% nominal growth in house prices is deemed likely and sustainable in official circles; and that to achieve that would require up to a 50% increase in private sector housebuilding annually. Such activity levels have not been seen since the building boom of the 1960s.

UK housebuilder Wimpey's "expected" profits warning at the start of this year may simply have been a reflection of the 2005 uncertainties over interest rates. The outlook from here appears brighter than for some time.

Company Survey

From the Model

The Objective Capital model works to identify possible examples of mispriced stocks at both ends of the scale. We try to identify: stocks that have been unduly beaten down by mildly adverse corporate developments; those whose price action may not have fully reflected positive developments; and those whose price may be well ahead of the performance justified by good news, or slow to discount the bad.

In this section of the company comments we attempt to isolate those stocks that fall towards the extreme ends of the distribution of the model's results. We then look in more detail – in a formalised way – at the reasons for their being priced as they are. Considerations for selecting the companies to highlight are standard valuation criteria including PSR, prospective PE relative to earnings growth, ROE, price to cash flow, prospective yield and margins.

We also particularly filter stocks for analyst coverage, preferring those stocks that rank as lower risk and where analyst coverage is thin or non-existent, on the basis that it is here that the scope for mispricing is greatest.

We then select the best three or four stocks on these criteria as a distillation of the model's results for this month. Where appropriate we provide information on broker forecasts and recommendations, using consensus numbers and recommendations where possible. We leave readers to judge how appropriate these recommendations may be.

How do we “watch” the whole market?

In such a large and diverse group of stocks as the small and mid-cap segment, every investor needs a way of directing their research effort. Because the key to any company is the quality of its management, we focus on an objective assessment of what the market currently pays for the management's ability and scope to improve the value of their company.

Using consensus estimates we can approximate what investors believe they are paying for management's “value add”. Changes in this level tell us when the market's view on the management or its situation has changed – and on which company's our attention needs to be focused.

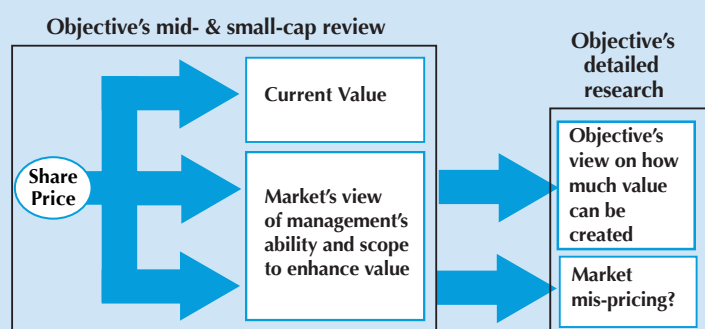
Our detailed company research answers the question of whether the change is justified or if what the market currently pays misses the real value management can add.

Not a recommendation – but a relative pricing tool

We aim to help our readers navigate the mid- and small-cap segment. Our screening tool is based on the same rigorous framework of risk and return that our detailed objective research uses.

When tracked over time, this model allows us to derive the market's expectation of the increase in value of business on a risk and interest rate adjusted basis. At a glance analysts or investors can see which stocks or sectors are relatively cheap or expensive. We provide the results of our screening tool as a service to our readers.

For more information on the detailed methodology of our screening tool or the interpretation of its results please contact us at +44 (0)870 080 2965.



What we are measuring ...

Management's Ability and Scope:

- to extract lasting improvements in asset and operating efficiency
- to enhance value through synergies from acquisitions, etc
- to enhance value through barriers to entry
- changes in the environment (e.g., de-regulation)
- the value of timing differences between capex and depreciation, tax and other mis-matches

This Month's Companies to Watch

Name (EPIC): CSS Stellar (CSS)

Sector: Media and Entertainment

Basic business: Sports management, representation, events and marketing. The company represents a number of sports stars, actors, writers and TV presenters, including Juan Pablo Montoya, Keira Knightly, Sir Bobby Robson, Nick Hornby, Michael Parkinson, Anne Robinson, and Piers Morgan. In the events area, the company's subsidiary Icon is responsible for signage at major sporting venues and conferences. The group has a range of other activities, including subsidiaries in North America, but attempts are being made to focus on and expand the more successful parts of the group. Some disposals of peripheral activities have already been made.

Reason for potential mispricing: Muted response to significant stake-building by an aggressive 'active value' investor. At the beginning of December, Acquisitor Holdings had a shareholding in the group of some 15.8%. It currently stands at 27.5%. Acquisitor is an active value investor, with a commitment to the generation of shareholder value in its target companies.

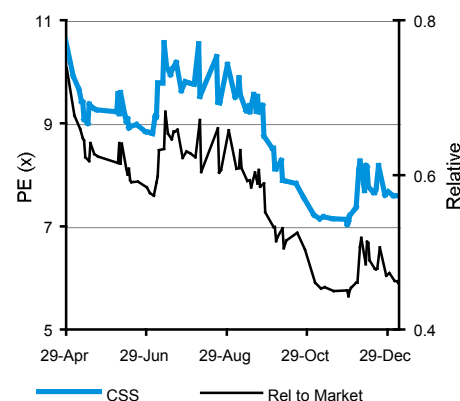
Value criteria: On the basis of the company's broker's expectations for the year just ended, CSS should generate pre-tax profits of £1.42m, versus a loss of some £560,000 in 2004. The company's market capitalisation is currently about 20% of sales and the shares stand on a near historic price earnings ratio of around 10 times, falling to about eight times for the 2006 year.

Analyst coverage: The company's broker, Bridgewell Securities, is the only firm publishing forecasts on the group.

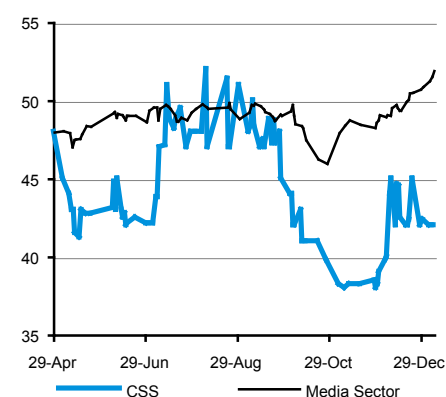
More information: www.css-stellar.com; www.acquisitorholdings.com

Next results: Finals – mid-March

CSS PE & PE relative



CSS v. Media sector



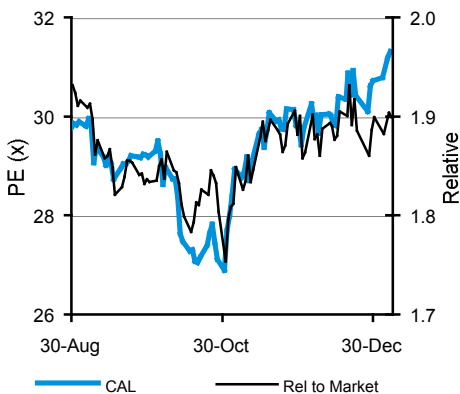
Name (EPIC): Capital & Regional (CAL)

Sector: Real estate

Basic business: Property investment, development and management, largely through investments that are jointly owned with large institutional investors, but managed by C&R and in which it has a minority shareholding.

Reason for potential mispricing: Price movement following latest declaration of property valuations appears overly modest relative to potential for the group in light of the introduction of REITs later this year. The company operates through three investment funds in which it has minority interests. The Mall Fund (26% owned) has investments in out of town shopping centres (currently over 20 properties), Junction Fund (27% owned) which operates more than a dozen major retail parks, and X-Leisure fund, which operates and owns leisure properties, in which the company has around an 11% interest. The recent announcement suggests that these three funds respectively had shown increases in value in the first 11 months of 2005 of 10.8%, 20.8% and 20.0% after allowance had been made for the gearing inherent in the funds.

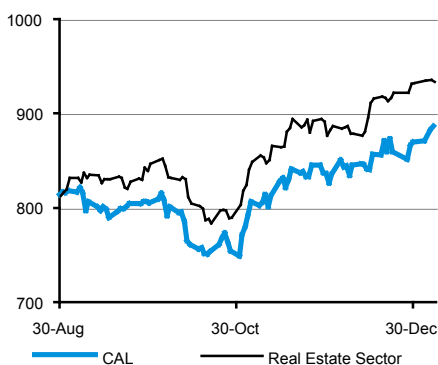
CAL PE & PE relative



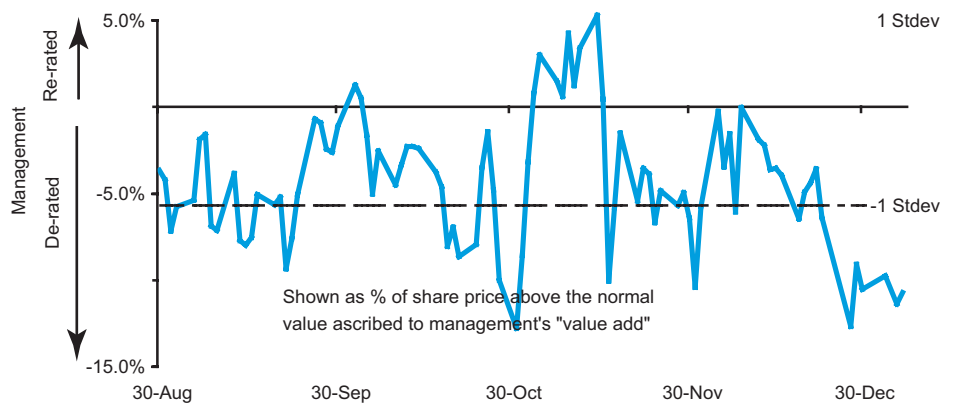
Value criteria: Forecasts of NAV for the year to December 2005 range from 825p per share to 894p, and for 2006 from 916p to 1015p, the lowest figure in each case being from the company broker. On a consensus number of 863p and 1002p, the company's shares are broadly in line with NAV for the year just ended, but at a 13% discount for expected 2006 NAV.

Conversion to a REIT, with the possibility of paying out almost all of earnings as dividends, would lead to a payout about 2.5 times the current one, implying a yield in the region of 5% on the current price and expected earnings for 2005.

CAL v. Real estate sector



Portion of CAL share price attributed to "management value add"



There have been instances of comparable companies being taken out at a significant premium to NAV. British Land bought Pillar Property for a 10% premium to NAV in May of 2005, and Capital & Regional is regarded by analysts as a company of comparable quality.

Analyst coverage: Four analysts provide coverage of the company, including UBS, Oriel Securities, Arbuthnot Securities, and Merrill Lynch.

More information: www.capreg.com

Next results: Finals – mid-March

Name (EPIC): Superscape (SPS)

Sector: Software & computer services

Basic business: With its origins in a company developing virtual reality products, Superscape is now involved in 2D and 3D games to be played on mobile phones. As of 31 October 2005 the group have 22 2D titles and 17 3D titles in the market place versus seven and six respectively at the end of January 2005. Shifting development and porting to low-cost areas abroad, notably Moscow, is containing costs. The company has good relationships with many mobile phone network operators and the market is considered a growing one.

Reason for potential mispricing: Muted response to an encouraging trading statement. The trading update for the third quarter suggested that revenues were increasing rapidly with sales of close to £900,000 booked in the third quarter, 143% up on Q2 and comparing to £188,000 booked in the same period of the prior year. Full year sales for last year to January 2005 were £4.1m, suggesting that the current quarter is the crucial one for sales growth and profitability.

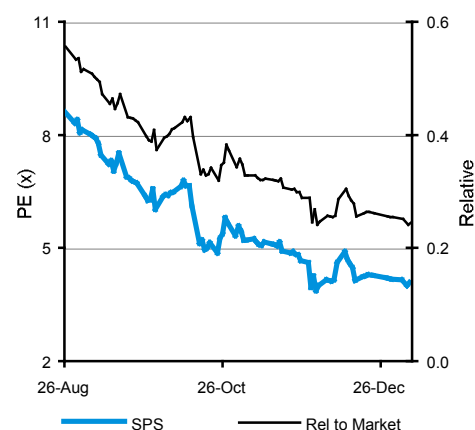
Value criteria: Superscape has had a long history of losing money (losses last year exceeded turnover). Investors can be forgiven for scepticism, but the company could now be turning the corner. The company sells at 4.4 times tangible book value and around 7.4 times trailing 12 months sales.

Analyst coverage: According to REFS, Evolution Securities, the company's broker, publishes research on the company, but no forecasts were available at the time of writing.

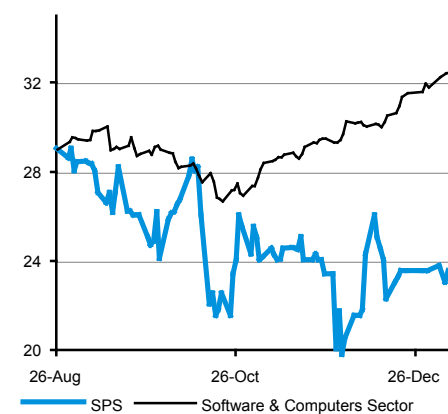
More information: www.superscape.com

Next results: Finals – mid-April

SPS PE & PE relative



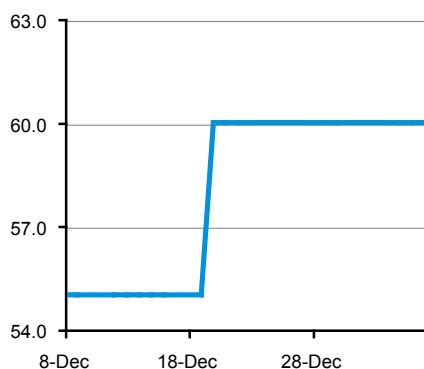
SPS v. Software & computer sector



Newcomer of the Month

This section analyses a recently listed company from a more qualitative standpoint. Futures issues of Objective's Small & Mid-Cap Review will comment periodically on the progress of these companies

CHD - price since listing



Price (p)	60
Quote	AIM
Ticker	CHD
Hi-Lo since listing (p)	60 - 50
Shares issued (m)	44.4
Market Cap'n (£m)	26.6
Issue price (p)	50
Net Proceeds (£m)	n/a

Advisers and brokers: Insinger de Beaufort

Charalambides Dairies (CHD)

Listed at 50p on 29th November, the stock traded at a modest premium almost immediately. The nominated adviser and broker is Insinger de Beaufort.

The company is a Cyprus based liquid milk processing and distribution company, first established as a business in 1945 and subsequently assuming a corporate entity in 1968. Following EU liberalisation of milk in 2002, the company sought a strategic partner, finding it in Delta Group, a leading Greek food group. After the advent of Delta as a major shareholder (it will still have 54.9% following the listing on AIM) the group successfully increased its market share in milk distribution to around 50%. The company has also expanded into chilled and frozen products, primarily sourced through an importation agreement with Delta, which now accounts for around a fifth of revenues.

The company's main branded products are milk, cream and butter under the Charalambides brand, and yoghurt and chilled desserts, fruit juices, cheese, ice cream, frozen foods, and frozen pastry under Delta-owned brand names.

The company has given its strategic objectives as being to participate in the consolidation of the currently fragmented Cyprus dairy products market for which EU health and safety legislation is likely to be a catalyst, to add additional Greek and international brands to its product range, and to improve its exposure in the catering trade in Cyprus. There are a number of areas where there is scope to increase market share substantially. In yoghurt, for example, the company has a negligible market share, whereas its market share in yoghurt based desserts is close to 30%. There is also scope to expand the market in chilled fruit juices, whereas long life concentrate products currently dominate the Cyprus market.

The company showed growth in turnover between 2002 and 2004 from C£16m to C£22.3m with EBITDA rising from C£0.94m to C£2.02m over the same period and pre-tax from C£0.4m to C£1.1m. Trading in the half year to June 2005 showed turnover up by around 10%, and EBITDA ahead by 44%. On a last 12 months basis, after tax profit is C£1.1m equating to around 3p per share in sterling terms.

At 60p this puts the shares on an historic PER of around 20 times. Further growth is likely to have occurred in the second half year. Gearing is modest and there is substantial asset backing from property plant and equipment, with little credit taken in the balance sheet for the value of brand names and customer and supplier networks.

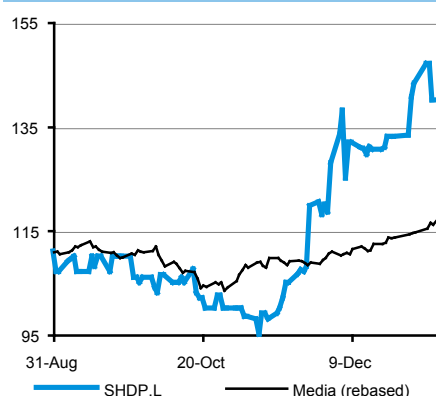
Press speculation on future flotations

Company	Market	Type	Mkt Cap/Amnt Raised	Period	Description
African Arabian Petroleum	Main	Placing	£600.0m / TBC	2006	Oil business
Argent Energy	Aim	Placing	TBC / £35.0m	2006	Renewable energy
CMC Group	Main	Placing	£750.0m / TBC	2006	Online spread-betting
Endemol	Main	Placing	£2,000.0m / TBC	2006	TV production company
Euclidian	TBA		£125.0m / TBC	2006	Fully integrated insurance group
Go Lower	Aim	Placing	TBC / TBC	2006	Health snacks
Hogg Robinson	Main	Placing	£700.0m / TBC	2006	Business travel
Match Day Media	Aim	Placing	TBC / £10.0m	2006	Stadium advertising
Merlin Petroleum	Aim	Placing	£7.8m / £6.0m	2006	Australian oil explorer
Pendragon Medical Technology	Aim	Placing	£68.0m / TBC	2006	Glucose monitoring device maker
QinetiQ	Main	Placing	£1,100.0m / TBC	2006	Defence research company
The Capital Pub Company	Aim	Placing	£20.0m / £10.0m	2006	Traditional pubs
Vue Entertainment	Main	Placing	£400.0m / TBC	2006	Cinema operator
Aberdeen Property Investors	Main		£150.0m / TBC	TBC	Property investment
ACG Holdings	Aim	Public Offer	£1.2m / TBC	TBC	Security software developer
Affinitas Financing	Aim	Placing	£6.0m / £1.0m	TBC	Financial Services
Altin	Main	Placing	£50.0m / TBC	TBC	Hedge fund investment
Altodigital	Main		£400.0m / TBC	TBC	Internet services
Amtico	TBA	Placing	£150.0m / £20.0m	TBC	Floor tiles specialist
Apex Platinum	Aim	Placing	£20.0m / £5.0m	TBC	Platinum exploration
Arakis	Aim	Placing	£100.0m / £25.0m	TBC	Drug development company
Betfair	Main	Placing	£700.0m / TBC	TBC	Online betting
Bio-Oz	Aim	Placing	£60.0m / £25.0m	TBC	Biotechnology
British Mediterranean Airways	TBA		£50.0m / TBC	TBC	British Airline
CLC Group	Aim	Placing	£40.0m / TBC	TBC	Housing maintenance
Cox & Kings	Main		£30.0m / TBC	TBC	Upmarket holiday operator
Crown Dilmun	Main		£150.0m / TBC	TBC	Upmarket housebuilder
CST Medical	Aim	Placing	£6.0m / TBC	TBC	Treatment of female sexual dysfunction
Dunelm	Main		£300.0m / TBC	TBC	Bedding and curtain retailer
Elateral	Main	Placing	£90.0m / £30.0m	TBC	Software developer
Fat Face	TBA		£60.0m / TBC	TBC	Ski and surf leisurewear
Fertility Medical Equipment	Aim	Placing	TBC / £10.0m	TBC	Producer of medical devices
Flybe	TBA		TBC / TBC	TBC	British regional airline
GasForce	Main		TBC / TBC	TBC	British Gas service arm
GoldQuest Mining Corp.	TBA	Placing	TBC / £1.0m	TBC	Gold expl. in the Dominican Republic
IAC Group	Aim	Placing	£40.0m / £15.0m	TBC	TV finance and development company
Intellipower	Aim	Placing	TBC / TBC	TBC	Energy conservation consultancy
Intersolar Group	Aim	Placing	£45.0m / £18.0m	TBC	UK solar technology company
IntroNet	Main		TBC / TBC	TBC	Edinburgh software company
Jackpotjoy.com	Aim	Placing	£100.0m / TBC	TBC	Internet bingo
Jaegar	TBA		TBC / TBC	TBC	Clothing retailer
Kazkommertsbank	TBA		TBC / TBC	TBC	Kazakhstan's largest bank
Links	TBA		£40.0m / TBC	TBC	Jewellery chain
Mango DSP	Aim	Placing	£16.4m / £2.0m	TBC	Israeli technology firm
Michelago	Aim	Placing	TBC / £20.0m	TBC	Australian gold miner
Ministry of Sound	Main		£100.0m / TBC	TBC	Dance club and leisure brand
Mloop	Aim	Placing	£20.0m / TBC	TBC	Online phone exchange
Motor World	Aim	Placing	£80.0m / TBC	TBC	Car accessories retailer
Oxford Natural Products	Aim		£100.0m / TBC	TBC	Natural pharmaceuticals firm
Proquote	Main	Placing	£50.0m / £5.0m	TBC	Internet-broking information service
Pubmaster Group	Main		TBC / TBC	TBC	Pub operator
Resourceworks	Aim	Placing	TBC / TBC	TBC	Corporate finance boutique
Rose Bowl	Aim	Public Offer	£7.5m / £5.0m	TBC	Sport and entertainment centre operator
Sporting Options	Aim	Placing	£15.0m / £5.0m	TBC	Online betting exchange
SSA Global	Main	Placing	£1,650.0m / TBC	TBC	Business Software Company
Sual	Main		£2,000.0m / TBC	TBC	Russian aluminium producer
Trucost	Main		£100.0m / £5.0m	TBC	Company rating service
Unicorn Entertainment	Main	Placing	£100.0m / TBC	TBC	Management company
United Biscuits	Main		TBC / TBC	TBC	Snack food manufacturer
Virgin Blue	Main		£520.0m / TBC	TBC	Australian airline
Xchanging	Main		£1,000.0m / TBC	TBC	Support-services group
Zeus Technology	Main	Placing	£150.0m / £15.0m	TBC	Internet software

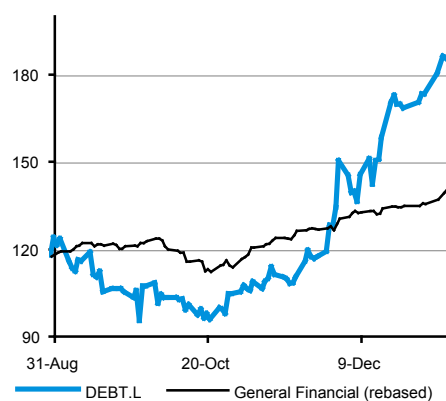
Companies in the News

The following comments relate to other companies highlighted by the model, and those that we have highlighted in previous issues, where news has emerged in the past month or so.

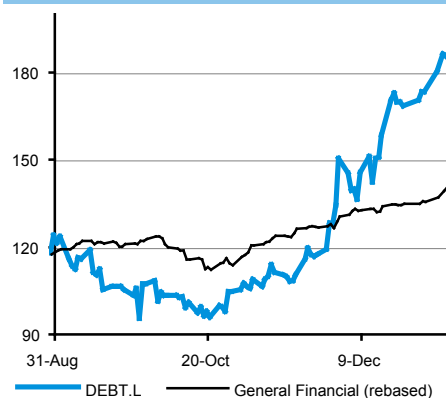
SHDP v. Media (rebased)



HFD v. General retailers (rebased)



DEBT v. General finance (rebased)



Shed Productions (SHDP)

ITV's *Footballers Wives* and *Bad Girls* have proved profitable for Shed, the independent company behind their production. Pre-tax profit was up 63% at £5.2m before flotation costs, compared with £3.2m in 2004. Both programmes are to be shown in the USA as well as being recommissioned by ITV.

The company has received its first primetime commission from the BBC - good news as it has relied almost exclusively until now on ITV. Shed is in a strong position over its rivals as its costs are significantly less. It charges £600,000 an hour compared with the £1m per hour average charged by many rival companies.

Some 44 hours of programming were delivered this past year compared with 25 hours in the previous year. There are more productions presently in funded development than ever before.

Shed has also just announced a major acquisition in the shape of Ricochet Ltd., a producer of factual and reality TV programming. The consideration of £25m is to be satisfied through £7.5m of cash, £10m through a share placing at around 101p, and the remainder through the issue of loan notes. The principals behind the development of Ricochet will be joining Shed's board. The company's programmes include *Supernanny*, *Risking it all*, *How not to decorate* and many others.

More information: www.shedproductions.com

Halfords (HFD)

The company appears to be impervious to the doom and gloom that has affected the rest of the retail sector. First half pre-tax profit grew 20.6% to £40.4m compared to £33.5m for the first half of 2004. This was due in the main to cheap Far East supplies and stringent cost controls. Like-for-like sales were up 4.1%, or 2.6% if the busy Easter period is excluded.

Unlike other retailers, Halfords does not have to rely on Christmas spending, as motorists' essentials such as de-icers and fan-belts are always in demand. In-car technology remains the biggest growth area and this month sees the launch of in-car audio systems which connect to MP3 players. Around 150 new stores are planned, with continued expansion in Ireland as well as in the UK.

More information: www.halfords.co.uk

Debtmatters (DEBT)

The company, which helps debtors restructure out-of-control borrowing by arranging legal agreements for repayment between creditors and debtors, has reported its first results since floating on AIM in June.

Pre-tax profit was up 530% to £818,000, compared with £130,000 for the same period in 2004. Revenues were £2.44m compared with £740,000 in 2004. Cash reserves currently stand at £1m with (appropriately) no debt.

Some 129 Individual Voluntary Arrangements (IVAs) were processed in April 2005, a figure which rose to 230 by September, an increase of 78%. Two more Insolvency Practitioners have been recruited to cope with demand. The core business remains IVAs. But the acquisition, since the float, of Unique Business Finance will enable the company to undertake a broader range of insolvency activities. New strategic alliances are in the pipeline, with one in the SE already proving fruitful.

More information: www.debtmatters.co.uk

Fountains (FNT)

Pre-tax profit for the year was £927,000, compared with £1.44m the previous year. The fall in profit was blamed on a drop in sales. These stood at £35.2m compared with £36.1m for 2004.

Results from the company, which provides a range of environmental services such as vegetation management in the UK and USA, were in line with expectations. Fountains had warned in the summer that figures would be adversely affected after a delay in the receipt of significant railway-related work. The company was also hit by a short-term increase in costs relating to a major electrical utility vegetation management contract.

The board admitted that the results were disappointing and said that it is to take firm action to restore profitability to a more satisfactory level. To address these issues a new management structure is now in place, together with improvements in the business processes. The order book is up, including approximately £28m for the current year. The group continues to seek out acquisitions, with a number of suitable businesses under consideration.

More information: www.fountainsplc.com

PayPoint (PAY)

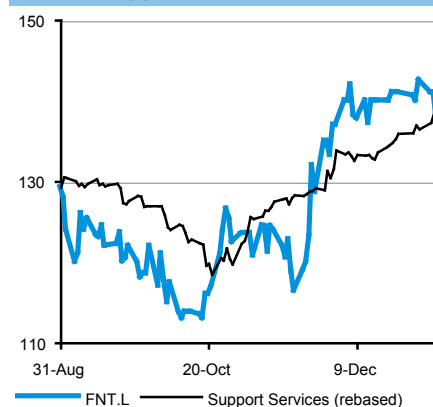
First half pre-tax profits were better than expected at £8.4m compared to £300,000 for the first half of last year. The company, which operates more than 14,000 pay terminals in shops for cash payment of utility and other bills as well as pre-payments for mobile phones, has benefited from the closure of many branch post offices where bills were previously paid. The total number of transactions rose by 23% to 138.7m over the course of the year, with a value of £1.6bn.

The group is optimistic for future growth, and has a target of 15,000 terminal sites to be operational by the end of the current financial year. The product range continues to increase with contracts to sell bus tickets being signed with companies such as First York and Blackpool-based Metro Coastlines. Paypoint terminals can also be used to pay the London Congestion Charge.

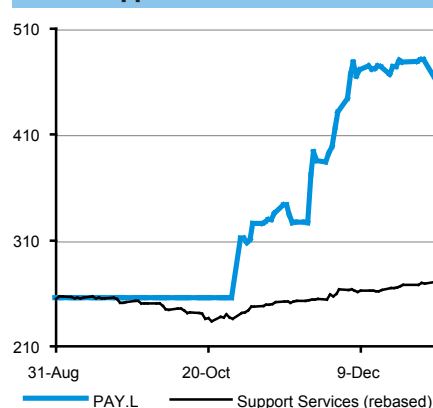
The company has also announced that it is to start offering international money transfer services in partnership with Western Union and expects that at least 1,000 outlets will be offering this service within a few years.

More information: www.paypoint.co.uk

FNT v. Support services (rebased)



PAY v. Support services (rebased)



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Recent flotation data

Company	Market	Type	Mkt Cap/Amnt Raised	Issue Date
ACP Capital	Aim	Placing	£64.2m / £50.0m	06-Jan-2006
Ekay	Aim	Placing	£8.0m / £0.1m	05-Jan-2006
Stratex International	Aim	Placing	£6.9m / £1.9m	04-Jan-2006
Appian Technology	Aim	Placing	£5.6m / £2.1m	04-Jan-2006
NextGen	Aim	Placing	£20.9m / £2.4m	30-Dec-2005
Rusina Mining	Aim	Introduction	£12.8m / n/a	30-Dec-2005
Allied Healthcare International	Aim	Introduction	£162.6m / n/a	30-Dec-2005
Nasstar	Aim	Placing	£2.7m / £0.2m	29-Dec-2005
The Ottoman Fund	Aim	Placing	£150.0m / £150.0m	28-Dec-2005
Venue Solutions	Aim	Placing	£7.4m / £0.3m	23-Dec-2005
Reconstruction Capital II Ltd	Aim	Placing	€ 24.4m / € 24.4m	23-Dec-2005
Irvine Energy	Aim	Placing	£6.0m / £3.0m	23-Dec-2005
India Capital Growth Fund	Aim	Placing	£75.0m / £75.0m	22-Dec-2005
CMR Fuel Cells	Aim	Placing	£35.7m / £10.3m	22-Dec-2005
London Capital Group	Aim	Placing	£31.4m / £15.0m	22-Dec-2005
China Real Estate Opp.	Aim	Placing	£23.0m / £23.0m	22-Dec-2005
Networx	Aim	Placing	£11.1m / £10.0m	21-Dec-2005
Gas Turbine Efficiency	Aim	Placing	£13.1m / £5.4m	21-Dec-2005
MWB Business Exchange	Aim	Placing	£55.3m / £15.0m	21-Dec-2005
Pan Pacific Aggregates	Aim	Placing	£50.8m / £2.5m	16-Dec-2005
Cartucho Group	Aim	Placing	£18.0m / £10.0m	16-Dec-2005
GVM Metals	Aim	Introduction	£3.0m / n/a	16-Dec-2005
UniVision Engineering	Aim	Placing	£9.4m / £1.5m	16-Dec-2005
Minmet	Aim	Introduction	£17.2m / n/a	16-Dec-2005
Zirax	Aim	Placing	£25.9m / £7.8m	16-Dec-2005
Drax	Main	Introduction	£2,034.6m / n/a	15-Dec-2005
China Education Group	Ofex	Public Offer	£18.5m / £0.8m	15-Dec-2005
Engel East Europe	Aim	Placing	£94.8m / £30.0m	15-Dec-2005
The Value Catalyst Fund	Aim	Introduction	£111.8m / n/a	15-Dec-2005
@UK	Aim	Placing	£22.5m / £8.0m	14-Dec-2005
Carluccio's	Aim	Placing	£53.6m / £26.5m	14-Dec-2005
EcoSecurities	Aim	Placing	£134.0m / £54.0m	14-Dec-2005
CardioMag Imaging	Aim	Placing	£29.0m / £5.3m	14-Dec-2005
Advanced Smartcard Tech.	Aim	Placing	£5.9m / £0.8m	14-Dec-2005
Equest Balkan Properties	Aim	Placing	£140.0m / £140.0m	14-Dec-2005

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