

## Welcome to Objective's Small & Mid-Cap Review

The cautious tone we have been setting for equities in recent editions appears to have been justified. The FTSE All-World index recorded a 7% gain in the last 3 months but that was driven by the emerging markets. Most of the major western markets registered desultory returns for the third quarter and are below recent peaks as the fourth quarter gets underway. Recent declines in the oil price and the occasional flurry of takeover activity (real or imagined) make the performance the more unsatisfactory.

We see little change in outlook for the fourth quarter. Economies are slowing down, corporate margins appear to have little room to expand (beyond the impact of any sustained drop in the oil price), US interest rates are likely to rise further, albeit modestly, and inflationary signals will remain as ambiguous to interpret as the sayings of the oracle of Delphi.

The culprit of course has been the oil price. For as long as the oil price remains high it will have policy makers scratching their heads over interest rates. Should they go up further if key inflation indicators rise further despite the all too evident signs of blood in the malls in the run-up to Christmas?

That uncertainty is likely in our opinion to result in "dull" rate cycles from here but with that dull equity markets in general. However we expect coming months to see another area of possible interest developing. Regulatory, demographic and technological changes are, in our opinion, coming together to prompt a revolution in the origination and delivery of entertainment content in the UK. We explore those prospects in the Sector Focus of this edition.

Andy Hartwill  
Research Director

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### Overview – busy watching paint dry

The cautious tone we have been setting for equities in recent editions appears to have been justified. The FTSE All-World index recorded a 7% gain in the last 3 months but that was driven by the emerging markets. Most of the major western markets registered desultory returns for the third quarter and are below recent peaks as the fourth quarter gets underway. Recent declines in the oil price and the occasional flurry of takeover activity (real or imagined) make the performance the more unsatisfactory.

We see little change in outlook for the fourth quarter. Economies are slowing down, corporate margins appear to have little room to expand (beyond the impact of any sustained drop in the oil price), US interest rates are likely to rise further, albeit modestly, and inflationary signals will remain as ambiguous to interpret as the sayings of the oracle of Delphi.

At the sector level, the Resources sector was the unsurprising leader among the global sectors although Basic Industries and Cyclical Consumer Goods managed a modest outperformance. But investors should beware any conclusion that somehow global equity markets have been in, or may be entering, a classical cyclical phase. Yield curves remain modestly sloped to flat at best offering no clear signal towards a re-accelerating expansionary phase in the next twelve months.

Indeed Cyclical Services recorded one of the worst performances globally, dragged down by the beleaguered retailers and their debt-laden customers. Without them any cyclical rally is unlikely to be sustained – as the French and German markets discovered to their cost in the expansion out of the early 1990s recession. Domestic demand did not pick up for some five years after the first signs of growth emerged with the industrial cyclicals in 1992/ 93.

We have written before of one of the problem areas: corporate profitability recently appears not to have responded as positively as in previous phases of growth. At the time we used the USA by way of example. As we write the UK has just published data for corporate profitability in the second quarter and the message appears to be similar.

The UK's Office of National Statistics uses ROCE as its preferred indicator. On that basis UK profitability rose modestly to 13.7% in Q2 after 13.3% in Q1. But strip away the almost 34% (31%) recorded by the Oil and Gas sector and the picture is less flattering. Both the Service and Manufacturing sector components were stuck around the same levels as in the previous four years at almost 17% and 8% respectively. Indeed those levels are similar to or below the levels of the late 1980s!

So much for the unprecedented period of expansion in the UK economy. This evidence lends support to critics of the miracle who suggest that the growth here

#### About Objective Capital:

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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.

has been driven by the growth only in public sector spending – and that looks like coming to a rather abrupt end if the IMF and European Commission have their way.

Of course the “glass half full” interpretation is that the situation is no worse despite the hikes in the oil price and could improve for the Service and Manufacturing sectors if the oil price were substantially and sustainably to ease in the coming quarters. But there appear to be few signs of that so far.

For as long as the oil price remains high it will have policy makers scratching their heads over interest rates. Should they go up further if key inflation indicators rise further despite the all too evident signs of blood in the malls in the run-up to Christmas?

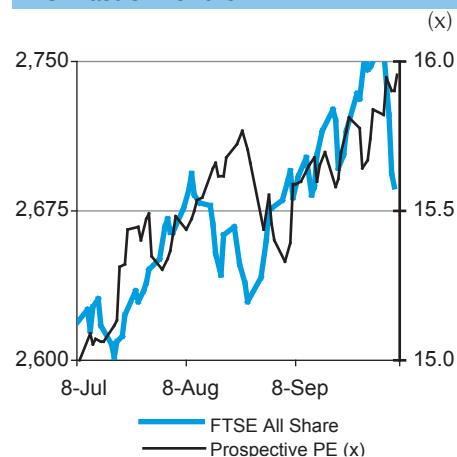
Whatever the reality of inflationary threats to economic stability currently, the fear of it is stalking now a global stage – and with it global markets. A recent study by SG Securities suggested that fully 75% of news articles on inflation talk about a worsening outlook, a pick up of 7 percentage points in just the last two months. That increase has coincided with a widening in the spread between yields on conventional bonds and on inflation-linked securities. The gap now is close to its widest level for over five years. In other words markets appear to expect that the pick-up in inflation will be persistent over several years.

Of course the culprit is surging energy prices which have pushed up the headline rate of US inflation. In the third quarter, headline inflation may rise by as much as 6%. But strip out the energy prices and a very different picture emerges. Core inflation, which excludes energy and food, remains subdued and, for supervised workers (representing 80% of the workforce) US hourly wages are increasing at exactly the same pace as a year ago – around 2.5% nominal.

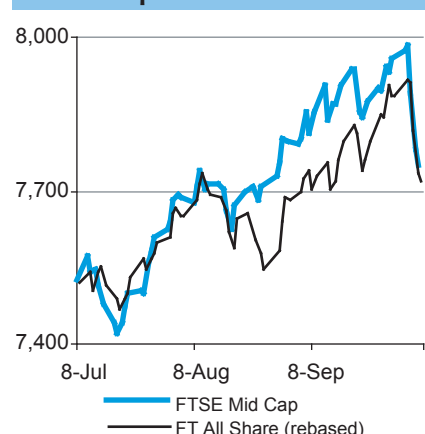
We suspect that the conundrum for policy makers will result in a period of only cautious change: modest further increases in the USA, delayed cuts elsewhere. And for equity markets that suggests to us another period of dull performance outside special situations.

Those special situations contributed to the hotspots of performance during Q2. Elections in Germany and Japan brought hopes of further progress towards economic reforms. And of course the oil price drove the Energy sector. We expect coming months to see another area of possible interest developing. Regulatory, demographic and technological changes are, in our opinion, coming together to prompt a revolution in the origination and delivery of entertainment content in the UK. We explore those prospects in the following sections. For the rest of the markets we are going back to check if the paint is dry yet.

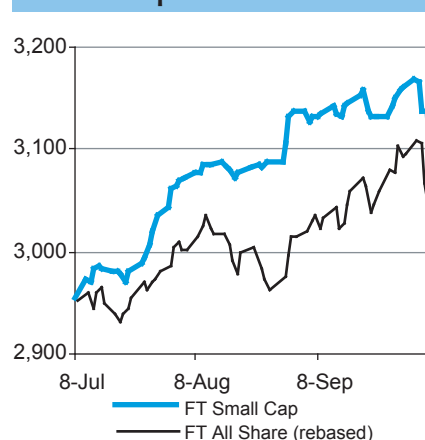
### FTSE last 3 months



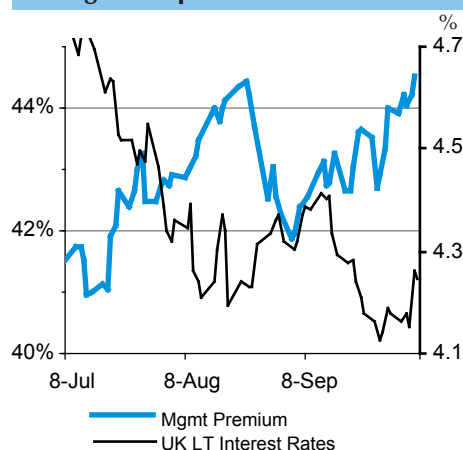
### FT Mid Cap last 3 months



### FT Small Cap last 3 months

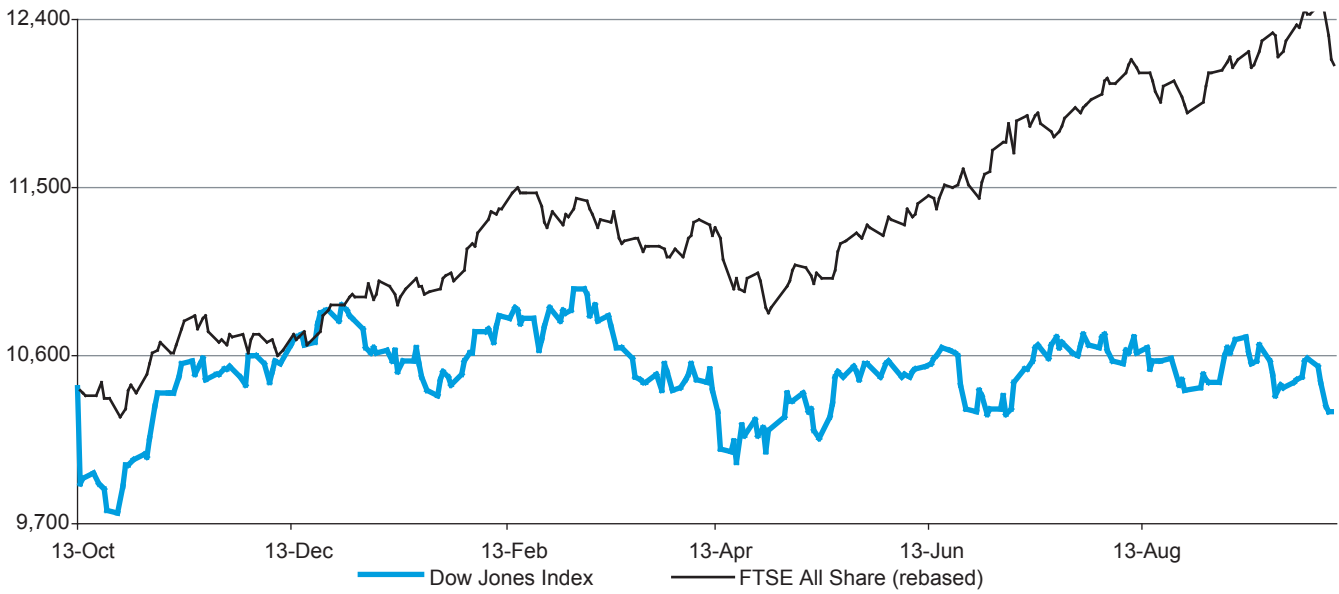


### Management premium in the FTSE<sup>1</sup>

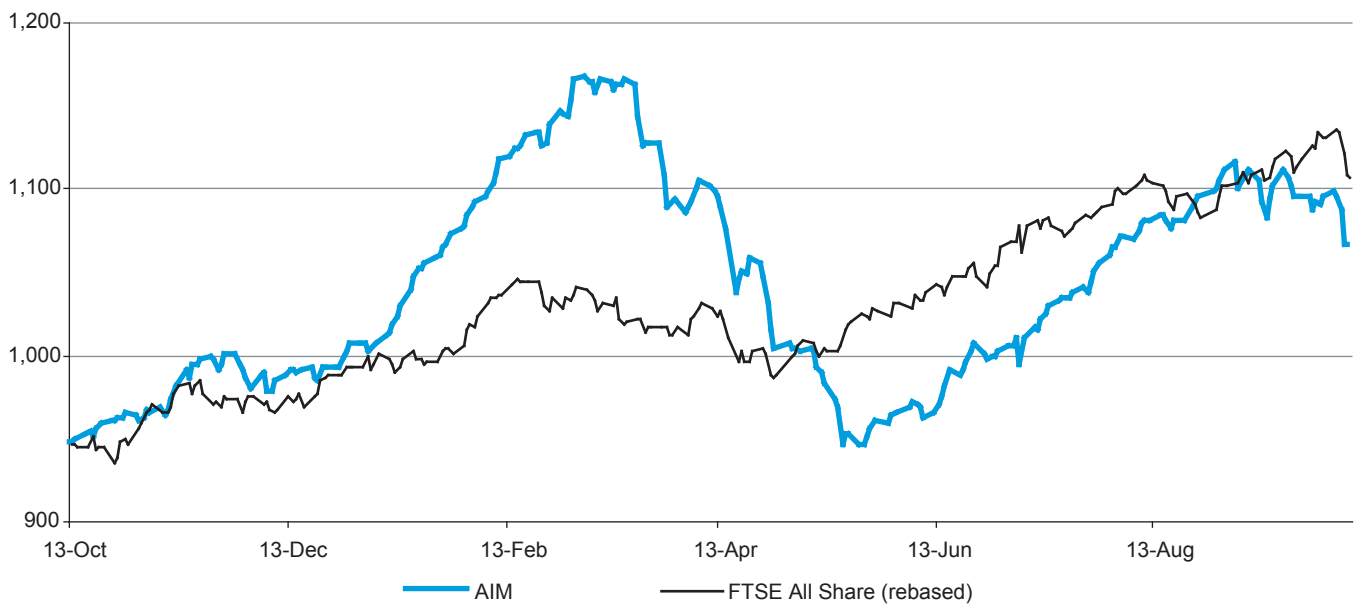


<sup>1</sup> management premium is the % of the FTSE that the market is paying for the “value” management is expected to generate. See page 11 for details.

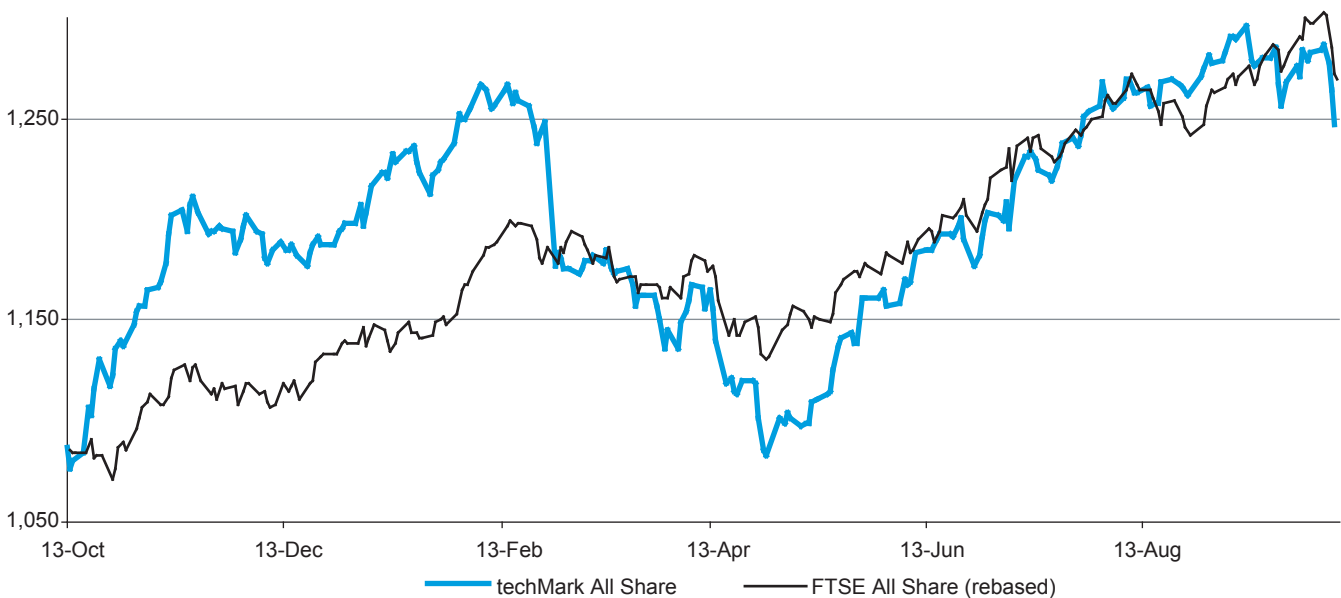
### FTSE v. Dow Jones, 12-mth



### 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
Euphony	TBA	Introduction	TBC / n/a	2006	Telecom services
Betcorp	Aim	Placing	£20.0m / TBC	2005/06	Internet gambling
Eyebright	Aim	Placing	£11.5m / £5.0m	2005	Elective day surgery
Radiancy	Main	Placing	£65.0m / £30.0m	2005	Cosmetic treatment company
Isle of Man Int.l Broadcstng.	Aim	Placing	£75.0m / £13.0m	2005	Radio broadcaster
IVT Wireless Technology	Aim	Placing	TBC / £2.0m	2005	Bluetooth products
Plasma Warehouse Group	Aim	Public Offer	£2.0m / TBC	2005	Specialist audio visual systems
Mandarin Merchant Capital	Aim	Placing	£22.2m / £22.1m	04-Nov-2005	Investment company
SPI Lasers	Aim	Placing	£35.0m / £12.0m	Oct / Nov	Fibre lasers
All African Resources	Aim	Placing	TBC / £0.8m	31-Oct-2005	Mineral exploration
Uranco	Aim	Placing	£300.0m / £150.0m	October	Uranium miner
Xceldiam	Aim	Placing	£30.0m / £10.0m	October	Diamond exploration
Gemfields Resources	Aim	Placing	£65.0m / £15.0m	October	Zambian gems
Leyshon Resources	Aim	Placing	TBC / TBC	26-Oct-2005	Chinese resource ventures
Advent Air	Aim	Placing	TBC / £1.7m	17-Oct-2005	Airline operator
Diablo Group	Aim	Placing	£3.3m / £1.0m	14-Oct-2005	Record label
Union Resources	Aim	Introduction	TBC / n/a	14-Oct-2005	Zinc, lead and silver exploration
DIC Entertainment	Aim	Placing	TBC / TBC	13-Oct-2005	Animator
Driver Group	Aim	Placing	£16.9m / £2.0m	13-Oct-2005	Dispute resolution services
CareTech	Aim	Placing	£60.0m / £11.3m	12-Oct-2005	Learning disability care services
Ex Libris	Aim	Placing	£60.0m / £20.0m	12-Oct-2005	Library software
Neptune Minerals	Aim	Placing	£14.4m / £9.3m	10-Oct-2005	Deep sea mineral exploration
Ashingo	Aim	Placing / Offer	TBC / TBC	TBC	Digital media advertising
Carlton Clubs	Aim	Placing	£40.0m / TBC	TBC	Bingo club owner
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
Anzon Energy	Aim	Introduction	TBC / n/a	TBC	Oil and gas
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 Corporation	Aim	Placing	TBC / £13.9m	TBC	Airport development
Max Petroleum	Aim	Placing	TBC / TBC	TBC	Oil explorer
Glennstars Investments	Aim	Placing	TBC / TBC	TBC	Investment company
Energy XXI Acquisition Corp	Aim	Placing	TBC / TBC	TBC	Oil and gas acquisitions
Celoxica Holdings	Aim	Placing	TBC / TBC	TBC	Software
Amiad Filtration Systems	Aim	Placing	£35.0m / £10.0m	TBC	Water filtration

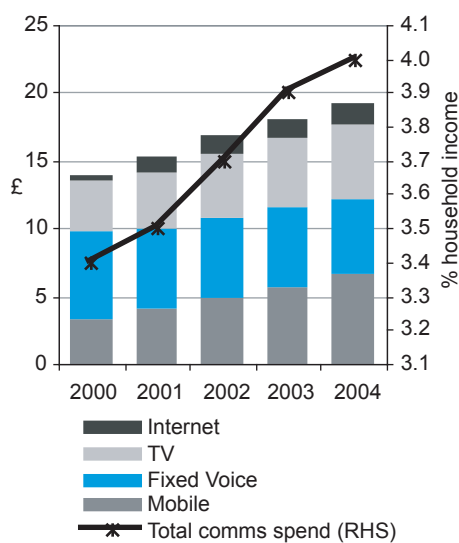
## Sector in Focus

### The changing face of UK broadcast entertainment.

In the beginning was the word. And the word was BBC. In fact it was the sound of Duke Ellington in August 1936 which heralded the dawn of public service broadcasting (PSB) in the UK. Since that first transmission the number of national terrestrial channels (with PSB obligations) has risen to five, satellite channels have proliferated and digital TV is due to replace all analogue TV by the end of the decade. Add to that the arrival of broadband services and advances in mobile technology and it is not hard to understand the revolution underway in the opportunities for "content delivery".

With those opportunities however come significant challenges for programme makers, broadcasters and other distributors of content. In the UK, the Communications Act of 2003 established OFCOM as the single regulatory body with responsibility to determine and implement changes in the regulatory framework governing the industry. In July 2005 it published "The Ofcom Broadcast Code" following extensive consultation. In addition the BBC Charter Review is underway. The combination will bring significant change to the shape of the broadcast industry in general and to the origination of content in particular. It is the latter on which we wish briefly to focus this month.

#### Avg. weekly household com. spend



Source: OFCOM

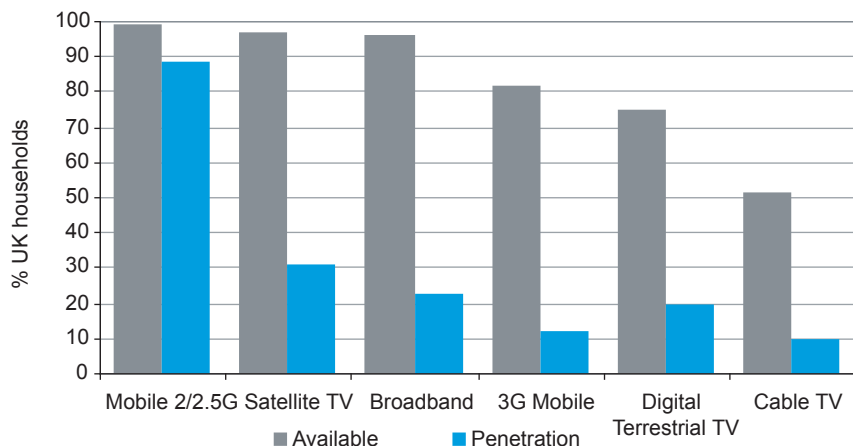
### The shifting dynamics of demand and delivery.

UK households have been accelerating their spend on communication services in recent years. The growth in demand for all communication services, including TV, rose to some 4% of household income in 2004 – roughly a 20% increase since 2000. Over the same period, gross disposable income rose by some 19%. In other words the annualised growth in spend on all communications was, we estimate, almost 9% taking the annual total to some £20bn. We expect recent data to confirm the trend albeit at a slower rate.

While the growth in and size of total spend is impressive, of at least equal importance is the changing composition of that spend. The chart to the left shows that the proportion of household income spent on Internet and Mobile services grew at 41% and 18% pa respectively over the same period. Spend on TV averaged 10% and the loser was fixed line telephony, shrinking at 3% pa. We believe that the acceleration in growth for such services is likely to continue, not least given the still relatively low penetration rates.

The availability of digital services in general is already high throughout the UK. Digital TV availability and penetration will trend towards 100% between now and 2012 as the UK broadcast system switches over to purely digital transmission. Penetration otherwise, with the exception of mobile 2G/ 2.5G, remain low reflecting, for the most part, the relative youth of the technologies. We expect penetration rates to increase generally as the technologies advance and prices ease.

## Digital service adoption (Q1 2005)



The obvious exception is Satellite TV where penetration rates appear to have hit something of a ceiling at around 30% over the last three years. That number may be considered low and vulnerable given the time that the service has been available. It is significant in our opinion that SKY has recently joined the “free to air” offerings of digital TV, albeit that it may view the development as an opportunity to migrate subscribers onto its full service.

The three charts to the right provide details of the recent growth in what we believe to be the most critical components of the communications revolution.

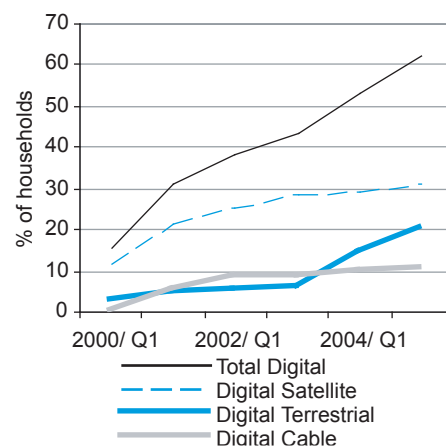
The rapid rise in the penetration of digital TV was driven initially by Satellite and Cable systems. Since 2003 however the acceleration has come principally from Digital Terrestrial TV (“Freeview”). In the future we expect digital TV over broadband to become a more significant component in the mix.

Latest data shows that Broadband has overtaken Narrowband (dial-up) in the number of UK internet subscriptions. As bandwidth expands and costs fall further we expect Broadband to represent the driving force behind increasing internet.

The chart shows the growth in retail revenues – probably the most reliable indicator of industry prospects given the already high availability and penetration rates (see above). Mobile telephony overtook Fixed revenues in 2003 and, again, we expect that pattern to continue. After a halting start we also expect growth in 3G services.

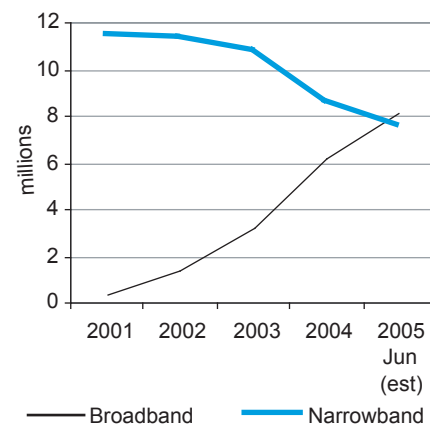
This evidence suggests to us that demand for communication services is set to track at least the growth in household incomes. More likely will be inclusion of a substitution multiplier as consumers choose these media for the delivery of their entertainment and lifestyle choices in preference to more traditional methods – such as going to the theatre/ cinema. Anecdotal evidence suggests that the combination of high speed broadband and 3G mobile telephony, where available, has

## Digital TV household penetration



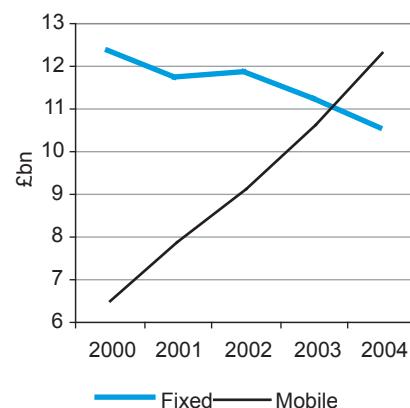
Source: OFCOM

## UK Internet subscriptions



Source: OFCOM

## UK telecoms industry retail revenues



Source: OFCOM

already “spoiled” the box office takings of at least one major film release. Such challenges are only going to increase and lead to changes in the shape of content origination, as well as the distribution mechanisms we have discussed here.

### **The changing shape of content origination**

The main thrust of regulatory changes, for the purposes of this article, is the acceleration of the trend away from in-house production by the broadcasters and towards independent production.

OFCOM has estimated that the major UK TV channels spent a total of £4.7bn on programming (content) in 2004. Of that, some £3bn was spent on Commissions (productions, whether in-house or by independents). Both numbers have grown annually by around 3% since 1999. Within the numbers there has been a shift to network production (+3% annually) i.e., for national broadcast, as opposed to regional production (down 4% annually).

Perhaps of most interest for the independent (“indie”) sector is the total budget for and growth of “first run originations” (new productions). The major UK TV channels spent some £2.6bn on such in 2004 (OFCOM est), a budget which has grown at some 4% annually over the last five years. But over the same period the growth rates for BBC digital and other “multi-channel” spend was 40% and 18% respectively. Another reflection of the response to new technologies.

The real prize for the indie sector however lies in the split currently between internal and external commissions. Across the major UK channels “indie” productions accounted for 42% of 2004 originations spend (OFCOM est). But that conceals major imbalances between the channels. Channels 4 and 5 and the multi-channels (excluding the BBC) devote 100% of their budget to the indies – as required by their charters. However they represents only some 28% of the total (about £750m, OC estimates).

By far the greatest opportunity for indies lies in expanding the proportion of external commissions at BBC1, BBC2, ITV1 and BBC digital. In 2004 indies represented less than 30% of the production budgets of these majors who, between them, spent almost £2bn on original productions with less than one third going to external commissions. Many observers expect that proportion to rise as the recently published OFCOM Broadcasting Code takes increasing effect and directly with the conclusion of the BBC Charter Review. One possible growth scenario for the indy sector revenues is shown in the table on the next page. Note that this is not a forecast.

We have used approximate numbers for the 2004 breakdowns and applied the 1999/ 2004 CAGRs for the period 2004/ 2010. The exception is BBC “multi” (ie digital) where we believe that historic growth rates are unlikely to obtain. On those illustrations, revenues to the “indie” sector could rise to £2.5bn in 2010 (CAGR of 11%) driven by the increasing penetration of indies into BBC1/ BB2, ITV1 and BBC multi.

The final feature of note which characterises the “indie” sector is the high degree of fragmentation. In a recent survey of the sector, OFCOM had responses from almost 160 production houses around the UK. Of those, and unsurprisingly, the majority by number were inside the M25 and represented some 85% of reported turnover for the “indie” sector. Of much greater interest is the dispersal in size. Of the 160 respondents only 3 had production turnover in excess of £50 and 13 had over £20m. Fully 110 had turnover of less than £4m.

As with other industries, it seems to us reasonable to anticipate a consolidation, if only as protection against the chill winds blowing from the East. After all if Hollywood blockbusters can be streamed to cell-phones in Korea, why not the next production of Jane Eyre?

### How to play the “indie” game?

So far we believe that we have demonstrated the significant opportunities for the “indie” sector. They arise from a combination of technological and regulatory change. Those changes in turn are intimately associated with the changing demographics of UK society, in particular the way we use our increasingly pressured leisure time.

In our opinion the opportunities for investors fall broadly into two areas, the growth in demand possible consolidation of a heavily fragmented sector: We have compiled a list (see over) of companies currently listed on the LSE and which are active in different aspects of the business space. They range from indies through the generators/ facilitators of mobile content to suppliers of software to the broadcast industry. We have also included those with ownership of intellectual property (libraries of titles) as one of the ingredients to the mix. And we have included speciality investment companies targeting TV and film production as a potential proxy for the activity we anticipate. That activity should also include new listings at various levels of the LSE as private companies seek new sources of funding to stay in the game. We have excluded companies with market caps over £200m and most fall below £20m.

### Poss. growth scenario for indie sector

£m	2004	CAGR	2010
	1999/ 04		
<b>100% penetration</b>			
Ch4	390	1	414.0
Five	120	2	135.1
S4C	110	0	110.0
Multi-ch (ex BBC)	130	18	350.9
	750	5%	1010
<b>BBC1</b>			
Total £m	780	4	987
Pen'n %	25		50
Indie £m	195	17%	493.5
<b>BBC2</b>			
Total £m	350	4	443
Pen'n %	25		50
Indie £m	87.5	17%	221.4
<b>ITV1</b>			
Total £m	780	0	780
Pen'n %	27		50
Indie £m	210.6	11%	390.0
<b>BBC multi</b>			
Total £m	280	20	836
Pen'n %	27		50
Indie £m	75.6	33%	418.0
<b>Indie totals</b>			
Already 100%	750	5%	1,010.1
Exp'g pen'n	568.7	18%	1,522.9
	1318.7	11%	2,533.0

Source: Object Capital estimates

## LSE-listed companies operating in entertainment content provision market

Principal business area	Company	Code	Recent Price (p)	Mkt cap (£m)	Comment
<b>Intellectual Property Ownership/ Exploitation</b>	Apac Media	APA	0.9	7.6	Creation/ distribution/ exploitation of intellectual property. Planning expansion in Central and Eastern Europe.
	Entertnmnt. Rights	ERT	28.25	117	Properties incl. Postman Pat & Basil Brush. Has animation studio.
	Content Film	CFL	3.4	5	Stopped production. Focus on film/TV sales, exploitation of library
	Maverick Ent.	MVK	0.4	1.6	Specialises in children's IPR. Properties include Muffin the Mule
<b>Indie Film/ TV production/ distribution</b>	Pinewood-Shepperton	PWS	157	72	Based on UK film studios.
	Television Corp	TCP	65	27	Productions include Question Time and Channel5 football. Children's drama series soon to screen on CBBC
	Talent Group	TTV	20	3	Productions include Test The Nation - BBC quiz show.
	Coolabi	COO	4	2	Formerly Alibi Communications. Productions include "The Safe House" and "The Inspector Banks Mysteries".
	Elcom	EIC	0.7	2.8	Previously the Einstein Group. Science and Technology channel in Germany/ Switzerland.
	Metrodome	MRM	3.6	2.6	Productions include Death of Richard Nixon; My Little Pony
	Parallel Media Grp	PAM	3.25	1.4	Specialises in golf tournaments. Provides golf coverage for CNBC
	Seven Arts	SVA	15	2	Own label video distribution. Recent results "disappointing".
	Tinopolis	TIN	51.5	12.8	Productions for S4C, the Welsh version of Channel4.
	TV Commerce	TVC	5.25	3.4	Provides two Sky channels including The Advert Channel. Moving into mobile content.
	Chorion	COR	341.5	87	IPR-based programming. Properties include Noddy, Mr Men, Agatha Christie and Raymond Chandler.
	RDF Media	RDF	159.5	55.3	Productions include Wife Swap and Holiday Showdown
	Ten Alps	TAL	48	21	Factual TV productions. Formed from ex-Planet 24 personnel. Reliance on Bob Geldof <2% turnover.
	Digital Classics	DTC	0.7	6	Web-distributor of opera/ ballet (Online classics.com). Also has production company, Iambic
Optimistic Ent.	OEP	77.5	21.7	Participation TV	
Yoomedia	YOO	8	37.7	Interactive TV and mobile content. Sony Pictures has 10% stake .	
<b>Mobile Content</b>	Monsternob	MOB	395	193	Mobile content. Chairman = Hans Snook (ex Orange)
	Cellcast TV	CLTV	71.5	20.3	Interactive mobile content
<b>Investment Co's</b>	Motive Television	MTV	2.5	1.6	Focus on TV production and licensing businesses. WKS holds significant stake. Significant share deals recently
	Works Media Grp	WKS	6.75	2.9	Finance, sale and distribution of feature films
	Intandem Films	IFM	3.5	2.9	Film finance in partnership with bodies such as Number9 Films, Channel 4 Films, Irish Film Board
	Investinmedia	IVM	94	15.3	Investments are in Complete Communication (products include Who Wants to be a Millionaire and MEM)
<b>Software and Services</b>	Pilat Media Global	PGB	43	21.7	Supplies business management software to broadcasters. Recent US\$15m contract with Fox
	Bango	BGO	195	51	Provides technology and services to companies developing/ selling mobile content. Recent contract with Sun Microsystems.

## International Ferro Metals (IFL)

Listed at 35p on 30th September, IFL is currently trading at around its issue price. The company was set up in 2002 to acquire and expand chromite mining and manufacturing at the Buffelsfontein mine in South Africa. Following a positive feasibility study, existing mine infrastructure is to be expanded and an integrated ferrochrome production facility built on the site to enable production of commercial qualities of the metal to be produced for export to world market. Ferrochrome is a key ingredient in the production of stainless steel.

The £75m raised from the placing together with an additional £19m equity investment from the Chinese steel producer Jisco (a key customer) and debt of £79m is to be applied largely to mine expansion and to the construction of the new plant. The company has committed itself to use best endeavours to commence the work within the next three months. The first commercial production of ferrochrome is likely to begin in about 21 months time, with full production reached nine to 12 months thereafter. Construction is largely on the basis of fixed price contracts. The design of the project allows for cost effective further expansion as and when necessary.

Expected production at a rate of around 267,000 tonnes per year implies a reserve life for the mine of 19 years. However the company has an option to purchase an 80% interest in a neighbouring property that has substantial additional reserves. It is also possible that the group may be able to purchase raw material produced as a waste product from nearby platinum mines, which would further extend the life of the project. Production at the indicated rate represents around a 6% share of South African output.

Extraction and production costs at the site are among the lowest in South Africa due to the integrated nature of production and modern design. The output is high quality, and South Africa accounts for 77% of this type of ferrochrome. South Africa, because of its dominant position in the market, has tended to be the price-setter for the product. It has a competitive advantage because of the presence of sizeable ore reserves, its lead in mining technology, low power costs and historically, a relatively soft currency.

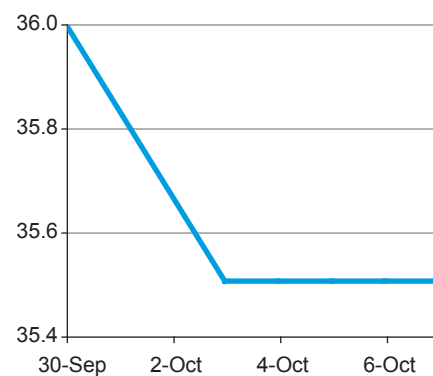
Demand for ferrochrome is expected to grow at around 4-5% pa over the long term. The main consumers for the product are in the US and Asia, specifically China and India. Outside of South Africa, the main producers, all much smaller in scale, are in various parts of the former Soviet Union, Scandinavia, Brazil and India.

Cash flow projections contained in the listing document suggest a conservatively calculated NPV for the project would be Rnd3.13bn based on a discount rate of 12%. This equates to £272m at current exchange rates.

## 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*

### IFL - price since listing



Price (p)	35.5
Quote	AIM
Ticker	IFL
Hi-Lo since listing (p)	36.0 - 35.5
Shares issued (m)	410.3
Market Cap'n (£m)	145.7
Issue price (p)	35
Net Proceeds (£m)	75.4
Advisors & brokers:	Grant Thornton; Numis

## 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.

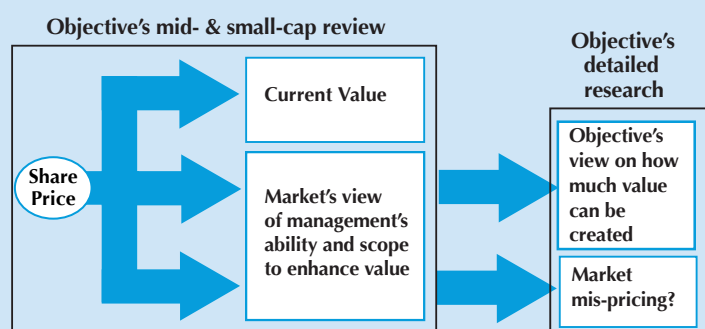
Our detailed company research answers the question of whether the change is justified or if what the market currently pays misses the real value management can add.

### 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):** Albemarle & Bond (ABM)

**Sector:** Speciality and other finance

**Basic business:** The company is a pawnbroker. It has some 62 retail outlets nationwide and also extends third party cheque cashing facilities and conducts unsecured lending (typically payday advances). It also operates as a jewellery retailer, selling both new items and unredeemed pledges. The company is 29% owned by EZ Corp International, a US company in the same line of business. Non-pawnbroking businesses now account for about half of turnover.

**Reason for potential mispricing: Significant price appreciation following recent marginally disappointing results.** Albemarle recently reported results for the year to June 2005. These showed pre-tax up by 13% and earnings per share up by 16%. The share price has risen by more than 20% in the past month despite results that appear to have been slightly below market expectations. Prior to the results, the only broker with forecasts published on the group was expecting pre-tax of £5.75m, compared to the actual outturn of £5.66m.

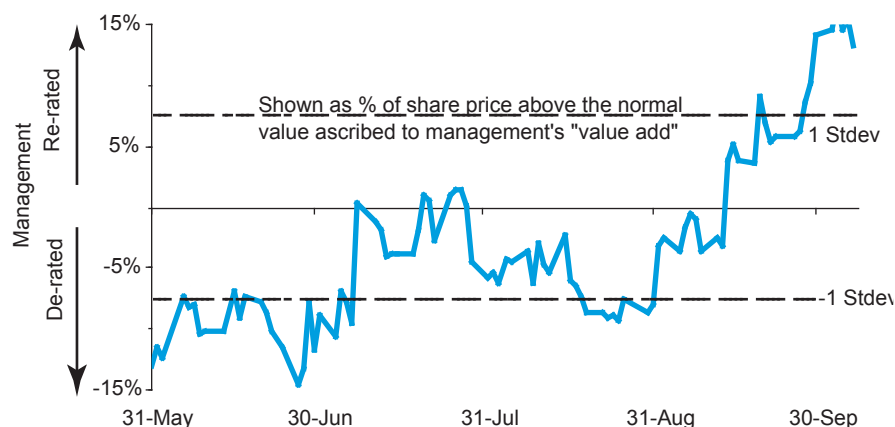
**Value criteria:** ABM stands on a PER of just under 16 times 2006 earnings, based on (fractionally reduced) forecasts issued after the results. Growth had already been expected to moderate somewhat in the current year and in 2007. Return on equity is a respectable 20% but, though a solid cash generator, the company's price to free cash flow ratio is around 35.

**Analyst coverage:** Two firms publish forecasts on the group. These are Seymour Pierce and the company brokers, Collins Stewart.

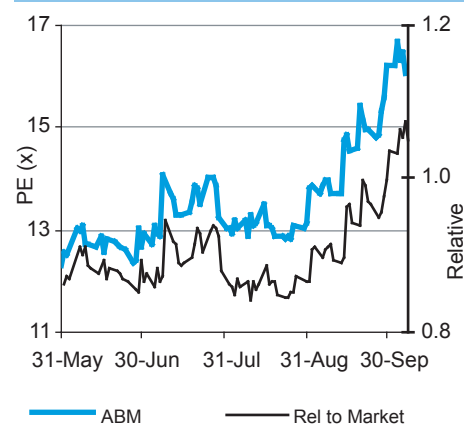
**More information:** [www.albemarlebond.com](http://www.albemarlebond.com)

**Next results:** Interim – early February

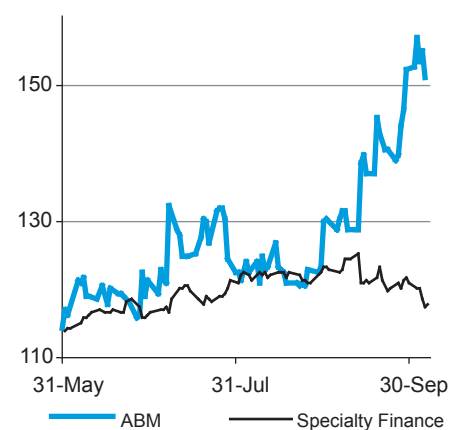
### Portion of ABM share price attributed to "management value add"



### ABM PE & PE relative



### ABM v. Specialty finance sector



**Name (EPIC): The Television Corporation (TCP)**

**Sector:** Media & entertainment

**Basic business:** Creation, production and distribution of TV programmes and video material, and the provision of television editing. A business in outside broadcasting has recently been sold. The group combines several programme-making businesses such as Mentorn, which among other programmes produces 'Unreported World' and BBC's 'Question Time', Sunset & Vine and VTV, leaders in sports programming, and Music Box, which produces music and children's programmes.

**Reason for potential mispricing: Share price edging down despite sharply reduced H1 losses.** The company instituted major management changes earlier in the year, with Peter Salmon joining the company as CEO and the former chief executive Jeffrey Foulser becoming director of sport. Since then the company has announced sharply reduced first half losses of £233,000 versus £831,000 last time. Pre-tax losses were £208,000 versus £1.15m while turnover rose from £17.4m to £22m.

The company has also announced major new commissions and a high level of activity across all areas, including the recent attraction to the group of two highly respected programme-makers from the BBC. The company has also been commissioned by the BBC to produce a major new children's series for CBBC. Despite this positive news, the share price has been lacklustre. This may be attributed to the comment at the time of the results to the effect that the market remains highly competitive and that margins on some one-off programmes are low.

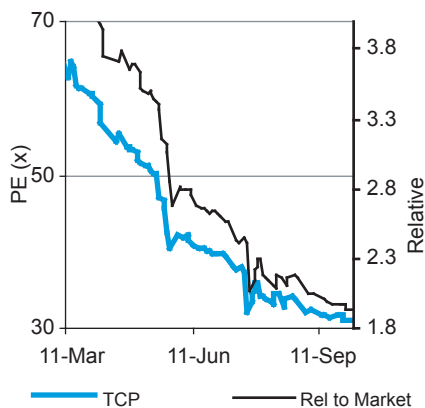
**Value criteria:** Forecasts suggest profits of around £800,000 for the year as a whole, producing EPS of 1.3p. On a price of 65p this makes the PER around 50 times. However, forecasts suggest earnings per share in excess of 2p in calendar 2006, with Baird, the company broker, forecasting as high as 2.94p per share in a note in late July. Return on equity is in single digits. The company sells on around 15 times historic cash flow.

**Analyst coverage:** Four firms research the company. These are Baird, the company broker, Rowan Dartington, Bridgewell and Panmure Gordon.

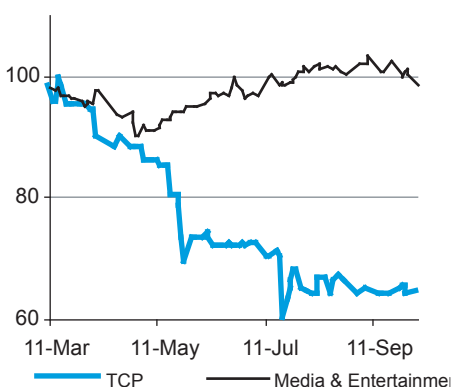
**More information:** [www.tvcorp.co.uk](http://www.tvcorp.co.uk)

**Next results:** Final – mid March

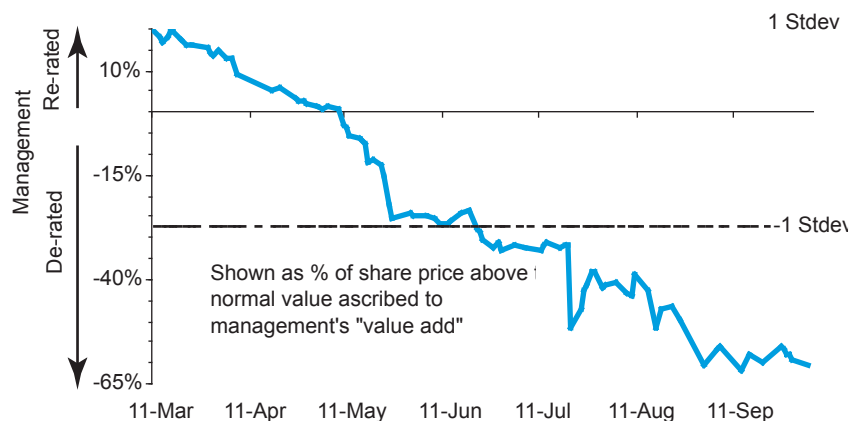
#### TCP PE & PE relative



#### TCP v. Media & entertainment sector



#### Portion of TCP share price attributed to "management value add"



**Name (EPIC):** Wellington Underwriting (WUN)

**Sector:** Insurance

**Basic business:** Insurance underwriting at Lloyds. The company manages Syndicate 2020 at Lloyds and owns a US-based insurance business. It undertakes UK and European property and cargo insurance and property and accident and health reinsurance in the USA.

**Reason for potential mispricing: Buoyant share price despite higher than anticipated Katrina losses.** The shares have risen by some 7.7% over the past month. Interim results were announced on September 6. These showed profits up 78%, a combined ratio of 82%, a return on equity in excess of 30%, and a 40% increase in the interim dividend. However, the company also revised up its estimate of potential losses as a result of Hurricane Katrina, now put at \$75m and comparable to the losses sustained for the same reason in 2004.

The positive spin on this event is that it will continue to lead to better pricing of risks in the market, and therefore benefit future profits, as indeed has been demonstrated this year. Nonetheless, profits do appear set to fall sharply in 2006. Broker forecasts since the results show a slightly reduced consensus pre-tax forecast for 2006, and appreciably reduced earnings forecasts, presumably because of a likely higher than anticipated tax charge.

**Value criteria:** The stock is currently on a PER of eight times for calendar 2005 rising to around 12 times those expected for calendar 2006. Wellington currently yields close to 4% and in excess of 4% on a prospective basis. The dividend is expected to be covered around 3.2 times in the current year.

**Analyst coverage:** Seven firms cover the stock, including ABN Amro. ABN Amro Hoare Govett is the company broker.

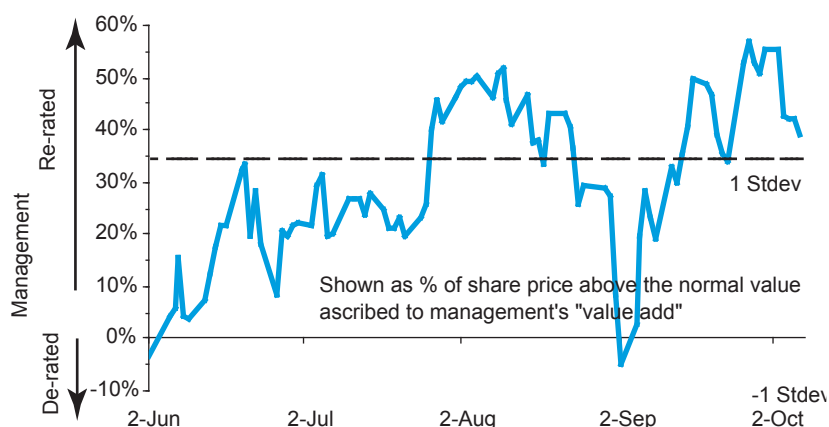
**More information:** [www.wellington.co.uk](http://www.wellington.co.uk)

**Next results:** Final – early March

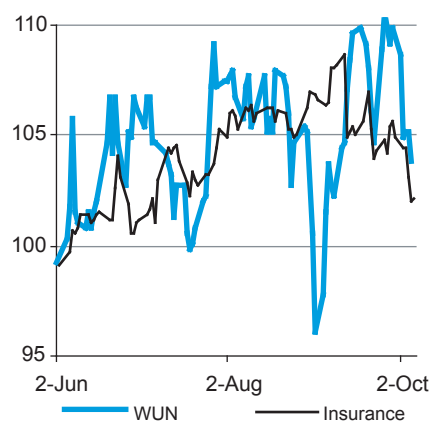
WUN PE & PE relative



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



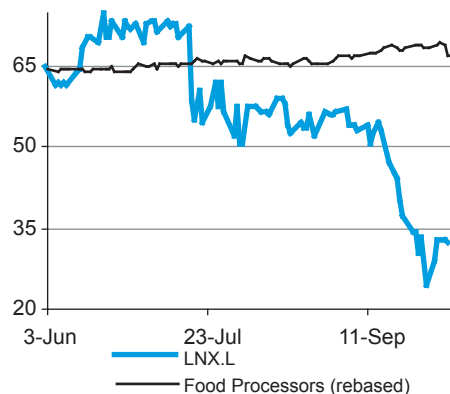
WUN v. Insurance xector



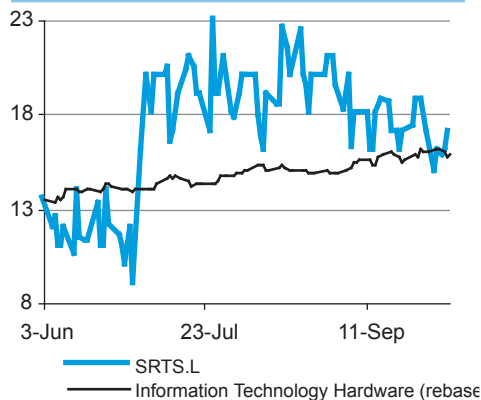
## Companies in the News

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.

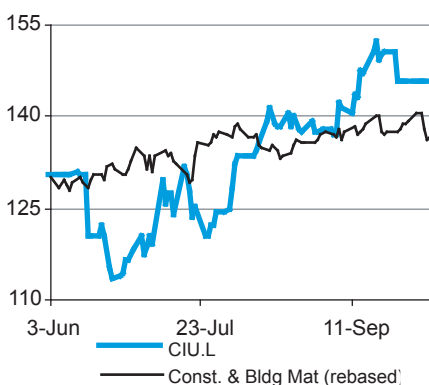
### LNx v. Food Processors (rebased)



### SRTS v. Info. Tech. Hardware (rebased)



### CIU v. Const. & Bldg Maint. (rebased)



### Lennox Holdings (LNx)

Interim results from the company, which began trading on AIM in December 2004, showed a pre-tax profit of £93,000 on revenues of £5m. This was lower than expected due to increased overheads and an increase in the cost of sales.

The company, which distributes branded and own label British food and drink products to Spain and Portugal for the tourist and ex-pat markets, has seen a change of directors. At the AGM in July shareholders voted to remove Peter Voller and Laurie Grove from the board, blaming a clash of management styles.

The plan to open a new UK distribution centre in Folkestone has been dropped as the current system of transporting goods directly from the suppliers' warehouses is considered more viable.

Future plans include expanding Lennox's own brand range and widening the product range to include non-food items. A move into the Spanish hotel, restaurant and catering industry is also in the pipeline. The company views this as offering similar potential to the retail market, in which it currently operates. Expansion into Mallorca is also planned with negotiations on warehousing already taking place.

**More information:** No identifiable corporate web presence.

### Surface Technology Systems (SRTS)

Interim results were as predicted with pre-tax losses of £2.49m compared with £2.55m in 2004, on revenue up 10% at £7.5m. The order backlog at the end of June stood at £6.5m compared with £4.0m at the end of December 2004 and £3.7m at the end of June 2004. Significant multiple repeat orders have been received from multi-national companies.

The company, which produces micro-electro-mechanical devices used in everyday items such as mobile phones, has seen an increase in orders for the third quarter partly due to the launch of its new Pegasus system. Other major new product launches are planned for the second half of the financial year.

The board said it is committed to return the business to profitable trading. Steps have been taken to improve operating results by introducing 'lean manufacturing' the benefits of which include increased productivity, reduced inventories, and better product quality. The company hopes this will place it in a strong position to benefit from improving market trends.

**More information:** [www.stssystems.com](http://www.stssystems.com)

### Cape (CIU)

First half results for the building services company were better than forecasts, with a pre-tax loss of £3.4m. This was due to one-off costs related to the setting up of a scheme for the long term financing of asbestos-related claims likely to be successfully made against the group. The scheme has been partly funded by a £22m share issue. This will be used to reduce borrowing if the fund is not required.

Without the exceptional charge the group would have made an operating profit of £2.3m, an increase of 53% from the £1.5m for the same period last year. Group turnover for the period rose 8.8% to £120.7m, compared with £110.9m for the same period in 2004.

Significant new contracts have been won in UK and international markets and the forward order book continues to grow.

**More information:** [www.capeplc.com](http://www.capeplc.com)

### Peel Hotels (PHO)

First half pre-tax profits rose 28.9% to £1.0m compared with £0.78m for the same period in 2004, reflecting the purchase of three leasehold hotels from Grace Hotels in May this year previously operated under a management contract. Turnover increased 17.6% to £7.99m from £6.79m for the first half last year. Operating profit was up 10.4% at £1.65m from £1.5m for the same period in 2004.

Sales at the six hotels owned by the group prior to this acquisition increased by 2.2% and accommodation revenue per available room increased by 1%. Total gross profit increased by 2.8% to £2.2m, with the three new hotels contributing £302,622 in the latest period.

The company said it sees considerable scope for improving performance but added a note of caution, saying that increases in the costs of energy, rates and statutory items were difficult to control.

**More information:** [www.peelhotel.com](http://www.peelhotel.com)

### Islamic Bank of Britain (IBB)

Pre-tax loss for the first half of the financial year has narrowed to £2.7m from £3.1m in the five months to December 2004 following a sharp increase in customer numbers. Operating income rose to £1.0m from £0.68m.

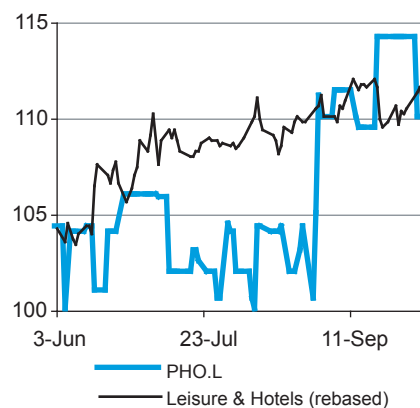
The current customer base at the bank, which provides financial products to Muslims in accordance with strict Islamic principles, stands at 5,962. A total of 10,511 accounts have been opened. The first two months of the second half have already seen a 40% increase in customer numbers.

Three new branches were opened in the first half with a fifth recently opened in Whitechapel to serve the 71,000 Muslims living in LB Tower Hamlets. A further two branches are due to open, in Birmingham and Manchester, in the second half of the year.

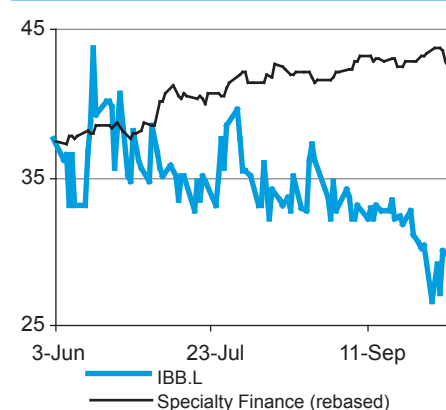
New products have continued to be developed such as Islamic current accounts, debit cards and Islamic-style mortgages.

**More information:** [www.islamic-bank.com](http://www.islamic-bank.com)

**PHO v. Leisure & Hotels (rebased)**



**IBB v. Speciality finance (rebased)**



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### Recent flotation data

Company	Market	Type	Mkt Cap/Amnt Raised	Issue Date
Kazakhmys	Main	Placing	£2.52bn / £315.4m	07-Oct-2005
Datong Electronics	Aim	Placing	£17.7m / £3.5m	07-Oct-2005
Fairground Gaming	Aim	Placing	£10.7m / £3.8m	04-Oct-2005
ACTA	Aim	Placing	£44.8m / £8.0m	04-Oct-2005
International Metals Ent.	Aim	Placing	£114.0m / £114.0m	03-Oct-2005
Travelzest	Aim	Placing	£10.2m / £5.2m	03-Oct-2005
Ashton Penney	Aim	Placing / Offer	£5.0m / £1.0m	30-Sep-2005
Consolidated Com. Corp.	Aim	Placing	£6.4m / £1.5m	30-Sep-2005
Moydow Mines International	Aim	Introduction	£4.6m / n/a	30-Sep-2005
International Ferro Metals	Aim	Placing	£143.6m / £80.0m	30-Sep-2005
Irish Estates	Aim	Introduction	£27.7m / n/a	30-Sep-2005
888 Holdings	Main	Placing	£590.0m / £147.7m	29-Sep-2005
Global Brands	Aim	Placing	£8.9m / £3.5m	29-Sep-2005
Sovereign Oilfield	Aim	Placing	£20.1m / £5.0m	28-Sep-2005
CDS Oil and Gas	Aim	Placing	£21.0m / £2.4m	27-Sep-2005
Investments West Midlands	Ofex	Public Offer	£0.4m / £0.2m	27-Sep-2005
Pantheon Leisure	Aim	Placing	£3.0m / £0.8m	27-Sep-2005
Lewis Charles Sofia Prop. Fund	Aim	Placing	£38.7m / £38.7m	27-Sep-2005
Wham Energy	Aim	Placing	£28.5m / £10.0m	26-Sep-2005
32Red	Aim	Introduction	£61.5m / n/a	23-Sep-2005
Glencar Mining	Aim	Introduction	£4.9m / n/a	23-Sep-2005
GETECH Group	Aim	Placing	£10.8m / £3.2m	23-Sep-2005
Hot Tuna International	Aim	Placing	£20.1m / £1.9m	23-Sep-2005
Syndicate Asset Management	Aim	Introduction	£74.5m / n/a	23-Sep-2005
i-mate	Aim	Placing	£248.9m / £38.9m	23-Sep-2005
Cellcast	Aim	Placing	£20.1m / £5.0m	21-Sep-2005
SQS Software Quality Systems	Aim	Placing	£29.6m / £10.8m	20-Sep-2005
IPSA Group	Aim	Placing	£14.8m / £8.0m	20-Sep-2005
Concorde Oil and Gas	Ofex	Public Offer	£1.0m / £0.2m	19-Sep-2005
Symphony Telecom	Aim	Placing	£12.8m / £4.5m	15-Sep-2005
Steppe Cement	Aim	Introduction	£46.5m / n/a	15-Sep-2005
Clipper Windpower	Aim	Placing	£180.8m / £65.0m	12-Sep-2005
Israeli Acquisitor I	Ofex	Public Offer	£0.5m / £0.4m	05-Sep-2005
Vimio	Aim	Placing	£25.6m / £5.6m	02-Sep-2005
Karelian Diamond Resources	Aim	Placing	£2.2m / £0.5m	01-Sep-2005

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