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Tel: 020 7929 3399
Fax: 020 7929 3377

www.hardmanandco.com
email: research@hardmanandco.com

4 -5 Castle Court
London EC3V 9DL

Leighton & Henley plc Residential Start-Up Signs Deal

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This residential development start-up company has contracted to buy another interesting development property in St. Albans. The site has cost £3.2m, will have a total cost after build-out of in the region of £5m, and is likely to yield a return on total costs of 19 – 20%. This equates to a profit on equity, after gearing up, of 80%+ and reinforces our view that Leighton & Henley has found an interesting and profitable niche in the northern home counties.

Since our last research note residential property values have continued to rise. This makes the deals which management locked into the company in 2006, ahead of its current capital raising, look very good value. This is true of any housebuilder with a land bank, of course, but Leighton & Henley is different because it is a start-up company that will be liquidated or sold after either four or five years. Leighton & Henley is strictly orientated towards returns to investors rather than corporate egos.

This company intends to turn round its sites quickly, and indeed the speed of the development and sale cycle makes a very significant impact on overall returns to investors.

Gross profits on the first three sites to be developed are expected to be over £1.8m, which will produce a significant premium after paying off launch costs.

The possibility, raised in the Budget, that AIM companies may at some point lose their Inheritance Tax and Business Taper Relief qualifications, does not apply to this unquoted company.

Corporate financiers Smith & Williamson are responsible for sourcing all new equity investment.

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Likely Issue Price: 100p

No. of Shares To Be Issued: 10m

Total No. of Shares To Be In Issue: 11.2m

Starting Value: £11.2m

NAV/Share After Issue Costs: 92.5p

Intended Gearing: 75% to assets

Sector: Housebuilding

Market: Not Listed

Issuing House:

Smith & Williamson

Sales Contact: Christian Elmes,
0207 131 4324

Website:
www.smith.williamson.co.uk

Previous Research Note:
'Promising New Residential Vehicle', 20.12.2006

Analyst: Roger Hardman

Background

Leighton & Henley PLC is a new property vehicle being offered to investors that is to specialise in small/medium sized residential developments in the Northern Home Counties.

- The business model is to buy land, develop it and sell on the properties. This is a trading company, it is *not* an investment company.
- The management has a good track record in the industry and is putting £1.2m of its own money into the vehicle.
- 3:1 gearing will permit high returns for investors if conditions in the housing market continue to be favourable.
- New investors get a 'free ride' on the preparatory work already undertaken on the acquisition and planning of the first sites.
- Dividend payments are planned from year 2.

As time goes by and the Home Counties property market continues to see rising prices, we feel the fourth of these points is becoming increasingly important. Contracts were exchanged on the first three development sites in mid/late 2006. Since then prices of both land and finished flats and houses have risen significantly. We believe that there is an inherent profit already locked into the company on these sites, even before the investor financing has been completed.

At the time of our last research note, L & H had exchanged on an 11 unit site at Hitchin, a 7 unit site in Bushey and entered into an option on a site for four houses in St. Albans. All three sites now have full planning permission.

Since then Leighton & Henley has completed on a fourth site, also in St. Albans.

The New St. Albans Site

The latest site to be purchased is the old Marlboro Motors property in Watsons Walk, near London Road. The railway station is less than half a mile to the North East, and the City Centre is half a mile to the West. The cost is in the region of £3.2m.

Planning permission is in place for this development. It is important to note that St. Albans is one of the few District Councils in the County that does not impose a social

housing requirement in its new planning applications.

The planning permission is for 11 two storey, three bedroom houses with a floor space of 1,074 sq. ft. and 2 two bedroom bungalows. In addition, two existing houses are to remain on the site and are to be refurbished, giving 15 units in all. Each house is to have car parking.

We expect the average selling price per unit to be in excess of £400,000 after solicitors' fees and agents' selling fees, giving a total sales income of approximately £6.2m. The project should yield a 19% return on total costs, which is equivalent to an 82% return on equity after gearing up and meeting interest payments.

We know the site (indeed, we know all the company's sites). This is a good one, and St. Albans is one of the best Cities/towns in Hertfordshire as far as residential property is concerned.

Bushey

Since our last research note planning permission has been obtained on the Bushey Hall site. Leighton & Henley has recalculated its costings, and it appears that the return on equity may now be as high as 97%. This site carries an above average profit because there are no demolition costs. Its location next to an historic golf course, should give the units a premium price and also helps account for the above average profit.

Strategy

Leighton & Henley has a deliberate policy of limiting the average size of its development, and keeping a relatively small number of properties under development at any one time. Kerry Kearton-Gee, the founder and managing director, firmly believes that running a tight ship and that being very selective in sites chosen for development results in a much higher return on capital than going for volume. His track record at his previous residential development company, London & Henley, bears this out. Like Leighton & Henley, London & Henley was a limited life company that was sold five years later generating an IRR of over 40% for investors. Previously his City Gate Estates returned 600% for investors over its life.

That was an exceptional performance and would require a favourable housing market from now until 2012 in order to be repeated. But it is an enviable track record nonetheless.