Circle Property

A strong harvest continues

FY18 results and outlook

Real estate

Circle actively manages its assets, placing an emphasis on total returns rather than short-term income maximisation. With three significant office refurbishments recently completed and in various stages of letting, it continues to harvest the benefit in terms of rising income and capital values, supporting growing dividends and NAV. FY18 NAV total return was 28.3% and, since the February 2016 IPO, the compound annual total return has been 26.2% pa. With a positive supply–demand balance in regional office markets continuing, we believe there are more gains to come.

Year end	Net rental income (£m)	Adjusted net profit* (£m)	Adjusted EPS* (p)	NAV per share (p)	DPS (p)	P/NAV (x)	Yield (%)
03/17	4.4	0.9	3.1	183	5.0	1.20	2.3
03/18	5.5	2.5	9.0	230	5.6	0.96	2.5
03/19e	6.8	2.7	9.5	258	6.3	0.85	2.9
03/20e	7.7	3.3	11.7	271	7.0	0.81	3.2

Note: *Edison adjusted net profit and EPS is adjusted for gains/losses on sales of investment property, revaluation movements and non-recurring items.

Progress with refurbishments driving gains

Primarily reflecting lettings success at recently completed refurbishments, net rental income grew 26% in FY18 and NAV per share by 25%, reflecting valuation uplifts. Absent EPRA disclosure, on our adjusted basis, PBT more than doubled to c £2.0m while the growth in adjusted net earnings (from £0.9m to £2.5m) and adjusted EPS (from 3.1p to 9.0p), benefiting from a tax credit, was higher still. The final dividend increased to 3.0p. The entire office space at recently refurbished Somerset House has been let since year-end, taking contracted rental income to c £7.6m, and advanced negotiations with multiple potential tenants continue at the two other recently completed refurbishments.

Faster letting progress reflected in forecast uplift

Circle specialises in acquiring short-let or part-vacant office properties in UK provincial cities where it can add value with lease renewals, rent reviews, lettings and refurbishments. Letting progress at significant completed refurbishments is driving income growth and valuation gains and with progress faster than we had previously allowed for, our revised estimates now assume full letting of remaining refurbished space by end-FY20. Our FY19 adjusted earnings/EPS increase c 2%, NAV c 6%, and DPS from 5.5p to 6.3p, with letting progress seen more fully in FY20. Liquidity is thin, but management is considering options for enlarging the shareholder base, perhaps in conjunction with growing the asset base.

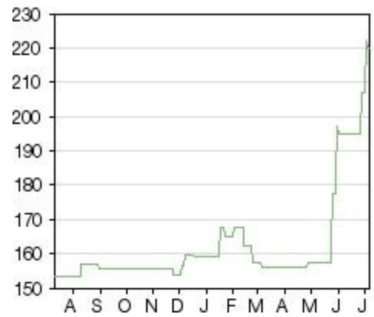
Valuation: Share gains reflect value growth

The shares have performed strongly over the past year, particularly since the April trading update ahead of FY18 results, to a large extent tracking the growth in NAV. Our revised forecasts show further growth in NAV and DPS over the next two years, leaving the shares at a c 20% discount to FY20e NAV and yielding 3.2% with a well-covered dividend.

9 July 2018

Price	**220p**
Market cap	**£62m**
Net debt (£m) as at 31 March 2018 (including unamortised debt costs)	49.3
Net LTV at 31 March 2018	43.2%
Shares in issue	28.6m
Free float	63.5%
Code	CRC
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	12.8	41.0	43.3
Rel (local)	14.5	33.2	37.4
52-week high/low		222.0p	153.5p

Business description

Circle Property is a property investment company registered in Jersey and listed on AIM. The company actively manages its assets, placing an emphasis on total returns rather than maximising short-term income. It targets the acquisition of well located regional office property where it has identified a clear opportunity to add value by undertaking active asset management.

Next events

AGM	25 July 2018

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Edison profile page

Circle Property is a research client of Edison Investment Research Limited

Brief overview of FY18 results

Circle Property delivered another strong result in FY18. Lettings successes across recently refurbished assets drove income growth and valuation gains, reflected in a further increase in dividends and a 25% rise in NAV per share. NAV per share has now increased by 54% since Circle listed in February 2016. Momentum has continued into the current year, with significant further lettings progress already achieved since year-end, but with considerable potential income reversion to estimated rental value remaining.

Exhibit 1: Summary of FY18 results

£000s unless otherwise stated	FY18	FY17	% change
Net rental income	**5,523**	**4,366**	**26%**
Administrative expenses	(2,368)	(2,115)	12%
Operating profit before revaluations & other one-off items	**3,155**	**2,251**	**40%**
Recurring net finance costs	(1,145)	(1,340)	(15%)
Edison adjusted PBT	**2,010**	**911**	**121%**
Tax	535	(22)	
Edison adjusted earnings after tax	**2,544**	**889**	**186%**
Edison adjustments:			
Gains on disposal	1	279	
Gains on revaluation	11,981	7,361	
Negative goodwill & listing costs	0	88	
Effective interest rate adjustment on borrowings	0	1,232	
Fair value movement on interest rate swaps	(1)	96	
IFRS net profit	**14,526**	**9,944**	**46%**
Edison adjusted EPS	**9.0**	**3.1**	**186%**
IFRS EPS (p)	51.3	35.1	
DPS declared (p)	5.60	5.00	12%
Dividend cover (Adjusted EPS/DPS)	1.61	0.63	
IFRS NAV per share (p)	**230**	**183**	**25%**
NAV total return	28.3%	23.0%	
Net LTV	43.2%	43.9%	

Source: Circle Property, Edison Investment Research

The key highlights of the FY18 results were as follows:

- The c 26% growth in net rental income primarily reflects progress with asset management initiatives, leasing void space, primarily in refurbished assets, and income reversion within the portfolio. The year-end contracted rent roll was c £6.8m compared with c £5.6m a year earlier, including a c £352k contribution from acquired properties, and has since risen further with the c £796k pa letting of the entire office space at Somerset House. The estimated rental value increased from c £8.9m to c £9.9m, representing a substantial further opportunity to increase income.
- Occupancy increased from 80% by total portfolio floor area to 85% during the year. Of the remaining 15%, 13.9% represented un-let space within the three refurbished office developments that recently completed. Excluding these three assets, portfolio occupancy was 98.9%. We estimate that the subsequent letting of 36,300 sq ft of office space at the refurbished Somerset House will have increased occupancy by c 5.5 percentage points.
- The externally assessed fair value of the investment portfolio increased by c £21.1m or c 23% to c £114.1m (the balance sheet value of £106.4m is after adjustment for unamortised lease incentives), and reflects a net initial yield of 5.62% (FY17: 5.65%) and a reversionary yield of 8.16% (FY17: 8.97%). Two properties were acquired late in the financial year at a cost of £4.5m, while c £4.2m was invested in refurbishment projects. The fair value gain of c £12.0m, a little more than 11% of the opening portfolio value, was driven by the asset management progress rather than yield compression.

- Administrative expenses grew by c 12%, lower than income growth, with the increase primarily reflected in staff bonuses and LTIP awards linked to the strong performance generated.
- Underlying net finance costs (excluding changes in the fair value of interest rate swaps declined, despite an increase in average borrowing, benefiting from a decline in loan arrangement fees. Borrowings increased from £45.7m to £51.9m, including £3.0m drawn late in the year as part payment for the two acquisitions. The interest cost of the debt is 1.85% above three-month LIBOR. The net loan to value ratio (LTV) reduced from 43.9% to 43.2%.
- Exhibit 1 shows the reconciliation of Edison adjusted earnings to IFRS. Circle does not report EPRA adjusted financial metrics, but we have similarly adjusted for fair value movements, gains on disposal, and other non-recurring items. Adjusted PBT more than doubled to c £2.0m, primarily as a result of the operational gearing that follows from previously vacant refurbished space. Adjusted net earnings and EPS further benefited from a tax credit during the year, with the latter increasing from 3.1p to 9.0p. The final dividend per share was increased to 3.0p, taking the annual dividend to 5.6p, up 12%. Dividends were covered 1.6x by adjusted earnings, in part reflecting the tax credit.
- With NAV up by 25%, the NAV total return (including dividends paid in the year) was 28.3%.

Circle provided a confident outlook statement, anticipating further growth from the capturing of reversionary potential in the portfolio and from letting the remaining space from recently completed refurbishments. It is engaged in advanced negotiations with multiple potential occupiers for 36 Great Charles St, Birmingham, and K2 Kents Hill Business Park, Milton Keynes. Management expects that the current provincial occupier demand for office space will continue, and that investment yields for good quality, well located, and securely let properties will firm further as supply remains tight. Against this backdrop, Circle will continue to actively manage its existing assets but has also increased its focus on finding additional opportunities to replenish its development pipeline, targeting assets with added value potential where the location and proven demand justify the development risks.

Circle is a regional refurbishment specialist

Circle is an internally managed property investment company registered in Jersey. It was initially founded as a limited partnership in 2002, became a Jersey Property unit trust (Circle Property Unit Trust or CPUT) in 2006, and has been quoted on AIM since February 2016. The company actively manages its assets, targeting well located regional office property where it has identified a clear opportunity add value, placing an emphasis on total returns rather than maximising short-term income.

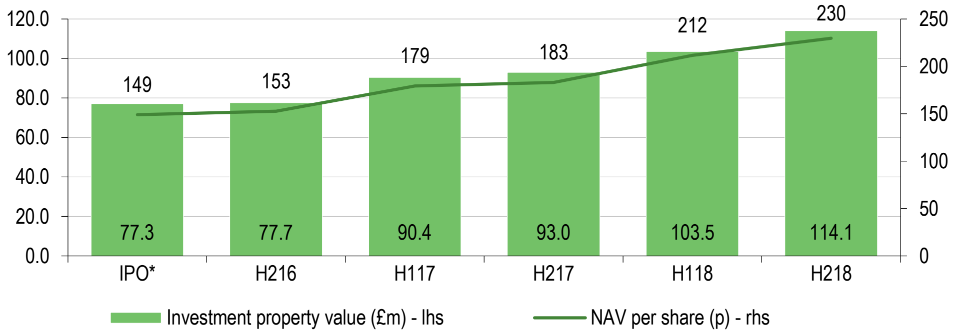
Circle's senior management team includes two full-time property professionals and the company is governed by a highly experienced board. Together, the management and board own approximately 24% of the company, closely aligning their interests with external shareholders. The company has a strong track record of NAV total returns both before and after IPO. In the 10 years to FY16 (the year of IPO), a period including the aftermath of the global financial crisis, it generated an average annual total return of more than 7.5% pa. Since IPO, and until the end of FY18, the compound annual increase in NAV total return has been 26.2% (see Exhibit 7), with recent asset management initiatives being positively reflected in income and supporting growth in capital values.

The current portfolio of 17 assets is now valued at £114.1m (31 March 2018), of which 13 office buildings comprise 91%. All the assets but one (an office property in Moorgate) are outside London. Significant refurbishment programmes have recently been completed at three of the assets, and we expect the continued letting of these to further significantly increase rental income and capital values.

Investment strategy targets total returns

Circle targets well located short-let, or part-let if the letting prospects are sufficiently strong, primarily office properties in the UK's provincial cities where it can add value by undertaking lease renewals, rent reviews, lettings and refurbishments. Acquisitions are typically at close to vacant possession value, which allows management to use its expertise to undertake cost-efficient refurbishment and development to maximise reversionary rental values and secure new leases on the properties. Once the process of refurbishing an asset is underway, management will seek to attract tenants quickly with competitive rents in order to beat local competition, but still aims to achieve attractive yields. In this way, management seeks to increase both rental income and capital values. The company will dispose of properties that are not considered to have further potential and where an attractive price can be struck. The board's strategy is to deliver annual total returns over 12% through targeting returns at the property level of at least 15% on the costs of development expenditure and acquisitions.

Exhibit 2: Strong growth in property valuations and NAV since IPO

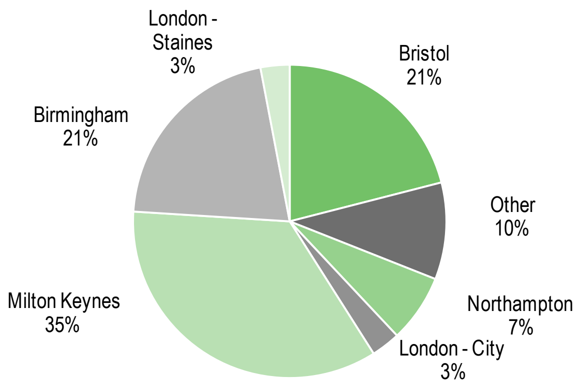


Source: Circle Property

Portfolio focused on regional offices

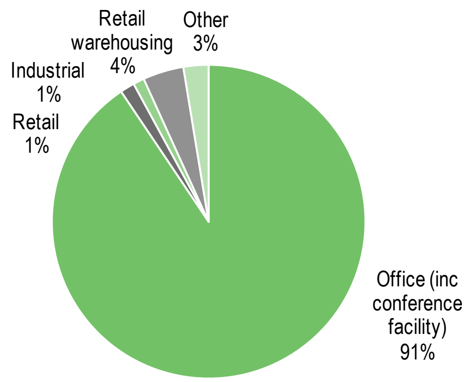
Although Circle seeks a diversified exposure to UK commercial property, its portfolio is currently weighted towards offices (91%), where management has identified attractive opportunities in current market conditions, and is relatively concentrated by number of properties (17), which partly reflects the very hands-on nature of its asset management strategy. Reflecting the number of properties, but also management's focus on areas where it expects letting prospects to be strong, there is a geographic bias towards Milton Keynes, Birmingham and Bristol, in aggregate 77% of the portfolio value. Details of each of the properties can be viewed on the company's website here.

Exhibit 3: Portfolio value by location



Source: Circle Property, 31 March 2018

Exhibit 4: Portfolio value by sector



Source: Circle Property, 31 March 2018

The tenant base provides an additional level of diversification. There are currently 52 tenants, including regional SMEs, national partnerships, and listed companies from both the FTSE250 and FTSE100. The largest tenant is Compass Contract Services, which leases office space at Circle's largest asset, Kents Hill Business Park in Milton Keynes. The Compass lease accounted for a significant 22.6% of end-FY18 rent roll but is long duration (25 years at inception, with a break at 15 years subject to a £2m penalty, with 23.5 years remaining), agreed by Circle after it acquired the property on a short lease in 2013. Other principal tenants include Which? Financial Services (4.9%), B&M Retail (4.1%) Grant Thornton (3.7%), and New World Trading (3.6%), although much of the portfolio is multi-tenanted. Circle has been focusing properties that are capable of subdivision to provide smaller office suites of up to 5,000 sq ft, more attractive to local professionals and SMEs that may well prove less prone to the uncertainties posed by Brexit.

The weighted average unexpired lease term (WAULT) to first break was 7.2 years at end-FY18 or 10.5 years to lease expiry.

As noted above, core occupancy within the stabilised portfolio is high at c 99%. The remaining unoccupied space within the portfolio is represented by recently completed significant refurbishment projects. Since end-FY18, Circle has let the entire office space at Somerset House in Birmingham (36,300 sq ft) and we estimate that the remaining void space at the recently refurbished 36 Great Charles Street, Birmingham and K2 Kents Hill Business Park, Milton Keynes (one of eight buildings on the site) to represent c 8.4% of the portfolio total (by lettable area). Management says that each of these properties has been well received in the letting market and that it is engaged in advanced negotiations with multiple potential occupiers.

With a current contracted rent roll of c £7.6m (the end-FY18 rent roll of c £6.8m adjusted to include the recent Somerset House letting), there remains considerable upside to the end-FY18 estimated rental value (ERV) of c £9.9m. Of the c £2.3m of potential upside, we estimate that c £1.1m relates to the letting of 36 Great Charles Street and K2 Kents Hill Business Park and the balance to capturing reversionary potential on the wider portfolio through lease renewal.

Market environment

Despite some slowing of UK economic growth, continuing Brexit uncertainty and a significant retracement of the boost to export competiveness that resulted from post EU-referendum sterling weakness, regional property markets have remained in good health over recent months. In general, across the regional markets, a positive occupational demand–supply balance continues, although there are indications that in some instances letting decisions are taking longer to execute. Regional markets continue to benefit from structural factors such as business relocation away from London, office conversion to residential use and a relative lack of new development in the years following the financial crisis. Circle management comments that it sees no sign of the trend of diminishing office supply across the regions abating. As a result, regional office rents are growing, but from affordable levels following a number of years of decline in real terms, and in many cases remain below the threshold necessary to bring forward new development. From an investment viewpoint, market data suggest that regional offices continue to represent attractive yield compared with London, and that regional secondary office yields have room to tighten further versus prime. As a result of investor demand, the average yield spreads between the regional and London offices has continued to narrow, but remains wider than it was before recovery took hold in the London market in 2009, and is similar to the longer-term average. As London recovered, the spread of secondary over prime yields narrowed steadily, while the recovery in the regions was later to take hold such that the regional spread of secondary over prime yields remains wide, despite more recent tightening.

The UK commercial property sector as a whole has recovered strongly since the financial crisis of 2007/8, but current conditions do not appear to indicate that the regional markets face any imminent risk of another significant cyclical correction. In addition to the relative lack of speculative new building and affordable rents, interest rates have remained low, and there is a stronger banking system less exposed to real estate lending.

Management and governance

Circle has an experienced and highly motivated board of directors, including the small team of executive directors that provide the internal property management. The executive directors have many years of experience in real estate asset management, and their extensive range of contacts has proven useful in providing access to less competitive off-marker acquisition opportunities. By managing the portfolio internally, Circle has direct control of costs (there is no NAV-linked annual management fee) and should benefit from economies of scale as the portfolio grows in size. Administrative and financial management services are provided externally by Consortia, the Jersey licensed trust and fund services company, which was paid £252k in fees in FY18, a similar amount to FY17.

Circle CEO John Arnold was one of the founders of Circle LP in 2002, the limited partnership forerunner of the company, along with James Hambro and John Bodie. The COO, Edward Olins, joined Circle in 2006 when Circle Property Unit Trust was created by way of acquisition of the Circle LP assets. Biographies for both can be found on page 14.

Including the CEO and COO, the board comprises seven members and is led by the non-executive chairman Ian Henderson (see page 14). Ian Henderson is widely experienced in the property industry and was formerly chief executive of Land Securities. The non-executive directors are Timothy Scott Warren, James Hambro, the Duke of Roxburghe and Michael Farrow. As noted above, James Hambro was one of the founders of Circle LP and remains a significant shareholder in the company. The Duke of Roxburghe was an investor in CPUT and remains a significant shareholder in the company. Both Tim Scott Warren and Michael Farrow have extensive financial services experience, and both are directors of Consortia Partnership.

The directors' interests in the shares of the company, including family interests, amounts to c 6.8m shares or a little under 24% of the total. The percentage of shares not in public hands, as defined by the AIM rules, is 36.5%, and also includes extended family interests that not included within the 24% figure.

In addition to their direct ownership in Circle, there is a performance-related LTIP under which the executive directors can earn bonuses of up to 100% of their salaries in nil cost options to acquire ordinary shares in the company. These are granted annually dependent on performance: a combination of total shareholder return (share price movement plus dividends) and total NAV return (NAV change plus dividends) is measured. The first is compared to a basket of peers selected by the Nomad (Peel Hunt) and the second is based on hurdle rates. If the performance is below the median, no awards will be made; if Circle reaches the median, a bonus equivalent to 50% of salary is earned, increasing to a maximum of 100% proportional to performance.

Better than expected FY18 and lifting forecasts

The end-FY18 NAV share of 230p was ahead of our 227p forecast and well ahead of the 214p that we had been forecasting prior to the trading update issued by Circle on 26 April. In the update note that we published in May, we left our recurring income earnings for FY18 unchanged, pending the detail of the full-year results. Net rental income was reported c 7% ahead of our forecast and adjusted net profit 28.0% ahead. Adjusted net profit benefited from a positive tax result, and the adjusted PBT beat versus our forecast was a little lower, at c 5%, with some additional administrative expense partly offsetting the income growth. DPS growth was also ahead of our forecast.

Exhibit 5: Performance versus forecast and forecast revisions

	FY18 versus forecast														
	Net rental income (£m)			Adjusted net profit (£m)			Adjusted EPS (p)			NAV per share (p)			DPS (p)		
	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)
03/18	5.2	5.5	7.2	2.0	2.5	27.9	7.0	9.0	27.9	227	230	1.4	5.3	5.6	5.7
	Estimate revisions														
	Net rental income (£m)			Adjusted net profit (£m)			Adjusted EPS (p)			NAV per share (p)			DPS (p)		
	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)
03/19e	6.2	6.8	9.5	2.6	2.7	1.9	9.3	9.5	1.9	245	258	5.6	5.5	6.3	14.5
03/20e	N/A	7.7	N/A	N/A	3.3	N/A	N/A	11.7	N/A	N/A	271	N/A	N/A	7.0	N/A

Source: Edison Investment Research

For FY19, we have increased our net rental income forecast by just over 9%, reflecting faster leasing progress than we had previously allowed for, and our adjusted PBT forecast by just over 10%. The increase in forecast adjusted earnings is just under 2%, with the FY18 tax credit being replaced by higher than previously assumed tax charges (see below). We have introduced a forecast for FY20 for the first time.

Our new forecasts now specifically include much of the upside from further letting of recently refurbished assets, whereas this was previously captured by a sensitivity analysis. The reasons for this are:

- Letting has already progressed at a faster pace than we had allowed for, and including the post-year-end letting at Somerset House, contracted rental income of c £7.6m is already at the level that we had assumed for end-FY19 (after adjusting for the recent acquisitions).
- Management has indicated that the properties have been well received, and that advanced negotiations with multiple potential occupiers are underway.
- Our forecast period now stretches out an extra year, providing more 'forecast time' for letting to proceed.

The key forecasting assumptions that we have made are as follows:

- **Contracted rental income.** We are now assuming contracted rents of £8.2m by end-FY19 and £8.8m by end-FY20. This effectively allows for full letting of 36 Great Charles St and K2 over the period, at slightly under the £1.1m ERV, plus a small amount (c 1.5% pa) of rent growth on the overall portfolio. Our previous forecasts implied only a partial letting, by end-FY19. The portfolio occupancy (by area) implied by our revised forecasts is c 98.5% by end FY20.
- Improving occupancy translates into lower void costs and a small decrease in overall property costs.
- Administrative expenses benefit from a slight fall in 'other overheads' in the current year, but otherwise grow broadly in line with inflation.
- Finance costs are slightly higher, tracking higher LIBOR on unchanged borrowings.
- **Property revaluation gains.** The Somerset House letting came after the year-end and is yet to be reflected in the external property valuation. We make no assumptions about whether the overall level of market valuation yields will rise or fall over the forecast period and on this basis we would expect the further letting progress that we have assumed to also have a positive impact on valuations. The £7.0m revaluation that we have included for FY19 and the £2.0m for FY20 (FY18: £12.0m), in combination with our contracted rent and ERV growth assumption (2.0% pa), imply an increase in the portfolio net initial yield (NIY) from 5.62% at end-FY18 to 6.61% at end-FY20. As more of the reversionary potential is captured in contracted rents the

implied reversionary yield declines slightly from 8.16% to 7.75%. Assuming no ERV growth over the period, the decline in the reversionary yield would be to 7.45%. The revaluation gains that we have assumed add 25p to NAV per share in FY19 and 8p per share in FY20 (FY18: 43p). A 0.10% increase in the FY20 NIY would reduce forecast NAV by c 7p per share.

The further letting progress that we now assume in our forecasts has a material impact on our forecasts, particularly in FY20. If we were to assume no further letting over the period (other than the already concluded Somerset House let), then FY19 and FY20 adjusted earnings would show only modest growth on FY18 with adjusted EPS of 9.1p and 9.2p, respectively. The valuation gain impact on NAV would also be lower as discussed above.

Over and above the successful letting of 36 Great Charles St and K2 that is contained with our revised forecasts, there remains additional reversionary potential of £1.2m.

Exhibit 6: Edison estimated contracted rents and ERV

£000s	
Contracted rent roll at 31 March 2018	6.8
Somerset House, Temple St, Birmingham	0.8
Adjusted contracted rent roll	**7.6**
Development assets expected rent (ERV)	
K2, Kents Hill Business Park, Milton Keynes	0.6
Great Charles St, Birmingham uplift	0.5
Potential rent including development assets	**8.7**
Other, rent reversion potential	1.2
Total portfolio ERV at 31 March 2017	**9.9**

Source: Edison Investment Research, Circle Property data

Given the relatively high current occupancy on the stabilised assets, and the c 98.5% occupancy across the whole portfolio implied by our forecasts, capturing this additional reversionary potential will depend very much on successful lease renewals and renegotiations as they occur.

We also note that it remains management's intention to grow the portfolio through acquisition, in particular to replenish its pipeline of development/refurbishment opportunities, with the added benefit of potential for scale economies. There is a modest amount of headroom (c £3m) in the current borrowing facility and the year-end cash balance was c £2.6m, but for more significant acquisition opportunities we would expect Circle to consider part-funding with equity. This would additionally provide support for management's aim to broaden the shareholder base and increase share trading liquidity.

Potential impact of tax rule changes

Circle Property and its two property owning subsidiaries, CPUT and Circle Property (Milton Keynes) Limited (CPMK), are all registered in Jersey. CPUT is not liable for tax in Jersey, and the Jersey tax rate applied to rest of the group is 0%. Circle is registered under the UK's Non-Resident Landlord Scheme and is liable to UK tax on its net rental income at a rate of 20%. The effective rate of tax since listing has been much lower, primarily benefiting from capital allowances. The UK Government has proposed changes that, if enacted, will affect the tax position of Circle. The first is that non-resident landlord companies are to be brought into the scope of UK corporation tax rather than income tax, from 1 April 2020. Additionally, from 1 April 2019, capital gains made by a non-resident on the disposal of commercial property will be subject to UK tax.

These proposed amendments have not yet been enacted and, as a result, Circle says that it is not yet possible to determine precisely their likely impact. Some income-focused companies that expect to be negatively affected by the proposed changes (eg Picton Property Income and UK Commercial Property Trust) have decided to convert to UK REIT status so as to mitigate the effects. Circle management indicates it is not considering REIT conversion, as the distribution rules would potentially inhibit the execution of the company's total return strategy.

In FY18, Circle recognised a tax credit of £535k, primarily as a result of capital allowances related to the refurbishment programme exceeding the tax liability on net rental income. Looking forward, any impact from UK Corporation Tax inclusion is likely to fall outside of our forecasting horizon, and we anticipate no realisation of capital gains during that period. We do, however, assume an increase in the effective rate of tax, to 12% in FY19 and 15% in FY20, as capital allowances should reduce with the current refurbishment programme now completed. We have assumed £1m pa of capex during FY19 and FY20, down from c £4m pa over the past two years.

Valuation

For Circle, unlike a REIT, capital returns are expected to be a significant element of overall total returns, which we think is best captured by NAV total return (the change in NAV per share plus dividends paid per share). On this basis, NAV total return from IPO to end-FY18, a period of just over two years, has been an aggregate 60.9%, or a compound 26.2% pa, well above the minimum 12% pa targeted by management. Our estimates for FY19 and FY20 imply total returns of 15.1% and 7.4%, although there remains considerable scope for Circle to do better than this if market conditions remain favourable and it is successful in continuing to let remaining vacant refurbished space and capturing reversionary potential through lease renewals.

Exhibit 7: NAV total return since IPO

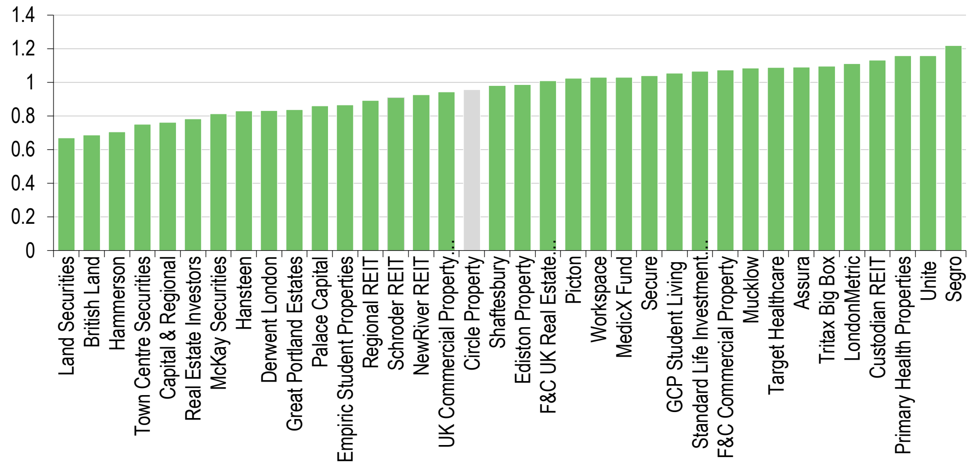
	FY16*	FY17	FY18	Since-IPO
Opening NAV per share (p)	149	153	183	149
Closing NAV per share (p)	153	183	230	230
Dividends per share paid (p)	0	4.8	5.2	10
NAV total return	2.5%	23.0%	28.3%	60.9%
Compound annual return				26.2%

Source: Circle Property data, Edison Investment Research. Note: *16 February 2016 to 31 March 2016.

The significant growth in Circle's NAV and adjusted earnings per share in the past two years highlights the difficulty of comparing it with the broader sector, including many companies that focus on recurring income generation rather than total return. As significant refurbishment projects have been completed and subsequent letting has progressed, the impact of rising income has had a geared effect on recurring earnings as well as property valuations and NAV per share. The timing of progress is not always easy to predict, and we have found ourselves steadily increasing forecast for Circle over the past year, rendering a static comparison with peers a less useful guide to the investment opportunity than our financial sensitivity analysis discussed above.

With that caveat, Exhibit 8 shows a price to NAV (last reported) comparison of Circle with a broad range of listed property companies. The Circle share price has improved noticeably in recent weeks, responding to positive newsflow, and at c 0.96x FY18 P/NAV has now moved closer to the broad sector median.

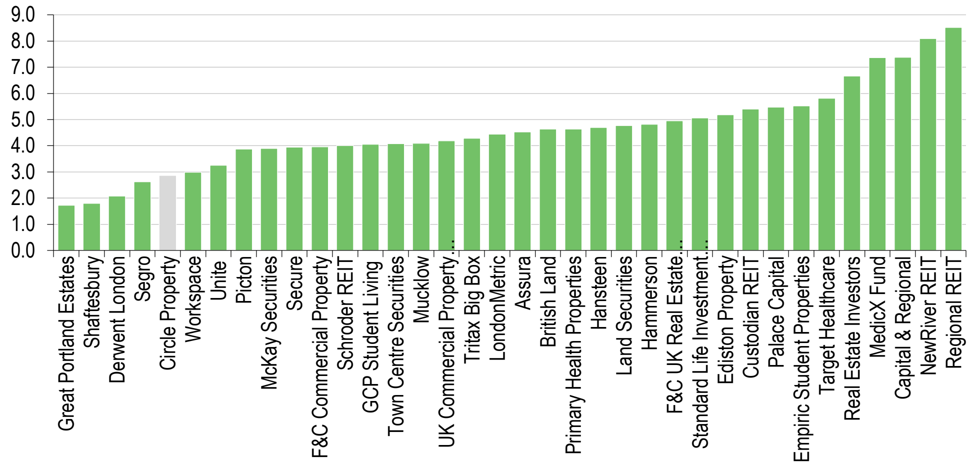
Exhibit 8: Historical P/NAV comparison for the sector



Source: Company data, Edison Investment Research, Bloomberg data as at 9 July 2018

A similar comparison using prospective dividend yield not surprisingly, given Circle's total return focus, positions it towards the lower end of the group, although its dividend cover is well ahead of group.

Exhibit 9: Prospective yield comparison for the sector



Source: Company data, Edison Investment Research, Bloomberg data as at 9 July 2018

This broad peer group contains a wide variety of property companies, REITs and non-REITs, and specialist vehicles (healthcare property, student accommodation), and covers a wide range of strategies, from a pure focus on income and collecting rents to varying degrees of asset management and capital growth. In Exhibit 10, we show a summary valuation comparison of Circle with a more similar peer group of regional property investors, although this group also includes a similar broad range of income versus total return strategies.

Exhibit 10: Peer group comparison

	Price (p)	Market cap. (£m)	P/NAV (x)	Yield (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
Custodian REIT	121	470	1.13	5.4	1%	7%	5%	0%
Mucklow	549	347	1.08	4.1	0%	7%	8%	-2%
Palace Capital	356	163	0.86	5.5	-1%	10%	-3%	-9%
Picton Property Income	92	498	1.02	3.9	1%	5%	10%	-1%
Real Estate Investors	54	101	0.78	6.7	0%	-3%	-9%	-11%
Regional REIT	95	352	0.89	8.5	0%	-5%	-10%	-11%
Schroders REIT	62	321	0.91	4.0	1%	5%	-3%	-5%
Median			**0.91**	**5.4**	**0%**	**5%**	**-3%**	**-5%**
Circle Property	**220**	**62**	**0.96**	**2.9**	**13%**	**41%**	**43%**	**-1%**
UK Property Index	1,840			3.9	-1%	3%	6%	-2%
FTSE All-Share Index	4,187			4.0	-1%	6%	5%	-3%

Source: Company data, Edison Investment Research, Bloomberg data as at 6 July 2018

The strong performance of the Circle share price relative to the peer group, the UK property index, and the FTSE All-Share stands out from Exhibit 10. Since we initiated coverage on 4 September 2017, the share price has risen by more than a third, but NAV per share and forecast DPS have also increased. The trailing P/NAV discount has narrowed from c 15% to c 4% over the period, and is now slightly above the peer group median. The prospective yield is slightly lower than when we initiated (c 2.9% versus c 3.2%) and remains below the peer group average, but dividend cover has increased and is among the highest in the group.

The annual compound NAV total return over the next two years (FY19 and FY20) implied by our forecast is 11.1%. The share of dividends in this total return is c 50%, and increase from c 25% since IPO.

Sensitivities

The commercial property market is cyclical, historically exhibiting substantial swings in valuation through cycles. Income returns are significantly more stable, but fluctuating with tenant demand and rent terms. We would also highlight the increased risks and uncertainties that attach to development activity, including planning consents, timing, construction risks and the long lead times to completion and eventual occupation. We consider the main sensitivities include:

- Sector risk: Circle targets relatively high total returns of above 12%, and a minimum 15% return on the costs of and acquisition and development expenditure at the property level. While some of the inherent cyclical risk to vacancy in commercial property can be mitigated by portfolio diversification, this strategy requires a degree of focus and Circle has a relatively concentrated portfolio in terms of the number of assets, with a focus on the office sector. It does, however, achieve a greater degree of diversity by location and tenant.
- Development risk: Circle's development activity is primarily refurbishment of assets where the key risks are cost escalation, timing delays and tenant acquisition. These risks are mitigated by detailed business planning for each assets and the employment of specialist project managers to oversee refurbishments, along with weekly site meetings. While we expect refurbishment projects to continue to be a key contributor to total returns, these are balanced by a substantial core of income-generating assets. The current refurbishment programme is completed and at various stages of letting, although management indicates that it seeks new opportunities from new development projects.

- Macro risk:
  - Although expanding by c 1.8% in 2017, UK GDP growth was weak in Q4, and into early 2018; although poor weather is likely to have had a temporary effect. The Bank of England continues to forecast a similar rate of growth in 2018 compared to 2017, although Brexit remains a source of economic and political uncertainty.
  - Having risen, partly due to sterling depreciation after the EU referendum and rising oil prices, inflation has recently moderated again, relieving some of the pressure for higher interest rates. Circle's borrowing facility is floating rate and currently unhedged, such that a rise in short-term interest rates would directly feed-through into borrowing costs, although hedging strategy is under constant review. An eventual increase in longer-term rates is likely to have a knock-on effect on NAV over time, through increased property yields, and could affect borrowing costs under the current facility if LTV were to increase above 55%.

Management risk: although supported by external service providers and experienced non-executive directors, Circle's internal management team is relatively small (CEO and COO), and if a member were to leave, he/she would need to be replaced.

Stock issuance: the board continues to be committed to enlarging Circle's capital and broadening its shareholder base in order to increase liquidity in the stock, and ultimately reduce further the share price discount to NAV, and to take advantage of continuing property acquisition opportunities.

Exhibit 11: Financial summary

Year ending 31 March	FY16	FY17	FY18	FY19e	FY20e
£000s	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Rental income	664	5,266	6,212	7,570	8,488
Other income	595	138	143	0	0
Total income	1,260	5,404	6,354	7,570	8,488
Property expenses	(123)	(1,037)	(831)	(765)	(760)
Net rental income	1,137	4,366	5,523	6,805	7,728
Administrative expenses	(293)	(2,115)	(2,368)	(2,386)	(2,450)
Operating profit before valuation gains	844	2,251	3,155	4,419	5,278
Gains on disposal of investment properties	0	279	1	0	0
Revaluation of investment properties	0	7,361	11,981	7,000	2,000
Exception items	374	88	0	0	0
Operating profit	1,217	9,979	15,137	11,419	7,278
Net finance costs	(112)	(13)	(1,146)	(1,379)	(1,379)
Profit before tax	1,106	9,966	13,991	10,040	5,898
Tax	(32)	(22)	535	(365)	(585)
Net profit	1,073	9,944	14,526	9,675	5,313
Adjusted for:					
Gain/(loss) on disposal of investment property	0	(279)	(1)	0	0
Revaluation of investment property	0	(7,361)	(11,981)	(7,000)	(2,000)
Fair value movement on interest rate swaps	2	(96)	1	0	0
Other non-recurring items	(374)	(88)	0	0	0
Edison adjusted earnings	648	889	2,544	2,675	3,313
Shares ('000s) exc. own shares held	28,297	28,297	28,297	28,297	28,297
IFRS EPS (p)	3.8	35.1	51.3	34.2	18.8
Diluted Edison adjusted EPS (p)	2.3	3.1	9.0	9.5	11.7
Dividend declared (p)	2.4	5.0	5.6	6.3	7.0
Dividend cover (adjusted earnings/DPS declared)	0.96	0.63	1.61	1.50	1.67
BALANCE SHEET					
Investment properties	75,781	86,054	106,373	114,373	117,373
Trade and other receivables	1,771	6,518	7,202	7,202	7,202
Deferred tax	915	1,142	1,728	1,142	1,142
Other non-current assets	0	1	0	0	0
Total non-current assets	78,490	93,744	115,359	122,773	125,773
Trade and other receivables	2,555	1,195	1,141	1,606	1,711
Deferred tax	105	128	0	586	586
Cash and equivalents	4,516	4,894	2,640	3,140	3,905
Total current assets	7,176	6,217	3,781	5,332	6,202
Total assets	85,665	99,962	119,140	128,105	131,976
Borrowings	(40,028)	(45,590)	(51,816)	(51,856)	(51,896)
Financial liability at FV through P&L	(95)	0	0	0	0
Total non-current liabilities	(40,123)	(45,590)	(51,816)	(51,856)	(51,896)
Trade and other payables	(2,306)	(2,550)	(2,325)	(3,160)	(3,460)
Total current liabilities	(2,306)	(2,550)	(2,325)	(3,160)	(3,460)
Total liabilities	(42,430)	(48,140)	(54,141)	(55,016)	(55,356)
Net assets	43,236	51,822	64,999	73,089	76,620
Basic and diluted IFRS NAV per share (p)	153	183	230	258	271
CASH FLOW					
Cash from operations	607	(1,416)	3,178	4,837	5,521
Tax paid	0	0	0	(365)	(585)
Net interest (paid)/received	(56)	(1,346)	(1,113)	(1,379)	(1,379)
Net cash from operations	551	(2,763)	2,065	3,093	3,557
Net cash from investing	3,610	(2,255)	(9,028)	(1,009)	(1,009)
Net cash used in financing	356	5,396	4,710	(1,585)	(1,783)
Net increase/(decrease) in cash and equivalents	4,516	378	(2,254)	500	766
Opening cash	0	4,516	4,894	2,640	3,140
Closing cash	4,516	4,894	2,640	3,140	3,905
Debt	(40,028)	(45,590)	(51,816)	(51,856)	(51,896)
Un-amortised loan arrangement costs & other	1,062	(130)	(86)	(46)	(6)
Net debt	(34,450)	(40,827)	(49,262)	(48,762)	(47,996)
Net LTV	44.3%	43.9%	43.2%	39.9%	38.4%

Source: Circle Property, Edison Investment Research

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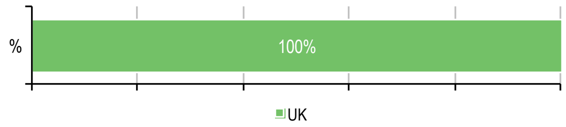
Revenue by geography



Leadership team

Non-executive chairman: Ian Henderson

Mr Henderson is a fellow of the Royal Institution of Chartered Surveyors and is a consultant to Capital and Counties (CAPC), Dolphin Square Foundation, and The Natural History Museum. He was formerly the CEO of Land Securities and has been widely involved in the UK property industry, including being a past president of the British Property Federation.

Chief executive officer: John Arnold

Mr Arnold is a fellow of the Royal Institution of Chartered Surveyors and worked at what is now CBRE from 1979 to 1986, when he joined Hambros. He became a director of the property subsidiary, Berkeley Hambro, in 1991, and a managing director of Investec Property in 1998 when it acquired Hambros Bank in 1998. He left Investec in 1999 and founded CPML in 2002.

Chief operating officer: Edward Olins

Mr Olins is a member of the Royal Institution of Chartered Surveyors. He joined DE & J Levy as a graduate surveyor and became a partner in 2000, leaving in 2003 to join London & County Estates as investment director. He joined CPML in 2006 to manage new business acquisitions and to assist Mr Arnold.

Principal shareholders (source: Circle Property)	(%)		(%)
Hastings	12.90	The Butterfly Trust	3.48
Hendref	8.76	Mary Christine Hambro	3.48
David Jeffrey Fisher	5.81	Charles Robert Henry Stone	3.31
Richard Moore	4.88	Nicola Jane Farquhar	3.31
Andrew Jonathan Stone	4.19	Judith Bodie	3.19
The Third Earl of Halifax 2004 Discretionary Trust	4.05		
Delta Securities Holdings	3.50		

Companies named in this report

Custodian REIT (CREI), Mucklow (MKLW), Palace Capital (PCA), Real Estate Investors (RLE), Regional REIT (RGL), Schroder REIT (SREI)

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