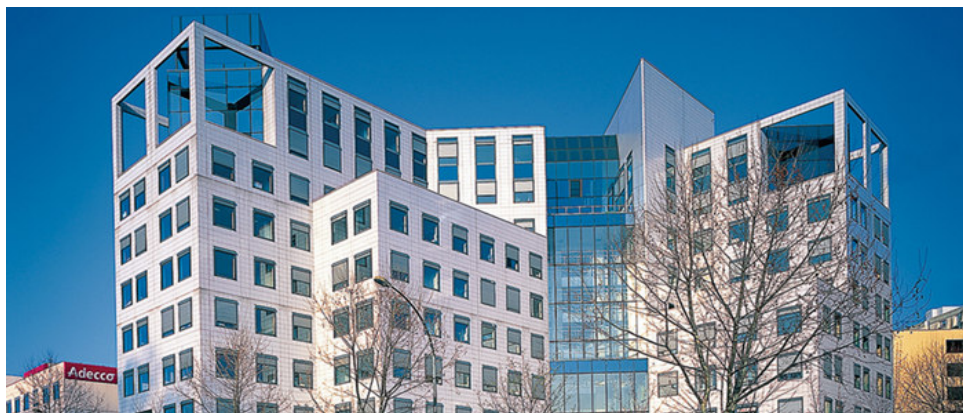


CLS Holdings (CLI)

Real Estate



INVESTMENT SUMMARY

- CLS is a property investment company with a diverse portfolio of £900m of modern, well-let properties in London, France, Germany and Sweden. The company's debt is well diversified with 64 loans from 19 banks and the loans are ring-fenced with all loans being non-recourse and at subsidiary level. The company is to further diversify its source of funding by issuing a retail bond (see below).
- Between 1 January 2008 and 30 June 2012, CLS produced a total return for its shareholders (capital growth plus distributions) of 106%, making it the top performing UK listed property company. The interests of management are closely aligned with those of shareholders as management own 54% of the company.
- The recently announced interim results, covering the six months to 30 June, revealed further growth in net asset value per share, as this rose to 1037.7p on an EPRA (European Public Real Estate Association) basis. The EPRA basis is used as it excludes certain non-recurring items and therefore is a better guide to the underlying business.
- The shares trade at a discount of 31% to underlying net asset value and although no dividend is paid the company distributes to shareholders via a tender offer twice a year - the payments for 2011 equate to a yield of 3.8%.
- In the recent interim results announcement, the group revealed plans to issue a retail bond on the LSE order book for retail bonds. Although details of the bond have yet to be publicized, it is expected that the bond will have a term of between 7 - 10 years and will be offered with an attractive coupon.

Results and Consensus Forecasts

Year to 31st December	Post-Tax Profit* (£m)	Earnings per Share* (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)	NAV per Share* (p)
2010A	20.1	42.5	16.8	23.65	3.3	952.9
2011A	29.7	64.9	11.0	27.20	3.8	983.1
2012E	31.0	69.0	10.3	30.00	4.2	1050
2013E	32.5	76.0	9.4	33.00	4.6	1100

* on EPRA basis

KEY DATA

Share Price:	714p
Prospective p/e ratio:	10.3x
Prospective net yield *:	4.2%
Market Capitalisation:	£313m
Next Results Due (Finals):	MAR
Gearing (at 30 June):	120%
NAV per share (EPRA basis):	1037.7p
* distributed as tender offer	



2011/12 Price Range: 726p/500p

BULLET POINTS

- Strategy of investing in high-yielding office properties funded by low cost debt
- Diversified portfolio with strong base of tenants
- The group's borrowings are well spread and the forthcoming bond issue will further advance this
- Experienced management team
- The shares trade at a significant discount of 31% to underlying NAV

Date of Report : 22 August 2012

www.brokerlink.co.uk

Company joined stockmarket in 1994

History

CLS made its initial investments in the UK in the 1980's with the main focus being on high-yielding office properties in London. The company joined the stockmarket in 1994. Subsequently, the group has increased its geographical spread to cover France, Germany and Sweden.

CLS generates superior returns by investing in high-yielding office properties funded by low cost debt

Aim to provide total return to shareholders of 12% per annum

Strategy

The group's strategy is to generate superior returns for its shareholders by investing in high-yielding office properties, which typically yield around 7%, with these assets being financed by cheaper loans, with the average cost of debt being 3.7% at 30 June 2012. As a result, the company is highly cash generative.

The group aims to provide a total return to shareholders of 12% per annum over the medium term through a combination of capital growth and distribution and this has been comfortably achieved since the start of 2008, with the total return being 106% between 1 January 2008 and 30 June 2012. The group pursues an active investment strategy focusing on cash returns but operating in diverse locations to reduce risk. The group maintains a broad base of tenants focused on governments and blue chip companies and utilises diversified sources of finance. An important feature of the group's finance arrangements is that the financing is taken out on specific properties upon which there is a specific charge - the loans are non-recourse and so in the event of any default on the loan only that property would be affected. The group maintains a tight control of costs and also looks to minimise vacant space in the portfolio.

Diverse investment portfolio. . . .

. . . . with 69% of rental income derived from governments or blue chips

Property Portfolio

The group has a diverse investment portfolio worth £904.4m, with properties in London (45%), France (26%), Germany (21%) and Sweden (8%). Of the 8% held in Sweden, 6% is held directly with 2% held through Catena AB, a Stockholm listed real estate company in which CLS has a stake of 29.9%. There are 76 properties within the portfolio, primarily office buildings, with a total area of 412,200 sq m.

The properties are let to a total of 408 tenants, with 41% of rental income derived from governments and a further 28% from major corporations such as BAE Systems or CAP Gemini. Of the group's rental income, 66% is subject to indexation. The portfolio currently has a historically low level of vacant properties at just 3.5%, whilst the weighted average lease length is 7.4 years. The group's rental income is currently £66.5m per annum.

The group's portfolio can be summarised as follows: -

Location	No. of Properties	Total Area (sq. m)	Value (£m)	Leading tenants
London	30	130,800	413	The Home Office, Secretary of State for Work & Pensions, Cap Gemini, BAE Systems
France	26	96,500	239	Grand Duchy of Luxembourg, Veolia
Germany	18	139,600	195	City of Bochum, E.on
Sweden	1	45,400	57	Vastra Gotaland County Council, Vanersborg Kommun
TOTAL			£904m	

Funding

The group has a well-managed financing strategy with 19 banks providing 64 loans whilst other types of debt include bonds and debentures. The majority of the group's debt is fixed or hedged, with 57% being floating rate loans which are capped, 23% being floating rate unhedged, 12% being fixed rate and 8% fixed through swaps. The group's policy is to ring-fence assets and loans at the subsidiary company level to protect the overall group as these loans are all non-recourse and are secured on just one property.

In May 2011, the group issued its first corporate bond, a SEK 300m issue in Sweden, which has been listed on the NASDAQ OMX in Stockholm. The group now proposes to follow this by issuing a retail bond in London (see details on page 4).

Other Property Assets

In addition to the above, the group has a 29.9% stake in the Stockholm listed real estate company Catena AB. In the first half of the year, the group also purchased a 16.6% stake in the Swedish residential property company Cood Investments Limited for £4.0m.

Corporate Bond Portfolio

CLS has a high level of liquid assets and, as interest rates have fallen to such low levels, the company uses corporate bond to generate a higher level of return. At the end of June, the bond portfolio had a value of £76.1m and had a yield of 10.3%. The portfolio consists of 34 bonds from 30 issuers.

Other Investments

The group also owns a 48.3% investment, carried in the balance sheet at £8.1m, in Bulgarian Land Developments Plc as well as a 20% stake in Nyheter 24 Group, A Swedish on-line news media company, which is carried in the balance sheet at £1.8m. .

*Corporate bond portfolio yielding
10.3%*

Increase in net asset value

Interim Results

In the six months to 30 June, the group has made significant progress with pre-tax profits on an EPRA basis rising to £17.9m (2011: £16.4m) although earnings per share on the same measure declined to 30.7p (2011: 37.4p), partly due to a higher tax charge. Net asset value per share on an EPRA basis also increased to 1037.7p (31 December 2011: 983.1p) helped by a reduction in vacancy levels; the pre-letting of a property in Germany and the gaining of planning permission for an important development in London. The group's property portfolio had increased in value to £904.4m (31 December 2011: £902.1m) whilst net debt at the end of the period was £546.3m. As usual, although no dividend has been declared, the company is to make a tender offer to shareholders on the basis that it will buyback 1 share for every 71 held at a price of 750p. Although the property market has remained difficult, the first half saw the group enjoy a number of planning gains and rent increases, whilst vacancy levels declined to a new low of just 3.5%. Other asset management initiatives included extending key leases and removing break clauses.

London - although the property market in London appears to be treading water, it is outperforming other areas of the UK and the portfolio increased in value by 3.1% in the first half. Although lettings are suffering around the M25, the market in Central London continues to outperform and CLS is benefitting from this. In May, the group secured planning consent on the first of its two applications in Vauxhall, for a mixed use scheme with 399 student bedrooms, a 120 bedroom hotel, a 561 sq m community centre and café, 469 sq m of office space, a 245 sq m convenience store and a new pedestrian mews. Construction of this should begin by the end of the year and the scheme should generate annual rental income of over £5m.

France - the slowing economy in France, combined with the election of a new president, has led to a more difficult property market with lower levels of enquiries and the group's vacancy rate rose from an all-time low of 2.7% last December to 3.8%. The value of the portfolio fell by 0.4% during the period as a result.

Germany - although the German economy has remained pretty resilient, office lettings in the top 6 cities were down 10.5% in the first half compared with 2011. However, with little new construction, vacancy levels at the group's properties fell to 5.2% and the decline in the value of the portfolio was limited to 0.2%.

Sweden - the group's Vanerparken property near Gothenberg is performing to plan with discussions due to begin soon on lease renewals, whilst Catena AB is continuing positive negotiations on its planning application for 950 apartments and 50,000 sq m of commercial space. It is hoped that consent will be received by the end of the year. Cood Investments, which specialises in holiday cottages and cabins, is performing satisfactorily.

New Retail Bond

In order to further diversify its borrowings, CLS is to issue a new retail bond which will be quoted on the London Stock Exchange Order Book for Retail Bonds. Although terms have still not been published, it is expected that the bond will have a term of around 7 years, thus making it eligible for SIPPs and ISAs. The minimum application seems likely to be £2,000 and interest will be paid twice a year. As is normally the case in these issues the bond will be unsecured.

GENERAL INFORMATION

COMPANY DATA

Stockbrokers:
Liberum Capital
N + 1 Brewin

Information:
Richard Tice
Chief Executive
t - 020 7582 7766

Contact Address:
86 Bondway
London
SW8 1SF

www.cls Holdings.com

SIGNIFICANT SHAREHOLDERS

	%
Sten Mortstedt	53.4
Other directors	1.06
Bengt Mortstedt	7.34
F & C Asset Management	5.61
Asset Value Investors	4.21

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1 Skipton Road
Ilkley
West Yorkshire
LS29 9EH

Tel : 01943 886602
Fax : 01943 886601
Email : info@brokerlink.co.uk
www.brokerlink.co.uk

