

Dexus (ASX:DXS)

ASX release



6 February 2019

2019 Half year results – Adding value

Dexus today announced its result for the half year and reaffirmed its guidance for distribution per security growth of circa 5% for FY19.

Dexus Chief Executive Officer, Darren Steinberg said: “It has been a productive six-month period where we have added value through enhancing our development pipeline and attracting new investors to our funds management business. This has all been achieved while maintaining low balance sheet gearing.

“In our office portfolio we continue to outperform the MSCI office benchmark¹ over one, three and five years through driving higher rents and lower incentives, particularly in Sydney which has been reflected in property valuations during the period.

“In our funds management business, we now have \$15 billion under management with investors and partners that can invest alongside us through the cycle, reinforcing our objective of being the wholesale partner of choice in Australian property.”

FINANCIAL HIGHLIGHTS

- Funds from Operations² (FFO) of \$353.3 million, up 9.8% on the previous corresponding period
- AFFO per security of 27.7 cents, up 14.5% on the previous corresponding period
- Distribution per security of 27.2 cents, up 14.8% on the previous corresponding period
- Net profit after tax of \$726.4 million, down 27.2% primarily due to net revaluation gains of investment properties being lower than those recognised in the previous corresponding period
- Gearing (look-through)³ of 23.7%, down from 24.1% at 30 June 2018

OPERATIONAL HIGHLIGHTS

Property portfolio

- One-year unlevered total return of 13.0% in the Dexus office portfolio and 15.5% in the Dexus industrial portfolio
- Increased office portfolio occupancy⁴ to 97.3% with Sydney office leasing spreads⁵ of +18%
- Progressed the group’s \$5.2 billion development pipeline, replenishing both the industrial and office development pipelines

Funds Management

- Achieved strong performance across all funds with outperformance for Dexus Wholesale Property Fund (DWPF) across all time periods
- Attracted new investors to Dexus’s funds management business
- Established a new circa \$2 billion unlisted trust that invests in Australian logistics properties seeded from Dexus’s existing portfolio

Trading

- Delivered \$34.7 million of trading profits (post-tax)
- Progressed developments to contribute to trading profits in future years

Financial results

Dexus’s net profit after tax was \$726.4 million, a decrease of \$270.7 million from the previous corresponding period. While FFO increased by \$31.5 million, the reduction in net profit was driven by net revaluation gains of investment properties of \$456.5 million, which were \$273.7 million lower than the previous corresponding period.

At 31 December 2018, 107 of Dexus’s 111 office and industrial assets were externally valued, including 45 office properties and 62 industrial properties. Valuation gains across the total property portfolio since 30 June 2018 were the primary driver of a 43 cent increase in NTA⁶ per security to \$10.07 at 31 December 2018.

Most of the valuation uplift across the office portfolio was due to further capitalisation rate compression and increasing market rents, particularly in Sydney. Revaluation increases across the industrial portfolio were driven by continued tightening in capitalisation rates at properties across the key Eastern seaboard markets.

The weighted average capitalisation rate across the total portfolio tightened 16 basis points over the past six months to 5.36%. The weighted average capitalisation rate of the office portfolio tightened 15 basis points from 5.37% at 30 June 2018 to 5.22% at 31 December 2018 and the industrial portfolio weighted average capitalisation rate tightened 26 basis points from 6.40% to 6.14%.

Distribution per security for the six months ended 31 December 2018 was 27.2 cents, up 14.8% on the previous corresponding period, with the distribution payout remaining in line with free cash flow in accordance with Dexus's distribution policy. The distribution will be paid to Dexus Security holders on Thursday, 28 February 2019.

Chief Financial Officer, Alison Harrop said: "We are in good shape financially and from a capital management perspective we undertook two long dated debt placements which further increased debt duration to 7.3 years. Our strong balance sheet provides us with the capacity to fund projects in our current and future development pipeline."

Dexus's gearing (look-through)³ of 23.7% at 31 December 2018 sits below the target range of 30-40%, with the average cost of debt at 4.2%.

Property portfolio

Dexus Office Portfolio

Key metrics	31 December 2018	30 June 2018
Occupancy by income	97.3%	96.0%
Weighted average lease expiry (by income)	4.5 years	4.6 years
Average incentives ⁵	11.9%	13.9%
Weighted average cap rate	5.22%	5.37%

Dexus Industrial Portfolio

Key metrics	31 December 2018	30 June 2018
Occupancy by income	96.8%	98.3%
Weighted average lease expiry (by income)	5.0 years	4.8 years
Average incentives	7.7%	12.6%
Weighted average cap rate	6.14%	6.40%

Executive General Manager, Office, Kevin George said: "Our office portfolio achieved a total return of 13.0%, driven both by valuation uplifts and leasing. Occupancy increased to 97.3% from 96.0% at 30 June 2018 driven by leasing in Sydney, our largest core market.

"Improving conditions in the Perth Prime office market continued to flow through to leasing activity at 240 St Georges Terrace resulting in 64% of the building now being leased⁷. We will capitalise on improving fundamentals in the local economy over the next 12 months as the property is repositioned.

"In Sydney, we've achieved office leasing spreads of +18% driven by continued strength in tenant demand. Leasing also progressed at 100 Mount Street, North Sydney with the development now 84% committed."

Other notable activity during the period included securing Heads of Agreement for a substantial portion of 2 and 4 Dawn Fraser Avenue, Sydney Olympic Park, with 59.4% of the total space across both buildings now committed.

The office portfolio achieved like-for-like income growth of 1.7%, which was affected by the vacancy at Sydney Olympic Park, however this is expected to normalise to 4-5% for FY19, consistent with the previously stated target.

Kevin George said: "Our industrial portfolio continues to benefit from an uptick in logistics and e-commerce demand, however occupancy decreased to 96.8% due to expiries during the period. We see further opportunities within the logistics sector as businesses seek to drive supply chain efficiencies and preferences for online retail continue to rise."

Development

Dexus progressed its \$5.2 billion group development pipeline, of which \$2.8 billion sits within the Dexus portfolio and \$2.4 billion within third party funds.

During the period, Dexus secured a prime office development site in the Melbourne CBD, through entering into agreements to acquire adjoining properties at 60 and 52 Collins Street, which, along with the development at 140 George Street, Parramatta increased Dexus's development pipeline to \$2.8 billion.

Chief Investment Officer, Ross Du Vernet said: "The Melbourne acquisitions provide Dexus with a presence in the tightly held 'Paris end' of Collins Street in the CBD. They also present a unique opportunity to undertake an office development creating long term value for investors in the next supply cycle, in a prime location where Dexus receives significant enquiry from its existing customer base."

Development works commenced at 240 St Georges Terrace in Perth which is due for completion in late 2020, one year earlier than previously stated due to the leasing success achieved over the past six months.

Construction topped out at 100 Mount Street in North Sydney, with the development expected to complete in May 2019. Works continue to progress at 180 Flinders Street in Melbourne and 12 Creek Street – The Annex in Brisbane.

Construction continues at four industrial properties across 83,600 square metres with three at Dexus Industrial Estate in Truganina, Victoria, two of which are pre-leased, and one at Greystanes which is also pre-leased.

Sustainability

Supporting Dexus's *New Energy, New Opportunities* strategy to achieve net zero carbon emissions by 2030, Dexus announced that terms had been agreed for one of Australia's first supply-linked renewable Energy Supply Agreements, which will purchase renewable energy off-site to power the base building services of more than 40 buildings across its New South Wales group property portfolio. This will be achieved through the procurement of renewable energy generation and presents a new lever for Dexus to achieve its 2030 target.

Dexus has made progress towards the group's target of having one million square metres of the office portfolio at a 5-star or above NABERS Energy rating by 2020, with 904,500 square metres now at this position.

Funds Management

Dexus now manages \$15.0 billion of funds on behalf of 73 third party clients after securing new investors during the period.

GIC is the foundation investor in the new Dexus Australian Logistics Trust (DALT or Joint Venture), a circa \$2 billion unlisted trust that invests in Australian logistics properties. The Joint Venture has been seeded with assets from Dexus's existing industrial portfolio comprising \$1.4 billion of core logistics properties and a \$138 million development landbank (circa \$0.5 billion on completion).

Executive General Manager, Funds Management, Deborah Coakley said: "The establishment of our new unlisted logistics vehicle unlocks the growth potential of the group industrial platform, broadening our relationships and providing a stable long-term source of capital to invest alongside us through the cycle."

During the period, Dexus also secured M&G Real Estate as a new investor in the Dexus Industrial Partnership. Since its establishment in June 2014, Dexus has achieved an unlevered IRR of 15.2% on its investment in the Partnership (including fees) and will continue to deliver on the Partnership's growth mandate through acquisitions and active management.

From a healthcare property perspective, works commenced on the North Shore Health Hub (a Dexus trading asset) targeted for the Healthcare Wholesale Property Fund which continues to generate interest from prospective investors and remains open for investment.

Supporting the group's commitment to the healthcare property sector, Dexus conditionally agreed⁸ to acquire an interest in Heathley Limited, the external manager of the Heathley Healthcare REIT, a new stapled vehicle proposed to list on the Australian Securities Exchange and in which Dexus would take a 10% cornerstone investment upon its listing. In December 2018, the proposed initial public offering was put on hold and discussions continue with the management of Heathley Limited.

All funds delivered strong performance, with DWPF achieving a one-year total return of 12.54%, outperforming its benchmark over one, three, five, seven and ten years. The Dexus Office Partnership delivered a one-year unlevered total property return of 12.09% and an annualised unlevered total property return of 14.59% since inception.

Dexus continued to progress the \$2.4 billion third party development pipeline which provides the opportunity to improve the quality of its clients' property portfolios and enhance future returns.

Trading

During the period, Dexus settled on the sale of an identified trading asset at 32 Flinders Street, Melbourne, which realised \$34.7 million of FY19 trading profits (net of tax).

A further five projects diversified across sectors and trading strategies have been earmarked to deliver trading profits of \$210-\$270 million pre-tax in future years, including 201 Elizabeth Street, Sydney where the hotel stratum is currently being marketed.

Construction is now underway at the North Shore Health Hub at 12 Frederick Street in St Leonards, with the facility now 51% leased ahead of expected completion in late 2020. The multi-tenanted facility will be located adjacent to the North Shore hospital precincts, offering occupants a new benchmark in medical workspace.

Summary and guidance

Darren Steinberg said: "As we head into 2019 we are cautious as a result of local and global uncertainty, however we are well positioned to continue to add value for our investors.

"In this environment we are supported by the positive office fundamentals in key markets driving high portfolio occupancy, our significant pipeline of development projects creating future value and quality unlisted partners to invest alongside us through the cycle. All of this is underpinned by our strong balance sheet."

Dexus reaffirms its market guidance⁹ for distribution per security growth of circa 5% for the 12 months ending 30 June 2019.

HY19 Reporting Suite

This *ASX announcement* should be read in conjunction with the *HY19 Results presentation*, *HY19 Financial Accounts* and *HY19 Property Synopsis*, released to the Australian Securities Exchange today and available on www.dexus.com

Investor conference call

Dexus will hold an investor conference call at 10.00am (AEDT) today, Wednesday 6 February 2019, which will be webcast via the Dexus website (www.dexus.com) and available for download later in the day.

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- 1 Period to 30 September 2018 which reflects the latest available MSCI Australia Annual Property Index (previously IPD) data available.
 - 2 FFO in accordance with guidelines provided by the Property Council of Australia (PCA): comprises net profit/loss after tax attributable to stapled security holders calculated in accordance with Australian Accounting Standards and adjusted for: property revaluations, impairments, derivative and FX mark-to-market impacts, fair value movements of interest bearing liabilities, amortisation of tenant incentives, gain/loss on sale of certain assets, straight line rent adjustments, deferred tax expense/benefit, transaction costs, rental guarantees and coupon income. Underlying FFO excludes trading profits net of tax. Adjusted FFO deducts maintenance capital expenditure and lease incentives.
 - 3 Adjusted for cash and for debt in equity accounted investments.
 - 4 By income.
 - 5 Excluding development leasing.
 - 6 Net tangible assets.
 - 7 Including Heads of Agreement post 31 December 2018.
 - 8 In October 2018, Dexus conditionally agreed that it would acquire an initial 28.5% interest in Heathley for \$11.3 million, with an option to acquire a further 21.5% interest in the future. Dexus would take a 10% cornerstone investment in the Healthcare REIT at the proposed issue price of \$2.00 per stapled security for consideration of \$37.3 million. Subject to the satisfaction of certain conditions including approval by Heathley shareholders and unitholders investing in existing Heathley-managed funds that are to become part of Healthcare REIT, key management personnel signing up to new employment contracts, successful completion of the IPO and no material adverse change in the PDS prepared with respect to the offer.
 - 9 Barring unforeseen circumstances, guidance is supported by the following assumptions: Impacts of announced divestments and acquisitions; FFO per security growth of circa 3%, underlying FFO per security growth of circa 3% underpinned by Dexus office portfolio like-for-like growth of 4-5%, Dexus industrial portfolio like-for-like income growth of 2.5-3.5%, management operations FFO and cost of debt broadly in line with FY18; trading profits of \$35-40 million net of tax; maintenance capex, cash incentives, leasing costs and rent free incentives of \$155-165 million; and excluding any further transactions.

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About Dexus

Dexus is one of Australia's leading real estate groups, proudly managing a high quality Australian property portfolio valued at \$28.9 billion. We believe that the strength and quality of our relationships will always be central to our success and are deeply committed to working with our customers to provide spaces that engage and inspire. We invest only in Australia, and directly own \$13.9 billion of office and industrial properties. We manage a further \$15.0 billion of office, retail, industrial and healthcare properties for third party clients. The group's \$5.2 billion development pipeline provides the opportunity to grow both portfolios and enhance future returns. With 1.7 million square metres of office workspace across 53 properties, we are Australia's preferred office partner. Dexus is a Top 50 entity by market capitalisation listed on the Australian Securities Exchange (trading code: DXS) and is supported by more than 27,000 investors from 19 countries. With more than 30 years of expertise in property investment, development and asset management, we have a proven track record in capital and risk management, providing service excellence to tenants and delivering superior risk-adjusted returns for investors. www.dexus.com

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