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Lodgement of Market Briefing

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Market Briefing

Interview with DEXUS senior management on the sale of its US industrial portfolio.

Interview with Darren Steinberg (CEO) and Craig Mitchell (CFO)

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DEXUS has just announced the sale of a portfolio of US industrial properties. Can you discuss the background to this portfolio sale, and what pricing was achieved?

Darren Steinberg

Our strategy is to exit offshore markets including the US, and this latest transaction follows the successful sale of the US$770 million central US portfolio at book value, to associates of The Blackstone Group in mid-2012.

We received a number of inbound inquires following the Blackstone transaction, and as a result we decided to run a formal process for the sale of our remaining US industrial portfolio. Due to the interest shown from several bidding parties, we were able to secure a price that represents a significant premium over book value for the majority of properties sold.

Twenty-five properties (including three land parcels) have been sold to an entity advised by Heitman LLC for US$542.8 million, a 13% premium to book value. In a separate transaction, another property, 1777 South Vintage Avenue, Ontario was acquired by an owner occupier at a 17% premium to book value. Selling South Vintage Avenue to a strategic buyer allowed us to achieve a stronger price for the property than if it were included in the portfolio sale.

In total, we achieved a US$561 million aggregate sale price (before transaction costs) compared to the properties' book value of US$494.5 million. This price represented a 13% premium to book. An entity sale also provides a clean exit from our US operations.

We will hold one remaining US asset in the short-term and will wind down our US operations by April 2013.

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What are your intentions for the one remaining US property?

Darren Steinberg

The remaining US based asset, known as Glendale, is located in Los Angeles and has a current book value of US$58.0 million and a 6.7% passing yield. The 456,000 square foot property is currently 100% occupied by 28 tenants, has a weighted average lease term of 3.4 years (in line with other comparable US industrial facilities), and only 5% of leases expiring over the next year.

The reason Glendale wasn't sold with the other US properties was due to further groundwater contamination issues from neighbouring sites identified during the due diligence process. Consequently, this property could not form part of the Heitman portfolio. This form of contamination is not uncommon in these types of industrial sites, and we expect to rectify the contamination issues in the next 12 months, allowing us to realise a fair and reasonable sale price for the property. The current book value of this property takes into account these contamination issues and estimated rectification costs.

The cost to rectify the contamination is expected to be approximately US$2 million and will involve the engagement of consultants. However, we are confident we will be able to sell this property within the next 12 to 18 months, which is within our targeted timeframe of exiting offshore markets.

CBRE will continue the property management of Glendale after the US operations are wound down until it is sold.

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What will happen to the US office and your US third party mandates?

Darren Steinberg

It is expected that the US office will be closed by April 2013.

The team, led by Bruce McDonald and Bryan Bentrott, has done an outstanding job in lifting portfolio occupancy and co-ordinating the sale of the central portfolio in June 2012 and now this transaction. Following the completion of this sale, the US based team will leave the DEXUS Group with the exception of Linda Smith, the Head of US Finance. Linda has been on secondment to the US office since June 2010 and will return to Australia.

The closure of our US operations is expected to generate an annual cost saving of approximately A$5 million. This cost saving is factored into our FY13 guidance and beyond.

The management agreements for approximately US$0.2 billion of third party mandates will end in early 2013, once the transaction completes. These agreements were short-term in nature and DEXUS provided only property management services.

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Where will DEXUS reinvest the sale proceeds?

Darren Steinberg

Our clear intention is to reinvest the proceeds from this sale back into our core Australian CBD office markets, where we believe we can add significant value.

We have shown over the past three months in particular that we can source product with favourable metrics, and we are confident in our abilities to reinvest this capital into our core markets, where considerable on and off market activity that fits our investment criteria is currently taking place. The sale provides us with various opportunities to consider. At present we have exposure to a number of potential acquisitions but we are also comfortable with a position of reduced gearing and quality earnings from our existing Australian portfolio.

In the meantime, at settlement, the net proceeds will initially be used to pay down debt. Gearing is expected to reduce from 29% to 24%, well below our target range of 30% to 40%, giving us the capacity to reinvest in opportunities in the current market cycle.

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What impact will the transaction have on the Net Tangible Asset backing of the Group?

Craig Mitchell

The transaction is expected to have a positive impact on Net Tangible Assets of $38 million or 0.8 cents per security, which equates to the accounting gain on sale (before recycling foreign currency translation reserves [FCTR]). The $66 million gross profit on sale is partially offset by $15 million in transaction costs and $13 million of finance payments taken to the P&L.

The transaction is expected to generate a statutory accounting profit of $11 million after recycling FCTR of $27 million. This FCTR amount is embedded in the equity of the Group's statutory accounts from prior net asset movements between 2004 and 2012. On disposal of foreign operations, the FCTR must be reallocated from reserves to retained earnings.

From a cash perspective, we expect to achieve gross sale proceeds of $561 million and have an associated 11% or approximately $61 million of total costs. A total of $15 million, or 3% of this, will be applied to transaction costs and property level pro-rations. The remaining 8%, or $46 million, relates to cash financing costs, primarily the upfront cost of a new in-the-money cross currency swaps, the close out costs associated with the fixed rate debt, and the mark-to-market on interest rate swaps.

These estimated accounting and cash flow impacts are broken down clearly in the appendix to our ASX announcement.

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DEXUS will retain some US Dollar denominated debt, so what will the Group's debt book look like after this transaction?

Craig Mitchell

In looking at this transaction it was important for us to maintain the diversity and duration of our debt sources.

Considering this objective, we have decided that we will partially repay the short-dated US 144A debt, with a US$50 million balance retained against our interest in Glendale. The early repayment is expected to result in a US$8 million make whole payment in accordance with the terms of the 144A document. A further payment, estimated at US$1-2million, will apply when we sell Glendale to either repay the remaining US$50 million balance or swap the balance to A$.

Our US private placement debt with 3.3 year duration and a low margin of 80 basis points is expected to be swapped back into Australian dollars at prevailing rates to allow us to further access this market in the future.

The long-dated 2021 expiry US 144A debt will not be repaid. To do this would be cost prohibitive, and equate to a cost around US$70 million. Further, we also want to be able to access this market in the future, and our preference is to retain longer duration debt. This bond has a US dollar coupon of 5.6% which would equate to a coupon of over 8% if we used a traditional cross currency swap to swap it back to Australian dollars. By using an in-the-money cross currency swap we expect to reduce the coupon to around 6.3%, at an upfront estimated cost of around US$29 million. This swap improves the ongoing earnings profile post the transaction and retains the long dated debt, while also allowing us to maintain a net cash flow positive outcome.

After the transaction our weighted average cost of debt is expected to be approximately 6.0%. Our debt is expected to have duration above four years and be around 60% hedged.

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What impact will this transaction have on DEXUS's earnings and distribution guidance?

Craig Mitchell

This transaction will not impact our 2013 financial year earnings or FFO guidance, with sale proceeds used to repay debt and associated transaction costs. This is largely a consequence of the $5 million savings associated with the closure of the US operations, which did not offer the scale benefits of our domestic operations. Our last stated earnings guidance of 7.75 cents per security and distribution guidance of 5.8 cents per security remains unchanged.

The transaction is also expected to have a neutral impact on earnings in 2014, however it is important to note that the quality of our earnings has significantly improved as we reallocate the proceeds from the offshore property sales to core Australian properties.

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Thank you, Darren and Craig.

For further information, please contact DEXUS Investor Relations on +61-2 9017 1424, ir@dexus.com or visit www.dexus.com