DEXUS Property Group (ASX:DXS)

ASX release

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2016 Annual results – Positioned for future growth

DEXUS Property Group (DEXUS) today posted a strong 2016 financial result, with Funds from Operations and distribution per security growth of 6.0%.

Darren Steinberg, DEXUS Chief Executive Officer said: "Four years ago we reset our strategy to focus our business on Australian office property and third party funds management. As a result, today we are Australia's largest office landlord with 1.8 million square metres of office space under management and have grown our third party funds from $5.6 billion in FY12 to $11.2 billion.

"We have fostered a culture of innovation and continuous improvement, invested in our people to build their capabilities and enhanced our customers' experience, delivering new products and services. Over the past four years, we have improved our efficiency reducing our Management Expense Ratio from 67 basis points to 35 basis points. At the same time, we have continued to maintain a strong balance sheet, and with recent divestments this further strengthens our position.

"We have expanded our development pipeline and identified trading opportunities, positioning the portfolio for future growth. The improving performance of our property portfolio has set us up to deliver a solid result in FY17 despite recent divestments, and we expect Underlying FFO per security to grow by 3.0-3.5% and distribution per security by 2.5-3.5%."

HIGHLIGHTS

- Funds from Operations[1] (FFO) of $610.8 million, up 12% on FY15
- Adjusted Funds from Operations[2] (AFFO) of $413.9 million, up 12% on FY15
- Statutory net profit of $1,259.8 million, up 104% on FY15, driven primarily by revaluations
- FFO per security of 63.1 cents and distribution per security of 43.51 cents, both up 6% on FY15
- Return on Equity[3] of 19.3% and an average of 12.2% over the past four years
- Group Management Expense Ratio[4] of 35bps, down 6bps from 41bps at FY15
- Net tangible assets (NTA) per security of $7.53 at 30 June 2016, up 13% or 85 cents from 30 June 2015
- Gearing[5] of 30.7%[8]

DEXUS property portfolio

- Strong one-year total returns of 16.0% in both the office and industrial portfolios
- Record year of office leasing activity with 385 leasing deals undertaken across 269,866 square metres[6]
- Improved office portfolio occupancy by income to 96.3%

Development

- Completed key office developments in Sydney, Perth and Brisbane, achieving strong returns
- Expanded the Group's pipeline of development opportunities over the next five years to $4.7 billion

Third Party Funds Management

- Delivered outperformance for third party clients
- Raised $658 million of equity in DEXUS Wholesale Property Fund (DWPF) from both existing and 10 new investors attracted to the Fund
- Management Operations income increased 18.2% to $44.8 million from $37.9 million in FY15

Trading

- Achieved settlement of Rosebery and Mascot trading properties, securing $63.3 million of trading profits net of tax
- Sold 57-65 Templar Road in Erskine Park, which settled in July 2016, contributing approximately $12 million pre-tax to FY17 trading profits
- Achieved leasing and planning outcomes at Parramatta and St Leonards enabling developments to progress, subject to appropriate regulatory approvals

Transactions

- Divested 36 George Street, Burwood[7] for $95 million and DEXUS's 50% interest of The Zenith, Chatswood for $139.5 million, reflecting 44% and 7% premia to book value respectively

DEXUS

PROPERTY GROUP

POST BALANCE DATE ACHIEVEMENTS

- Entered into an agreement to sell St Hilliers Road, Auburn, expected to contribute approximately $25 million pre-tax to FY17 trading profits
- Exchanged contracts to sell 108 North Terrace, Adelaide[7] for a gross sale price of $86.5 million, in line with the property's book value
- Entered into an agreement to sell Southgate Complex, Melbourne for a net sale price of $578 million, reflecting a 12% premium to book value, to settle across two equal tranches in FY17 and FY18

FINANCIAL RESULTS

DEXUS delivered a 12.2% increase in FFO to $610.8 million, or 63.1 cents per security, reflecting a 6% increase. The Underlying business excluding trading profits delivered FFO per security of 56.5 cents, up 3.1% on the prior year. The remainder of the FFO increase was achieved through the realisation of $63.3 million in trading profits (net of tax), up $20.7 million on the prior year.

Statutory net profit after tax was $1,259.8 million, an increase of $641.1 million on the prior year. This movement was driven primarily by the $814.4 million of net revaluation gains on investment properties, which were $573.4 million higher than the gains in FY15.

NTA per security increased 85 cents to $7.53, primarily as a result of investment property revaluation gains.

Distribution per security was 43.51 cents for the 12 months ended 30 June 2016, up 6% on the prior year, with the payout ratio remaining in line with free cash flow. The distribution for the six months ended 30 June 2016 of 20.46 cents per security will be paid to DEXUS Security holders on Wednesday, 31 August 2016.

Capital management

Key metrics	30 June 2016	30 June 2015
Gearing[5] (look-through)	30.7%[8]	28.5%
Weighted average term of debt	5.5 years	5.7 years
Cost of debt	4.8%	5.2%
Hedged debt[9]	64%	69%

Chief Financial Officer, Alison Harrop said: "We continue to maintain a strong balance sheet, with gearing of 30.7%[5] expected to reduce to approximately 27% over the next six months post the receipt of proceeds from recently announced divestments.

"We acted on reverse enquiry during the year, securing $260 million of capital markets debt on average terms of 10.2 years, which assisted in keeping DEXUS's debt duration high at 5.5 years. DEXUS also has minimal short term refinancing requirements and remains within all of its debt covenant limits and target ranges."

IOF transaction

DEXUS remained disciplined in the proposal (Proposal) put forward to acquire all of the units in Investa Office Fund (IOF), which arose in December 2015 as a consequence of an unsolicited approach from the advisers to the Independent Board Committee (IBC) of Investa Listed Funds Management Limited to DEXUS.

At the IOF Unitholder Meeting held on 15 April 2016, the resolution relating to the Proposal was not passed by the requisite 75% of IOF Unitholders, despite having support from the IBC, Independent Expert, Proxy Advisers and a large number of IOF Unitholders, and the transaction did not proceed.

PORTFOLIO UPDATE

Valuations and portfolio total returns

Recent leasing success, combined with comparable market transactions for quality Australian office property with strong tenant covenants, contributed to a $769.1 million or 9.1% increase in valuations on prior book values across DEXUS's office portfolio. The weighted average capitalisation rate for the office portfolio tightened 55 basis points from 6.71% at 30 June 2015 to 6.16% at 30 June 2016.

Continued strong investment demand for well-located prime quality industrial facilities contributed to a 39 basis point tightening of capitalisation rates across DEXUS's Industrial portfolio from 7.77% at 30 June 2015 to 7.38% at 30 June 2016, resulting in an uplift of $45.3 million or 2.7% on prior book values.

Darren Steinberg said: "Following strong valuation growth in the first six months of the year, the second half of the year saw further cap rate improvement in line with our expectations. The 'lower for longer' interest rate cycle is expected to underpin demand for quality real estate assets in FY17 and continue to support asset values."

DEXUS office portfolio

Portfolio value:	$9.2 billion
Total area:	1,562,997 square metres
Area leased during the year:	269,866 square metres[6]

Key metrics	30 June 2016	30 June 2015
Occupancy by income	96.3%	95.3%
Occupancy by area	96.3%	95.5%
WALE by income	4.7 years	4.3 years
Average incentive	17.7%	15.0%
Retention rate	62%	61%
Total return – 1 year	16.0%	9.6%

Kevin George, Executive General Manager, Office and Industrial, said: "We had a record year of leasing across our portfolio with high demand for A-grade space in the Sydney CBD and the flight to quality now filtering through to Premium properties. Our suite strategy and the repositioning of Premium properties, including Grosvenor Place and 1 Farrer Place in Sydney, have enhanced our leasing success across the portfolio, enabling us to capitalise on the demand from small space users and the acceleration in the flight to quality occurring in the Sydney CBD market."

During the year, DEXUS leased 269,866 square metres[6] of office space across 385 transactions. Office portfolio occupancy (by income) increased to 96.3% from 95.3% at 30 June 2015, delivering on the 'above 95%' target set at the start of the year. Office portfolio WALE improved to 4.7 years, driven by the final completion of major developments in Sydney, Perth and Brisbane.

DEXUS maintained tenant retention of 62% and successfully leased 72% of the area vacated during the year, with average downtime of six months across all space vacated. Effective deals represented a lower percentage of total leasing in FY16 compared to FY15, which meant that overall office portfolio incentives rose marginally. An opportunity for DEXUS to further enhance value exists with 59% of FY17 expiries located in the Sydney CBD office market. Office property FFO increased by $33.9 million, or 6.4% to $567.2 million underpinned by the acquisition of Waterfront Place Complex, Brisbane, with office like-for-like income increasing by 1.0% compared to FY15.

In FY17, DEXUS will focus on maintaining office occupancy above 96% and is targeting office like-for-like income growth to return to normalised levels of 2-3% (3.5-4.5% excluding 240 St Georges Terrace, Perth).

DEXUS industrial portfolio

Portfolio value:	$1.8 billion
Total area:	1,284,554 square metres
Area leased during the year:	204,238 square metres[6]

Key metrics	30 June 2016	30 June 2015
Occupancy by income	90.4%	92.4%
Occupancy by area	89.3%	91.7%
WALE by income	4.1 years	4.0 years
Average incentive	9.5%	10.8%
Retention rate	32%	53%
Total return – 1 year	16.0%	11.3%

Kevin George said: "Industrial occupancy was impacted over the year by some large tenant movements, longer downtime and reduced leasing activity, particularly in Melbourne's south east. The Sydney portfolio, however, is performing strongly with occupancy of 95.9%, and industrial demand continues to benefit from solid economic growth in NSW, with increased take-up from sectors such as automotive parts, dairy, health and pharmaceuticals."

During the year, DEXUS leased 204,238 square metres[6] of industrial space across 73 transactions, of which 42 were new leases. Industrial portfolio WALE remained steady at 4.1 years. Average incentives decreased slightly to 9.5%.

Industrial property FFO decreased by $6.2 million, or 5.5% to $106.1 million as a result of the sale of Mascot and Rosebery at the start of FY16. In addition, like-for-like income reduced 7.1%, driven by vacancies at Knoxfield, Matraville and Dandenong, coupled with longer downtime. This was partially offset by fixed rental increases across the remainder of the portfolio and the acquisition of Lakes Business Park, Botany.

In FY17, DEXUS will focus on actively managing the industrial portfolio to improve industrial occupancy from current levels and is targeting industrial like-for-like income growth to return to normalised levels of 3-4%.

Development

After completing $720 million worth of projects on-balance sheet in FY16, DEXUS has replenished the Group pipeline which now stands at $4.7 billion, of which DEXUS's balance sheet pipeline accounts for $1.7 billion. Key office developments in Sydney, Brisbane and Perth were all completed during the year with the office space substantially committed or secured by rental guarantees on practical completion. This, along with market cap rate compression, has resulted in the strong returns achieved at these projects.

In FY17 DEXUS will commence the construction of its office development at 100 Mount Street, North Sydney[10]; advance pre-commitments to enable activation of identified office and industrial developments for DEXUS and its third party clients; and continue to progress master planning for developments including the Waterfront Place precinct in Brisbane and an opportunity in the Sydney CBD.

FUNDS MANAGEMENT

Third party funds under management increased to $11.2 billion, up 17% from 30 June 2015, driven by acquisitions, developments and revaluations.

DWPF achieved a one-year total return of 14.7%, and outperformed its benchmark over one, three, five and seven years. DWPF was also successful in raising $658 million of equity from both existing and 10 new investors attracted to the Fund.

The DEXUS Office Partnership portfolio delivered an unlevered one-year total property return of 17.7% and an annualised 14.6% unlevered total property return since inception in April 2014. DEXUS Security holders have received a levered total return of 21.1% per annum, including the initial 14.9% interest in the former Commonwealth Property Office Fund.

Development completions included three key office developments in Sydney, Brisbane and Perth, industrial developments at Greystanes, Richlands and Larapinta and retail refurbishments at Westfield Hurstville and Westfield North Lakes.

Major retail redevelopments commenced at Willows Shopping Centre in Townsville and Westfield North Lakes, and city retail redevelopments at Gateway and Grosvenor Place in Sydney are due for completion in late 2016. Pre-commitments have been secured for new industrial facilities at Quarrywest in Greystanes, with these projects commencing in FY17.

TRADING

Trading profits of $63.3 million net of tax were achieved in FY16, which included the settlement of 5-13 Rothschild Avenue and 22-55 Rosebery Avenue, Rosebery and 154 O'Riordan Street, Mascot in July 2015.

DEXUS is well positioned to deliver future trading profits, having identified six priority projects earlier in the year to generate trading profits over the next three years.

Of the priority projects, DEXUS sold 57-65 Templar Road in Erskine Park for $50 million, which settled in July 2016 and will contribute approximately $12 million pre-tax to trading profits in FY17.

Construction commenced at 105 Phillip Street in Parramatta, after securing a 12-year lease with Government Property NSW over 100% of the development, with completion expected in March 2018.

In August 2016, DEXUS entered into an agreement to sell 77-99 St Hilliers Road in Auburn for $65 million which is expected to contribute approximately $25 million pre-tax to FY17 trading profits.

In FY17, DEXUS is targeting trading profits of approximately $45-50 million, net of tax. The Parramatta development will be progressed; the proposed mixed-use development at St Leonards will be de-risked; the remaining priority projects will be further progressed; and DEXUS will continue to focus on the trading pipeline for future years.

SUMMARY AND FUTURE FOCUS

Darren Steinberg said: "As you can see from today's results, our strategy is working.

"We are in a strong position to capitalise on improved conditions along the East Coast CBD office markets, particularly in Sydney, and we have a significant development pipeline with opportunities identified to add value.

"The downward shift in global interest rates together with strong underlying investor demand for quality Australian real estate will continue to underpin future asset valuations. We are focused on capturing market rental growth and managing cash flows by reducing incentives and capex, which will drive future returns.

"Our focus on the customer and excellence in asset management, combined with a strong local knowledge of Australian real estate, will continue to drive long term investment performance.

"This means that we will remain active in leasing, acquiring, developing and recycling properties. Going forward, improved office market conditions combined with our scale in core CBD office markets, which provides valuable customer insights, will contribute to strong performance for our investors and third party clients."

Taking into account recently announced divestments DEXUS's guidance[11] for the 12 months ending 30 June 2017 is:

- 3.0-3.5% growth in Underlying FFO per security
- FFO per security in line with FY16, and
- 2.5%-3.5% growth in distribution per security.

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About DEXUS

DEXUS Property Group is one of Australia's leading real estate groups, investing directly in high quality Australian office and industrial properties. With $22.2 billion of assets under management, the Group also actively manages office, industrial and retail properties located in key Australian markets on behalf of third party capital partners. The Group manages an office portfolio of 1.8 million square metres located predominantly across Sydney, Melbourne, Brisbane and Perth and is the largest owner of office buildings in the Sydney CBD, Australia's largest office market. DEXUS is a Top 50 entity by market capitalisation listed on the Australian Securities Exchange under the stock market trading code 'DXS' and is supported by more than 31,000 investors from 21 countries. With more than 30 years of expertise in property investment, development and asset management, the Group has a proven track record in capital and risk management, providing service excellence to tenants and delivering superior risk-adjusted returns for its investors. View our new website at www.dexus.com

Download the DEXUS IR app to your preferred mobile device to gain instant access to the latest stock price, ASX Announcements, presentations, reports, webcasts and more.

1. 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, amortisation of intangible assets, rental guarantees and coupon income.
2. AFFO is calculated in line with the Property Council of Australia definition and comprises PCA FFO adjusted for: maintenance capex, incentives (including rent free incentives) given to tenants during the year and other items which have not been adjusted in determining FFO.
3. Return on Equity is calculated as the growth in NTA per security plus the distribution paid/payable per security divided by the opening NTA per security.
4. Group Management Expense Ratio is calculated as annual costs arising from managing DEXUS assets and corporate activity divided by balance sheet funds under management at the end of the year.
5. Gearing is adjusted for cash and for debt in equity accounted investments.
6. Including Heads of Agreement.
7. Owned by the DEXUS Office Partnership, in which DEXUS has a 50% interest.
8. Proforma gearing is expected to reduce to circa 27% post the receipt of proceeds from the sale of 57-65 Templar Road, Erskine Park; The Zenith, Chatswood; 108 North Terrace, Adelaide; the first 50% tranche of Southgate Complex, Melbourne and 79-99 St Hilliers Road, Auburn.
9. Average for the year (excluding caps). Average for the year (including caps) was 71%.
10. Owned 50% DEXUS and 50% DWPF.
11. Barring unforeseen circumstances guidance is supported by the following assumptions: Impact of dilution from the divestment of: 36 George Street, Burwood; 57-65 Templar Road, Erskine Park; The Zenith, Chatswood; 108 North Terrace, Adelaide; the first 50% tranche of Southgate Complex, Melbourne and 79-99 St Hilliers Road, Auburn; 2-3% like-for-like income growth across the DEXUS Office portfolio and 3-4% like-for like income growth across the DEXUS Industrial portfolio, weighted average cost of debt of circa 4.6%, trading profits of circa $45-50m net of tax, Management Operations FFO of circa $45-50m (including third party development management fees), and excluding any further transactions.