Dexus (ASX:DXS)

ASX release

14 February 2018

2018 Half year results – Positive momentum

Dexus today announced a strong result for the first six months of FY18 and upgraded its guidance for distribution per security growth for FY18.

Darren Steinberg, Dexus Chief Executive Officer said: "Our core office markets across the country are all showing positive leasing activity and the latest record employment numbers support our view of continued positive momentum over the next few years.

"We have seen more evidence of strong take up in Sydney and Melbourne and have converted significant levels of enquiry to leasing commitments at 240 St Georges Terrace in Perth.

"Our focus on enhancing returns through the activation of office development projects in Melbourne, Brisbane and Perth enables us to leverage our leasing and development expertise and is an efficient use of capital at this point in the cycle.

"Our funds continue to deliver strong performance and we completed the first equity raise for the new Healthcare Wholesale Property Fund, generating interest in the sector from global and domestic investors, and adding three new clients onto our platform.

"We advanced opportunities that will contribute to future trading profits and are confident of securing our FY18 target.

"From an employee perspective, we achieved an engagement score of 87% in our latest Willis Towers Watson employee engagement survey, which is eight percentage points higher than the Australian National Norm and two percentage points above the Global Property and Asset Management Norm."

FINANCIAL HIGHLIGHTS

- Net profit after tax of $997.1 million, up 39.3% on the previous corresponding period
- Funds from Operations[1] (FFO) of $321.8 million, up 8.7% on the previous corresponding period
- Underlying FFO per security (FFO excluding trading profits) of 30.2 cents, up 1.7% on the previous corresponding period
- Distribution per security of 23.7 cents, up 9.2% on the previous corresponding period
- Reduced the Group Management Expense Ratio to 33 basis points
- Completed Dexus's largest ever debt raising of $653 million, achieving Dexus's longest average duration for a debt issue of 13.5 years and extending Dexus's total debt duration to 7.0 years
- Gearing (look-through)[2] of 26.5%

OPERATIONAL HIGHLIGHTS

Property portfolio

- One-year unlevered total return of 15.8% in the Dexus office portfolio and 15.4% in the Dexus industrial portfolio
- High office portfolio occupancy[3] of 96.5% with Sydney office leasing spreads[4] of +16%
- Continued industrial leasing activity, increasing industrial portfolio occupancy[3] to 97.5%
- Activation of three office projects in Dexus's $2.1 billion development pipeline

Funds Management

- Top quartile performance for Dexus Wholesale Property Fund (DWPF) over one, three, five, seven and ten years, and completed a $300 million equity offer, following DWPF's acquisition of a 25% interest in the MLC Centre
- One-year unlevered total property return of 16.5% for the Dexus Office Partnership, and an annualised unlevered property return of 15.3% since inception
- Completed the first equity raise for the Healthcare Wholesale Property Fund
- Acquired 56 Berry Street, North Sydney and exchanged contracts to sell 11 Waymouth Street, Adelaide for the Dexus Office Partnership[5]

Trading

- $14.3 million of trading profits net of tax
- Advanced the trading pipeline through progressing development proposals to contribute to profits in future years

Financial results

Dexus's net profit after tax was $997.1 million, an increase of $281.1 million from the previous corresponding period. The key drivers of this movement included: FFO, which increased by $25.8 million resulting in FFO per security of 31.6 cents, an increase of 3.3%; and net revaluation gains of investment properties of $730.2 million, representing a 6.4% uplift across the total portfolio, were $334.2 million higher than the previous corresponding period. This was partially offset by the change in gains from the sale of investment properties compared to the previous corresponding period.

The underlying business excluding trading profits delivered FFO per security of 30.2 cents, up 1.7% on the previous corresponding period.

At 31 December 2017, 96 of Dexus's 103 assets were externally valued, comprising 44 office properties and 52 industrial properties. Valuation gains across the total property portfolio were the primary driver of a 71 cent increase in NTA[6] per security to $9.16 at 31 December 2017.

Most of the valuation uplift was due to further capitalisation rate compression experienced in both Sydney and Melbourne, supported by market sales evidence, with the remainder from market rent growth. The weighted average cap rate across the total portfolio tightened 29 basis points over the past six months to 5.66%. The weighted average capitalisation rate of the office portfolio tightened 28 basis points from 5.78% at 30 June 2017 to 5.50% at 31 December 2017 and the industrial portfolio weighted average capitalisation rate tightened 23 basis points from 6.88% to 6.65%.

Distribution per security was 23.7 cents for the six months ended 31 December 2017, up 9.2% 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 Wednesday, 28 February 2018.

Alison Harrop, Chief Financial Officer, said: "From a capital management perspective we completed our largest ever debt raising of $653 million, achieving Dexus's longest average duration for a debt issue of 13.5 years and extending our total debt duration to 7.0 years."

Dexus's gearing (look-through)[2] of 26.5% at 31 December 2017, sits below the target range of 30-40%, with the average cost of debt at 4.0%.

Property portfolio

Dexus Office Portfolio

Key metrics	31 December 2017	30 June 2017
Occupancy by income	96.5%	97.2%
Weighted average lease expiry (by income)	4.6 years	4.8 years
Average incentive	15.0%[4]	14.5%
Weighted average cap rate	5.50%	5.78%

Dexus Industrial Portfolio

Key metrics	31 December 2017	30 June 2017
Occupancy by income	97.5%	96.5%
Weighted average lease expiry (by income)	5.0 years	5.1 years
Average incentive	15.8%	14.5%
Weighted average cap rate	6.65%	6.88%

Our office and industrial portfolios achieved returns of 15.8% and 15.4%, driven mostly by valuation uplifts and leasing.

Kevin George, Executive General Manager, Office and Industrial said: "The high levels of leasing enquiry we've experienced in the Perth office market have materialised into significant leasing at 240 St Georges Terrace, with three deals secured across 15,464 square metres of the future space that Woodside will vacate in December 2018, bringing committed space to approximately 40%. We're encouraged by the early tenant interest, and hope to capitalise on improving economic and market fundamentals over the next 18 months as the asset is repositioned.

Like-for-like income in the office portfolio of -0.4% was impacted by activity at 30 The Bond in Sydney. Excluding 30 The Bond, like-for-like income growth in office was 6.1%. Dexus remains confident of achieving its FY18 like-for-like income growth target in office of 4-5%.

Office portfolio occupancy reduced slightly to 96.5% as a result of Commonwealth Bank Australia vacating 2 Dawn Fraser Avenue, Sydney Olympic Park in December 2017, which also impacted retention for the period. Dexus is currently in discussions with a number of parties in regards to the vacancy, with the property presenting well for groups looking to consolidate their accommodation needs.

Kevin George said: "In Sydney we've achieved office leasing spreads of +16% and over the past 18 months have benefited from the trend of large companies in the health, insurance and pharmaceutical sectors centralising into the CBD, while in Melbourne the education sector has grown its footprint in the CBD."

Since completion of the acquisition of the MLC Centre, six leasing deals have been completed with small space users, with all deals supporting our acquisition metrics in relation to rents and incentives.

Kevin George said: "Our industrial portfolio continues to benefit from an uptick in logistics and e-commerce demand, which contributed to an improvement in occupancy to 97.5%."

The industrial portfolio achieved like-for-like income growth of 1.0% and Dexus remains confident of achieving its FY18 like-for-like income growth target of 3-4% in industrial.

From a sustainability perspective, Dexus now has over 765,000 square metres of its office properties with a 5 star NABERS Energy rating or above, progressing the group's target of having one million square metres at this position by 2020.

Development

Dexus progressed its $4.2 billion group development pipeline, of which $2.1 billion sits within the Dexus portfolio and $2.1 billion within third party funds.

Ross Du Vernet, Chief Investment Officer said: "With leasing success in our core office markets we have the confidence to activate two more high quality office projects. 180 Flinders Street will be a 20,100 square metre project in the heart of Melbourne's CBD, while our 12 Creek Street Annex project is on a prominent corner in Brisbane's golden triangle where we will bring to market a very boutique small floorplate offering."

Works progressed at 100 Mount Street, North Sydney, and NBN was secured as a new customer across 20,364 square metres, the first major leasing deal at the project, since construction commenced in early 2016. As a result, the building is now 60% committed by area, ahead of its completion in early 2019. Works at 105 Phillip Street, Parramatta remain on track with construction topping out in September 2017.

In industrial, two developments leased to Isuzu and Anmar covering 37,600 square metres were completed in Laverton North, Victoria and construction continues at five properties, two located in Laverton North and three in Greystanes, NSW with all five properties 100% pre-leased.

Dexus is finalising the development plans for 240 St Georges Terrace, Perth which will become part of Dexus's development pipeline from FY19. The extensive works include creating a new street entry, a new north facing outdoor terrace on Level 16 for functions, new end-of-trip facilities and gymnasium, in addition to an improved retail offering. The targeted returns are in line with previous office developments, targeting a yield on cost of circa 7% and a double-digit IRR.

Transactions

The group completed $1.6 billion of transactions including the settlement of the acquisition of the MLC Centre, Sydney, 100 Harris Street, Sydney and 90 Mills Road, Braeside. Other transactions included the Dexus Office Partnership's acquisition of 56 Berry Street, North Sydney and the exchange of conditional contracts to sell 11 Waymouth Street, Adelaide.

Funds Management

Dexus now manages $13.4 billion of funds on behalf of 73 third party clients following the completion of the first equity raise for the Healthcare Wholesale Property Fund. The fund is seeded with approximately $370 million of properties (on completion value) and has a pipeline of high quality opportunities with estimated on completion values of approximately $445 million including the North Shore Health Hub at 12 Frederick Street, St Leonards in Sydney and a medical research facility in Adelaide.

All funds delivered strong performance, with DWPF achieving a one-year total return of 13.75%, outperforming its benchmark over one, three, five, seven and ten years. The Dexus Office Partnership delivered a one year unlevered total property return of 16.5% and an annualised unlevered total property return of 15.3% since inception.

During the six months to 31 December 2017, Dexus completed DWPF's $300 million equity offer following the acquisition of its 25% interest in the MLC Centre, Sydney.

Dexus continued to progress the $2.1 billion third party development pipeline which provides an opportunity to improve the quality of its clients' property portfolios and enhance future returns.

Trading

During the period, $14.3 million of trading profits (net of tax) were recognised primarily in relation to the sale of 105 Phillip Street Parramatta. This property was divested in May 2017 with profits recognised across both FY17 and FY18 in line with development progress. 105 Phillip Street will secure approximately 60% of FY18 trading profits. Dexus is confident of achieving the full year profit target of $35-$40 million post tax through the sale of one other trading property, which is expected in the second half of FY18.

Progress was made at 12 Frederick Street, St Leonards with the completion of a leasing expression of interest campaign in late 2017 and submission of development concepts for planning approval. Six projects have been earmarked to deliver trading profits in future years, including potential opportunities at Parramatta and Gladesville.

Outlook and guidance

Darren Steinberg said: "Our long-standing strategy is working for investors. The combination of earnings from our properties, funds management and trading, has enabled us to deliver consistent growth in distributions through a variety of market conditions over the past six years.

"Australia is set to continue to benefit from global economic growth, population growth and considerable construction activity in the infrastructure sector over the next two years. We believe this will have a positive flow on effect on demand for office and industrial space over the same time period.

"We expect to see support for real estate values over the next 12 months as a result of the strength of property fundamentals in Sydney and Melbourne along with the improving fundamentals in Perth and Brisbane."

Dexus is well positioned to continue to benefit from positive property fundamentals and deliver future growth.

Recent volatility in equity markets, has resulted in Dexus announcing plans to initiate an on-market securities buy-back of up to 5% of Dexus securities on issue, providing the opportunity to enhance investor returns.

As a result of improved performance across a number of areas in the underlying business, Dexus has upgraded its market guidance[7] for distribution per security growth to 4.5-5.0% from 4.0-4.5% for the 12 months ending 30 June 2018.

HY18 Reporting Suite

This *ASX announcement* should be read in conjunction with the *HY18 Results presentation*, *HY18 Financial Accounts* and *HY18 Property Synopsis*, released to the Australian Securities Exchange today and available on www.dexus.com

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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, rental guarantees and coupon income. Underlying FFO excludes trading profits net of tax. Adjusted FFO deducts maintenance capital expenditure and lease incentives.

2 Adjusted for cash and for debt in equity accounted investments.

3 By income.

4 Excluding development leasing.

5 In which Dexus holds a 50% interest.

6 Net tangible assets.

7 Barring unforeseen circumstances guidance is supported by the following assumptions: impacts of announced divestments and acquisitions; underlying FFO per security growth of 2.5-3.0% underpinned by Dexus office portfolio like-for-like growth of 4-5%, Dexus industrial portfolio like for like growth of 3-4%, management operations of c.$50 million and cost of debt broadly in line with FY17; trading profits of $35-40 million net of tax; maintenance capex, cash incentives, leasing costs and rent free incentives of $165-170 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 $26.5 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 $13.1 billion of office and industrial properties. We manage a further $13.4 billion of office, retail, industrial and healthcare properties for third party clients. The group's $4.2 billion development pipeline provides the opportunity to grow both portfolios and enhance future returns. With 1.8 million square metres of office workspace across 55 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 28,000 investors from 20 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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