

DEXUS Property Group (ASX:DXS)

ASX release

15 February 2017

2017 Half year results - Delivering growth in underlying business

DEXUS Property Group (DEXUS) today announced that it had achieved strong operational results, delivering growth in its underlying business, and has upgraded market guidance for the 2017 financial year.

Darren Steinberg, DEXUS Chief Executive Officer, said: "Our commitment to delivering value for investors has seen us remain active through leasing, development and transactional activity.

"Income growth from leasing activity and development completions during FY16 helped to offset the impact of recent asset sales, driving a solid underlying result.

"We've progressed priority projects in our trading pipeline as well as opportunities to restock the future pipeline and we're confident that the remaining forecast trading profits will be realised in the coming months, delivering on our FY17 target."

HIGHLIGHTS

- Increased underlying Funds from Operations¹ (FFO) to \$287.7 million, up \$27.1 million or 10.4% on the previous corresponding period
- Improved the Group Management Expense Ratio² to 36 bps, down 4 bps from the previous corresponding period
- Increased Net Tangible Assets (NTA) per security by 6.9% or 52 cents from 30 June 2016 to \$8.05 at 31 December 2016
- Achieved gearing³ of 26.5%, down 4.2 percentage points from 30 June 2016

DEXUS property portfolio

- Delivered a strong one-year total return of 13.9% across the DEXUS Office portfolio
- Achieved significant leasing volumes, with 225 leasing transactions undertaken across 327,938 square metres⁴, including record levels of leasing across the DEXUS Industrial portfolio
- Improved the DEXUS Industrial portfolio's occupancy by 4.5 percentage points to 94.9%

Development

- Commenced construction of the core of 100 Mount Street, North Sydney
- Added new projects to the uncommitted development pipeline including 201 Elizabeth Street, Sydney
- Post period end, secured 39,112 square metres of industrial development pre-commitments

Funds Management

- Delivered outperformance against respective benchmarks for all third party clients
- Acquired Carillon City retail centre in Perth CBD on behalf of DEXUS Wholesale Property Fund (DWPF)
- Opened the new Gateway and Grosvenor Place food/restaurant precincts in Sydney, enhancing investor returns and improving the amenity for our office tenants

Trading

- Delivered \$8.3 million of trading profits⁵ in HY17. In January 2017, secured a further \$17 million towards the FY17 trading profit target of \$45-50 million⁵
- Progressed priority trading projects and focussed on opportunities to restock the future trading pipeline, receiving local Council and Regional Planning Panel endorsement of a concept scheme for an office building at 140 George Street, Parramatta

Transactions

- Settled on \$688 million of asset sales, including the sale of 39 Martin Place, Sydney⁶
- Acquired The Mill in Alexandria, expanding DEXUS's customer offering and providing the opportunity to activate underutilised floor space and capture rental growth

FINANCIAL RESULTS

DEXUS's underlying business (excluding trading profits) delivered FFO per security of 29.7 cents, up 10.6% on the previous corresponding period. Statutory net profit after tax of \$716.0 million was largely impacted by lower revaluations and lower trading profits which also drove the overall reduction in FFO, Adjusted Funds from Operations (AFFO) and distribution compared to the previous corresponding period.

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Income growth from leasing activity and development completions helped to offset the impact of recent asset sales, driving a solid underlying result with Underlying FFO of \$287.7 million, up \$27.1 million on the previous corresponding period.

NTA per security increased 52 cents from 30 June 2016 to \$8.05 primarily due to gains on the revaluation and sale of investment properties.

Distribution per security of 21.71 cents for the six months ended 31 December 2016, represented a 5.8% decrease compared to the previous corresponding period and was impacted by the timing of trading profits. The distribution will be paid to DEXUS Security holders on Tuesday, 28 February 2017.

Alison Harrop, DEXUS Chief Financial Officer, said: "It is pleasing to see our underlying business performance being reflected in our numbers this period. Our gross Management Expense Ratio also improved, reducing to 36 basis points from 40 basis points in the previous corresponding period. We maintained our funding relationships, and have continued to capitalise on reverse enquiry for longer term capital markets debt, assisting with maintaining our debt duration at 5.6 years.

"We have significantly reduced our gearing as a result of the settlement of asset sales over the past six months. As the sales resulted in a substantial increase in our percentage hedged, we terminated expensive interest rate swaps to reinstate our hedging back towards target levels, reducing our forecast weighted average cost of debt for FY17."

DEXUS has minimal short term refinancing requirements and remains within all of its debt covenant limits and target ranges.

PORTFOLIO UPDATE

Valuations and portfolio total returns

The combination of a buoyant Sydney office leasing market, comparable market transactions and recent leasing success at DEXUS's properties contributed to a \$381.4 million or 4.3% increase in valuations on prior book values across the office portfolio. The Perth office market remained challenging with properties such as 240 St Georges Terrace decreasing in value as a result of the impending expiry of Woodside in FY19. The weighted average capitalisation rate for the DEXUS Office portfolio tightened 21 basis points from 6.16% at 30 June 2016 to 5.95% at 31 December 2016. The one-year total return of 13.9% for the DEXUS Office portfolio was driven by strong leasing outcomes in Sydney and gains from the sale of investment properties.

DEXUS's Industrial portfolio achieved an uplift of \$14.6 million or 0.8% on prior book values as a result of continued investment demand and leasing success for well-located prime quality industrial facilities. This also contributed to a 10 basis point tightening of capitalisation rates across the DEXUS Industrial portfolio from 7.38% at 30 June 2016 to 7.28% at 31 December 2016. The one-year total return of 10.4% for the DEXUS Industrial portfolio was driven by a combination of capitalisation rate compression and development completions.

Darren Steinberg said: "While property fundamentals continue to improve in Sydney and Melbourne, we expect to see underlying valuation assumptions improving and further capitalisation rate compression for Prime properties over the next 12 months which will continue to support values in our key markets over 2017."

Property transactions

DEXUS had a busy period of transactional activity which included settlement of the sales of its 50% interests in The Zenith, Chatswood (\$139.5 million) and 108 North Terrace, Adelaide (\$43.2 million), and the first 50% tranche of the Southgate Complex, Melbourne (\$578.0 million total).

The finalisation of negotiations relating to the compulsory acquisition of properties for the Sydney Metro rail project resulted in the sale of DEXUS's and DWPF's combined 100% interest in 39 Martin Place, Sydney⁶ for \$332.0 million.

The \$110.2 million acquisition of The Mill, Alexandria was announced in the period and settled in January 2017. The Mill is a multi-tenanted property across a significant landholding in a prime South Sydney location, and provides the opportunity to actively manage underutilised space and capture rental growth.

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DEXUS Office portfolio

Portfolio value: \$9.2 billion
Total area: 1,484,246 square metres
Area leased during the period: 98,839 square metres⁴

Key metrics	31 December 2016	30 June 2016
Occupancy by income	96.3%	96.3%
Occupancy by area	96.5%	96.3%
WALE by income	4.7 years	4.7 years
Average incentive	14.3%	17.7%
Retention rate	63%	62%
Total return – 1 year	13.9%	16.0%

Kevin George, Executive General Manager, Office and Industrial, said: “Demand for office space in Sydney continued to be buoyed by an increase in withdrawals, resulting in DEXUS securing a number of displaced tenants from the construction of the Sydney Metro and residential conversions. Some remaining vacancy in our portfolio provides further opportunity to capitalise on market rental growth.”

DEXUS leased 98,839 square metres⁴ of office space across 157 transactions on average lease terms of 6.8 years. Notable leasing volumes were achieved at 385 Bourke Street in Melbourne and 30 The Bond in Sydney, with 13,864 square metres and 10,784 square metres leased respectively. Tiffany & Co. also intends to expand its footprint to cover 2,275 square metres of office and retail space upon relocating to a proposed newly developed three-storey flagship store at 175 Pitt Street, Sydney in 2018.

Office portfolio occupancy (by income) and portfolio WALE were maintained at 96.3% and 4.7 years respectively. Tenant retention of 63% was affected by the decision to negotiate an early surrender of Lendlease’s space at 30 The Bond in Sydney. DEXUS successfully re-leased 62% of the area vacated in the past 12 months, with average downtime of only 5.8 months. Average incentives across the office portfolio reduced to 14.3% from 17.7% in FY16.

Office property FFO increased by \$20.3 million, or 7.5%, to \$292.6 million, underpinned by leasing success which offset the impact of divestments. Office like-for-like income growth of 9.6% was positively impacted by receipt of a surrender payment from Lendlease, partially offset by the impact of a rent review within Woodside’s lease during the period. DEXUS has tightened its expectation for office like-for-like income growth to 2.5-3% for FY17.

DEXUS Industrial portfolio

Portfolio value: \$1.8 billion
Total area: 1,331,345 square metres
Area leased during the period: 229,099 square metres⁴

Key metrics	31 December 2016	30 June 2016
Occupancy by income	94.9%	90.4%
Occupancy by area	94.0%	91.7%
WALE by income	4.6 years	4.1 years
Average incentive	14.6%	9.5%
Retention rate	65%	32%
Total return – 1 year	10.4%	16.0%

Kevin George said: “Our focus on improving industrial portfolio occupancy resulted in a record leasing period, which improved key portfolio metrics. This was achieved through targeting industry groups with specific locational requirements and capitalising on the improving demand in West Melbourne.”

DEXUS leased 229,099 square metres⁴ of industrial space across 68 transactions, of which 32 were new leases. This represents a significant increase on the 144,661 square metres⁴ leased in the previous corresponding period and reflects 17% of the portfolio’s area.

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Notable deals undertaken at DEXUS Industrial Estate, Laverton North included a lease renewal with CUB which involved expansion into the adjoining building (45,493sqm) and the securing of new leases with Best Bar (13,008sqm) and Unipod (17,470sqm).

Portfolio occupancy increased to 94.9%, WALE improved to 4.6 years and the retention rate doubled to 65%. Average incentives increased to 14.6% (HY16: 9.5%).

Industrial property FFO increased by \$1.2 million, or 2.3% to \$53.7 million, despite the settlement of asset sales during the period. Like-for-like income grew by 1.0%, driven by fixed rental increases and leasing success at properties including 2-4 Military Road, Matraville, partially offset by the impact of vacancies at Axxess Corporate Park, Mount Waverley.

Development

DEXUS continued to enhance future investor returns through the progression of its \$4.5 billion Group development pipeline, of which \$2.0 billion sits within the DEXUS portfolio and \$2.5 billion within third party funds.

Construction was completed at the first stage at Quarrywest, Greystanes, across 36,045 square metres of space, with this stage now 100% leased. A 10,194 square metre facility, fully leased to Wrightson Seeds, was also completed at Laverton North. Post period end, DEXUS secured a lease with Anmar Group over 15,720 square metres and agreed terms with another tenant over 23,392 square metres at Laverton North, enabling the construction of these facilities to commence.

Construction of the core of 100 Mount Street in North Sydney is also underway with completion of the building expected in early 2019.

A number of projects in DEXUS's development pipeline advanced through planning stages or are being marketed for tenant pre-commitment. These include the submission of a State Significant Development application for the construction of a mixed-use 59,546 square metre mixed-use tower at 201 Elizabeth Street, Sydney and in January 2017, the submission of a development application for the construction of a new flagship store for Tiffany & Co. at 175 Pitt Street, Sydney.

FUNDS MANAGEMENT

Third party funds under management increased to \$11.7 billion, up \$0.5 billion from 30 June 2016, driven by acquisitions, developments and revaluations, partially offset by divestments.

Darren Steinberg said: "We continued to deliver on our clients' investment objectives with our funds outperforming their respective benchmarks."

DWPF achieved a one-year total return of 13.5%, outperforming its benchmark over one, three, five and seven years, and the DEXUS Office Partnership portfolio achieved a 12.9% one-year unlevered property return.

DEXUS delivered on DWPF's investment objectives through the acquisition of its first retail property in Perth at Carillon City and the sale of its 50% interest in 324 Queen Street, Brisbane.

The new Gateway and Grosvenor Place food/restaurant precincts in Sydney also opened, enhancing returns for investors and improving office tenant amenity.

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

TRADING

During the period, DEXUS settled on the sale of 57-65 Templar Road, Erskine Park, contributing \$8.3 million⁵ to FY17 trading profits. In January 2017, DEXUS settled on the sale of 79-99 St Hilliers Road, Auburn, securing a further \$17 million⁵ towards FY17 trading profits. The sale of one other trading property is expected to result in the achievement of the FY17 target of \$45-\$50 million post tax.

DEXUS has progressed its priority trading projects and focused on opportunities to restock the future trading pipeline, receiving local Council and Regional Planning Panel endorsement of a concept scheme for an office building at 140 George Street, Parramatta.

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SUMMARY

Darren Steinberg said, "While geopolitical uncertainty is expected to continue to influence business confidence in domestic and international markets throughout the year, DEXUS is well positioned to deliver strong results for the 2017 financial year.

"Our team is focused on two simple strategic objectives; office sector leadership which we will achieve by being the market's preferred workplace partner; and being a wholesale partner of choice. Driving investment performance remains a priority and our portfolio is well placed to deliver income growth with strong fundamentals in key markets and an enhanced pipeline of development opportunities."

As a result of the improved performance in the underlying business and confidence in achieving trading sales, DEXUS has upgraded its market guidance⁷ for growth in underlying FFO per security from 3.0-3.5% to circa 4%, growth in FFO per security to circa 1% and distributions will be paid in line with free cash flow, delivering distribution per security growth of 3.5-4.5% for the 12 months ending 30 June 2017.

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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 \$22.7 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 1.7 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 30,000 investors from 20 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. 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.



DEXUS Funds Management Ltd ABN 24 060 920 783, AFSL 238163, as Responsible Entity for DEXUS Property Group (ASX: DXS)

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.
2. 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 period.
3. Gearing is adjusted for cash and for debt in equity accounted investments. Pro-forma gearing is expected to increase to 26.8% post the settlement of the acquisition of the Mill, Alexandria and the sale of 79-99 St Hilliers Road, Auburn.
4. Including Heads of Agreement.
5. Trading profits are post tax.
6. Owned 50% by DEXUS and 50% by DWPF. Refer to ASX announcement dated 14 November 2016.
7. Barring unforeseen circumstances guidance is supported by the following assumptions: Impacts of announced divestments and acquisition; 2.5-3% 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 4.2%, trading profits of circa \$45-50m net of tax, and Management Operations FFO of circa \$45-50m (including third party development management fees).