Dexus (ASX: DXS)

ASX release

6 February 2020

2020 Half year results – Continuing to benefit from office occupier and investor demand

Dexus today announced its result for the half year and upgraded its guidance for distribution per security growth from circa 5% to circa 5.5% for FY20.

Dexus Chief Executive Officer, Darren Steinberg said: "We continue to make significant progress towards our vision of being globally recognised as Australia's leading real estate company. Urbanisation continues to drive demand for quality space in Australian cities and the growth in pension capital is increasingly chasing the favourable returns that real estate can offer. We are responding by remaining focused on enhancing the attractiveness of our properties, while leveraging our market intel and capabilities to create spaces where our customers want to be, while at the same time partnering with like-minded third party capital to invest alongside in our core markets.

"For the first six months of the financial year we have continued to benefit from office occupier and investor demand for quality properties in our core markets, achieving record Melbourne rents and strong asset valuation uplifts. Our funds business has seen a significant increase in interest from offshore investors seeking to invest directly in quality office properties. These factors combined with recent transactional evidence and the lower for longer interest rate environment, reinforce our view that there will be further increases in asset values."

FINANCIAL HIGHLIGHTS

- Net profit after tax of $994.2 million, up 36.9% primarily due to net revaluation gains of investment properties being higher than those recognised in the previous corresponding period
- Underlying Funds From Operations[1] (FFO) per security of 31.9 cents, up 1.9% on the previous corresponding period
- Distribution per security of 27.0 cents, consistent with the previous corresponding period
- NTA[2] per security increased by 5.9% over the six-month period to $11.10
- Gearing (look-through)[3] remains conservative at 25.5%
- Successfully completed the issue of $200 million of Medium-Term Notes with a 10-year tenor and post 31 December 2019, completed a further $500 million issue of Medium-Term Notes with a 12-year tenor at an attractive all-in rate

OPERATIONAL HIGHLIGHTS

- Maintained high occupancy[4] of 97.4% for Dexus office and 96.0% for Dexus industrial portfolios
- Completed the 240 St Georges Terrace development in Perth and progressed the group's $11.2 billion development pipeline
- Dexus Wholesale Property Fund (DWPF) raised circa $180 million of new equity and continued to outperform its benchmark across all time periods
- Exercised the second tranche rights for GIC to acquire an additional 24% interest in the Dexus Australian Logistics Trust (DALT) core portfolio[5]
- Realised $27.8 million of trading profits (net of tax), driven by the sale of the first tranche of 201 Elizabeth Street in Sydney
- Recognised as the Global Industry Leader for the Real Estate Sector by DJSI, Global Sector Leader in GRESB and achieved A list status in the latest CDP results

Financial results

Dexus's net profit after tax was $994.2 million, up 36.9% from the previous corresponding period and driven by net revaluation gains of investment properties of $724.4 million, which were $267.9 million higher than the previous corresponding period.

At 31 December 2019, 109 of Dexus's 118 office and industrial assets were externally valued, including 43 office properties and 66 industrial properties. Valuation gains across the total property portfolio since 30 June 2019 were the primary driver of a 5.9% increase in NTA[2] per security to $11.10 at 31 December 2019.

Distribution per security for the six months ended 31 December 2019 was 27.0 cents, 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 Friday, 28 February 2020.

Although underlying FFO per security increased by 1.9%, Adjusted Funds From Operations[6] (AFFO) per security reduced to 26.9 cents as a result of lower trading profits. All FY19 trading profits were recognised in the six months ended 31 December 2018. Further trading profits are expected to be received over the remainder of FY20.

Chief Financial Officer, Alison Harrop said: "We successfully completed the issue of $200 million of Medium-Term Notes with a 10-year tenor and post 31 December 2019, issued a further $500 million of Medium-Term Notes with a 12-year tenor at an attractive all-in rate. As part of our active approach to capital management and in response to security price volatility, we also activated an on-market securities buy-back of up to 5% of DXS securities on issue, providing an opportunity to enhance investor returns."

Dexus's gearing (look-through)[3] of 25.5% at 31 December 2019 remains below the target range of 30-40%, with the average cost of debt reducing to 3.5%.

Property portfolio

Dexus Office Portfolio

Key metrics	31 December 2019	30 June 2019
Occupancy by income	97.4%	98.0%
Weighted average lease expiry (by income)	4.5 years	4.4 years
Average incentives[7]	16.2%	13.4%
Weighted average cap rate	4.98%	5.15%

Dexus Industrial Portfolio

Key metrics	31 December 2019	30 June 2019
Occupancy by income	96.0%	97.0%
Weighted average lease expiry (by income)	4.6 years	4.7 years
Average incentives	13.3%	11.7%
Weighted average cap rate	5.78%	5.92%

Executive General Manager, Office, Kevin George said: "Our office portfolio occupancy remains very high and we continue to capture the upside in the Sydney CBD market, achieving 18% re-leasing spreads this period. Up to the end of FY22, we have the opportunity to reset rental levels across 139,677 square metres of vacant or expiring space across our Sydney portfolio, which remains under-rented. This represents approximately 19% of our total office income.

"In Melbourne where prime office vacancy has tightened to a record low of 1.8%, our leasing focus at 80 Collins Street has resulted in record rents and set new benchmarks for the Melbourne CBD with metrics exceeding our acquisition underwrite. Six new tenancies were secured across 15,418 square metres, increasing leased space at the South Tower from 63% to 97%, and leaving only one floor available to lease.

"The December 2019 quarter has seen increased enquiry levels across a broad range of industries compared to the previous corresponding period and we expect that continued solid employment growth in Sydney and Melbourne combined with positive conditions in the business services sector will positively influence occupier demand over the next 12 months."

The Dexus office portfolio continues to outperform its benchmark over the three and five year time periods. Average incentive levels ticked up as a greater proportion of leasing was undertaken in the Brisbane and Perth markets this period, with face deals also representing a higher proportion of leasing.

The office portfolio achieved like-for-like income growth of 8.9%, enhanced by positive re-leasing spreads at Sydney properties such as Australia Square and MLC Centre, and leasing success at other properties. Like-for-like income growth is expected to be in the range of 4.5-5.5% for FY20, impacted by downtime at Grosvenor Place as the space vacated by Norton Rose in December 2019 is refurbished.

The Dexus industrial portfolio is now outperforming its benchmark over both the three and five-year time periods. During the half year period, occupancy remained high at 96.0% and like-for-like income growth was 3.5%. Average incentives increased as a result of leasing at office park suites in South East Melbourne.

Executive General Manager, Industrial, Retail and Healthcare, Stewart Hutcheon said: "The industrial sector has some good tailwinds with continued asset value appreciation and strong support from institutional investors. We see further opportunities within the sector as businesses seek to drive efficiencies in their supply chains and online retail demand continues to rise."

The weighted average capitalisation rate across the total property portfolio tightened 17 basis points over the past six months to 5.09%. The weighted average capitalisation rate of the Dexus office portfolio tightened 17 basis points from 5.15% at 30 June 2019 to 4.98% at 31 December 2019 and the Dexus industrial portfolio weighted average capitalisation rate tightened 14 basis points from 5.92% to 5.78%.

Developments and Transactions

During the period, Dexus completed its office development at 240 St Georges Terrace in Perth (now 94.7% committed with 7.3 year WALE) in addition to two city retail projects, a 9,200 square metre distribution and office facility for Dunlop Flooring at 380 Doherty's Road, Truganina and the Healthcare Wholesale Property Fund's (HWPF) new Calvary Adelaide Hospital.

Dexus's group development pipeline now stands at a cost of $11.2 billion, of which $5.7 billion sits within the Dexus portfolio and $5.5 billion within third party funds.

Construction commenced at the $84 million Richlands project in Queensland and the $142 million South Granville project in NSW, both held within DALT. Construction continues at five other industrial properties taking the total committed group pipeline to over 250,000 square metres.

Chief Investment Officer, Ross Du Vernet said: "We've made solid progress across our development pipeline and reached agreement to move forward with the development scheme for Eagle Street Pier and surrounds at the Waterfront Precinct after an extensive engagement process with Queensland Government and Brisbane City Council. We have significant embedded value in our pipeline from the anticipated development margins and fees associated with key projects in the eastern core CBD markets of Sydney, Melbourne and Brisbane."

Dexus exchanged contracts to sell its 100% interest in Garema Court, 140-180 City Walk, Canberra. Gross proceeds achieved from the sale are $71.5 million[8], consistent with the property's book value, and will be used to reduce debt. Settlement is expected to occur in late February 2020. Garema Court was Dexus's remaining Canberra property and its sale is consistent with the strategy of divesting assets from non-core markets, enabling Dexus to recycle capital and focus on the core office markets of Sydney, Melbourne, Brisbane and Perth.

Trading

Dexus realised $27.8 million of HY20 trading profits (net of tax) driven by the sale of the first tranche of 201 Elizabeth Street in Sydney.

Dexus sold its initial 25% interest in 201 Elizabeth Street, Sydney and entered into a put and call option for the remaining 25% in late 2020 for a total of $315 million. The sale contributed circa $34 million to pre-tax trading profits this period and is expected to contribute a further circa $34 million in pre-tax trading profits in FY21 in the event that either option is exercised.

Dexus also sold the North Shore Health Hub, currently under construction, on a fund-through basis to HWPF with trading profits to be realised across FY20 and FY21, with the amount for each financial year dependent on the progress of the development and leasing.

Funds Management

Dexus manages $17.0 billion of funds on behalf of 79 third party clients.

HWPF welcomed a new domestic investor and completed the development of the New Calvary Adelaide Hospital, a 12-storey, 343 bed hospital offering clinical services, consulting suites and a 24-hour emergency department.

HWPF acquired the North Shore Health Hub, Stage 1 currently under development at 12 Frederick Street, St Leonards. The state-of-the-art mixed-use healthcare facility, being developed by Dexus, will support existing infrastructure in a growing healthcare precinct on Sydney's lower North Shore and is due for completion in late-2020, with circa 51% of the facility already pre-committed.

Executive General Manager, Funds Management, Deborah Coakley said: "We've seen a significant increase in engagement from existing and potential new unlisted investors and capital partners, driven by the attractiveness of real assets as an investment class, the growth in pension fund capital and a lower for longer interest rate environment globally. We are working with these investors to satisfy their needs."

DWPF raised circa $180 million of new equity from existing investors to fund its future development pipeline and DWPF achieved a one-year total return of 8.2%, outperforming its benchmark over one, three, five, seven and ten years. All funds delivered strong performance with the Dexus Office Partnership delivering a one-year unlevered total property return of 13.3% and an annualised unlevered total property return of 14.4% since inception.

Dexus continued to progress the $5.5 billion third party development pipeline which provides the opportunity to improve the quality of its clients' property portfolios and enhance future returns.

Environmental, Social and Governance (ESG) update

Dexus's focus on ESG factors continues to be reflected through its leading performance in global ESG benchmarks. During the half, Dexus was acknowledged for its continued leadership in sustainability including being recognised as the Global Industry Leader for the Real Estate Sector by the Dow Jones Sustainability Index (DJSI), a Global Sector Leader in the Global Real Estate Sustainability Benchmark (GRESB), and achieving A-List status by CDP.

The Australian bushfire crisis has highlighted the importance of climate resilience across the group property portfolio. While no Dexus buildings were directly impacted by the bushfires, smoke haze blanketed the core Eastern seaboard markets, indirectly impacting air quality in the CBDs.

Recognising the importance of maintaining safe and healthy indoor environments, Dexus conducted indoor environmental air quality sampling at select office properties on days with poor outdoor air quality in order to identify strengths and areas for improvement to enhance portfolio resilience.

Dexus has put in place health and wellbeing initiatives to support employees and is matching employee donations to bushfire relief fundraising initiatives that support affected communities and wildlife.

Summary and guidance

Darren Steinberg said: "These results have been underpinned by our high-quality property portfolio, with its diversified expiry profile and fixed annual rental increases of 3.5-4%. When combined with our significant development pipeline and strong balance sheet we are well positioned to continue to deliver value for investors over the long term.

"While issues such as the Australian bushfires and the Coronavirus have increased uncertainty about the short-term economic outlook, there are reasons to be positive about the white-collar industries which underpin office demand. Conditions in the technology, finance and business services sectors are much more positive than in many other sectors, and interest rates are expected to remain lower for longer, supporting investment demand for real estate."

As a result of progress this period, Dexus upgrades its market guidance[9] for distribution per security growth from circa 5% to circa 5.5% for the 12 months ending 30 June 2020.

HY20 Reporting Suite

This *ASX announcement* should be read in conjunction with the *HY20 Results presentation*, *HY20 Financial Accounts* and *HY20 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 9.30am (AEDT) today, Thursday 6 February 2020, which will be webcast via the Dexus website (www.dexus.com) and available for download later in the day.

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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, certain transaction costs, amortisation of intangible assets, movements in right of use assets and lease liabilities, rental guarantees and coupon income. Underlying FFO excludes trading profits net of tax.

2 Net tangible assets.

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

4 By income.

5 Second tranche excludes 250 Forest Road South, Lara for which the put and call options have been deferred to mid-FY21. As part of the initial joint venture, GIC acquired 25% of DALT's core portfolio, with Dexus and GIC entering into a put and call arrangement for a further 24% interest. GIC took an initial 49% interest in DALT's development landbank and is funding its share of the development spend.

6 AFFO 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, certain transaction costs, amortisation of intangible assets, movements in right of use assets and lease liabilities, rental guarantees and coupon income, less maintenance capital expenditure and lease incentives.

7 Excluding development leasing of 25,723 square metres.

8 Gross proceeds are before settlement adjustments and transaction costs.

9 Barring unforeseen circumstances, guidance is supported by the following assumptions: Impacts of announced divestments and acquisitions; FFO per security growth of circa 4%, underlying FFO per security growth of circa 4%, underpinned by Dexus office portfolio like-for-like income growth of 4.5-5.5%, Dexus industrial portfolio like-for-like income growth (excluding one-offs) of 3-4%, management operations FFO of circa $60 million, cost of debt of mid-3%; trading profits of $35-45 million net of tax; maintenance capex, cash incentives, leasing costs and rent free incentives of $170-180 million; and excluding any further transactions.

About Dexus

Dexus is one of Australia's leading real estate groups, proudly managing a high quality Australian property portfolio valued at $33.8 billion. We believe that the strength and quality of our relationships is 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 $16.8 billion of office and industrial properties. We manage a further $17.0 billion of office, retail, industrial and healthcare properties for third party clients. The group's $11.2 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 27,000 investors from 20 countries. With 35 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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