AVJennings

AVJennings Limited

Investor Briefing Presentation Speaker Notes
(to be read in conjunction with the FY20 Full Year Results Presentation released to the market on Thursday, 20 August 2020)

Presented by: Peter Summers, CEO & MD and Larry Mahaffy, CFO

Welcome all to this briefing for AVJennings Limited's results for the 12 months to 30 June 2020.

The Australian bushfires and the COVID-19 pandemic have not only provided significant challenges to business, they have impacted directly on so many lives and to all those who have been impacted, especially to those who have lost loved ones, we express our sympathies.

In relation to COVID-19, our priority has always been to ensure the safety of our customers, staff, suppliers and sub-contractors and to offer support where possible.

The global COVID-19 pandemic has clearly impacted the FY20 results and continues to be the main challenge for the business today. In this briefing I will try to give you a sense of the impact of COVID-19. But I also want to give you an understanding of how we have dealt with it and why I think the Company is in a good position to take advantage of improved market conditions when they occur.

Market Conditions, Sales and Revenue

Let's begin by discussing the 8-or-so months before the really significant impacts of COVID-19 hit in March 2020.

Entering FY20 our expectations were strong on the back of

- A recovery in the Australian residential markets, particularly in Sydney and Melbourne
- The recognition of material revenue and profit from pre-sales at Hobsonville Point, Auckland
- A much stronger contribution from our Queensland operations.

The anticipated recovery was slower to materialise than hoped. However, signs started to emerge in the latter months of 2019 with enquiry levels increasing. The bushfire season arrived early and had an immediate impact. In many cities, notably Sydney and to a slightly lesser extent Melbourne, air quality issues meant visitations to sales centres dropped dramatically. As the seriousness of the fires developed, the negative impact on the economy and on consumer confidence became apparent.

Whilst the timing of the recovery in Sydney and Melbourne was slow to develop, we delivered a strong result in the first half of FY20, largely on the back of a solid contribution from our Hobsonville Point, Auckland project. Our New Zealand operations are substantially based on pre-sales of superlots to builders and timing of recognition of revenue and profit is lumpy in nature.

Pleasingly, we had also seen a turnaround in our Queensland operations. A number of actions had been taken in FY19 which were designed to improve performance. One example was the acquisition of the remaining 50% interest in our Riverton, Jimboomba, project which enabled it to be recommenced. Despite the impact of COVID-19, our Queensland business was able to increase revenue for the year. We are confident it will continue to improve further in coming years.

Entering the early months of 2020, things turned around quickly. Late January and particularly February saw strong growth in enquiry and sales, reflecting what we had believed for some time – strong underlying demand existed which would drive the residential property recovery.

By early March, things were looking positive and we remained confident of a strong finish to FY20.

Then the impact of the pandemic started.

As I mentioned above, our immediate response to the pandemic was first-and-foremost to focus on safety. We acted in every way we practically could to address the safety of staff and everyone who interacts with the Company. But we also were determined to remain open for business, we just had to find new ways to do it.

There were a number of other short term urgencies some of which are set out on Slide 6 and are talked about in more depth throughout the presentation.

One strong motivation was the number of pre-sales that related to product that was almost complete. We know how important housing is to people's lives and we wanted to do everything we could to ensure the aspirations, needs and dreams of our customers were met.

Of course, we understood the impact of job losses and social distancing restrictions may be a barrier to completing settlements for those pre-sales. Despite initial concerns, settlements held up well in the second half, with only moderate extensions to contracted settlement periods required in a few cases that pushed some settlements into FY21. While the contract rescission rate increased, the value and number of affected contracts remains very low as a proportion of turnover and lots settled during the period.

No doubt an important aspect to pre-sales holding up has been our focus on a traditional customer base. Housing is a fundamental need for all and even in the middle of a pandemic the first question for those who may have faced personal issues wasn't "if" but "how". Wherever possible, we worked with our customers to find solutions.

As the environment moved rapidly and with uncertainty, we were able to focus even more on the individual needs and challenges facing our customers.

In January we created a new role of Head of Customer Experience, Marketing and Sales to sit across the customer facing sections of our business to place even greater focus on our customers. Little did we know the impact of COVID-19 would make this appointment even more critical in supporting our customers who, like the Company, were trying to navigate the challenges of the pandemic. We also moved quickly to an on-line, digital approach to sales and marketing. Some of this involved the acceleration of planned changes, whilst other initiatives were assessed and implemented swiftly. I am sure we have all identified certain aspects of our businesses which are likely to have benefited permanently from the COVID-19 crisis. I am sure this is one area we will see continue to provide on-going benefits to customers and AVJennings.

In the early stages of the pandemic, we identified quickly those buyers still engaging and introduced campaigns such as our Essential Workers promotion.

First home buyers often are the market segment which responds early. Prices have moderated in major cities and together with government incentives, particularly State based stamp duty relief which are often aimed at this segment, both have combined to provide greater opportunities for first home buyers.

In FY19 we saw other builders (other than in Auckland where this remains our main business model) reduce their land securing activities. This aligned with our previously espoused strategy of an increased focus on building on our own land. Interestingly, the March to June period saw us enter to a number of builder sale arrangements. We also entered into some other sales of commercial sites. This provided some important confidence and continuity in the early months of the pandemic whilst retail buyers took time to assess circumstances or were hampered due to restrictions around movement.

I expect most people would agree that planning in the early months of the pandemic was very challenging, with lockdowns and restrictions not seen by most in their lifetime. Pleasingly, net contract signings were better than we expected. Including B2B, in March, April, May and June contract signings were 57, 51, 86 and 97 respectively. Revenue recognition from these will mainly carry over to FY21. A total of 385 contracts were carried over at 30 June 2020, with a further 76 contracts signed in July 2020.

Production

Where pre-sales or commercial considerations didn't support on-going construction activity, we were able to quickly adjust production levels. Our horizontal development focus allowed us to assess and adjust quickly.

This adjustment was made easier due to changes last year in our organisational structure which saw us implement a national strategy supporting local delivery as opposed to the previous State based model. Times of crisis require quick but co-ordinated decisions. By understanding impacts across the business – from the impacts of implementing high safety measures, treasury considerations, customer needs and so on, we were able to develop specific plans and controls across all of our business in a precise, yet coordinated, manner.

Whilst site-based activity was slowed, planning and design work continued largely unabated, leaving the Company well placed to resume physical works in key locations as Government stimulus measures were introduced and buyer confidence began to return.

Acquisitions and land bank

Our results announcement for the first half of FY20 highlighted the agreements which we have entered into for Caboolture, Queensland and Brunswick West, Melbourne. Since year end, our Mernda acquisition in Melbourne's norther growth corridor became 'unconditional' after it was zoned residential.

We have also achieved some other important milestones at some other projects including:

- Warnervale where DA approval for the first land stage, some 158 lots, was received on 3 July 2020;
- Huntley where the Neighbourhood Plan has progressed through Wollongong Council in April 2020 and is now waiting formal adoption; and

- Kogarah where the amended favourable DA was achieved on 1 July 2020 with consent authority being the Land and Environment Court.

Whilst in FY20 our land under control has both increased in size, and developed in terms of maturity, we continued our conservative approach to acquisitions. We will maintain a conservative approach, but also be open to opportunities that may present, as long as we believe those opportunities reflect the current environment and risk.

All results are a sum of many moving parts, but none more so than FY20. To see how all of the above have played out in terms of consolidated numbers I will now handover to Larry Mahaffy, our CFO.

Thank you, Peter.

Slide 11 shows that revenue of $262.3M was down 11.5% on the prior corresponding period, while statutory profit, before and after tax, were both 45% lower at $13.2M and $9.0M, respectively.

When compared with fiscal 2019, the decline in revenue arose entirely from fewer apartment settlements worth $13.2M, down $43.5M. This was mostly a function of the timing of project delivery as the GEM building at 'Waterline Place', Williamstown Victoria was completed and largely settled in 2019, while the next apartment building 'Empress' will not reach practical completion until later in fiscal 2021. Revenue from land-only and integrated building product rose moderately to $246.4M from $234.9M in 2019, due to good presales in prior periods and strong settlement management, resulting in only modest extensions to some contracts and a handful of contract rescissions. I'll return to this feature in a moment.

The disproportionate decline in profitability is attributable to a combination of:

- lower revenue;
- a 1.7 percentage point reduction in average gross margin to 22.8%, reflecting changes in product mix (specifically more built form) and some realignment to market prices of completed houses in NSW and residual apartments in Victoria, noting that gross margins from land and integrated dwellings in other jurisdictions improved in comparison with 2019; and
- just under $3.3M in aggregate impairments relating to several regional projects in South Australia and a small project in Brisbane, additional provision for loss on an equity accounted investment and a fair value adjustment to a financial asset, both of which relate to the Company's small co-investment in a number of land and apartment projects in Perth, Western Australia, together with a small fair value adjustment to the carrying value of retail property in Waterline Place. The corresponding line items contributed just under $500K in 2019.

Expenditure on overheads reduced by more than $4.9M year-on-year, before taking account of a $1.6M credit under the Federal Government's 'JobKeeper' scheme, as the business continued to improve its efficiency. Directors, executives and general staff agreed to reductions in remuneration and entitlements that form part of the reduced overheads referred to earlier. Some of these changes will continue to have a positive effect in fiscal 2021.

Profitability was affected by COVID-19 pandemic-related restrictions on business and social activity over the period March-June 2020 inasmuch as it suppressed sales of land-only and integrated dwellings, which were otherwise expected to strengthen over the course of the second half of fiscal 2020. This was unfortunate given the strong improvement in the Queensland operation flowing from good settlements from 'Arbor', Rochedale and first settlements from 'Riverton', Jimboomba; a reduction in the loss incurred by the South Australian business due to efficiency gains and settlement of most of the remaining dwellings from 'Buckley B', the final stage of the Company's Hobsonville Point, Auckland project. New South Wales projects, including those located in south-western Sydney in the Spring Farm and Cobbitty regions, remained strong contributors, albeit at lower levels than anticipated, while the year-on-year profitability of the Victorian business reduced mainly due to the timing of apartment project delivery. I'll touch on this again shortly.

Earnings per share declined proportionately, and directors prudently decided to refrain from declaring a final cash dividend, to ensure that the Company retains enough liquidity to cater for contingencies.

Slide 12 graphs the relative contribution to revenue from land, integrated dwellings and apartments over fiscal 2019 and 2020.

Slide 13 gives a bar chart comparing the year-on-year change in revenue from land-only and integrated dwellings in each of our jurisdictions.

Slide 14 shows that the balance sheet remains strong, with Net Tangible Assets down only one cent per share to 96.0 cents per share. Net debt was just over $2.0M higher than the prior corresponding period at $184.4M and gearing remained moderate, with net debt to total assets of 28.1% (a rise of only 1.5 percentage points) situated well within the Company's target range of 15-35%. $250M of the Company's $300M core revolving debt facility matures in September 2022 (the balance in September 2021). The Company has adequate undrawn banking facilities and is compliant with all lending covenants, leaving us well placed to deal with the ongoing financial challenges presented by the pandemic.

Inventories declined moderately (down $37.6M) as settlements outweighed new acquisitions and discretionary expenditure was curtailed from early March, in response to uncertainty surrounding the impact of the virus on the business.

Slide 15 depicts the fundamental stability of gearing over the past three years.

Slide 16 shows the significant, intentional reduction in WIP during the second half of fiscal 2020, down from 1,480 lots in the first half to 1,117 lots.

Slide 17 depicts strong growth in lots under control due to the inclusion of a 3,500 lot equivalent site in Caboolture, Queensland over which the Company holds options that are subject to the achievement of certain planning milestones. Excluding land under option, controlled inventory of approximately 8,634 lots was just under 900 lots down on the position at 30 June 2019. Total inventory including land under option stood at 12,134 lots (30 June 2019: 13,031 lots).

These themes are borne out in the summary cash flow statement shown on Slide 18, which indicates that net cash from operations turned around strongly year-on-year to positive $10.0M, from a net outflow of $45.8M in the prior period, assisted by solid settlements and reduced expenditure on production, acquisitions and overheads.

I will now hand back to Peter.

Thank you Larry.

Outlook

As mentioned earlier the onset of the COVID-19 pandemic stopped the momentum for a strong finish to FY20. However, sales did continue although they related more to transactions for recognition in FY21 and the pre-sales on hand at 30 June 2020 of 385 are an important starting point to FY21.

As lockdown restrictions were first eased in late May, we saw enquiry levels ramp up quickly. This reflected the pre-existing strong underlying demand. The impacts of COVID-19 have not been shared equally across society and there remain significant sectors who remain in a strong position to continue to move forward on their housing needs.

It also reflected the impact of the announcement of the Federal Government's HomeBuilder scheme in early June 2020 which definitely stimulated buyers' decisions in terms of timing.

However, there is no doubt the environment remains volatile and uncertain.

It is plausible to argue a glass-half-full case. Whilst the impacts of COVID-19 have been significant, in many aspects we are well ahead of some of the earlier predictions. Case numbers have been contained well within early forecasts of possible outcomes. There was a reasonable expectation in March that significant restrictions could be in place Australia wide until September. Whilst restrictions still exist in all areas, especially in relation to Australia and New Zealand's borders, substantial parts of our economy are currently subject to much lower levels of restrictions. Early forecasts of unemployment and other economic outcomes too have yet to materialise.

It is equally plausible to point to the impacts of the current Victorian situation, increases in Sydney COVID-19 numbers, Auckland moving back into level 3 restrictions and the potential impact of any easing of JobKeeper or JobSeeker support initiatives and so on.

Confidence will play a key role, as it always does in residential property. This is always so difficult to predict. Whilst it is easy to assume the impact will be quite strongly negative, Australians and New Zealanders have in the past shown a remarkable ability to bounce back quickly and positively.

Interest Rates

The approach of banks and other financial institutions will also be important. To date, availability of loans has been less of an issue than the time it is taking for our customers to obtain finance. Clearly the cost of debt is going to remain at very low levels for many years to come.

Affordability

There is much commentary around house prices. We have stated before we believed a price correction had been needed and we have seen some moderate corrections in 2018 and 2019 in our particular markets. But as we have also said, it is important to not mix our more traditional (and arguably more rational) market segments with the established markets, driven often by pricing mechanisms such as auctions, or with markets such as high rise apartments which often rely on high level of investor and overseas buyer profiles.

Underlying demand

Strong underlying demand has existed for some time, and whilst it was slowed during the early months of the pandemic, there is still evidence it exists. However, adding to this demand, through positive migration will obviously not occur in the short term. To some extent supply, particularly in the higher density sector, has abated already. And whilst the traditional housing markets won't be immune to the impacts, they will be more stable as supply has been limited in recent years in many markets.

Population growth

Longer term, it is fair to expect Australia and New Zealand will be both motivated and well placed to support strong migration.

Economic recovery and the importance of government stimulus programs

With all of this uncertainty, it is going to be vital that Governments at all levels provide confidence, certainty and support. HomeBuilder was a welcome announcement and whilst such schemes rarely create demand, they can certainly provide timing stimulus. To date, the Federal Government in particular has shown a desire to play a strong role in our recovery and all governments have or are expected to announce significant public sector initiatives.

It is highly likely residential housing will form a significant component of these initiatives, recognising the economic importance it plays in the economy. It is also hoped that the opportunity is not lost to address homelessness and other parts of the community vulnerable to secure housing. Our recent agreement with the Victorian Government at Brunswick West will see more and substantially better public housing delivered to those in need. We are working with a number of Community Housing Providers across Australia to explore more opportunities.

Employment

Throughout the pandemic, there has rightly been a heavy focus on two things: health and jobs. We all recall those early images of queues outside Centrelink offices. Just like social distancing measures assisted in flattening the health curve, JobKeeper, JobSeeker and other government initiatives have had significant impact in flattening the unemployment curve and overall economic impact, giving businesses and the economy critical time. As large parts of Australia have opened up we have seen employment rebound in many areas – Victoria being the obvious exception at this time – and it will be important for government support to remain where needed.

I talked earlier about the fact the impacts of COVID-19 haven't been equally shared across all parts of society. We feel for all those who have been severely impacted, however, there are large parts of the economy where job security is strong. And it is also likely the short term impact will be felt more strongly by the rental market. Employment sectors such as entertainment and hospitality, which have been significantly impacted by the pandemic, tend to be more weighted towards casual employees who are also more likely to be renters.

Whatever the challenges around unemployment, we all need to work together to get Australia on a strong path to recovery. And whilst we do so we must never forget that no matter what anyone's status is, housing remains a fundamental need for all.

Of course, as impactful as external issues such as the pandemic are, we need to be absolutely focussed and accountable to every opportunity and challenge in our control.

When the pandemic hit hard in mid-March, we quickly focussed on what we could control. I have mentioned we put safety first, followed by production levels, settlement of pre-sales, costs and liquidity.

Likewise, we now need to focus on completing development of Stage 1 at Ara Hills, Auckland and the Empress apartment building at Waterline Place, Williamstown as well as a number of other land and built form stages around the country. These will play a critical role in what we are able to deliver in terms of a financial result for FY20.

In terms of stock availability, although Work-In-Progress levels decreased as at 30 June – appropriate to the conditions at that time - planning and design work continued largely unabated, leaving the Company well placed to resume physical works in key locations as Government stimulus measures were/are introduced and buyer confidence began to return.

Larry spoke to our land bank. Transactions relating to Caboolture and Brunswick West have the potential to provide significant long term benefits. The lower level of sales in FY20 and probable lower levels in FY21 than otherwise would have been the case if the pandemic hadn't occurred, do mean we are not under short term pressure to replenish stock.

The advancement of Warnervale, Mernda, Huntley and Kogarah projects closer to starting development is important for the medium term future.

The impact of schemes such as HomeBuilder has also provided an opportunity to unlock funds from some older projects such as Murray Bridge and Goolwa in South Australia and acceleration of the release of capital in other older projects is also being targeted.

One of the critical aspects of our land bank is its geographical diversity. Residential markets around Australia, and in New Zealand, aren't always in sync and diversity has provided some protection around this. However, this is proving even more important at present as the impact of COVID-19 and resulting government restrictions vary so much from region to region.

We will drive further improvement in Queensland and continue to manage the South Australian business to ensure it does what it can to improve the overall Company position, even if that is mainly in returning existing funds invested.

At a time when there is so much uncertainty and stress, we must continue to focus on delivering to our customers what they need, in terms of their housing needs and also in areas such as support and trust. As a Company that built a strong brand based on trust and reliability over 88 years, we are well placed to do so.

We are also well placed to address changes post the pandemic as no doubt many aspects of our lives will change.

Internally, we have a desire and capacity to change. We will continue to explore all avenues to drive better ways to operate. That will involve challenging conventional thinking and practices in some cases and taking time to think about everything from what we do, how we do it, and importantly, why we do it.

And of course, there are our people. I couldn't have been prouder at the way AVJennings' people have responded to the crisis. Responsive, hard-working, caring, resilient – under enormous pressure. They will continue to be the defining difference to how we emerge and thrive going forward.

Summary

FY21 will continue to be challenging. It will almost certainly continue to see change and require reaction. But I am sure it will also throw up opportunities. The stimulus provided by HomeBuilder, together with existing pre-sales, particularly at Waterline Place and Ara Hills will provide a base for FY21.

The timing of pre-sales and other factors, including allowing for the economy to start some type of recovery, will see a heavy bias towards the second half. We will provide more updates on this as appropriate and particularly at the AGM.

Longer term, we remain confident in the residential markets in Australia and New Zealand. Whilst short term cycles will always exist, housing remains a fundamental need for us all. Both Australia and New Zealand, in most parts, have traditionally produced too little housing compared to underlying needs. As both countries open up their borders, they will both no doubt seek to attract new citizens and continue to benefit from our richly diverse cultures as well as the economic benefits of growth.

We also believe the pandemic is likely to see a strengthening of traditional housing markets. The increased levels of community reached during the pandemic support the types of communities we develop. The likely increase in working from home, resulting in less commuting time, will also see demand for traditional housing, in traditional communities, grow.

We also hope one other change from the pandemic survives. The response to the pandemic has seen a new level of cooperation between industry and governments. Hopefully this continues into the future and allows for proper and much needed reform.

That concludes todays presentation.

ENDS.