Dexus Convenience Retail REIT (ASX:DXC)

ASX release

5 February 2024

Resilient portfolio supporting organic property income growth

Dexus Convenience Retail REIT (DXC) today announced its results for the half year ended 31 December 2023, confirming a distribution of 10.4 cents per security.

Summary

- **Funds From Operations (FFO)**[1] of $14.5 million or 10.5 cents per security was down 7.1%, due to the impact of higher interest rates on net finance costs more than offsetting like-for-like income growth
- **Increased like-for-like net property income growth to 2.8%** due to 3.5% average rent reviews combined with a stabilisation in non-recoverable outgoings
- **Solid capital position with gearing of 32.6%** at the midpoint of the target range, with 81% of debt hedged in HY24 and a weighted average hedge maturity of 3.3 years
- **Optimised debt costs** via cancellation of $30 million of surplus facilities, with a weighted average debt maturity of 3.8 years and no debt maturities until FY26
- **FY24 FFO and Distribution guidance updated** to 20.8 – 21.1 cents per security, reflecting an increase in the lower end of the range
- Post 31 December 2023, DXC **exchanged contracts on the sale of 52 Aldershot Road, Lonsdale, SA, for $4.73 million**. The sale is priced in line with the property's book value as at 31 December 2023 and is expected to reduce gearing by circa 40 basis points

Jason Weate, DXC Fund Manager said: "Our portfolio continues to deliver solid like-for-like income growth despite the challenging economic environment, demonstrating the strength of our high-quality tenant base, and enhanced portfolio quality following significant portfolio curation activity over the last 18 months. Gearing of 32.6% remains well placed in the current environment, in line with the midpoint of our 25 – 40% target range and with significant headroom to covenants. We have increased the lower end of our FY24 guidance range due to greater visibility into average floating rates, and remain well positioned for the long term."

Strategy

"Today's result demonstrates continued delivery of our investment proposition to generate defensive property income with embedded growth, supported by prudent capital management and an active approach to portfolio optimisation.

"DXC benefits from a diverse customer base, with 95% of income derived from national and international major tenants. Our top tenants continue to meaningfully invest in the long-term performance of their operations, including Viva Energy's (17% of income) recent acquisition of Coles Express and On the Run Group in addition to 7 Eleven International's acquisition of 7-Eleven Australia (13% of income).

"We are well positioned to commence Stage 1 of the Glass House Mountains redevelopment in Q3 FY24 post finalisation of Agreements for Leases (AFLs). The redevelopment is expected to deliver strong returns and will provide a balanced tenancy mix with 45% of income expected to be derived from quick-service restaurants.

"Despite a challenging interest rate environment, fuel and convenience transaction volumes have remained relatively robust, allowing for material price discovery to inform asset valuations and NTA. We will continue to explore asset divestment opportunities to prudently manage the balance sheet and position the vehicle for long-term growth opportunities."

Financial result

The statutory result reflected a net loss after tax of $1.7 million, impacted by net fair value losses on investment properties and derivatives.

FFO of $14.5 million or 10.5 cents per security reflected a decline of 7.1%, as the impact of a higher cost of debt reflecting higher interest rates and reduced property income from divestments more than offset solid like-for-like property income growth.

Portfolio like-for-like net operating income growth of 2.8% reflected a blend of fixed and CPI-linked rental escalators embedded within the portfolio.

DXC had 45 of its 101 investment properties independently valued during the half, with the remainder subject to internal valuations. The external and internal valuations resulted in a moderate decline of 1.7% on prior book values, with contracted rental growth partly offsetting the impact of capitalisation rate expansion. The combination of asset revaluations and net valuation declines on derivatives contributed to the reduction in NTA per security of 12 cents or 3.2%, to $3.63.

Gearing of 32.6% remains conservative, reflecting the mid-point of the 25 – 40% target range, despite asset devaluation pressures over the past 18 months. Hedged debt for the half averaged 81% and the weighted average maturity of hedges is 3.3 years. During the half, a $30 million facility was cancelled to reduce excess debt headroom and optimise overall debt costs. The weighted average debt maturity is 3.8 years with no debt expiries until FY26.

Property portfolio and asset management

DXC's property portfolio includes 101 assets valued at $753 million. The portfolio is diversified by geography, tenant and site type, with 12% of income generated from convenience retail tenancies.

The portfolio is 85% weighted (by value) to metropolitan and highway assets, with regional properties comprising the remainder. Metropolitan and highway assets benefit from higher traffic flow with greater flexibility to explore alternate land usage over time to support consumer trends toward greater convenience retail spend per visit.

The portfolio weighted average capitalisation rate has expanded by 20 basis points over the past six months to 6.30%, reflecting price discovery across relatively robust transaction market volumes in the current interest rate environment.

Portfolio occupancy increased to 99.6% and is underpinned by experienced national and global tenants, with 95% of rental income derived from major tenants. The portfolio offers strong income security and visibility with a weighted average lease expiry of 9.3 years and 89% of income expiring in FY30 or beyond.

The portfolio consistently generates organic rental growth with average rent reviews of 3.5% achieved for the half. The portfolio generates 75% of income from fixed rental increases, while 25% is from CPI escalations with approximately half of these subject to caps of 3 – 4%.

Development

The Glass House Mountains project presents an opportunity to utilise excess land and significantly enhance the convenience retail offering across the 87,660 square metre dual highway site. The potential redevelopment comprises two stages with total project costs expected to be circa $45 million.

DXC is well positioned to commence the $20 million redevelopment of the Northbound site in Q3 FY24, subject to finalisation of Agreements for Leases. The project is expected to generate a yield on cost within a range of 5.5 – 6.0% and deliver strong development returns for DXC, while also providing a balanced tenancy mix with 45% of income expected to be derived from high-quality retail tenancies including McDonalds, Guzman y Gomez and KFC, which in aggregate will deliver a 15-year average lease term.

Environmental, Social and Governance (ESG)

DXC is committed to delivering meaningful sustainability outcomes and aligns to the Dexus sustainability strategy, including an aspiration to unlock the potential of real assets to create a lasting positive impact and a more sustainable tomorrow. This also includes delivering against the sustainability priority areas of Customer Prosperity, Climate Action and Enhancing Communities.

Recognising the importance of climate action, 100% renewable electricity is sourced for assets where DXC has operational control. DXC also maintained a carbon neutral position across its business operations and controlled building portfolio for FY23 as part of the Dexus group submission under the Climate Active Standard[2].

DXC supports its tenants' ESG aspirations and their varied approaches to the shift in the energy mix. During the half, a solar supplier was selected for the rollout of onsite solar at 20 Chevron sites in DXC's portfolio with works expected to begin in late 2024.

For the Glass House Mountains redevelopment, sustainability initiatives have been embedded into the project design including plans for six electric vehicle charging stations, rooftop solar, rainwater harvesting, grey water reuse and new fuel tank technology.

Overview and outlook

DXC is well placed to deliver defensive and growing property income and will retain its focus on:

- enhancing portfolio attributes that deliver certainty of income
- preserving balance sheet strength (including exploring additional asset sales to provide value-enhancing redeployment opportunities)
- executing portfolio optimisation initiatives (including the potential redevelopment of Glass House Mountains)
- benefiting from Dexus's capabilities across transactions, leasing, development and asset management.

In addition, DXC expects continued relative valuation resilience for service station and convenience retail assets due to their predictable cash flows, strong tenant covenants and a weighted average cap rate that provides a positive spread against the marginal cost of debt.

DXC updated its FY24 guidance range to FFO and distributions of 20.8 – 21.1 cents per security from 20.7 – 21.1 cents previously, reflecting an attractive distribution yield of circa 8%[3]. Guidance has been provided based on property income growth supported by contracted rental increases, current interest rate expectations and barring unforeseen circumstances (assuming average floating interest rates (90-day BBSW) of circa 4.5% and no further transactional activity).

Authorised by the Board of Dexus Asset Management Limited

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About Dexus Convenience Retail REIT

Dexus Convenience Retail REIT (ASX code: DXC) (formerly APN Convenience Retail REIT (ASX code: AQR)) is a listed Australian real estate investment trust which owns high quality Australian service stations and convenience retail assets. At 31 December 2023, the fund's portfolio is valued at approximately $753 million, is predominantly located on Australia's eastern seaboard and leased to leading Australian and international convenience retail tenants. The portfolio has a long lease expiry profile and contracted annual rent increases, delivering the fund a sustainable and strong level of income security. The fund has a conservative approach to capital management with a target gearing range of 25 – 40%. Dexus Convenience Retail REIT is governed by a majority Independent Board and managed by Dexus (ASX code: DXS), one of Australia's leading fully integrated real asset groups, with over 35 years of expertise in property investment, funds management, asset management and development. www.dexus.com

Dexus Asset Management Limited (ACN 080 674 479, AFSL No. 237500) (the "Responsible Entity") is the responsible entity and issuer of the financial products in respect of Convenience Retail REIT No.1 (ARSN 101 227 614), Convenience Retail REIT No.2 (ARSN 619 527 829) and Convenience Retail REIT No.3 (ARSN 619 527 856) collectively the Dexus Convenience Retail REIT (ASX code: DXC) stapled group. The Responsible Entity is a wholly owned subsidiary of Dexus (ASX code: DXS).

The registered office for the Responsible Entity is Level 30, 50 Bridge Street, Sydney NSW 2000 and its principal place of business is Level 5, 80 Collins Street (South Tower), Melbourne VIC 3000.

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[1] The Directors consider the Property Council of Australia's (PCA) definition of FFO to be a measure that reflects the underlying performance of the Group. FFO comprises net profit/loss after tax attributable to stapled security holders, calculated in accordance with Australian Accounting Standards and adjusted for: property revaluations, derivative 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, non-FFO tax expenses, certain transaction costs, one-off significant items, movements in right-of-use assets and lease liabilities, rental guarantees and coupon income.

[2] Final Climate Active certification expected to be achieved post-reporting period. Covers scope 1, 2 and some scope 3 emissions. Refer to Sustainability Data Pack available on Dexus website for scope 3 inclusions.

[3] Based on closing security price as at 2 February 2024.