Arena REIT
(ASX code: ARF)

**ASX Announcement**
25 August 2014

# FY14 RESULTS AND INTERNALISATION OPPORTUNITY

### Delivering on our strategy

Arena Investment Management Limited (**Arena**), as responsible entity of Arena REIT (**ARF**), today announced:

1. Annual results for the year ending 30 June 2014 with a statutory profit of $44.6 million (up 159% on FY13), and earnings of 8.85 cents per security (up 7.5% on FY13);
2. FY15 distribution guidance of 9.75 cents per security[1] (increase of 11.4% on FY14);
3. Opening of a Distribution Reinvestment Plan from the September 2014 quarter distribution onwards (refer separate announcement); and
4. Arena has entered into an exclusivity agreement for ARF to consider an internalisation of its management rights and assume the management rights over two wholesale funds.

Arena's Chairman Mr David Ross said "It has been a very active first full year for ARF since the ASX listing with significant earnings growth and measurable delivery on our investment strategy. During the first half of the year we executed two major transactions; the first being the addition of 6 medical centres then valued at $54.7 million and secondly, the acquisition of 14 existing childcare centres leased on a long term basis to the newly ASX listed Affinity Education Group. The second half of the year was focused on improving the quality of our childcare portfolio by building a development pipeline of tenant pre-committed large scale childcare centres in high demand areas which have been partly funded by the disposal of 12 smaller and older childcare assets at attractive prices."

Mr Ross added "The activity of the past 12 months is reflected in ARF's ASX total return to investors of 26% for FY14. ARF is well positioned moving into FY15, with Arena providing distribution guidance of 9.75 cents per security reflecting double digit growth. We also believe that, in the absence of a superior proposal, the opportunity to internalise the management of ARF will help position ARF even better in the years ahead through improved alignment of management."

## 1. FY14 FINANCIAL SUMMARY

| Key metrics | FY14 | FY13 | Change (%) |
|---|---|---|---|
| Statutory net profit | $44.6m | $17.2m | 159% |
| Distributable income | $18.5m | $11.2m | 65% |
| Distributable income per security | 8.85¢ | 8.23¢ | 7.5% |
| Distribution per security | 8.75¢ | 8.00¢ | 9.4% |
| Distribution pay-out ratio | 98.9% | 97.2% | 1.7% |

1 On a status quo basis assuming no new acquisitions and developments in progress are completed in line with budget assumptions, and tenants comply with all their lease obligations.




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Arena

| Key metrics | FY14 | FY13 | Change (%) |
|---|---|---|---|
| Total assets | $375.3m | $241.3m | 56% |
| Balance sheet gearing | 33.3% | 10.4% | 220% |
| Net asset value | $238.2m | $210.1m | 13% |
| ASX market capitalisation[2] | $253.8m | $218.7m | 16% |
| NTA per security | $1.13 | $1.02 | 11% |
| Securities on issue | 211.5m | 206.3m | 2.5% |

Mr Bryce Mitchelson, Arena's Joint Managing Director commented "The financial performance of ARF was driven by new investment and the strong returns generated from the underlying childcare and medical centre property portfolio with like for like average rental growth of 2.9% and a NTA increase of 10.8%. Underlying earnings or distributable income was up 65% or 7.5% on a per security basis."

**Capital management**

In relation to ARF's debt facilities and borrowings, the following key activities occurred:

- **Extended maturity on debt facilities** – The existing debt facilities were extended to have an average maturity of 4 years (+1 year).
- **Increased facility limit** – During the year, the debt facility limit was increased to $155 million and has unutilised capacity of $30 million.
- **Improved interest cost** – Margins on the existing debt facility were reduced by 40 basis points. Base interest rates remain at historically low levels.
- **Extended fixed interest rate hedging** – Fixed rate hedging now extends out to June 2021 with an average duration of 3.1 years. Interest rate hedging cover is currently 68%.

ARF is comfortably satisfying its debt covenants as noted below:

| | Covenant | Actual |
|---|---|---|
| LVR | 50% | 36.3%[3] |
| ICR | 2 x (EBITDA: Interest) | 5.9 |

From an equity perspective, ARF issued 5.2 million new securities (+2.5%) during FY14 to the investors in Sydney Healthcare Trust (**SHCT**) who elected to roll into the ARF stapled group.

**Investment portfolio**

During the year, the asset management team was particularly active with the property portfolio with many of the key metrics improving such as reduced vacancy, longer weighted average lease term, larger scale and higher metropolitan exposure.

[2] Based on ASX closing price of $1.20 as at 30 June 2014
[3] Based on last independent valuation.

| As at 30 June 2014 | Medical centres | Leased childcare centres | Vacant childcare centres | Childcare Centre development sites | Total FY14 | Total FY13 |
|---|---|---|---|---|---|---|
| No of properties | 7 (+7) | 174 (+7) | 2 (-4) | 10 (+6) | 193 (+16) | 177 |
| Carrying value ($m) | 64.2 | 270.0 | 1.6 | 20.0 | 355.8 | 235.0 |
| Annual rent ($m) | 5.3 | 23.7 | – | – | 29.0 | 21.1 |
| Ave rental yield[4] | 8.31% | 8.75% | – | – | 8.7% | 9.3% |
| Occupancy (by number) | 100.0% | 100.0% | – | – | 99.5% | 96.5% |
| WALE (by income)[5] | 8.5 | 8.5 | – | – | 8.5 | 8.3 |

The key portfolio highlights for the year include:

- **Improved diversification –** The addition of the medical centres leased to Primary Health Care Limited increased ARF's exposure to healthcare property to 19% of the overall investment portfolio.
- **Broadened tenancy base** – During FY14, we have significantly diversified the underlying tenancy base which now includes three ASX listed entities.
- **Rental growth –** During the period, all properties owned for the period[5] were subject to rent reviews with an average increase of 2.94%. The average increase for the childcare properties was 3.1% and the healthcare centres 2.5%.
- **Leasing activity** – Two vacant properties were leased on ARF's standard lease structure with the tenants undertaking significant upgrade works to each of the properties.
- **Remixing of portfolio** – The portfolio grew in net terms by 16 properties over the year, including 7 medical centres. In net terms, the childcare portfolio grew by 9 properties with 12 sold and 21 acquisitions. Of these acquisitions, 6 were new childcare sites and 15 were existing leased centres.
- **Property revaluations** – During the period 76 independent valuations were undertaken representing 46.3% by value of the portfolio. The remaining properties were internally valued. For the year, the total revaluation increment booked was $24.5 million reflecting a like for like increase of 9.6% for the childcare portfolio and 7.4% for the healthcare portfolio.
- **Significant development pipeline of c$40 million, all with tenancy pre-commitments:**
  - **For completion in 1HFY15 –** There are 5 projects owned and currently under construction that will have a total cost of C$11 million and are expected to generate an average initial yield on completion of 9.3%.
  - **For completion in 2HFY15** – There are 3 projects owned or under contract (2 of which are awaiting subdivision approval), which are expected to be completed in 2HFY15. They have a budgeted cost of c$7 million and are expected to generate an average initial yield of 9.5%.
  - **Development Awaiting Planning Approvals** – There are 5 projects owned or under contract, which are presently awaiting planning approval. These are expected to have a total project cost of c$23 million and generate an average initial yield of 9%. They should be completed in FY16.

[4] Excludes office component
[5] Excludes vacant centres and developments

| Portfolio attributes | FY14 | FY13 | % change |
|---|---|---|---|
| Assets % located in Australia | 100% | 100% | No change |
| Assets % freehold title | 100% | 100% | No change |
| Assets % Metropolitan (by value) | 58.9% | 58.0% | 1.5% |
| Childcare size (Number places) | 84 | 80.7 | 4.1% |
| Childcare Average rent/place | $1,596 | $1,546 | 3.2% |

**Market commentary**

The market for securely leased and well located childcare and healthcare assets has become more competitive during the period. This is indicated by the strong sale prices recently achieved for ARF's 10 childcare centres which were sold in June 2014 significantly above current book value. It appears that market values have moved materially during the period in context of a low interest rate environment and investors wanting attractive yielding investments.

At the same time, the underlying demand for both childcare and medical services remains strong with structural shortages in many locations, especially in metropolitan areas with strong population growth.

The recently released draft Productivity Commission report into the childcare sector makes several important recommendations in relation to increasing and changing the mix of government funding. This report reinforces the importance of the availability of quality childcare and early learning services from the perspective of economic growth. In our view, the recommendations overall are positive for the sector.

Mr Bryce Mitchelson added "Over the next 12 months, we will aim to take advantage of opportunities to develop assets on relatively high returns and dispose of smaller and older assets at lower yields. This capital recycling should assist in generating a relatively high return on equity in the current market. In relation to non-childcare investment strategy, we will continue to take an opportunistic investment approach and only invest where suitable assets that meet our investment criteria are identified. We are prepared to be patient in broadening out the portfolio."

## 2. FY15 DISTRIBUTION GUIDANCE

Looking forward into the next financial year, taking into account new developments in progress, ARF appears well placed to continue delivering relatively high earnings growth over FY15. In this respect, Arena provides distribution guidance for FY15 of 9.75 cents per security[6]; this is an increase of 1 cent per security and equates to 11.4% distribution growth over FY14.

## 3. OPENING OF DRP

To assist with the funding of the current development pipeline, ARF today announced that it has opened its Distribution Reinvestment Plan (**DRP**) applying for the September quarter distribution onwards. The reinvestment price will be a 1.5% discount to the 15 business day volume weighted average price calculated under the DRP Rules. Arena encourages investors who wish to participate

[6] On a status quo basis assuming no new acquisitions and developments in progress are completed in line with budget assumptions, and tenants comply with all their lease obligations.

in the DRP to complete their election form (available on the web site) and lodge this with the registry prior to 30 September 2014 (participation deadline is close of business on 1 October 2014).

## 4. INTERNALISATION OPPORTUNITY

Arena today also announced that it had entered into an exclusivity agreement for a period of six months with Citrus II Investments Pty Limited (the ultimate owner of Arena Investment Management Limited) for ARF to consider an internalisation of its corporate governance and management function and to assume the management rights over two wholesale funds, being PHC Darlinghurst Syndicate and Trust and BSH Joint Venture (which both own healthcare properties).

The implied purchase price, after net asset adjustments, would be approximately $10.7 million for the ARF and wholesale funds management (intangible) rights; which is equivalent to 2.65% of total assets under management.

If Arena decides to proceed with a proposal, it would be subject to several key conditions including:

- ARF security holders approving the proposal;
- An Independent Expert concluding that the proposal is in the best interests of ARF security holders;
- No superior proposal; and
- All required consents of financiers and other third parties.

The opportunity outlined above will be actively considered by the independent directors of the Arena Board. No decision has been made by Arena to proceed with any proposal and as such, there is no certainty that the proposal will proceed.

If Arena decides to proceed with a proposal, it is intended that a Notice of Meeting and Explanatory Memorandum would be issued for a security holder meeting to be held towards the end of calendar 2014.

Mr David Ross commented “The 2015 financial year is shaping up to be a very active period for ARF. On top of the usual portfolio and development activities, Arena’s consideration of the internalisation opportunity will be an important activity during the next few months.”

**– ENDS –**

**ARF online results presentation and hosted conference call**
Arena will be hosting an online presentation and conference call at 11.00am today (Monday 25 August), to discuss the FY14 results and internalisation opportunity in more detail. You can register for the webinar at www3.gotomeeting.com/register/896619374, or dial into the conference call using the following details:

- Australian dial-in number: +61 2 8373 3507
- International dial-in number: + 61 2 8373 3550
- Passcode for participants: 84128390

**About Arena REIT**

Arena REIT is an S&P/ASX 300 listed stapled group with a strategy to invest in sectors such as childcare, healthcare, education and government tenanted facilities leased on a relatively long term basis. ARF owns 176 childcare centres, 10 childcare development sites and 7 multi-disciplinary medical centres situated throughout Australia with an aggregate value of over $355 million. Distributions are paid to investors on a quarterly basis.

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