novion Property Group

18 February 2015

ASX Announcement

FY15 interim results

Novion Property Group (Novion or the Group, ASX:NVN) delivered a net profit of $412.7 million for the six months ended 31 December 2014, driven by strong growth in asset valuations, benefits of Internalisation[1] and steady property income growth. An interim distribution of 6.9 cents per security, which is up 1.5% on the prior corresponding period, will be paid to securityholders on 26 February 2015.

Mr Angus McNaughton, Managing Director and CEO, said: "It has been another successful period for Novion featuring strong valuation gains, increasing duration and diversity of the debt profile, commencing a major redevelopment project and once again being acknowledged for one of the strongest sustainability programs amongst retail REITs globally. In addition, we are excited about the proposed merger with Federation Centres (Federation, ASX:FDC), and believe it is a unique and compelling opportunity that creates significant value for our securityholders."

Key operating highlights for the period included:

- net profit of $412.7 million, up from $188.2 million in the prior corresponding period, driven predominantly by strong property valuation growth
- an 8.0% increase in distributable income[2] to $210.5 million
- declaring a distribution of 6.9 cents per security for the period, up 1.5% from the prior corresponding period
- net property income[3] increasing by 12.4% to $306.7 million, while like-for-like[4] net property income rose by 2.0%
- net tangible asset backing per security (NTA) of $1.97, up 3.7% compared to $1.90 at 30 June 2014 and net asset value per security up 3.5% to $2.09 from $2.02 over the same period
- identifying and implementing efficiencies and additional income through an operational review which commenced post Internalisation
- total assets increasing to $9.7 billion, from $9.5 billion at 30 June 2014
- gearing[5] remaining conservative at 29.4%
- issuing US$200 million of US Private Placement (USPP) notes, increasing duration and diversity of the debt profile
- commencing construction works on the next stage of redevelopment of Chadstone Shopping Centre
- recycling capital through the sale of Post Office Square, QLD and The Entertainment Quarter, NSW for a combined sale price of $107.0 million
- maintaining effectively full portfolio occupancy at 99.7%
- specialty store sales growth of 2.8% from the comparable[6] shopping centre portfolio[7]
- being ranked number one retail REIT in Australia and number two retail REIT globally in the Global Real Estate Sustainability Benchmark survey

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1 Internalisation of the Group was completed on 24 March 2014.

2 Distributable income is a key non-IFRS earnings measure used by management to assess the performance of Novion. It represents Novion's underlying and recurring earnings from ordinary operations. Refer to page 3 for the full reconciliation of net profit to distributable income.

3 Net property income (NPI) and like-for-like NPI are unaudited, non-IFRS financial information and are not key profit measures of Novion. They are used by management to monitor the performance of the Direct Portfolio. Refer to Appendix 1 for the calculation of NPI and like-for-like NPI.

4 Adjusted for changes in ownership of properties, and significant one-off items, impacting either period and excluding development impacted centres.

5 Gearing equals borrowings as a percentage of total assets. For this calculation, borrowings is the amount of debt drawn and total assets exclude the fair value of derivatives.

6 Comparable centres refer to those centres that are not undergoing or have not undergone substantial redevelopment in either period of comparison.

7 Shopping centre portfolio excludes Myer Bourke Street, Emporium Melbourne and the DFO portfolio.

Novion Property Group
Comprising:
Novion Limited
ABN 79 167 087 363
Novion Trust
ARSN 090 150 280

Responsible Entity
Novion RE Limited
ABN 33 084 098 180 AFSL 235384

Level 39, MLC Centre
19 Martin Place
Sydney NSW 2000
GPO Box 4048
Sydney NSW 2001

T +61 2 8229 7700
F +61 2 8229 7705
W novion.com.au

- acquiring three shopping centres for $198.4 million[8] for Novion Enhanced Retail Fund (NERF)
- completing our Board membership with the commencement of Mr Peter Hay as an Independent Non-executive Director
- Mr Richard Jamieson commencing as Chief Financial Officer, and
- launching our new corporate identity as Novion Property Group.

For more information on Novion's performance during the period, refer to the Appendix 4D which was released today and can be found on the Group's website, **novion.com.au**

Merger of Novion and Federation

On 3 February 2015, Novion and Federation announced that they had entered into a Merger Implementation Agreement to merge subject to certain conditions (the Merger). The Merger will create one of Australia's leading REITs with over $22 billion in assets under management, invested across the full retail asset spectrum (the Merged Group).

Mr Richard Haddock AM, Chairman, said: "The Merger is a compelling opportunity for Novion and Federation securityholders to be part of the creation of a group that will be a top 30 company listed on the Australian Securities Exchange, the second largest listed manager of Australian retail assets, and a top 10 retail REIT globally."

The Merger combines two highly complementary platforms to provide existing Novion and Federation securityholders with an enhanced investment proposition relative to each group on a stand-alone basis, including:

- increased portfolio scale and expertise
- material value creation via cost savings and future opportunities
- significant earnings and distribution accretion for each group
- improved growth opportunities
- enhanced asset, geographic and tenant diversification, and
- greater relevance for equity and debt investors.

The Merged Group will be a significant owner and manager of Australian retail assets, fully diversified by retail asset type, geographic location and tenant mix. Key metrics of the Merged Group include:

- over $22 billion of retail assets under management across 102 retail assets with over $18.2 billion in annual retail sales[9]
- second largest listed manager of Australian retail assets and a top 10 listed manager of retail assets globally
- #1 owner / manager of Australian sub-regional centres, #1 in outlet centres and #2 in super-regional and regional centres combined
- one of the largest retail landlords in Australia, with over 500 million annual customer visits to more than 9,500 retail tenancies over 3 million sqm of lettable area under management, and
- a market capitalisation of over $11 billion[10], the third largest A-REIT and an ASX top 30 entity.

Mr Haddock added: "The Novion and Federation boards unanimously support the Merger and believe it represents a unique and compelling opportunity that creates significant value for both Novion and Federation securityholders. For Novion securityholders alone, on an FY15 pro forma basis[11] the Merger is expected to be 14.6% and 8.9% accretive to earnings and distribution respectively, on a per security basis."

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8 Excluding acquisition costs and including Mildura Central, VIC, which settled post the period.
9 Adjusted for acquisitions and divestments post the period.
10 Based on the combination of Novion's and Federation's stand-alone market capitalisations as at 2 February 2015.
11 FY15 pro forma impact assuming the Merger was implemented on 1 July 2014 and total net P&L cost savings of approximately $77 million p.a. are achieved (i.e. excluding $7 million p.a. of capitalised cost savings).

The Merger requires a number of approvals, including the approval of Novion securityholders voting at a meeting expected to be held in May 2015. A scheme booklet will be mailed to securityholders in April 2015. If approved, the Merger is expected to be implemented in June 2015.

Financial results

Net profit for the six months to 31 December 2014 was $412.7 million, compared to $188.2 million for the prior corresponding period. The significant uplift in net profit was driven predominantly by a net gain on property valuations of $253.7 million (compared to $12.8 million net gain for the prior corresponding period).

Distributable income, which more closely reflects operational earnings, was up 8.0% to $210.5 million compared to the prior corresponding period, due to the benefits of Internalisation as well as underlying performance. On a per security basis the distribution was 6.9 cents, up 1.5%.

Total net property income increased 12.4% to $306.7 million, supported by fixed annual specialty store rental increases, the completion of the DFO Homebush and Emporium Melbourne developments, the acquisition of an additional 25% of DFO South Wharf in early 2014, and property expenses saved as part of Internalisation. On a like-for-like basis, net property income was up 2.0%.

Reconciliation of net profit to distribution $m, for the six months ended	**31-Dec-14**	**31-Dec-13**	**Change (%)**
Net profit	**412.7**	**188.2**	
net gain from property valuations	(253.7)	(12.8)	
net loss/(gain) from derivative valuations	28.4	(0.5)	
straight-lining revenue	0.1	(1.6)	
movement in fair value of unrealised performance fees	-	2.0	
non-cash convertible notes interest expense	-	0.6	
Internalisation costs	0.5	2.8	
income tax expense	3.2	-	
amortisation of intangibles	1.4	-	
amortisation of project items	9.9	10.3	
other items[a]	8.0	5.9	
Distributable income	**210.5**	**194.9**	**8.0**
net transfer from undistributed reserves	-	9.8[b]	
Distribution	**210.5**	**204.7**	**2.8**
Securities on issue (end of period) (million)	3,051	3,010	1.1
Distribution per stapled security (cents)	**6.9**	**6.8**	**1.5**

a. Includes capitalised lost rent.
b. Securities issued in December 2013 ranked equally with securities on issue at the time and were entitled to the full December 2013 distribution. Consequently, an amount of $9.8 million was transferred from undistributed reserves for the December 2013 distribution payment.

Operational review

Mr McNaughton said: "At our FY14 results announcement in August, I highlighted that we had commenced an operational review to ensure we have the most efficient and effective organisational structure and processes in place to operate as an internally managed vehicle.

"Through our operational review we have already identified and implemented a number of operational improvements, the financial benefits of which will offset the dilution of selling two non-core assets during the period.

“We have reduced corporate overheads, reduced our cash holding (reducing debt and lowering interest expense) and undertaken a comprehensive review of our outgoings. Other initiatives as part of the operational review include reducing downtime on vacancies and intensifying our focus on income, cost efficiencies and customer experience at a centre level. Some organisational changes were placed on hold pending the outcome of the Merger.”

Investment performance

Novion’s security price reached its highest level since 2008 during the period, and while the Group delivered a Total Securityholder Return (TSR)[12] of 7.2% over the six months to 31 December 2014, it underperformed the UBS Retail 200 Property Accumulation Index (the Index) return of 15.4%. Novion continues to deliver on its objective to provide superior and stable risk-adjusted returns over the long term, with notable outperformance against both the Index and the broader S&P/ASX 200 Property Accumulation Index, by 5.3 and 7.7 percentage points per annum respectively, over a 10-year period.

Capital management

Mr Richard Jamieson, Chief Financial Officer, said: “In line with our strategy, we continued to be disciplined in our approach to capital management during the period. We issued US$200 million of USPP debt notes, recycled $107 million of capital through the sale of two non-core assets and we raised $65 million through Novion’s dividend and distribution reinvestment plan (DRP) for the June 2014 payment. Post the period, we have also repriced $400 million of bank debt facilities.”

Key debt metrics As at	**31-Dec-14[a]**	**30-Jun-14**
Weighted average interest rate[b] (%)	5.3	5.3
Weighted average debt duration (years)	3.9	3.5
Proportion of debt hedged[c] (%)	82.9	87.1
Weighted average interest rate on hedged debt[c] (%)	4.9	4.8
Weighted average hedged debt duration[c] (years)	3.5	3.2
Gearing (%)	29.4	30.9
Undrawn debt facilities ($ million)	512	393
Long-term credit rating (S&P)	A[d]	A
Interest cover ratio[e] (times)	3.2	3.2
Loan to value ratio[e] (%)	34	36

a. Adjusted for $400 million of bank debt facilities repriced post the period.
b. Including line fees and margins.
c. Including all fixed-rate debt and excluding fees and margins.
d. S&P credit watch negative following the Merger announcement.
e. As defined in the Interim Report released to the ASX today.

“As a result, the Group’s balance sheet has been strengthened and with strong valuation gains during the period, gearing has reduced to 29.4% from 30.9% at 30 June 2014. The diversity and duration of our debt profile has also improved, with only $100 million of bank debt expiring over the next 12 months and we remain well positioned to fund the development pipeline. Importantly, with Novion’s security price trading in excess of the conversion price of the July 2016 convertible notes, post the Merger announcement, we have maintained sufficient liquidity should we need to repay these notes in full,” added Mr Jamieson.

12 TSR comprises stapled security price performance and distribution income yield.

Strategic Partnerships

Novion has a fully integrated platform that provides a suite of funds and asset management services for our strategic partners which include wholesale funds and mandates, the joint owners of assets in Novion's Direct Portfolio (assets held on Novion's balance sheet) and other third parties.

Our Strategic Partnerships business comprises $5.8 billion of assets under management across 19 retail assets, nine of which are co-owned with Novion. The following table outlines the composition of our Strategic Partnerships business.

Strategic Partnerships Retail assets under management [a,b]	**Number of assets**	**Value of assets ($b)**
Funds and asset management mandates		
Novion funds – jointly owned with Novion	3	0.6
Novion funds – other	9	1.4
Asset management mandates		
Joint owners of Novion assets	6	3.5
Third parties	1	0.3
Strategic Partnerships	**19**	**5.8**

a. Excludes funds in wind down and office properties.
b. Includes assets settled post the period.

Mr Michael Gorman, Deputy CEO and Chief Investment Officer, said "We made good progress on fulfilling the equity commitment for NERF during the period. Including Mildura Central, VIC which settled post the period and combined with the two assets acquired earlier in the period, Gateway Plaza, Leopold VIC and Bathurst City Centre, NSW, NERF now has five assets with a total asset value of $340 million.

"In line with strategy, NERF's portfolio consists of neighbourhood and sub-regional assets with a mix of core assets and centres where we are able to extract superior returns for our wholesale investors through leasing or development opportunities. We are also well progressed on sourcing additional assets for this fund."

Non-core asset divestments

Novion sold two non-core assets from its Direct Portfolio during the period. Post Office Square, QLD and The Entertainment Quarter, NSW were sold for a combined value of $107 million (Novion share).

Mr Gorman said: "These transactions are in line with our strategy of divesting non-core assets and Novion has achieved the lower end of its target range of divesting $100-200 million of non-core assets over FY15 and FY16."

Valuations

As announced in December 2014, half (52%) of the Direct Portfolio was independently valued in the period, resulting in a $253.7 million gain compared to book value.

Mr Gorman said: "On the back of a highly competitive transaction market and recent evidence, the capitalisation rate of our retail assets compressed in the current round of valuations driving significant valuation growth, averaging a 5.6% increase on prior book value of those assets valued."

The weighted average capitalisation rate for the Direct Portfolio (excluding the DFO portfolio) tightened to 6.06% from 6.25% at 30 June 2014.

Retail sales

Mr Gorman said: “Economic growth remains positive and interest rates remain very low. Together with sharply falling petrol prices and a lower AUD/USD exchange rate, this should support greater retail expenditure in Australia. However, challenging proposed Federal Budget measures, sub trend economic growth and a relatively soft employment environment have weakened consumer sentiment, which is expected to constrain the rebound in retail sales in the short-term.

“The Direct Portfolio generated $7.8 billion of moving annual turnover (MAT) to 31 December 2014 and remains effectively full at 99.7% occupancy. Our comparable specialty store MAT growth to 31 December 2014 improved to 2.8%, up from 2.2% to 30 June 2014 for the shopping centre portfolio. At the DFO centres, the activation of the food and beverage precinct at South Wharf, the recently completed redevelopment of Homebush and our focus on increasing the brand names and improving services at these assets continues to drive strong traffic and sales growth.”

The average re-leasing spreads on specialty store leases that expired during the period was -3.6% for the Direct Portfolio, an improvement on the -4.3% reported in FY14. Excluding the DFO portfolio, re-leasing spreads were -5.7% (improved from -6.1%).

Mr Gorman added: “Despite the softness in the retail market, we have maintained our fixed 5% annual increases in new specialty store leases, with no incentives for renewing tenants. Comparable specialty store tenant productivity improved during the period with MAT of $10,554 per sqm, up from $10,457 per sqm at 30 June 2014 and occupancy costs of 17.2% compared to 17.1% six months earlier.”

Development

Mr Gorman said: “Work remains on track at the redevelopment of Chadstone Shopping Centre, with demolition and site excavation complete and the commitment of a number of high profile tenants. While at Emporium Melbourne, where we celebrated our official launch during the period, we have been very pleased with the performance and customer response to this world class asset post development completion, with just over 15 million visitors since opening.”

Novion has a development pipeline of $1.2 billion, $544 million of which relates to the Direct Portfolio. Direct projects under construction have a development cost of approximately $303 million (Novion share) with approximately $254 million remaining to be spent.

Chadstone Shopping Centre, VIC – under construction

Construction of the $580 million (Novion share $290 million) redevelopment site at Chadstone Shopping Centre commenced during the period.

The project involves the expansion and redevelopment of the northern end of the centre, including a revitalised West Mall and a world-class entertainment and leisure precinct featuring international flagship and luxury tenants around a central atrium. Concurrently, a 10-level, 17,000 sqm office building with four levels of basement parking is being built on the southern end of the site. Associated works will include the construction of a retail car park deck and a 14-bay centralised bus interchange. In total, approximately 20,000 sqm will be added to retail GLA and 14,000 sqm (net) will be added to office NLA.

The new North Retail precinct will include a state-of-the-art Hoyts digital cinema complex, up to five international flagship stores in 11,000 sqm of space, 40 additional retailers, and a new 1,300-seat, 20-plus tenancy food gallery. Target will also be relocated to the lower ground floor in a new 7,000 sqm store. Both the retail and office components are targeting 5 Star Green Star ratings.

The project is targeting an initial yield on completion of greater than 6%, with a target internal rate of return greater than 10% and is expected to open in stages through to completion by mid-2017.

Responsible Property Investment

Mr McNaughton said: "During the period Novion was again highly ranked amongst our retail REIT peers globally in the area of sustainability, a reflection of the quality of our sustainability program and our approach as a responsible corporate citizen."

During the period, we received the following recognition:

Global Real Estate Sustainability Benchmark (GRESB)

Novion was ranked the highest of all retail REITs in Australia and second of retail REITs globally for the 2014 GRESB survey. GRESB surveyed over 630 property companies and funds globally on their approach to sustainability, which includes a range of environmental, social and governance indicators.

CDP (formerly Carbon Disclosure Project)

Mr McNaughton said: "In 2014, CDP once again ranked us highly for our approach to the risks and opportunities presented by climate change. Novion was recognised as a Climate Disclosure Leader for the fifth consecutive year, and ranked in the top 10 for performance for the third consecutive year, for ASX 200 listed entities.

"Our environmental performance reporting allows us to benchmark the performance of our assets to ensure that we can effectively manage the risks and opportunities presented by climate change and identify opportunities to make further efficiency gains across our portfolio."

Other sustainability indices

Novion was again included in the long standing sustainability benchmark indices being the DJSI suite of region-specific indices and the FTSE4Good Index, which the Group has been a part of since 2001 and 2004 respectively.

Summary and outlook

Mr McNaughton said: "We are well on track to achieve our FY15 objectives. We have improved our debt profile through the issuance of US$200 million of long-dated USPP notes, we have divested over $100 million of non-core assets, we are well progressed on the Chadstone redevelopment, we have made good progress on our operational review, and we have acquired three assets for NERF.

"Through the second half of FY15, we will be focused on the successful progression and execution of the proposed Merger with Federation. We will also continue to focus on business operations, progressing the Chadstone redevelopment and refining the tenant mix and customer experiences across our portfolio, while looking to fulfil wholesale fund mandates."

Mr McNaughton added: "Our full-year FY15 distribution guidance[13] is 13.8 cents per security."

ENDS

[13] Assuming there is no unforeseen material deterioration to existing economic conditions. If the Merger proceeds, distribution guidance for FY15 is at least 13.8 cents per security.

For further information please contact:

Angus McNaughton
Managing Director and CEO
T +61 2 8229 7801
E angus.mcnaughton@novion.com.au

Michael Gorman
Deputy CEO and Chief Investment Officer
T +61 2 8229 7802
E michael.gorman@novion.com.au

Penny Berger
Head of Investor Relations and Communications
T +61 2 8229 7760
M +61 402 079 955
E penny.berger@novion.com.au

Troy Dahms
Investor Relations and Communications Manager
T +61 2 8229 7763
M +61 412 055 996
E troy.dahms@novion.com.au

About Novion Property Group
Novion Property Group (Novion, ASX:NVN) is one of Australia's leading retail property groups, with a fully integrated funds and asset management platform, and $14.9 billion in retail assets under management. Listed on the Australian Securities Exchange, Novion holds interests in 27 directly-owned retail assets across Australia, manages 19 assets on behalf of strategic partners (9 of which are co-owned with Novion) and has over 17,000 investors across 19 countries. For more information, visit **novion.com.au**, or use your smartphone to scan this QR code to visit our Investor centre.

Appendix 1 – Calculation of net property income (NPI) and like-for-like NPI

$m, for the six months ended	31-Dec-14	31-Dec-13	Change (%)
Property revenue	390.5	366.0	
Share of net profit from equity accounted investments before fair value adj.	2.7	1.6	
Dividend income	-	1.4	
Property expenses	(104.5)	(110.8)	
Straight-lining revenue[a]	0.1	(1.6)	
Amortisation of project items[a]	9.9	10.3	
Other items[a, b]	8.0	5.9	
Net property income	**306.7**	**272.8**	**12.4**
Like-for-like adjustments			
Development-affected properties[c]	(17.9)	(6.7)	
Adjustment for changes in ownership of properties[d]	-	0.3	
Property expenses eliminated post Internalisation	(18.7)	-	
Other one-off adjustments[e]	(1.0)	(2.5)	
Like-for-like net property income	**269.1**	**263.9**	**2.0**

a. Refer to Note 2(b) of the Interim Report released to the ASX today, for the explanations of adjusting items.
b. Includes capitalised lost rent.
c. Properties have been excluded from the like-for-like calculation where income has been significantly affected by development in either period. Properties excluded are DFO Homebush and Emporium Melbourne.
d. Novion sold Post Office Square in November 2014, Rosebud Plaza in November 2013 and acquired a further 25% interest in DFO South Wharf in May 2014. An adjustment is made to the like-for-like calculation to reflect the changes in ownership interests.
e. One-off redundancy costs for The Entertainment Quarter and lease premiums have been excluded from the like-for-like calculation for the six months ended 31 December 2014. Queensland flood insurance claims and lease premiums have been excluded from the like-for-like calculation for the six months ended 31 December 2013.