PFI ANNOUNCES RECORD ANNUAL RESULTS

The PFI management team will present these results via live webcast from 10.30 am NZT today. To view and listen to the webcast, please visit https://edge.media-server.com/mmc/p/5n3sjqp8. We recommend you log on a few minutes before the start time, and if you cannot attend the live webcast, a recording will be available on PFI's website shortly after the conclusion of the live event. Alternatively, you can listen to the live presentation by dialling in on 0800 667 018 and using the access PIN 9797585.

Highlights

- **Record annual results:** profit after tax of $176.3 million, Funds From Operations (FFO)[1] earnings up 2.6% to 9.07 cents per share, Adjusted Funds From Operations (AFFO) earnings up 4.4% to 7.79 cents per share
- **Dividends AFFO covered:** cash dividends of 7.60 cents per share, AFFO dividend pay-out ratio of 98%
- **Strong balance sheet:** net tangible assets up 15.6% or 27.8 cents per share, bank facilities and bonds secured for an average of 4.1 years, gearing of 28.2%
- **Positive portfolio activity:** nearly 100,000 square metres or 17% of the portfolio leased during the year to 24 tenants for an average increase in term of 6.7 years, rent reviews completed on 103 leases delivered an average annual uplift of ~4.6%
- **Priorities advanced:** four Auckland industrial opportunities secured totalling $106.4 million, $40 million of non-industrial divestments contracted during the year, committed to or completed ~$26 million of value-add strategies

Property for Industry Limited (PFI, the Company) today announced record results for the year ended 31 December 2019.

"This year we achieved a record annual result, continued to deliver strong, stable investor returns, and made constant progress on focusing the portfolio on our core industrial strengths." says PFI Chief Executive Officer Simon Woodhams.

Financial performance

Net rental income increased by $4.2 million or 5.3% to $83.3 million. Positive leasing activity contributed an increase of $3.3 million or 4.2%, and acquisitions contributed a further increase of $1.8 million. These increases were partially offset by disposals ($0.4 million), lost rental income from properties now under re-development ($0.3 million), and lost rental income from a fire at 314 Neilson Street, Penrose[2] in April 2019 ($0.2 million).

Property costs – net of recoveries from tenants – increased by $0.3 million and administrative expenses increased by $0.4 million.

Interest expense and bank fees increased $0.2 million or 1.3%: average borrowings increased by $21.2 million, but the impact of this was partially offset by a reduction in the Company's weighted average cost of debt[3], down ~23 basis points from the end of the prior year to 4.63%.

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[1] Funds From Operations (FFO) and Adjusted Funds From Operations (AFFO) are non-GAAP financial information and are common property investor metrics, which have been calculated in accordance with the guidelines issued by the Property Council of Australia. Please refer to Appendix 1 for more detail as to how these measures were calculated.

[2] PFI has material damage insurance up to a value of $9.65 million and 24 months of business interruption insurance in place for this property. The final amounts to be received under these insurance policies are yet to be determined and received.

[3] Weighted average cost of debt comprises float interest rates, hedging, margins and all borrowings related fees.

PFI's effective current tax rate was 22.9% during 2019, up from 20.2%[4] in the prior year, in part due to a higher level of maintenance capex in the prior year.

Profit after tax for year of $176.3 million (35.35 cents per share) was up $66.2 million (13.27 cents per share) on the prior year and this is the highest level of profit ever recorded by the Company.

FFO and AFFO

FFO earnings of 9.07 cents per share were 0.23 cents per share or 2.6% ahead of the prior year, whilst AFFO earnings of 7.79 cents per share were 0.33 cents per share or 4.4% ahead of the prior year.

AFFO adjustments totalled $6.4 million in the current year, down $0.5 million or 8.0% from the prior year. A key component of AFFO adjustments is maintenance capex. As noted in previous communications, PFI expects that maintenance capex on its existing portfolio will average 35 basis points per annum, but that the timing of this will be volatile. This volatility can be illustrated when comparing the level of maintenance capex in the current and prior years: in 2019, maintenance capex totalled $3.4 million or 25 basis points, whereas in 2018, maintenance capex totalled $4.5 million or 35 basis points.

Q4 Final Dividend

The PFI Board has today resolved to pay a fourth quarter final cash dividend of 2.1500 cents per share. The dividend will have imputation credits of 0.8015 cents per share attached and a supplementary dividend of 0.3637 cents per share will be paid to non-resident shareholders. The record date for the dividend is 24 February 2020 and the payment date is 4 March 2020. The dividend reinvestment scheme will not operate for this dividend.

The fourth quarter dividend will take cash dividends for the full year to 7.60 cents per share, an increase from the prior year of 0.05 cents per share, resulting in an FFO dividend pay-out ratio of 84% (2018: 85%) and an AFFO dividend pay-out ratio of 98% (2018: 101%, refer Appendix 2).

Given the level of volatility in maintenance capex and other AFFO adjustments, PFI will also be mindful of the AFFO dividend pay-out ratio over a longer time horizon than any one year when setting dividends. For example, the average AFFO dividend pay-out ratio is 101.0% since PFI began disclosing AFFO[5] in 2016 (refer Appendix 4).

Guidance

PFI Chief Finance and Operating Officer, Craig Peirce, notes: "At the beginning of 2018, we announced our transition to a dividend policy that is based on FFO and AFFO. Since then, we have been working to grow earnings at a faster rate than we have been growing dividends. Now that our dividends are covered by AFFO earnings, we will target an increase in the rate of growth of our dividends. Historically, dividends have increased by 0.05 cents per share each year, if performance allowed, but in 2020, we plan to lift dividends by 0.05 to 0.10 cents per share resulting in a forecast dividend of between 7.65 to 7.70 cents per share, subject, of course, to matters outside of our control."

The Company expects that this level of full year cash dividends will approximate 80% to 90% of FFO earnings and 95% to 100% of AFFO earnings, in line with the Company's dividend policy.

Net tangible assets (NTA)

PFI's NTA per share increased by 27.8 cents per share or 15.6% from 177.7 cents per share as at the end of 2018 to 205.5 cents per share as at the end of the year.

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[4] 2018 excludes the impact of the June 2017 internalisation.
[5] AFFO has been disclosed for the financial years ended 31 December 2016 to 31 December 2019.

The change in NTA per share was driven by the increase in the fair value of investment properties (described below, +25.1 cents per share), retained earnings (+1.4 cents per share), gains made on the disposal of PFI's non-industrial properties (+0.8 cents per share) and the decrease in the net fair value liability for derivative financial instruments (+0.5 cents per share).

Capital management

PFI's bank facilities were refinanced in November 2019. Existing lenders ANZ, BNZ, CBA and Westpac each committed a quarter of a combined total of $300 million of facilities, up from $275 million prior to the refinancing. The facilities are in two equal $150 million tranches, expiring November 2022 and 2023.

When combined with the Company's November 2024 ($100 million) and October 2025 ($100 million) bonds, at 31 December 2019, the weighted average term to expiry of PFI's bank facilities and bonds stands at 4.1 years.

PFI's weighted average cost of debt[6] reduced during the year to 4.63% as at 31 December 2019 from 4.86% as at 31 December 2018. The Company remains well placed to continue to take advantage of the current low interest rate environment: based on current hedging and debt levels, an average of approximately 59% of PFI's debt will be hedged at an average rate of approximately 3.58% during 2020, down from 3.75% as at 31 December 2019, with the remainder on low floating interest rates.

The Company ended the year with gearing[7] of 28.2% and an interest cover ratio[8] of 4.0 times. After allowing for 2019 tax, the Q4 final dividend, settlement of the divestment of 2 Pacific Rise and capital commitments, gearing could move up to ~33%. Allowing for the divestment of PFI's remaining non-industrial properties, gearing could return to ~27%.

Portfolio performance

Portfolio snapshot as at	31 December 2019	31 December 2018
Book value	$1,476.2m	$1,322.0m
Number of properties	94	94
Number of tenants	144	148
Contract rent	$84.9m	$82.0m
Occupancy	99.0%	99.3%
Weighted average lease term	5.38 years	5.39 years
Auckland property	84.1%	83.1%
Industrial property	90.0%	87.3%

Further to the announcement in December 2019, PFI recorded an annual increase in the value of its property portfolio from independent valuations of $125.2 million or 9.3% to $1,476.2 million. Around one-third of this valuation outcome was due to rental growth, which in part reflects the successful leasing outcomes, described below. Continued high levels of demand for industrial property from both investors and owner occupiers was also an influence, with movements in cap rates contributing the remaining two thirds of the increase in value. As a result of the year-end valuation process, PFI's passing yield firmed from 6.21% to 5.75%.

An independent market rental assessment of the entire portfolio was completed at the end of the year as part of the independent valuation process. This assessment estimates that PFI's portfolio is ~3.5% under-rented, but internal estimates are that the Company's Auckland industrial portfolio is around 6%

[6] Weighted average cost of debt comprises BKBM, hedging, margins and all borrowings related fees.
[7] That is, total borrowings as a percentage of the most recent independent valuation of the property portfolio. Covenant: 50%.
[8] That is, the ratio of interest expense and bank fees to operating earnings excluding interest expense and bank fees. Covenant: 2 times.

under-rented.

Nearly 100,000 square metres, representing more than 17% of PFI's existing portfolio by rent, was leased during the interim period to 24 new and existing tenants for an average increase in term of 6.7 years. Lease renewals accounted for more than 76% of the contract rent secured, with 16 PFI tenants retained for an average increase in term of 6.9 years. Across these leasing transactions, low levels of incentives and capital expenditure were required to attract and retain tenants, with average leasing costs of less than half a month per year of term.

Included in these totals is a renewal of DHL's lease at 7-9 Niall Burgess Road in Mount Wellington, and a new lease to Coca-Cola Amatil at the recently refurbished 6 Donnor Place, also in Mount Wellington. You can learn more about both of these transactions in PFI's annual report, released today.

Rent reviews were completed on 103 leases during the year, resulting in an average annual uplift of ~4.6% on ~$52.7 million of contract rent. 11 market rent reviews on $5.3 million of contract rent delivered an annualised increase of 4.7% over an average review period of 3.6 years, and these reviews were settled at an average of approximately 7.5% above December 2018 market rental assessments.

At the end of the year, the Company's portfolio was 99.0% occupied and just 6.5% of contract rent is due to expire in 2020. When combined with rent reviews, almost 73% of PFI's portfolio is subject to some form of lease event during 2020.

In their December 2019 Auckland Market Outlook, CBRE predict industrial rental growth over the next five years to average 2.5% per annum for Prime properties and 3.0% per annum for Secondary properties. PFI will continue to access this projected market rental growth as approximately 23% of the Company's 2020 lease events[9] are market related.

Market update

In their January 2020 Quarterly Economic Outlook, ANZ note that: "The [New Zealand] economy is at a crossroads and the political and international context will be crucial."

On the one hand, they highlight that monetary policy appears to be doing its job, that the housing market has strengthened, fiscal spending is supportive, and the labour market is strong. Countering this, they also believe that credit availability will be crucial, and that business investment will be constrained. Drought conditions in some parts of New Zealand – and floods in others – combined with the risks from the novel coronavirus, are also potential risks.

Given these conditions, they forecast for 2020 and 2021 to end with an Official Cash Rate of just 1.00%, with forecast 10-year Bond Rates of 1.30% and 1.20% respectively.

Low interest rates play an important part in the attractiveness of property and its returns relative to other asset classes. In December 2019 Auckland Market Outlook, CBRE note: "Low interest rates combined with property's return profile relative to other assets… underpin further yield firming for the next two years."

"Omnichannel retailing" is also expected to be a key driver for industrial property, according to CBRE. They estimate that for every $1 billion of additional online sales, an extra 100,000 sqm of distribution space is required. With the likes of H&M and Chemist Warehouse recently arriving in New Zealand, and others like Cos, Costco, Decathlon, Ikea and Uniqlo signalling their arrival, this trend is expected to gather momentum in the medium term.

[9] Being 16.6% of total contract rent.

Also in their December 2019 Auckland Market Outlook, CBRE note other favourable indicators: they estimate total industrial vacancy of just 1.4%, rental growth in the last 12 months of 3.3% in prime industrial and 4.1% in secondary industrial, firming yields and continued increases in industrial zoned land.

These factors combine to result in secondary industrial remaining as their top ranked category in in their December 2019 Auckland Market Outlook. CBRE's forecast of secondary industrial annual returns over the next five years totals 10.6% per annum (June 2019: 11.2%), comprising an income return of 5.8% (June 2019: 6.0%) and capital growth of 4.8% (June 2019: 5.2%).

Prime industrial is also set to deliver above-average returns: despite falling from second place in June 2019 to fourth place (out of 12) in December 2019, CBRE have forecast a small increase in average annual returns over the next five years expected to 9.0% per annum (June 2019: 8.9%), comprising an income return of 4.9% (June 2019: 5.1%) and capital growth of 4.1% (June 2019: 3.8%).

Our priorities

Simon Woodhams notes: "We are pleased to report excellent progress on the four priorities we stated at the beginning of the year."

In addition to the asset management activity, discussed earlier in this announcement, these priorities included the replacement of PFI's non-industrial properties with quality industrial properties in sought-after areas.

Simon Woodhams continues: "To that end, $106.4 million has been committed during the year to four prime Auckland industrial opportunities. 12-year leases have been secured at three of the four sites, with tenant commitment to be secured by PFI's leasing team at the fourth property in Tidal Road whilst the property is under construction. Across these transactions, the return to PFI is estimated to be around 5.57%."

Significant progress has also been made in divesting PFI's non-industrial properties, with $40 million of divestments contracted during the year. Included in this total is the divestment of the mixed-use property at 229 Dairy Flat Highway in Albany, Auckland, for $33 million, and you can learn more about this divestment in the Company's annual report, released today. Non-industrial properties now account for just 10% of PFI's portfolio.

Finally, value-add strategies within the existing portfolio also formed an important part of the Company's 2019 priorities. In addition to the $14.6 million spent during 2019, PFI has committed a further $21 million to four new significant projects. These projects include the completion of the refurbishment of PFI's property at 6 Donnor Place in Mount Wellington, Auckland, prior to occupation by Coca Cola Amatil. More details on this project can also be found in PFI's annual report.

Simon Woodhams concludes: "In 2020 we will continue on our pathway to becoming a pure-play industrial listed property vehicle. In order to achieve that goal, we will remain focused on our core asset management and value-add strategies within our portfolio. We also plan to supplement that activity with the replacement of PFI's remaining non-industrial assets – including Carlaw Park in Parnell, Auckland – via acquisition of quality industrial properties in sought-after areas."

ENDS

ABOUT PFI & CONTACT

PFI is an NZX listed property vehicle specialising in industrial property. PFI's nationwide portfolio of 94 properties is leased to 144 tenants.

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Attachments

NZX Form – Results Announcement
NZX Form – Distribution Notice
Annual Results Presentation
Annual Report

Appendices

Appendix 1 – FFO and AFFO Calculations

Funds / Adjusted Funds From Operations **(unaudited, $000, unless noted)**	**For the year ended** **31 December 2019**	**For the year ended** **31 December 2018**
Profit and total comprehensive income after income tax attributable to the shareholders of the Company	**176,286**	**110,094**
Adjusted for:		
Fair value gain on investment properties	(125,193)	(66,370)
Material damage insurance income	(1,125)	-
Loss / (gain) on disposal of investment properties	(4,126)	(53)
Fair value (gain) / loss on derivative financial instruments	(2,577)	(2,009)
Amortisation of tenant incentives	2,656	2,330
Straight lining of fixed rental increases	(1,690)	(1,203)
Deferred taxation	986	3,316
Adjustment to current taxation for the deductibility of the termination of the management agreement	-	(1,994)
Other	12	-
Funds From Operations (FFO)	**45,229**	**44,111**
FFO per share (cents)	**9.07**	**8.84**
Maintenance capex	(3,446)	(4,476)
Incentives and leasing fees given for the period	(2,955)	(2,426)
Other	-	(10)
Adjusted Funds From Operations (AFFO)	**38,828**	**37,199**
AFFO per share (cents)	**7.79**	**7.46**

Appendix 2 – FFO and AFFO Dividend Pay-out Ratios

Full year dividends per share (cents)	**7.60**	**7.55**
FFO dividend pay-out ratio (%)	**84%**	**85%**
AFFO dividend pay-out ratio (%)	**98%**	**101%**

Appendix 3 – AFFO Pay-out Ratios (2016 – 2019)

Year	AFFO per share (cents)	Full year dividends per share (cents)	Pay-out ratio (%)
2016	6.95	7.35	105.8%
2017	7.49	7.45	99.5%
2018	7.46	7.55	101.2%
2019	7.79	7.60	97.6%
Total	**29.69**	**29.95**	**101.0%**