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ALE boosts distributions to securityholders by 17.9% in first half, forecasts increase in full year payout

ALE Property Group (ASX: LEP), the owner of Australia's largest portfolio of freehold pub properties, increased distributions by 17.9% for the half year to 31 December 2015 and forecasts an increase in full year distributions.

Key Points

- Accounting profit for the half year of $63.1 million includes revaluations
- Distributable profit for the half year of $14.8 million
- Half year distribution of 9.90 cents per security
  - increase of 17.86% on previous December half year
  - on track to achieve full year guidance of at least 20.00 cps
  - funded out of current and prior year accumulated distributable profits
- Weighted average capitalisation rate reduced from 5.99% to 5.74%
- Statutory valuation of 86 properties increased by 5.93% to $953.9 million
- Capital position remains strong
  - debt maturity dates diversified across next eight years
  - 4.35% p.a. all up cash interest rate fixed until next maturity in Aug 2017
  - base interest rate hedging extended from seven to around ten years
  - gearing reduced from 48.0% to 45.7% and provides significant headroom
- Distribution guidance progressively restores gearing to target range
  - FY16 distribution of at least 20.00 cps (up from FY15 of 16.85 cps)
  - expect half and full year distribution to be 100% tax deferred
  - increasing subsequent annual distributions by CPI
  - consideration of additional distributions following completion of 2018 market rent review
- ALE Property Group named top A-REIT for FY15 by BDO
- 2003 investment of $1.00 in ALE has a current accumulated value of $11.33.

Results for Year Ending 31 December 2015

A summary of the results is provided in the table below:

Year Ended ($ Millions)	**December 2015**	December 2014	Change
Revenue from properties	**$28.0**	$27.4	0.6
Other Revenue	**$0.5**	$1.2	(0.7)
Borrowing Expense	**$10.3**	$11.1	(0.8)
Management Expense	**$2.3**	$2.2	0.1
Land Tax Expense	**$1.1**	$1.1	-
Distributable Profit	**$14.8**	$14.4	0.4
Securities on Issue (Millions)	**195.7**	195.7	-
Distributable Profit (cps)	**7.58c**	7.37c	0.21
Distribution per Security (cps)	**9.90c**	8.40c	1.50

Difference between distribution and distributable profit was paid from 3.33c of prior period accumulated distributable profits. Distributable profit excludes non-cash accounting items.

Accounting Result

ALE's operating profit after tax of $63.1 million for the half year to 31 December 2015 includes non-cash adjustments for the increase in the value of the properties and a reduction in the value of interest rate derivatives. The profit also includes other non-cash items including amortisation of pre-paid financing costs and CIB accumulating indexation. A full reconciliation of accounting profit to distributable profit has been provided in the Directors' Report.[1]

Distributable Profit

There were several significant influences on distributable profit during the half year to December 2015.

Property income increased due to the annual CPI based rental escalations. Borrowing expenses were lower due to lower average debt balances and the full impact of the reduced credit margins arising from the June 2014 refinancing. Management expenses were slightly higher than the prior period and ALE's management expense ratio remains one of the lowest in the AREIT sector. All the above factors led to ALE delivering a distributable profit of $14.8 million.

The distribution of 9.90 cents per security is expected to be 100% tax deferred.

Statutory Property Valuations

As announced on 16 December 2015, the statutory valuations of ALE's 86 properties were formally increased to $953.9 million at 31 December 2015, an increase of $53.4 million over the half year. This was based upon independent valuations of 38 properties by CBRE. ALE's weighted average capitalisation rate reduced from 5.99% to 5.74%.

Directors' valuations of the remaining 48 properties (also independently valued over the previous two years) are supported by advice from CBRE that it is reasonable to apply the same percentage movement in the weighted average capitalisation rates, on a like for like basis, that they determined would apply to the 38 properties they independently valued at 31 December 2015.

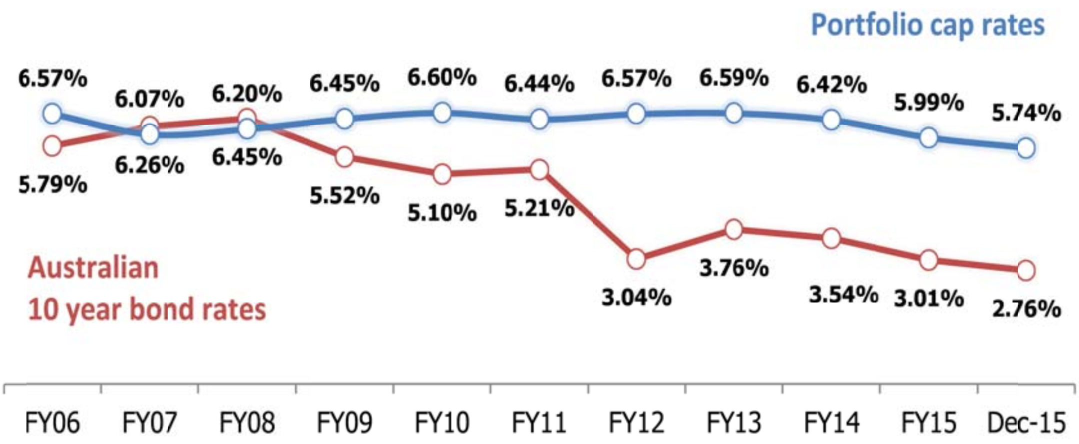
All independent and directors' valuations excluded any portfolio premium or discount. CBRE have previously indicated that an investor's view of market rent prospects and value may be positively influenced by full disclosure of the tenant's operating profitability at each of the properties.

The property valuations were also positively impacted by the annual CPI based increase in rent. The land tax expense for the Queensland portfolio was largely unchanged due to a number of successful objections by ALE.

Over and above the existing portfolio, ALE continued to evaluate a range of investment opportunities with the appropriate level of discipline required in the current market.

Capitalisation Rates And Long Term Bond Rates

Over the 10 years to December 2015, long term bond rates have fallen by around 300 basis points compared to ALE's capitalisation rates which fell by around 80 basis points. Bond rates have since fallen further and ALE's cap rates now exceed long term <u>real</u> bond rates by more than 500 basis points.



ALE considers that the current lower levels of long term nominal and real bond rates provide a helpful buffer to ensure future capitalisation rate stability.

Other Property Matters

ALE continues to work constructively with ALH toward agreeing a range of developments that are potentially value enhancing for the properties.

One example of this constructive working relationship is the development of the Somerville Hotel, located in the heart of Victoria's popular Mornington Peninsula. ALH invested around $5 million of capital towards the recent completion of a major refurbishment of the hotel. This development is expected to be beneficial to both ALH's earnings and ALE's future market rent prospects.

Over the past 12 years, ALH has funded and constructed at least 30,000 square metres of additional improvements on ALE's properties as well as a large number of refurbishments within the existing buildings.

ALH elected to extend the lease on the Brass Monkey Hotel, Perth to June 2020. The associated market rent review left the rent unchanged based upon an independent determination that market rent should represent 40% of that hotel's average EBITDAR.

ALE's Unique and Favourable Lease Arrangements

In arriving at their property valuation assessments, CBRE paid due regard to the strength of ALE's unique and favourable lease arrangements. The particular terms of the leases that are notable include:

- Essentially triple net leases – for 83 of the 86 properties;
- Long term leases - weighted average lease expiry profile of around 13 years;
- Near term market rent reviews – next in 2018 for 79 of the 86 properties;
- The significant amounts of capital expenditure that ALH has funded at the properties and the positive impact that this expenditure is expected to continue to have on ALH's operating profitability at the properties;
- Strong assignment protections – following ALE approved assignments, ALE continues to enjoy the benefit of an effective guarantee from ALH of any new tenant's obligations for the remaining lease term of around 13 years, as ALH is not released on assignment; and
- Strong operating profit protections – subject to regulatory changes and requirements, ALH has provided undertakings that they will not reduce the number of gaming entitlements below 90% of the current numbers across ALE's properties.

ALE understands that a number of the above positive attributes are not commonly available in the wider pub property lease market.

Capital Management

The refinancing completed in June 2014 reduced ALE's annual interest expense. A full impact of those significant savings were realised in the current half year.

The Board and management continues to explore a range of debt funding solutions in both the domestic and offshore capital markets with a view to positioning ALE for future debt refinancings and implementation of any additional debt funded acquisitions. This has included meetings with major equity and debt capital market investors throughout Asia and most recently meetings with a large number of major US Private Placement debt investors.

As announced on 4 February 2016, ALE extended the interest rate hedging at low rates.

The extension in hedging will protect ALE's securityholders from changes in interest rates on around 100% of ALE's forecast net debt for an additional three years to November 2025 at a base interest rate of 3.46%.

This additional hedging was entered into at a time when long term base interest rates are at one of the lowest levels ever offered in the Australian capital markets. The following diagram demonstrates how longer term interest rates have moved over recent years:

3 year swap rate (% p.a.) commencing Nov-22

As a result of this transaction, ALE's securityholders will enjoy base interest rate certainty for an extended period of time.

ALE had previously put in place a combination of fixed rate CIB and AMTN debt and forward start interest rate hedging. To August 2017, the weighted average interest rate on all of ALE's debt is 4.35% p.a. comprising a base rate of 3.28% and a credit margin of 1.07%. After the 2017 and 2020 maturities of the fixed rate AMTN debt the base rates are hedged at 3.83% p.a. until November 2022 on around 100% of ALE's net debt.

Following this recent extension, the base rates are hedged at 3.46% p.a. from November 2022 to November 2025 on around 100% of ALE's net debt.

ALE's debt capital structure includes the following other positive features:

- a simplified debt structure with just two types of fixed rate bonds
- an investment grade credit rating of Baa2 (Moody's)
- gearing ratio moved during FY15 from 51.7% to 48.0%. Currently 45.7%
- maturity dates spread across the next eight years.

ALE currently enjoys significant headroom to a number of market standard debt covenants. The value of ALE's properties would need to fall by around 24% or $230 million before the nearest covenant is met.

ALE's Performance

The value of ALE securityholders' $1.00 investment at the time of ALE's listing nearly 12 years ago, with reinvested distributions, grew to $11.33[2] as at 5 February 2016. This has delivered a total return to securityholders of 21.9% p.a. over that period.

Total returns over the past one, three and five years to 31 December 2015 were 29.3%, 25.1% and 22.9% p.a. respectively. Over each of these time periods ALE has outperformed both Australia's real estate investment trust sector and the wider equity market benchmarks.

Distribution Payment and DRP

The distribution per stapled security of 9.90 cents will be paid on 7 March 2016 to stapled securityholders on ALE's register as at 5.00pm on 29 December 2015. The half year distribution is expected to be 100% tax deferred.

ALE announced on 19 June 2014 that the Distribution Reinvestment Plan (DRP) had been suspended until further notice. The suspension reflected ALE's strengthened capital and debt position. The decision will be regularly reviewed having regard to ALE's potential future capital needs and ALE will notify the market and securityholders if there is a move to reinstate the DRP.

FY16 Outlook

The outlook for both the 2018 and 2028 rent reviews remains positive given the increase in ALH's operating profitability across a large number of ALE's properties.

Current expectation is for the portfolio's rents to increase at the November 2018 rent review with increases for each property capped and collared at 10%. The EBITDAR levels for each property in the years leading up to 2018 will be an important factor in the final determination.

There is a continuing positive outlook for significant market rent increases in 2028. The Board's views on the value impact of this review were included in a separate announcement made on 12 November 2013. ALE's securityholders are encouraged to review that announcement for more information.

There is increasing engagement between ALE and ALH to identify opportunities to monetise or develop underutilised parts of 970,000sm (approx.) of total land area to further to enhance portfolio returns.

As outlined above, ALE's capital structure remains strong and is characterised by low base interest rates and credit margins locked in for the long term.

After consultation with securityholders, the Board announced at the 2015 Annual General Meeting that it was aiming to progressively move gearing back towards the target range of between 50% and 55%. To achieve this, the following guidance was provided:

- FY16 distribution increased to at least 20 cps comprising
    - around 18 cps from current and accumulated distributable profits
    - around 2 cps from surplus cash balances
- FY16 distribution is expected to be 100% tax deferred
- annual distributions to increase by CPI; and
- consideration of additional distributions following completion of 2018 rent review.

All the above guidance assumes the existing property holdings, hedging and capital structure remains unchanged.

Finally, in a market where low interest rates and strong equity prices prevail, ALE will continue to review acquisitions that align with our disciplined strategy and meet our criteria.

- Ends -

Further Notes

1. ALE has a policy of paying distributions which are subject to the minimum requirement to distribute taxable income of the trust under the Trust Deed. Distributable Profit is a non-IFRS measure that shows how free cash flow is calculated by ALE. Distributable Profit excludes items such as unrealised fair value (increments)/decrements arising from the effect of revaluing derivatives and investment property, non-cash expenses and non-cash financing costs. The reconciliation between Operating Profit before Tax and Distributable Profit has not been audited or reviewed by KPMG. AMTN covenant gearing = (Net Finance Debt – Cash) / (Total Assets – Cash – Deferred Tax Assets). This ratio is considered, in the opinion of the Directors, most relevant to securityholders as it is the debt covenant that is most relevant for assessing the headroom available.
2. Accumulated value includes security price of $3.84 at 31 December 2015 plus reinvestment of all distributions and renunciation payments since ALE's 2003 listing. Total returns are sourced from UBS.

Contact:

Andrew Wilkinson
Managing Director
ALE Property Group

02 8231 8588
Website: www.alegroup.com.au