Dexus (ASX:DXS)

ASX release

15 August 2018

2018 Annual results – Strong foundations, positive momentum

Dexus today announced that it had achieved distribution and AFFO per security growth of 5.1% for FY18.

Darren Steinberg, Dexus Chief Executive Officer said: "We performed well across all areas of the business, meeting or exceeding our financial and operational targets, while continuing to position the group for the future.

"A key driver of sustained growth is investment performance at the asset level, and our office portfolio continued to outperform the IPD office benchmark over one, three and five-year periods. In addition, our focus on maximising cash flow has seen us deliver distribution per security growth of 6.9% per annum over the past six years and for FY19 we are expecting this momentum to continue, with growth of circa 5%.

"We continue to focus on our strategic objectives as we build out our pipeline of developments across Australia's key cities. In our funds management business, we are also broadening our relationships to invest alongside us through the cycle.

"Our highly engaged workforce underpins our ability to deliver these results and we are excited about the year ahead."

FINANCIAL HIGHLIGHTS

- Net profit after tax of $1.73 billion, up 36.8% on FY17
- Funds from Operations[1] (FFO) of $653.3 million, up 5.8% on FY17
- Distribution per security of 47.8 cents and AFFO per security of 47.7 cents, both up 5.1% on FY17
- Return on Contributed Equity[2] of 7.6% and Return on Equity[3] of 19.8%
- Gearing (look-through)[4] of 24.1%

OPERATIONAL HIGHLIGHTS

Property portfolio

- Achieved high office portfolio occupancy[5] of 96.0%
- Delivered 4.5% like-for-like income growth and a one-year total return of 16.9% in the office portfolio
- Leasing increased industrial portfolio occupancy[5] to 98.3%
- Progressed the group's $4.2 billion development pipeline, and post 30 June 2018 replenished the pipeline by entering into agreements to acquire three industrial development sites (one jointly with Dexus Wholesale Property Fund (DWPF)) with a combined end value of circa $700 million

Funds Management

- Strong performance across all funds with top quartile performance for DWPF
- Completed the first equity raise for the Healthcare Wholesale Property Fund
- Planning underway that will see the launch of new funds or partnerships over the next 12 to 18 months

Trading

- Delivered $36.6 million of trading profits net of tax in FY18, with FY19 trading profits de-risked
- Progressed development proposals and added 201 Elizabeth Street, Sydney to the future trading pipeline

Financial results

Dexus's net profit after tax was $1.73 billion, an increase of $465 million from the prior year. The key drivers included FFO, which increased by $35.6 million, and net revaluation gains of investment properties of $1.2 billion, up 10.5% across the total portfolio and which were $497 million higher than the prior year. This was partially offset by lower gains from the sale of investment properties compared to the prior year.

The underlying business excluding trading profits delivered FFO per security of 60.6 cents, up 2.9% on the prior year.

The entire Dexus office and industrial property portfolios (excluding trading assets) were externally valued in December 2017 and again in June 2018. Valuation gains across the total property portfolio were the primary driver of the $1.19 increase in NTA[6] per security to $9.64 at 30 June 2018.

The valuation uplift was driven primarily by the Sydney office portfolio, where capitalisation rates have compressed further, and the buoyant leasing market which has delivered higher market rents.

The weighted average capitalisation rate across the total portfolio tightened 43 basis points over the past 12 months to 5.52% and 14 basis points since December 2017. Over the past six months, the weighted average capitalisation rate of the Dexus office portfolio tightened 13 basis points from 5.50% at 31 December 2017 to 5.37% at 30 June 2018 and the Dexus industrial portfolio weighted average capitalisation rate tightened 25 basis points from 6.65% to 6.40%.

Distribution per security was 47.8 cents for the 12 months ended 30 June 2018, up 5.1% on the prior year, with the distribution payout remaining in line with free cash flow in accordance with Dexus's distribution policy. The distribution for the six months ended 30 June 2018 of 24.1 cents per security will be paid to Dexus Security holders on Thursday, 30 August 2018.

Since announcing plans in February 2018 to initiate an on-market securities buy-back of up to 5% of Dexus securities on issue, Dexus has acquired and cancelled 207,665 securities. Dexus will continue to utilise the buy-back where there is an opportunity to enhance investor returns.

Alison Harrop, Chief Financial Officer said: "A standout achievement was the extension of our total debt duration to 7.0 years as a result of completing our largest ever debt raising via the US Private Placement market. Our strong balance sheet provides us with the capacity to fund projects in our current and future development pipeline."

Dexus's gearing (look-through)[4] of 24.1% at 30 June 2018 sits below the target range of 30-40%, with the average cost of debt at 4.2%.

Property portfolio

Dexus Office Portfolio

Key metrics	30 June 2018	30 June 2017
Occupancy by income	96.0%	97.2%
Weighted average lease expiry (by income)	4.6 years	4.8 years
Average incentives[7]	13.9%	14.5%
Weighted average cap rate	5.37%	5.78%

Dexus Industrial Portfolio

Key metrics	30 June 2018	30 June 2017
Occupancy by income	98.3%	96.5%
Weighted average lease expiry (by income)	4.8 years	5.1 years
Average incentives	12.6%	14.5%
Weighted average cap rate	6.40%	6.88%

Kevin George, Executive General Manager, Office and Industrial said: "Our office portfolio delivered 4.5% like-for-like income growth and the total return of 16.9% for the year was driven by increased market rents. Occupancy reduced marginally to 96.0% driven by the known departure of CBA at Sydney Olympic Park, providing the opportunity for us to improve this position during FY19.

"Tenant activity and market dynamics have remained positive in all of our core office markets, with strong levels of enquiry in Perth converting to significant leasing at 240 St Georges Terrace (57%[8] of the impending Woodside vacancy now solved) and Kings Square, as tenants seek to upgrade to better quality buildings and centralise into the CBD.

"Our industrial portfolio delivered 3.0% like-for-like income growth and continues to benefit from an uptick in logistics and e-commerce demand, contributing to an improvement in occupancy to 98.3%.

"From a sustainability perspective, this year we launched our *New energy, New opportunities* strategy that sets a pathway for Dexus to achieve net zero emissions by 2030 through improving energy efficiency and increasing renewables. We have achieved 89% progress towards the group's target of having one million square metres of the office portfolio at a 5-star NABERS Energy rating or above by 2020, with more than 890,000 square metres now at this position."

Customer

Customer advocacy at Dexus continues to underpin asset and portfolio performance reflected by continued IPD benchmark outperformance.

Kevin George said: "Our team continued to drive great customer experience outcomes during the year as evidenced by our strong overall Net Promoter Score of +32 and customer satisfaction score of 8.3 out of 10 in our latest customer survey. These scores have improved, and survey participation increased, on the back of the strength of our customer relationships."

Development

Ross Du Vernet, Chief Investment Officer said: "We have a significant opportunity to drive future value through our $4.2 billion group development pipeline, which is diversified across uses and locations and the most efficient way to access quality product at this point in the cycle. We are also shortlisted or in an exclusive position on circa $2 billion of potential concept development projects."

This year we activated two office projects at 180 Flinders Street in the Melbourne CBD and 12 Creek Street - The Annex in Brisbane, and in July 2018 we commenced development works at 240 St Georges Terrace in Perth. Works also progressed at 100 Mount Street, North Sydney, where NBN Co. was secured as a new customer across 20,364 square metres. In aggregate, 50%[8] of the space is already committed at these four key office developments, with completions scheduled over the next four years.

Post 30 June 2018, Dexus replenished the industrial development pipeline by entering into agreements to acquire three industrial development sites in Melbourne, Sydney and Brisbane, one of which will be acquired jointly with DWPF. These developments have a combined end value of circa $700 million and will be built out over the next five to seven years. They provide the opportunity to leverage our extensive market knowledge, development and leasing capabilities, and track record in each of these markets.

Transactions

Dexus announced or completed $2.4 billion[9] of transactions for the group including the settlement of the acquisitions of the MLC Centre, Sydney, 100 Harris Street, Sydney and 90 Mills Road, Braeside in addition to the divestment of 11 Waymouth Street, Adelaide and Dexus's remaining interest in Southgate, Melbourne. Other transactions included the Dexus Office Partnership's acquisition of 56 Berry Street, North Sydney and 140 George Street, Parramatta in addition to the sale of 46 Colin Street, West Perth.

Funds Management

Deborah Coakley, Executive General Manager, Funds Management said: "We continue to deliver strong performance for all of our clients and are progressing the funds management development pipeline which provides a source of organic growth. Planning is also underway that will see the launch of new funds or partnerships over the next 12 to 18 months."

Dexus now manages $13.9 billion, covering the office, industrial, retail and healthcare property sectors on behalf of 73 third party clients. The first equity raise for the Healthcare Wholesale Property Fund was completed, with development progressing at Calvary Adelaide Hospital. Retail developments were completed at Willows Shopping Centre, Townsville, Smithfield Shopping Centre, Cairns, and Westfield Plenty Valley, Mill Park.

All funds delivered strong performance, with DWPF achieving top quartile performance and a one-year total return of 13.8%, outperforming its benchmark over one, three, five, seven and ten years. The Dexus Office Partnership delivered a one-year unlevered total property return of 16.0% and an annualised unlevered total property return of 14.9% since inception.

Trading

In FY18, Dexus delivered $36.6 million of trading profits net of tax from the sale of two Parramatta properties located at 105 Phillip Street and 140 George Street. The exchange of contracts to sell 32 Flinders Street, Melbourne has de-risked FY19 trading profits.

Future projects were progressed with 201 Elizabeth Street, Sydney added to the trading pipeline, and planning approval received for Stage 1 of 12 Frederick Street, St Leonards (North Shore Health Hub). A total of six projects diversified across sectors and trading strategies have been earmarked to deliver trading profits of $260-280 million pre-tax in future years.

Outlook and guidance

Darren Steinberg said: "In an era of emerging technologies, evolving cities and changing customer expectations, the business environment is rapidly changing and Dexus is well positioned for continued success.

"We are building on the strong foundations developed not only over the past decade since becoming Dexus, but over the past 34 years from the establishment of our first associated property trust.

"Australian cities, and our portfolio that is concentrated within their CBDs, are expected to continue to benefit from urbanisation, strong population growth, a supportive economic backdrop and ongoing infrastructure investment.

"Our development pipeline across mixed uses and locations is responding to opportunities presented by evolving cities and is a source of embedded value enhancement. Our diversified funds management business with its strong track record of outperformance is set to benefit from continued growth in superannuation and global fund flows.

"From an asset value perspective, we expect further cap rate compression of circa 10 to 15 basis points over the next 12 months, driven by continued investment demand, combined with strong property fundamentals in Sydney and Melbourne and improving conditions in Perth and Brisbane.

"Our market guidance[10] for the 12 months ending 30 June 2019 is to deliver distribution per security growth of circa 5%."

2018 Annual Reporting Suite

This *ASX announcement* should be read in conjunction with the *2018 Annual Results presentation*, *2018 Financial Accounts, 2018 Annual Report* and *2018 Property Synopsis*, released to the Australian Securities Exchange today and available on www.dexus.com

Investor briefing

Dexus will hold an investor presentation briefing at 9:30am (AEDT) today, 15 August 2018, which will be webcast via the Dexus website (www.dexus.com) and available for download later today.

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1 FFO in accordance with guidelines provided by the Property Council of Australia (PCA): comprises net profit/loss after tax attributable to stapled security holders calculated in accordance with Australian Accounting Standards and adjusted for: property revaluations, impairments, derivative and FX 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, deferred tax expense/benefit, transaction costs, rental guarantees and coupon income. Underlying FFO excludes trading profits net of tax. Adjusted FFO deducts maintenance capital expenditure and lease incentives.

2 Return on Contributed Equity (ROCE) is calculated as AFFO plus the net tangible asset impact from completed developments divided by the average contributed equity during the period.

3 Return on Equity (ROE) is calculated as the growth in net tangible assets per security plus the distribution paid/payable per security divided by the opening net tangible assets per security.

4 Adjusted for cash and debt in equity accounted investments.

5 By income.

6 Net Tangible Assets.

7 Excluding development leasing.

8 Includes Heads of Agreement signed post 30 June 2018.

9 Includes transactions settled or announced post 30 June 2017, as well as three acquisitions announced post 30 June 2018 being 11-167 Palm Springs, Ravenhall, VIC, 425-479 Freeman Road, Richlands, QLD, 54 Ferndell Street, South Granville, NSW.

10 Barring unforeseen circumstances guidance is supported by the following assumptions: Impacts of announced divestments and acquisitions; FFO per security growth of circa 3%, underlying FFO per security growth of circa 3% underpinned by Dexus office portfolio like-for-like growth of 4-5%, Dexus industrial portfolio like-for-like growth of 2.5-3.5%, management operations FFO and cost of debt broadly in line with FY18; trading profits of $35-40 million net of tax; maintenance capex, cash incentives, leasing costs and rent free incentives of $155-165 million; and excluding any further transactions.

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About Dexus

Dexus is one of Australia's leading real estate groups, proudly managing a high quality Australian property portfolio valued at $27.2 billion. We believe that the strength and quality of our relationships will always be central to our success and are deeply committed to working with our customers to provide spaces that engage and inspire. We invest only in Australia, and directly own $13.3 billion of office and industrial properties. We manage a further $13.9 billion of office, retail, industrial and healthcare properties for third party clients. The group's $4.2 billion development pipeline provides the opportunity to grow both portfolios and enhance future returns. With 1.7 million square metres of office workspace across 53 properties, we are Australia's preferred office partner. Dexus is a Top 50 entity by market capitalisation listed on the Australian Securities Exchange (trading code: DXS) and is supported by 27,000 investors from 20 countries. With more than 30 years of expertise in property investment, development and asset management, we have a proven track record in capital and risk management, providing service excellence to tenants and delivering superior risk-adjusted returns for investors. www.dexus.com

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