ASX Announcement

15 February 2023

1H FY23 result driven by retail sector resilience and strong execution. FY23 guidance revised, despite near-term uncertainty

Result headlines

- 1H FY23 result reflects continued operational execution and resilient retail sector
  - Statutory net profit after tax ('NPAT') of $176.3m (1H FY22: $650.2m)
  - Funds from operations ('FFO')[1] of $357.1m or 7.84cps (1H FY22: $287.7m, 6.32cps)
  - Adjusted FFO ('AFFO') of $332.8m or 7.31cps (1H FY22: $254.1m, 5.58cps)
  - Interim distribution of 5.75cps, representing a payout ratio of 79% of AFFO
- Progressed strategy to deliver sustained growth with quality asset management and leasing outcomes, execution of development pipeline and strengthened third party capital relationships
- NTA[2] reduced 2 cents to $2.34 driven by a reduction in asset valuations
- Robust balance sheet maintained, enabling continued investment in growth initiatives
- Continued retail sector resilience; consumer demand benefiting from tight employment market and robust income growth and savings rates
- Occupancy increased to 98.6% supported by strong leasing activity
- Development Approval received for retail and mixed-use development at Buranda Village in QLD
- FY23 earnings guidance revised. FFO per security and AFFO per security now expected to be in the range of 14.0 to 14.6 cents and 11.8 to 12.4 cents, respectively. Full year distribution payout expected to be towards the lower end of Vicinity's target range of 95-100% of AFFO[3]

Financial performance

Vicinity Centres ('Vicinity', ASX:VCX) today announced its results for the six months ended 31 December 2022 ('1H FY23'), with NPAT of $176.3 million.

NPAT principally comprised $357.1 million of FFO, offset by non-cash items, including a net property valuation loss of $109.2 million[4].

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[1] A reconciliation of FFO to statutory net profit is in Note 1(b) of the 31 December 2022 Half Year Financial Report released to ASX today. FFO is a non-IFRS measure.
[2] Net tangible assets per security.
[3] Vicinity's guidance assumes no material deterioration in existing economic conditions and no further reversals of prior year waivers and provisions in 2H FY23.
[4] Excludes statutory accounting adjustments.

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FFO growth was driven by a 20.5% uplift in Net Property Income ('NPI') to $459.6 million. Continued sales growth and a persistent focus on collecting prior period billings resulted in a $25.1 million reversal of prior year waivers and provisions in 1H FY23 (1H FY22: $51.8 million reversal).

While strong NPI growth largely reflects the comparison of 1H FY23 to a lockdown-impacted 1H FY22, NPI growth also benefitted from the continued strength of retail sales leading to improved cash collections, rental growth, and higher percentage rent. Furthermore, the recovery in ancillary income accelerated during the period. This was partially offset by higher net interest costs and property outgoings as normal operations resumed in 1H FY23 relative to 1H FY22.

Vicinity's CEO and Managing Director, Mr Peter Huddle said: "Our FY23 interim result reflects our disciplined approach to delivering long-term, sustainable growth that is underpinned by quality operational and financial metrics. The Australian retail sector continues to enjoy elevated growth, despite near-term uncertainty, while the residual impact of the pandemic on Vicinity is now largely limited to the ongoing recovery of our CBD assets."

The Board declared an interim distribution per security of 5.75 cents (1H FY22: 4.7 cents), representing a payout ratio of 79% of AFFO (1H FY22: 84%). Vicinity expects the full year distribution payout to be towards the lower end of its 95% - 100% of AFFO target range.

As at 31 December 2022, gearing of 25.7% remained at the lower end of the target range of 25%-35%. Vicinity maintained its investment grade credit ratings of A/stable (S&P) and A2/stable (Moody's).

Vicinity's weighted average cost of debt[5] for 1H FY23 was slightly higher at 4.3% and the weighted average duration was 4.5 years on drawn debt, and 4.2 years on hedged debt.

Valuations

Vicinity's portfolio recorded a 0.7% or $109.2 million decline[6] in asset valuations for the six months to 31 December 2022. The modest valuation decline reinforced the resilience of the retail property sector and the benefit of owning a high quality, diversified asset portfolio.

While the valuation result reflects a three basis points softening in the portfolio's weighted average capitalisation rate, Vicinity's focus on negotiating more long-term deals with fixed annual growth rates at improving leasing spreads supports longer term income growth, which in turn, has partially offset the valuation decline.

The reduction in Regional and larger Sub Regional asset valuations reflected transactional evidence indicating softer valuation metrics. Meanwhile Vicinity's Neighbourhood and smaller Sub Regional centres experienced steady income growth, which partly offset higher capitalisation rates.

The market leading position of Vicinity's Outlet portfolio supported current capitalisation rates. Furthermore, the steady valuation improvements were driven by continued income growth resulting from buoyant leasing activity.

[5] The average over the six months ended 31 December 2022 and inclusive of margin, drawn line fees and drawn establishment fees.

[6] Excludes statutory accounting adjustments.

The strength of Chadstone was further demonstrated by a $53.2 million valuation uplift in 1H FY23. This increase was driven by income growth and a 12.5 basis point tightening of Chadstone's capitalisation rate to 3.75%, following the approval of the One Middle Road office tower and fresh food dining precinct developments during the period. The revised capitalisation rate reflects Chadstone's position as Australia's leading retail destination, significant future development opportunities, minimal leasing capital requirements and the outlook for robust rental growth.

CBD asset valuations remained broadly in line with the prior period, supported by relevant CBD transaction evidence as well as robust leasing activity. Sophisticated retailers continued to consolidate their store networks into larger format, flagship stores in Vicinity's premium CBD centres.

Portfolio performance

Critical to Vicinity delivering sustained growth, the Company remained focused on growing current and future income via higher occupancy and negotiating a greater number of long-term leasing deals at improving spreads.

During 1H FY23, Vicinity completed 833 leasing deals, 190 more deals than 1H FY22 and 43% higher than pre-COVID levels (1H FY20).

Leasing spreads continued to show positive momentum, with a flat leasing spread for 1H FY23 (-0.1%) relative to -4.8% reported over FY22 and -6.4% for 1H FY22. Vicinity continued to achieve high single digit spreads for Chadstone and DFOs, driven by ongoing retailer demand for premium assets.

Continuing the trend observed through FY22 into 1Q FY23, the Apparel and Footwear category again performed strongly and remained the largest contributor to deal count with a favourable leasing spread for 1H FY23.

Vicinity maintained its traditional retail lease structures while focusing on bringing in-demand retailers to its assets to drive longer term growth. Cumulatively, 96% of the new leases have fixed annual growth rates of at least 4%, of which 75% have fixed 5% annual growth escalators. Furthermore, the average lease tenure of new deals negotiated in 1H FY23 was 5.0 years, largely in line with FY22.

Vicinity leased 160 vacant stores in 1H FY23 and occupancy increased to 98.6%, from 98.3% reported at 30 June 2022 and 98.0% reported at the height of the pandemic (as at 31 December 2020).

Collection of gross rental billings averaged 97% in 1H FY23 (FY22: 91%, 2H FY22: 93%), with collections from national and majors tenants now at pre-COVID levels.

Rent collection from SME tenants improved to 92% over 1H FY23, up from 80% over FY22, reflecting Vicinity's focus on collecting current and prior period rent as well as strengthened retail sales. Encouragingly, SME retail sales growth relative to pre-COVID sales levels was broadly in line with non-SME specialty sales growth.

Retail trading performance
Mr Huddle said, “Elevated retail sales growth of 20.0% for 1H FY23 compared to 1H FY20 (representing a CAGR of 6.3%) continued to reflect the resilience of the Australian consumer, which was also evidenced by improving visitation, increasing dwell times and spend per visit being sustained at 1.3 times pre-COVID levels.

“Luxury retail and apparel & footwear, particularly at our Outlet centres remain amongst the strongest performing categories and our long-term investment strategy is focused on bolstering our market leadership position in these growing segments.”

Mr Huddle commented, “Vicinity’s luxury category now represents more than $1 billion in sales annually, amounting to 11% of mini majors and specialty sales. For 1H FY23, luxury retail sales have grown by 55.8% or 15.9% on a CAGR basis, compared to 1H FY20.

“Our growth in luxury is the result of our deliberate investment strategy to enhance our luxury landlord credentials. Pleasingly, existing luxury brands are demanding more space to extend and elevate their product offerings and we have a pipeline of potential new brands to bring to our premium centres in the short to medium term.”

Building on the strong September quarter sales result, the majors delivered 14.6% growth in 1H FY23 relative to 1H FY20 (representing a CAGR of 4.6%) and mini majors and specialities combined delivered 23.6% growth (representing a CAGR of 7.3%).

Within the mini majors and specialties, Apparel & Footwear together with jewellery and leisure, were amongst the strongest performing categories, reflecting ongoing consumer demand for discretionary goods. Food retail also performed strongly in 1H FY23, likely benefiting from inflation, whilst food catering continues to strengthen as shopper dwell time recovers.

Progress on development pipeline
During 1H FY23, Vicinity continued its disciplined execution of the retail and mixed-use development pipeline, with a number of important retail redevelopments completing as well as major retail and mixed-use projects receiving approval and commencing construction.

Mr Huddle said, “Our development pipeline represents an exciting source of growth and is a critical part of creating thriving community precincts and delivering value for all stakeholders. However, against a backdrop of elevated construction costs as well as rising costs of capital, we will continue with our disciplined approach to evaluating and deploying capital to ensure we preserve our strong balance sheet and credit ratings.”

Of particular note, Vicinity was recently delighted to receive Development Approval for its retail and mixed-use development at Buranda Village, in Queensland. With a project value of approximately $750 million, the scheme envisages a retail and dining village, office and other health-related uses, subtropical landscaped public realm areas and more than 620 apartments (click here to view Vicinity’s Development Showcase for more information).

Chadstone’s new Entertainment and Leisure precinct – The Social Quarter – will open in early March 2023, while construction of Chadstone’s One Middle Road office tower and fresh food dining precinct has commenced. In December 2022, Vicinity announced homewares retailer, Adairs as the first tenant secured for 5,500 sqm of combined office and studio space at One Middle Road.

The new mini majors precinct at Bankstown Central was completed in October 2022 and includes a new Uniqlo, Services Australia and Glue Store, as well as a flagship Foot Locker store. Also, at Bankstown Central, the new fresh food precinct, known as 'The Grand Market', was completed in November 2022, having welcomed a new Coles supermarket as well as a number of new and returning tenants. The precinct is accessed directly from a new, 190 space on-grade car park.

Having opened in 1Q FY23, the new Coles-anchored retail and dining precinct in Box Hill South is fully leased and trading well. The redevelopment involved a complete revitalisation of the existing mall with the addition of dual frontage restaurants which open up onto Carrington Road. The construction of a new A-grade office space over multiple levels in Box Hill South, which is 100% leased to Hub Australia, will open in March 2023.

Revitalisation of the fresh food and dining offer at Chatswood Chase Sydney has commenced and is the first step in a major redevelopment which, subject to relevant approvals, includes a complete elevation of the centre's offer and an expanded luxury precinct, as well as a new rooftop office village.

In November 2022, Vicinity commenced construction of contemporary office suites and co-working spaces above the retail centre at Bayside, as a first step towards the transformation of the centre into a major retail and mixed-use precinct. A government agency has been secured as the first tenant of the office suites which are expected to be completed in 2H FY23, while the co-working space is due to open in 2H FY24.

Sustainability
On Vicinity's Sustainability program, Mr Huddle commented, "At Vicinity, we believe that having a sustainable business is critical to delivering long-term value for all our stakeholders."

During 1H FY23, Vicinity's sustainability program was recognised on the global stage. GRESB[7] once again ranked Vicinity as the Sector Leader of Australia and New Zealand for Listed Retail Shopping Centres and third globally in its 2022 survey, and DJSI[8] ranked Vicinity eighth out of more than 450 real estate companies globally in its annual survey.

Vicinity's 2022 Sustainability Report was released in December 2022 and details Vicinity's Sustainability strategy, journey to date and performance across its People, Place and Planet pillars (click here to access Vicinity's 2022 Sustainability Report).

Also, during the period, Vicinity released its third Modern Slavery Statement.

[7] Global Real Estate Sustainability Benchmark.
[8] Dow Jones Sustainability Index.

Summary and outlook
Mr Huddle said, "Our first half result highlights our focus on delivering quality operational and financial performance in a resilient, but somewhat uncertain retail environment.

"From a consumer demand perspective, the Australian retail sector continues to be a benefactor of an extremely tight employment market and robust household income growth[9] and savings rates. That said, we are mindful of the impact of rising interest rates and increased costs of living on Australian households in the near term and we expect the rate of retail sales growth to moderate in 2H FY23.

"The strength of our balance sheet and our proactive approach to managing our capital enables us to invest in our existing growth initiatives, notably our retail and mixed-use development pipeline.

"Vicinity remains well positioned in a rising interest rate environment given our consistent and prudent approach to managing interest costs. With 81% of our drawn debt hedged over FY23[10], and a very modest step down in FY24, we will maintain an active focus on hedging this year and in the years ahead."

Guidance
Given the reversal of prior year waivers and provisions and Vicinity's strong performance in 1H FY23, FY23 earnings guidance has been revised.

FFO per security and AFFO per security are now expected to be in the range of 14.0 to 14.6 cents and 11.8 to 12.4 cents, respectively. Of note, FY23 NPI is positively skewed to the first half, largely due to the $25.1 million reversal of prior year waivers and provisions.[11]

Vicinity expects its full year distribution payout to be towards the lower end of its target range of 95-100% of AFFO.

Mr Huddle concluded, "Even when adjusting for the benefit from prior year waivers and provisions in the 1H FY23 result, our revised FFO per security guidance range for FY23 exceeds the original FY23 FFO guidance range announced to the market on 16 August 2022. This outperformance reinforces the resilience of our operating and financial performance in the somewhat uncertain retail environment.

"In closing, together with the Board and the Executive Leadership Team, I would like to acknowledge and thank everyone who is affiliated with Vicinity for their ongoing support, most especially our securityholders, retail partners, joint venture and capital partners, customers and of course, the Vicinity team."

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Additional detail on Vicinity's 1H FY23 results can be found in the investor presentation released to the ASX today. A briefing by management elaborating on this announcement will be webcast from 9:30am (AEDT) today and can be accessed via vicinity.com.au.

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[9] Measured by Gross Disposable Income as defined by the Australia Bureau of Statistics
[10] As at 31 December 2022.
[11] Vicinity's guidance assumes no material deterioration in existing economic conditions and no further reversals of prior year waivers and provisions in 2H FY23.

Authorisation
The Board has authorised that this document be given to ASX.

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About Vicinity Centres
Vicinity Centres (Vicinity or the Group) is one of Australia's leading retail property groups with a fully integrated asset management platform, and $24 billion in retail assets under management across 60 shopping centres, making it the second largest listed manager of Australian retail property. The Group has a Direct Portfolio with interests in 59 shopping centres (including the DFO Brisbane business) and manages 29 assets on behalf of Strategic Partners, 28 of which are co-owned by the Group. Vicinity is listed on the Australian Securities Exchange (ASX) under the code 'VCX' and has 25,000 securityholders. Vicinity also has European medium term notes listed on the ASX under the code 'VCD'. For more information visit vicinity.com.au or use your smartphone to scan this QR code.