

# Global Asset Management

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Manager of CFS Retail Property Trust Group

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# **CFS RETAIL PROPERTY TRUST GROUP (CFX)**

# Annual results for the 12 months ended 30 June 2012

CFS Retail Property Trust Group (CFX) delivered another solid result for the 12 months to 30 June 2012, providing 3.1% growth in distributions per security for securityholders.

Angus McNaughton, Managing Director, Property, Colonial First State Global Asset Management, said: "While we continue to see a range of headwinds and tailwinds in the retail property sector, CFX has once again delivered a solid result for its securityholders, driven by its quality portfolio and intensive asset management activities."

Michael Gorman, CFX Fund Manager, said: "Despite the tough operating environment, comparable retail specialty stores in our shopping centres reported moving annual turnover (MAT) growth of 1.7%."

"Pleasingly, in the 12 months to June 2012, we were also able to achieve an average rental increase of 3% with standard fixed 5% annual increases for specialty stores that were re-leased, while gross occupancy costs remained steady at 17.1%," added Mr Gorman.

Key operating highlights for the year included:

- Net profit of \$409.2 million, compared to \$532.6 million in the prior year, with the decrease predominantly due to lower valuation increases than in the prior year and the mark to market of interest rate swaps
- A 6.1% increase in distributable income to \$371.5 million reflecting a full year of DFO income
- Distribution of 13.10 cents per security for the full year, which was up 3.1% on the prior year
- Net property income growth of 4.1% and like-for-like<sup>1</sup> property income growth of 2.4%
- Net tangible asset backing (NTA) per security improving to \$2.07 from \$2.05 at 30 June 2011
- Divestment of a 50% interest in The Myer Centre Brisbane for \$366 million in line with book value
- Total assets of \$8.4 billion, decreasing marginally due to the partial divestment of The Myer Centre Brisbane
- A reduction in CFX's gearing<sup>2</sup> to 26.6%, down from 27.0% at 30 June 2011
- A reduction in the weighted average cost of debt to 6.0% from 7.0% at 30 June 2011
- Commencement of an on-market buy-back for up to \$150 million of CFX securities
- Progression of the \$1.3 billion redevelopment pipeline
- Maintained an effectively full portfolio occupancy of 99.7%, and
- Achieved an average 3% increase in rents on renewal, with standard 5% fixed annual increases for specialty stores that were re-leased.

CFX will pay an annual distribution of \$371.5 million<sup>3</sup> compared to \$359.7 million for the prior year. This equates to a distribution per security of 13.10 cents, which is a 3.1% increase on the 12.70 cents paid in the previous year, and is in line with guidance.

Adjusted for changes in ownership of properties in either of the 12-month periods, excluding development impacted centres and significant one-off land tax refunds.

Gearing equals borrowings to total assets. For this calculation, total assets exclude the fair value of derivatives and borrowings is the amount drawn down.

Excluding the capital distribution of 0.2 cents per unit, or \$5.7 million, reinvested in CFS Retail Property Trust 2, as approved by investors on 28 May 2012. This distribution enabled the initial capitalisation of CFX2.

#### Financial results

CFX's net profit for the 12 months to 30 June 2012 was \$409.2 million, compared to \$532.6 million for the previous year, with the decrease due to lower valuation increases than in the prior year and the mark to market of interest rate swaps. The profit included a net gain on investment properties revaluations of \$164.3 million (compared to a \$201.4 million net gain for the previous year), and a net loss on the fair value of derivatives of \$87.9 million (compared to a net gain of \$12.9 million for the previous year).

Distributable income was up 6.1% to \$371.5 million, compared to \$350.3 million for the previous year. The improvement was primarily due to CFX receiving a full year of income from the DFO portfolio acquired in late 2010, solid net income growth across static centres, and greater net income generated by recently developed centres.

Total net property income increased by 4.1% to \$547.9 million, with a 2.4% increase in net property income on a like-for-like basis.

# Capital management and asset recycling

The major transaction completed during the year was the sale of a 50% interest in The Myer Centre Brisbane for \$366 million, in line with valuation. This sale follows CFX's stated strategy of recycling capital.

Immediately following this transaction, the Manager announced an on-market buy-back for up to \$150 million of CFX securities, which at 30 June 2012 had resulted in CFX buying back 10.6 million securities at an average price of \$1.86. At the same time, interest rate swaps were reset to reduce CFX's average cost of debt in addition to reducing debt. The Myer Centre Brisbane transaction also provided funding to enable the Manager to deliver more from CFX's redevelopment pipeline, in particular the next redevelopment stage of Chadstone Shopping Centre.

Continued concern over European sovereign debt issues and its impact on global conditions resulted in the Reserve Bank of Australia reducing the official cash rate further throughout the financial year as caution reentered credit markets.

Mr Gorman added: "In this environment, we maintained our disciplined approach to capital management to ensure CFX's balance sheet remains flexible and a competitive cost of capital is maintained.

"In what was a very active year, we restructured CFX's convertible notes, arranged new domestic and offshore bank debt, tapped the US Private Placement market and accessed the domestic bond market. We also reset interest rate swaps at a cost of \$105 million to lower CFX's average cost of debt by approximately 100 basis points."

After adjusting for post period capital management initiatives, CFX has \$629 million<sup>4</sup> of undrawn debt facilities. At 30 June 2012, CFX's gearing level was 26.6%, down from 27.0% at 30 June 2011, with borrowings of \$2.2 billion. CFX's debt was 87% hedged at the end of the period. The Manager will progressively move towards 75% in the short to medium term.

A number of significant capital management activities have been undertaken post the period. The adjusted debt summary reflecting post period capital activities is detailed below.

Debt	30 June 2012 (adjusted⁴)	30 June 2012 (actual)	30 June 2011 <sup>5</sup> (actual)
Debt interest cost <sup>a,b</sup> (%)	5.9	6.0	7.0
			-
Debt duration <sup>a</sup> (years)	3.5	2.8	3.5
Hedged debt interest cost <sup>4,c</sup> (%)	5.1	5.4	6.1
Hedged debt duration (years)	3.9	3.3	4.5
Undrawn debt (\$m)	629	807	360

- a. Weighted average.
- b. Including line fees and margins.
- c. Excluding line fees and margins and including convertible notes and fixed-rate medium-term notes.

Adjusted for the drawing of debt to repay \$198.5 million of August 2014 convertible notes put to CFX on 21 August 2012, the commencement of the \$120 million USPP (12 July 2012) and \$125 million five-year bank debt facility (2 September 2012), the repayment of \$225 million of MTNs on 2 September 2012 and interest rate swaps entered into on 26 July 2012.

<sup>&</sup>lt;sup>5</sup> Adjusted for capital management activities undertaken post the period.

### **CFX** stapling

In May 2012, CFX investors overwhelmingly supported the stapling of units in CFS Retail Property Trust (CFX1) to units in a new trust, CFS Retail Property Trust 2 (CFX2). Together, these units now trade as stapled securities in CFS Retail Property Trust Group.

"The advantage of the new stapled entity is that, through CFX2, we can now pursue further avenues to create additional non-rental income streams from CFX's existing portfolio of shopping centres. In 2013, this will involve the purchase and operation of digital in-mall advertising screens in select CFX shopping centres," Mr Gorman said.

### **Investment performance**

CFX delivered a total return<sup>6</sup> of 14.8% for the 2012 financial year, which was marginally above CFX's benchmark UBS Retail 200 Property Accumulation Index (the 'Index') return of 14.7%. Over the three, five and 10-year periods, CFX outperformed the Index by 3.0, 12.0 and 7.0 percentage points per annum respectively.

As reported in the half-year report, for the six months to 31 December 2011, CFX outperformed the benchmark<sup>7</sup> by 4.5 percentage points. Accordingly, the Responsible Entity was entitled to a performance fee of \$5.3 million for that period.

For the six months to 30 June 2012, CFX underperformed the benchmark by 9.7 percentage points. After including the carry-forward outperformance, the Responsible Entity was entitled to a performance fee of \$5.0 million for the six months ended 30 June 2012. The carry-forward balance at 30 June 2012 is 45.6 percentage points of positive performance relative to the benchmark.

The fair value of unrealised performance fee liability recognised in the balance sheet at 30 June 2012 is \$34.7 million, an increase of \$3.4 million on the prior year. Total performance fee expense recognised in the statement of comprehensive income is \$13.7 million, representing both the capped performance fees paid for the year and the increase in the fair value of future performance fees.

No performance fee is assessed for CFS Retail Property Trust 2, and the base fee of 45 basis points of gross assets has been waived for the first five years of operation. Full details of the performance fee are detailed in Note 12(d)(ii) of the Financial report.

# Portfolio update

Total assets at 30 June 2012 were \$8.4 billion, decreasing marginally from \$8.5 billion at 30 June 2011, driven predominantly by the sale of a 50% interest in The Myer Centre Brisbane, which was partially offset by valuation gains.

CFX's portfolio consists of 29 retail properties, located predominantly in the capital cities of six Australian states, with 77% of the shopping centre portfolio<sup>8</sup> comprising super-regional and regional shopping centres<sup>9</sup>.

## Retail sales

The shopping centre portfolio recorded MAT of \$7.0 billion in the 12 months ended 30 June 2012 and comparable retail specialty store sales growth was 1.7%. Retail specialty MAT was underpinned by continued strength in the food and services categories, along with consumer favourites such as smart phones and tablet devices. See Appendix 1 for further details.

The DFO centres reported flat MAT growth to 30 June 2012, due to the significant remixing activities at those centres.

"At the DFO centres, we continue to make strides in our strategy for the remix and repositioning of these assets. With 93 leasing deals executed over the year, we have further improved the tenant mix and enhanced income. These leasing deals resulted in a 30% uplift on rentals. The flat MAT growth is distorted by these intensive management activities, with a number of shops temporarily ceasing trade to undertake new shop fit-outs," said Mr Gorman.

As defined by the Property Council of Australia.

Total return comprises stapled security price performance and distribution income yield.

<sup>&</sup>lt;sup>7</sup> For the purposes of calculating the performance fee, the benchmark, which is the UBS Retail 200 Property Accumulation Index, is customised to remove the effect of CFX on the Index. A 20-day volume weighted average price (VWAP) is applied to both the CFX accumulation index and the customised index.

<sup>8</sup> Excluding Myer Melbourne.

The Shopping Centre News 'Big Guns' survey results were released in March 2012, with Chadstone Shopping Centre once again achieving the highest MAT for the 11<sup>th</sup> consecutive year. The centre achieved MAT for the 12 months to 30 June 2012 of \$1.33 billion.

### Asset valuations

The entire property portfolio was independently valued over the 12 months to 30 June 2012. The independent valuations resulted in a net \$164.3 million valuation gain, which represents a 2% net uplift from the 30 June 2011 book value.

The shopping centre portfolio weighted average capitalisation rate<sup>10</sup> firmed from 6.49% at 30 June 2011 to 6.45% at 30 June 2012.

### **Development**

Mr Gorman said: "Redevelopment of CFX's portfolio of assets is a key driver of income accretion. Our development pipeline is constantly reviewed to identify and pursue opportunities to add value and enhance asset performance."

CFX has delivered a weighted average initial yield of 7.6% and an internal rate of return of 12.5% across 39 projects, with a total spend of \$1.7 billion over the past seven years.

"Our focus throughout 2012 has been on selectively progressing projects where there is strength in underlying demand. In addition to Emporium Melbourne, we have commenced projects focused on convenience-based retailers at Brimbank, Forest Hill Chase and Roxburgh Park shopping centres, and advanced plans at the highly productive DFO Homebush and Chadstone Shopping Centre, meeting the current demand from international and luxury retailers. At the same time, those projects which focus on midlevel apparel have been placed on hold until the leasing environment improves," commented Mr Gorman.

CFX's development pipeline now stands at \$1.3 billion, with developments typically targeting an average yield on first year income of 7.0% to 8.0%<sup>11</sup>. Projects currently under construction have a development cost of \$683 million, with \$276 million remaining to be spent.

### Key developments under construction

Emporium Melbourne, Melbourne, VIC

Works continued on the \$1.12 billion (CFX share \$560 million) Emporium Melbourne development project during the period. Significant progress has been made on construction and the leasing program remains on track. Retailers such as Topshop and another international flagship store not currently represented in Australia have agreed to lease space and discussions with other international flagship retailers are well advanced. In addition, the Manager is well progressed with its luxury and Australian designer leasing, with tenants such as Salvatore Ferragamo, Michael Kors, Scanlon & Theodore, sass & bide and Zimmerman agreeing to lease space. The target initial year-one yield is greater than 6% and target internal rate of return is greater than 9%. The project remains on track to be completed at the end of 2013.

## Roxburgh Park Shopping Centre, Roxburgh Park, VIC

The \$65 million redevelopment of Roxburgh Park Shopping Centre commenced construction during the year, with completion expected early 2013. The development will include a new large format Coles supermarket, Aldi and 40 new specialty stores. The Manager has also taken the opportunity to increase the original project scope to remix tenancies and add three new mini major tenants in the existing centre. Roxburgh Park will more than double in size to approximately 25,000 sqm, but will continue to focus on convenience-based retailing, with 700 car spaces added as part of the project. The project is on track to achieve the target initial year-one yield of greater than 8% and the target internal rate of return of greater than 10%.

# Future development

Chadstone Shopping Centre, Chadstone, VIC

The project has reached a significant milestone with Council approval of a Planning Scheme Amendment that will allow the redevelopment and expansion of the northern part of the centre. The Planning Scheme Amendment is now awaiting gazettal by the Minister. The project will involve redeveloping approximately 60,000 sqm of space and producing an additional 25,000 sqm of retail floor area, adding further international retailers and reinforcing Chadstone as Australia's premier shopping centre destination. The project has an indicative cost of \$520 million (CFX share \$260 million).

Excluding Emporium Melbourne.

Excluding Myer Melbourne, 15 Bowes Street, Woden and the DFO retail outlet centres.

# DFO Homebush, Homebush, NSW

The Manager has finalised the scope of the project to include a complete upgrade of the property, with a total project cost of \$100 million. The project involves a remix of tenancies, the addition of a food court and bulky goods retailers, an expansion and reconfiguration of the car park, as well as a substantial upgrade to the existing building. Additional luxury retailers will be targeted for the centre, with Armani and Michael Kors already agreeing to lease space. The project will commence once an amendment to an existing development approval is secured.

### Responsible property investment

Mr Gorman said: "Our business approach, which considers environmental, social and governance aspects through our responsible property investment program, continues to achieve industry recognition."

The responsible property investment program has resulted in efficiencies being achieved across the portfolio. CFX's shopping centres <sup>12</sup> are now:

- 9% more energy efficient
- 30% more water efficient, and
- reflecting 15% lower emissions intensity.

CFX was awarded \$0.8 million by the Australian Federal Government Green Building Fund to contribute to efficiency improvement schemes over four centres.

This year, CFX also achieved:

- joint highest ranking with a score of 96 in the Carbon Disclosure Project for the ASX200 and NZX50 Carbon Disclosure Leadership Index
- two merit awards and best country submission in the 2011 Asia Pacific Real Estate Awards, recognising best practice in valuations and investment performance reporting, and
- recognition as a leader in the Global Real Estate Sustainability Benchmark.

Comprehensive detail in relation to the Manager's approach to responsible property investment can be found on CFX's website **cfsgam.com.au/cfx**.

# Outlook

Mr McNaughton said: "We anticipate a number of headwinds and tailwinds in the retail sector in the year ahead, with the positive influences of steady wages and consumption growth, low interest rates and government stimulus contending with high levels of offshore travel, low consumer sentiment and the impact of internet sales. Notwithstanding, CFX's quality Australian shopping centre portfolio and proven intensive asset management model will continue to drive performance."

Mr Gorman added: "In the year ahead, we will continue to focus on delivering value through the redevelopment pipeline and we will also begin the roll out of digital in-mall advertising screens in select CFX centres.

"Our marketing strategy to drive sales through our centres will focus on improving the customer experience and converting online shoppers to in-store shoppers.

"We will also continue to investigate opportunities to free up capital over time, which may come from the sale of 100% interests in smaller, non-core assets or by selling or swapping 50% interests in wholly-owned regional shopping centres where we would still retain the benefit of the leasing leverage and diversification those assets deliver. The alternative uses available for redeployment of the capital would be reviewed on receipt.

"We anticipate retail specialty sales growth of approximately 3% for the 2013 financial year and provide a full-year distribution guidance<sup>13</sup> of 13.6 to 13.7 cents per security, an increase of approximately 4% on the prior year," Mr Gorman concluded.

#### **ENDS**

<sup>12</sup> Compared to an FY08 baseline.

Assuming performance fees are payable for the full 12-month period and there is no material deterioration in existing economic conditions.

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### **About CFS Retail Property Trust Group**

CFS Retail Property Trust Group (CFX) includes a retail sector-specific Australian Real Estate Investment Trust (A-REIT) which invests in high quality retail assets including super-regional, regional, sub-regional and retail outlet shopping centres across Australia. Its stock market trading code is CFX. CFX is managed on behalf of more than 17,000 investors from 22 countries.

### **About CFSGAM Property**

CFSGAM Property is the specialist property division of Colonial First State Global Asset Management, and is one of the largest real estate fund managers in Australia with \$18 billion in funds under management. CFSGAM Property offers a fully integrated real estate investment platform including investment management, asset management, development management, origination and execution. CFSGAM Property manages a suite of wholesale investment products, as well as three listed real estate investment trusts in Australia and New Zealand.

# Appendix 1

# 12-month comparison tables

Retail sales by category for the 12-month rolling period to 30 June 2012 are detailed below:

	Comparable <sup>14</sup>		Actual	
Category	MAT 30 June 2012 \$m	MAT growth (%)	MAT 30 June 2012 \$m	MAT growth <sup>2</sup> (%)
Department stores	625.7	(2.5)	659.0	(2.9)
Discount department stores	708.5	(1.9)	780.0	(2.2)
Supermarkets	1,362.5	8.0	1,568.6	0.9
Mini majors	682.4	(1.7)	758.8	0.6
Retail specialty	2,547.9	1.7	2,756.0	1.8
Other retail <sup>15</sup>	453.0	6.9	494.4	7.5
Shopping centre portfolio <sup>16</sup>	6,380.0	0.6	7,016.8	0.9
DFO centres	540.0	(0.8)	540.0	(0.8)
Total portfolio	6,920.0	0.5	7,556.8	0.8

Retail specialty store sales by category for the 12-month rolling period to 30 June 2012 are detailed below:

Shopping centre portfolio <sup>15</sup>	Compa	arable	Actual	
Retail specialty category	MAT 30 June 2012 \$m	MAT growth (%)	MAT 30 June 2012 \$m	MAT growth (%)
Food retail	170.9	6.4	192.5	5.5
Food catering	374.1	5.4	407.7	5.9
Apparel	896.7	(1.5)	959.9	(0.9)
Jewellery	205.2	(1.4)	219.7	(1.5)
Leisure <sup>17</sup>	173.3	(6.1)	188.1	(6.5)
General retail <sup>18</sup>	220.9	0.0	246.8	0.2
Homewares	219.6	12.8	228.8	11.7
Mobile phones	101.7	7.3	111.1	6.8
Retail services	185.5	5.6	201.4	4.6
Total retail specialty	2,547.9	1.7	2,756.0	1.8

Comparable centres refer to those centres that are not undergoing or have not undergone substantial redevelopment in either

period of comparison.

Other retail includes cinemas and sales reporting tenancies under 400 sqm including travel agents, auto accessories, Lotto and other entertainment and non-retail stores.

Excluding Myer Melbourne, 15 Bowes Street, Woden and DFO retail outlet centres.

Also reflects a reduction in floor space across the portfolio.

General retail comprises giftware, pharmacy and cosmetics, pets, discount variety, florists and toys.