



**ARF.ASX**

# **Arena REIT**

## FY15 Annual Results

### Delivering value for investors

25 August 2015



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Strong  
operating result

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Active portfolio  
management

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Strong  
investment case

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# 1

## FY15 Overview

# FY15 Highlights

Active and successful 12 months

## Strong operating result

- > Statutory Profit \$61 million, (+37% on FY14)
- > Operating Profit \$22 million (+19% on FY14)
- > Operating Profit per security 10.2 cents (+15% on FY14)
- > NAV per security \$1.33 (+18% on FY14)
- > Return on Equity 22% (FY14: 20%)

## Active portfolio management

- > 45 leases extended (100% options exercised) increasing WALE to 8.9 years (+0.4 years)
- > 3.4% like-for-like annual rent growth
- > 4 older-style childcare properties sold at an average 51% price premium to book
- > 6 purpose-built childcare centre developments and one existing centre expansion completed for approximate cost of \$17m yielding 9.4%
- > Development pipeline replenished; 6 childcare development sites acquired and one existing site sub-divided

## Solid business platform

- > Successful implementation of management internalisation and reduced MER
- > Gearing reduced to 29% (down from 33%)
- > Undrawn debt capacity of \$44 million to fund the development pipeline, new acquisitions

**FY16 Distribution Guidance – 10.7 cents<sup>1</sup> (+7%)**

<sup>1</sup> Estimated on a status quo basis assuming no new acquisitions or dispositions, developments in progress are completed in line with budget assumptions, and tenants comply with all their lease obligations.



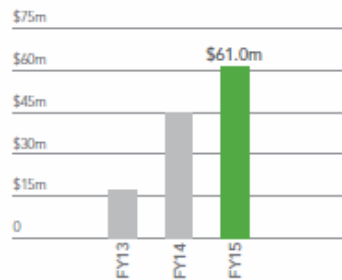


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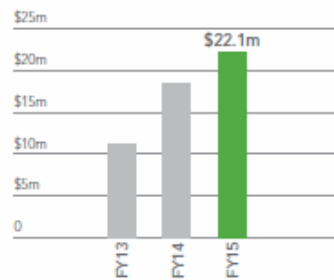
## Financial results

# 2.1 Financial highlights

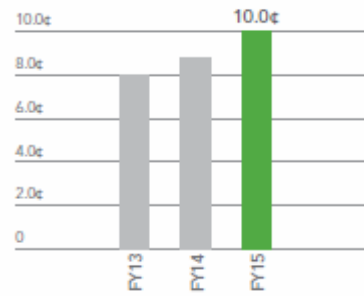
## Strong earnings result



Statutory profit  
**+37%**



Operating profit  
**+19%**



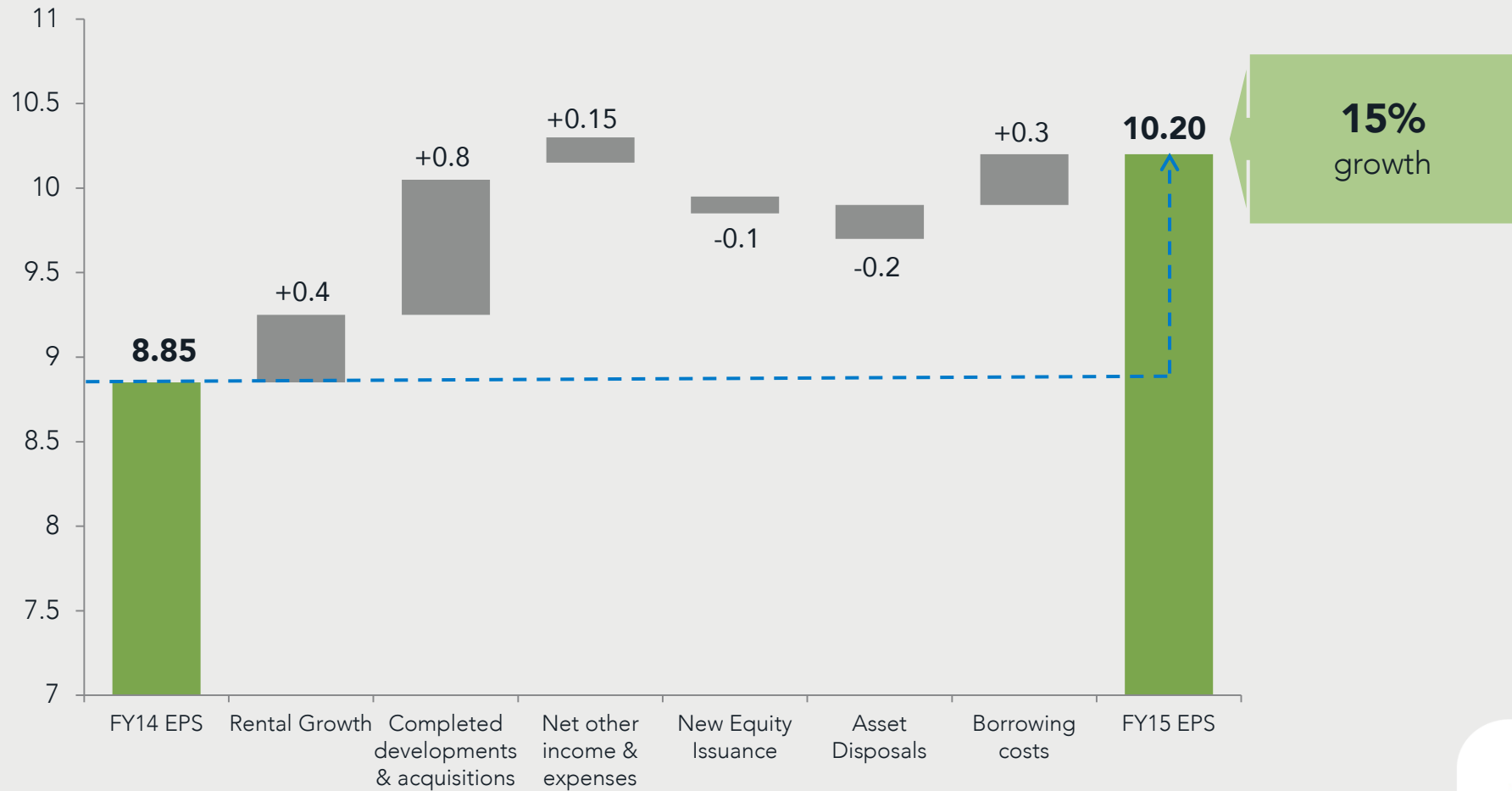
Distribution per security  
**+14%**

Key metrics	FY15	FY14	Change	
			Value	%
Statutory profit (million)	\$61.0	\$44.6	\$16.4	+37%
Operating profit (million)	\$22.1	\$18.5	\$3.6	+19%
Distributable income per security	10.2¢	8.85¢	1.35¢	+15%
Distribution per security	10.0¢	8.75¢	1.25¢	+14%
Management expense ratio (MER)	0.70%	1.01%	-31bps	-31%

- 15% growth in EPS, notwithstanding reduced gearing from equity raised during FY15.
- Growth in Operating Profit reflecting new investments and development pipeline post IPO.
- Annual MER reduced by 31bps reflecting 6 months of savings in net management costs post internalisation.
- Statutory Profit includes investment property, derivative revaluations, asset sales and other non-cash or non-recurring items (eg, property revaluations).
- Rental growth, yield compression and lease extensions contributed to valuation gains.

# Key drivers of earnings growth

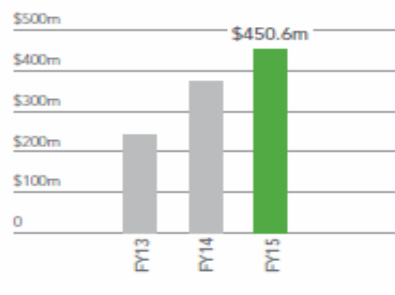
## 15% increase in Operating Profit per security



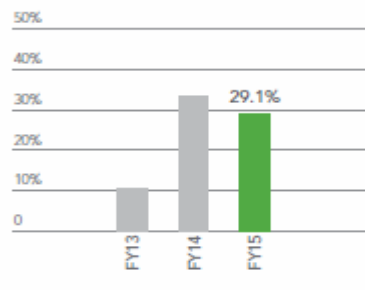


## 2.3 Financial highlights

### Strengthened balance sheet



Total assets  
**+20%**



Gearing  
**-420** basis points (bps)

- Low increase in borrowings compared to funds invested due to asset sales and equity raised.
- Gearing below 30% due to equity raised in February placement and DRP, positive asset revaluations and recycling capital from asset sales to fund development pipeline.
- NAV per security up 18% due to positive asset revaluations and equity raised.

Key metrics	FY15	FY14	Change	
			Value	%
Total assets (million)	\$450.6	\$375.3	+\$75.3	+20%
Borrowings (million)	\$131.0	\$125.0	+\$6.0	+5%
Balance sheet gearing	29.1%	33.3%	-420 bps	- 12.6%
Net asset value (million)	\$303.5	\$238.2	+\$65.3	+27%
NAV per security	\$1.33	\$1.13	+\$0.20	+18%
Securities on issue (million)	228.3	211.5	+16.8	+8%
ASX market capitalisation <sup>1</sup> (million)	351.6	253.8	+\$97.8	+39%

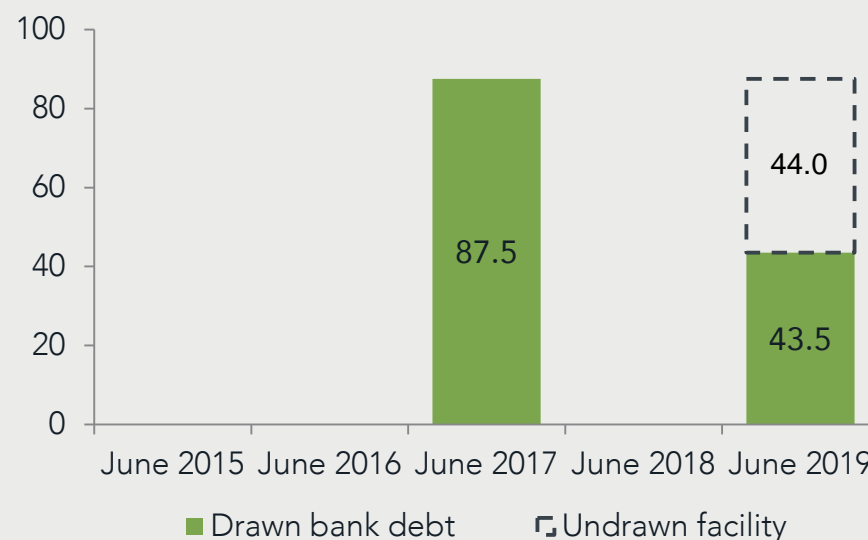
# Capital management

## Stable credit profile and liquidity

Key metrics	FY15	FY14
Facilities (million)	\$175	\$155
Drawn (million)	\$131	\$125
Undrawn (million)	\$44	\$30
Average facility term	3.0 years	4.0 years
Interest rate hedging cover	69%	68%
Weighted average hedge term	3.5 years	3.1 years
Gearing	29.1%	33.3%
Weighted average cost of debt	4.3%	4.8%

- Increased funding available to accommodate development pipeline.
- Equity placement (\$25m) and strong asset revaluations contributed to reduce gearing below 30%.
- Hedge maturity profile extended.
- No near term debt expiry.
- Substantial headroom in debt covenants.

Debt maturity profile and headroom (\$m)



### Debt covenants

	Covenant	Actual
Loan to value ratio (LVR)	50%	35% <sup>1</sup>
Interest cover ratio (ICR)	2.0 x	4.5 x



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# Portfolio update

## 3.1 Portfolio strategy

### Positive results from a disciplined approach

#### Objectives

#### FY2015 progress

##### Landlord of choice

- Successful internalisation of property management and accounting functions.
- Deeper understanding of business comparative advantage issues.
- 100% lease option renewal rate.
- Explored new business opportunities with existing partners.

##### Actively manage reversionary risks

- 7 properties added to the development pipeline (incl a subdivision).
- 45 options exercised, extending WALE to 8.9 years.
- 4 properties sold at an average premium to book value of 51%.

##### Further diversify the portfolio

- 6 completed developments and 1 centre extension costing \$17 million yielding 9.4%.
- 11 sites with 8 projects in development costing approx. \$45 million yielding 8.4%.
- Limited suitable opportunities for diversification outside childcare.

##### Provide strong returns

- 20% - 12 month total property return.
- 3.4% - income growth (like-for-like).
- 11% - 12 month revaluation growth (like-for-like).

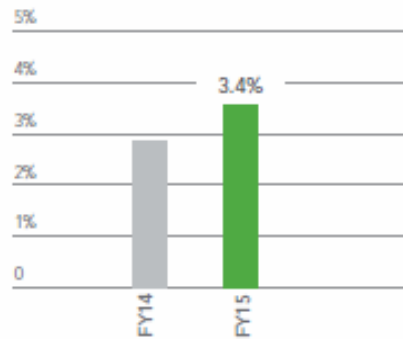


# 3.2 Portfolio metrics

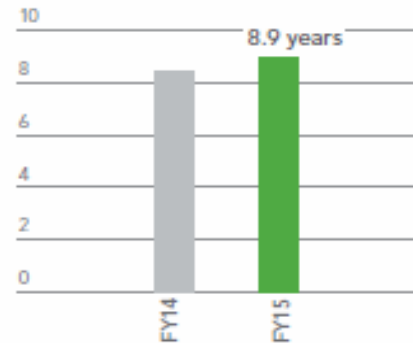
## Strengthened portfolio fundamentals



Portfolio value  
**+18%**



Average rent review  
**3.4%**

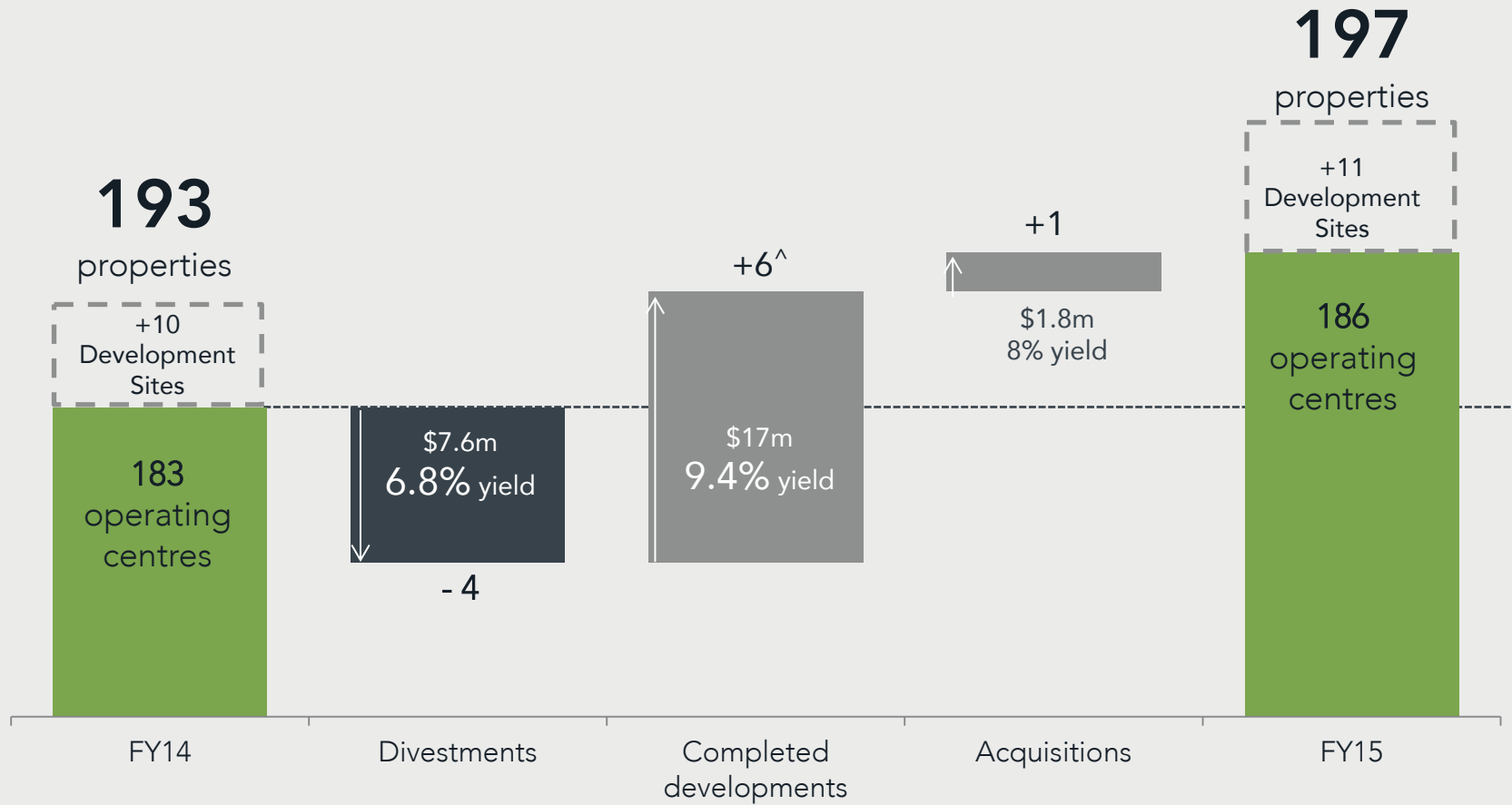


WALE  
**+0.4 years**

	Medical centres	Childcare centres	Development sites	Total 30 June 2015	Total 30 June 2014
No of properties	7	179	11	<b>197</b>	193
Value (million)	\$67	\$323	\$30	<b>\$420</b>	\$356
Like-for-like rental growth*	2.7%	3.5%	–	<b>3.4%</b>	2.9%
Average passing yield	8.2%	8.0%	–	<b>8.0%</b>	8.7%
Occupancy (by number)	100%	99%	–	<b>99%</b>	99%
WALE (by income) years	7.5	9.3	–	<b>8.9</b>	8.5

### 3.3 Portfolio composition

## Remixing portfolio to improve returns



- Divested older style centres and replaced with purpose built assets on new leases.
- Positive yield spread between acquisition/development and divestment.
- Development pipeline replenished with six new sites acquired and one existing site sub-division.

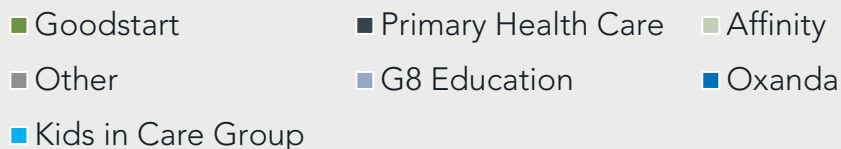
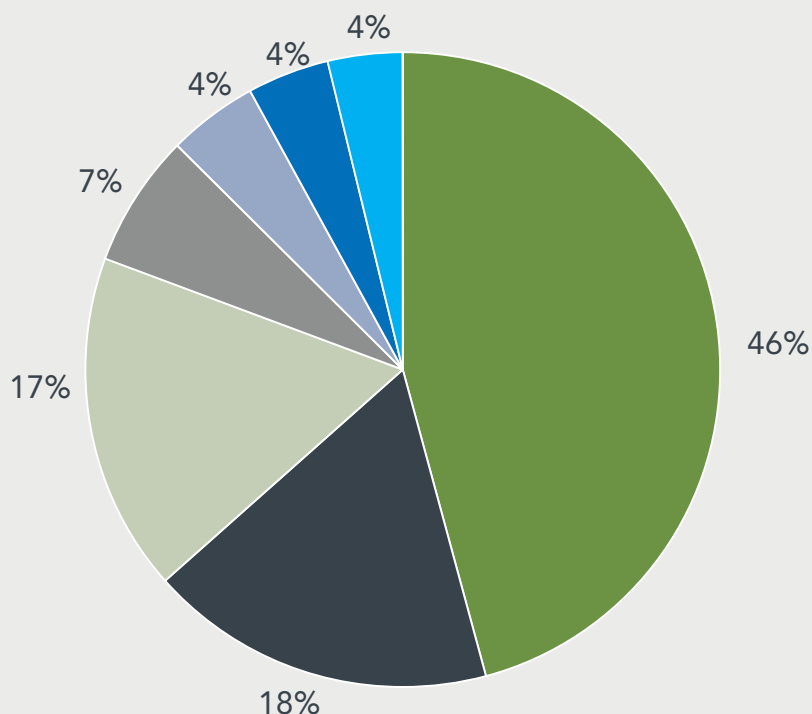
<sup>^</sup> Excludes Augustine Heights expansion (total seven developments completed).



# Tenant profile

## Strong recurring rental streams

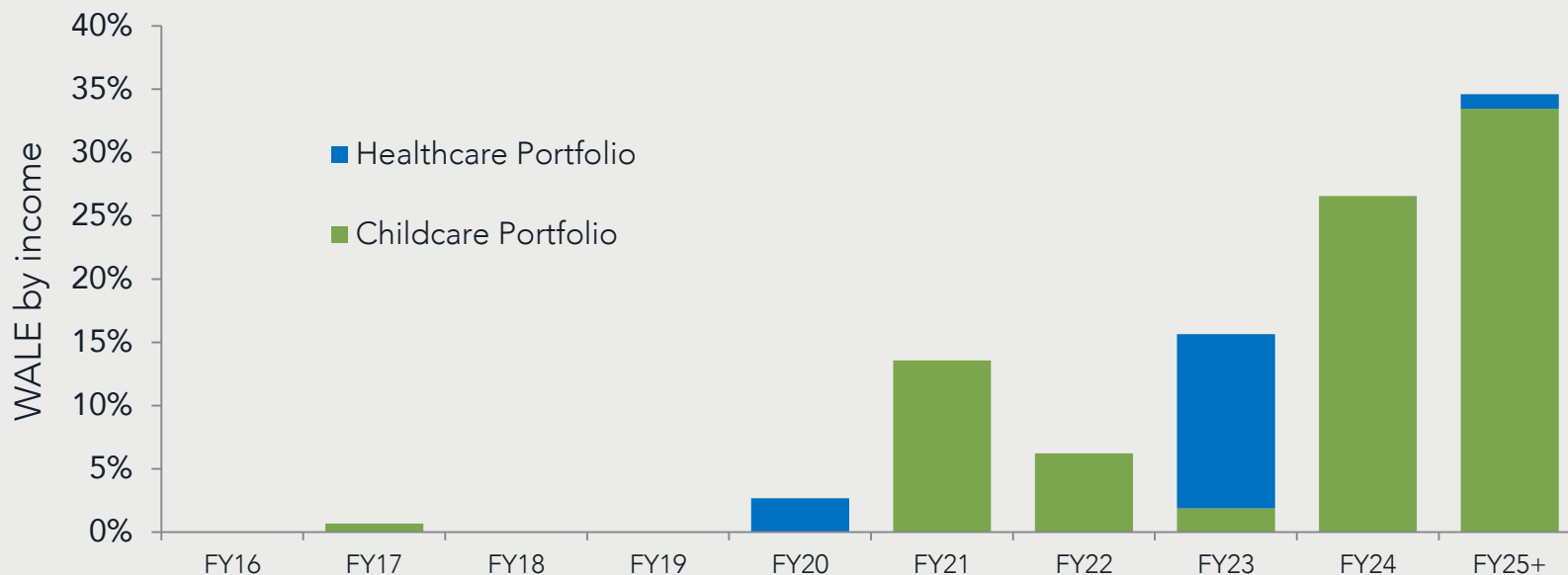
Tenants by income



- 40% of ARF's income is supported by ASX listed tenants.
- Childcare operator profitability up in FY15.
- Improved covenant strength with further industry consolidation in childcare operators.
- 25% of the childcare portfolio was subject to market rent reviews in FY15.
- Average rent review increase of 3.4%.
- Average rent per childcare place \$1,685.
- Medical centre rents remain comfortably under economic replacement cost.

# Lease maturity profile

No material lease expiries in short term









- No expiries in FY16.
- Less than 5% of income expires in next five years.
- 35% of income has >9 years remaining lease term.
- Portfolio WALE has increased to 8.9 years (8.5 years as at 30 June 2014).



# FY15 completed developments

## Successful completion of seven childcare centre projects

7 projects							
Location	Maddingley, Victoria	Port Douglas, Queensland	Augustine Heights*, Queensland	Griffin, Queensland	Seaford Meadows, SA	Caloundra, Queensland	Marian, Queensland
No. of places	103	88	74	75	72	121	104
Lease start	Q2FY15	Q2FY15	Q2FY15	Q2FY15	Q3FY15	Q4FY15	Q4FY15
Yield on cost	9.5%	9.5%	9.5%	9.0%	9.3%	9.5%	9.5%

- Seven purpose built childcare developments were completed at a total cost of approximately \$17 million and average initial yield on cost of 9.4%.
- Completed project costs ranged from \$1.7 million to \$3 million.
- All leased on Arena's preferred triple net 15 year lease structure.

## 3.7 Development pipeline

### Creating quality investments



**3** properties in construction phase



**1** ready to commence construction



**4** awaiting development approval



**2** sites already owned in negotiation with tenants



**1** site already owned in feasibility stage

**8 sites**

**\$45 million**

Estimated total project costs

**8.4%**

Average initial yield

**10%**

Total asset value

**11 sites**

**3 owned sites**

# Portfolio value movement

Positive portfolio gains as at 30 June 2015

Valuations	Number of assets	Value (\$m)	Passing Yield	6 month value Movement (%)
Childcare Independent Valuations	18	30	7.9%	18.7%
Childcare Director Valuations	172	323	8.0%	6.8%
Healthcare Director Valuations	7	67	8.2%	2.7%
Total Director Valuations	179	390	8.0%	5.8%
<b>Portfolio value</b>	<b>197</b>	<b>420</b>	<b>8.0%</b>	<b>6.6%</b>

- 6 month net revaluation increase of \$25.9 million at 30 June 2015 (\$39.8 million for FY15).
- 7% of the portfolio independently valued at 30 June 2015 (36% for FY15).
- Portfolio passing yield firming 43 bps at 30 June 2015 (71 bps for FY15).

# Property market environment

## Competitive market conditions

- High investor demand in less than \$5 million market likely to continue.
- Sales evidence indicates childcare yields during the year are in the range of approximately 6.5% to 7.5%, potential for further compression in the short term.
- Strong supply response to childcare demand is evident and likely to continue into FY16.
- Increasing government support likely to lead to higher profitability of childcare operators (subject to new supply).
- Existing childcare centre rents likely to have upward pressure.
- Strong demand for healthcare accommodation.



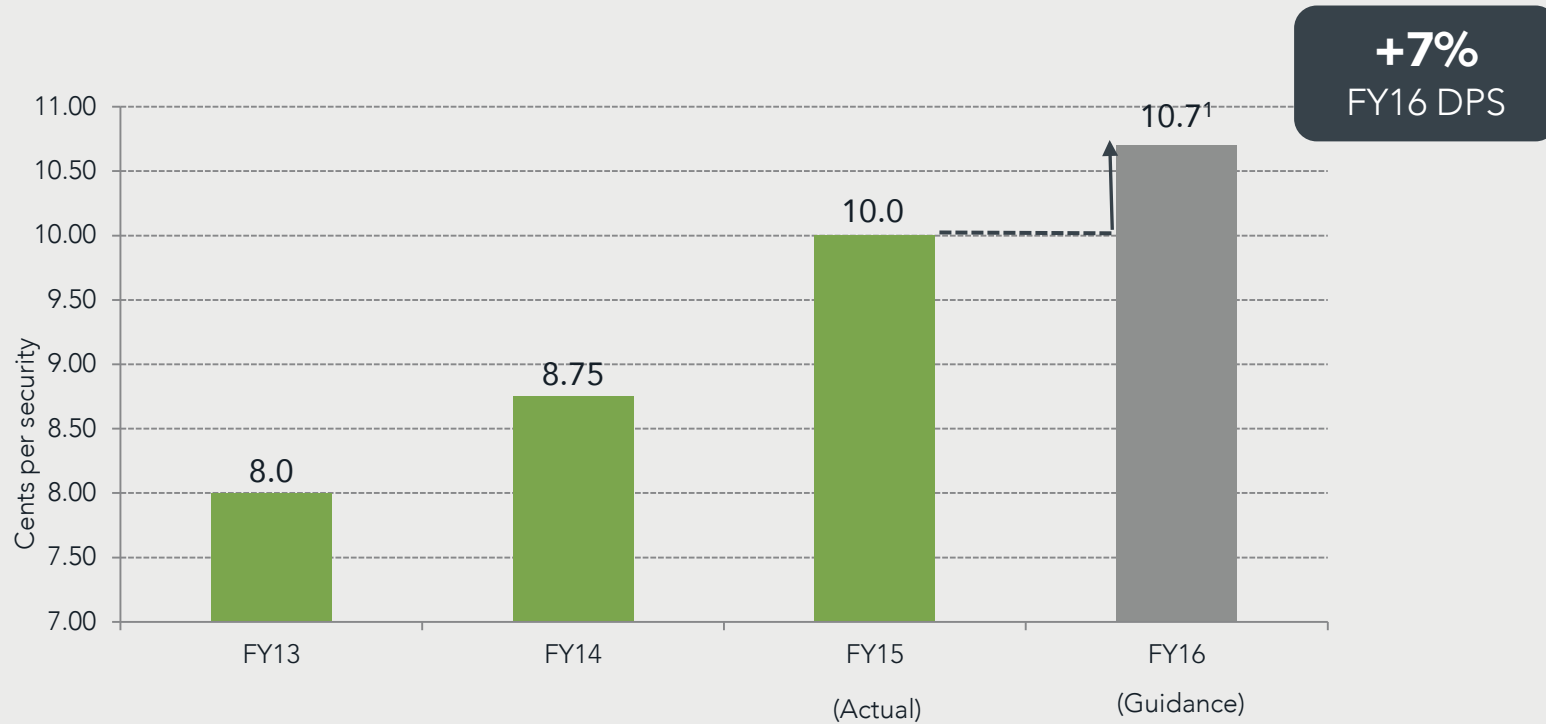


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## Outlook

# Expected distribution growth

## Solid growth set to continue into FY16



<sup>1</sup> On a status quo basis assuming no new acquisitions or dispositions, developments in progress are completed in line with budget assumptions, and tenants comply with all their lease obligations.

## 4.2 Investment case

### Solid fundamentals



#### Relatively Long leases

Weighted average lease expiry (WALE)

**8.9** years

Provides a predictable income stream.



#### Geographic diversity

Childcare centres located across all 6 states of Australia and the Northern Territory, 7 medical centres located in and around Sydney and Brisbane.



#### Favourable macro fundamentals

Growing population driving demand for childcare and healthcare services.

**59%**<sup>1</sup> of children aged up to 5 years in childcare (**40.7%** in formal childcare).

**+\$3.5b** proposed boost in federal funding via Govt's 'Jobs for Families child care package.'



#### Experienced internalised management

Strong capability in property funds management, overseen by majority independent RE Board.

Internalised management enhances alignment of Board and Management with investor interests.



#### Strong balance sheet

Arena REIT's gearing ratio is currently **29%**, below maximum gearing range of 35-45%.

**\$44m** undrawn debt available to fund developments and new investments.

All figures as at 30 June 2015, unless otherwise noted.

<sup>1</sup> Source: Childhood Education and Care, Australia, June 2014 ABS: 44020DO001\_201406





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Questions?





# 6

## Appendices: Additional information



## 6.1 Income statement

\$ million	30 June	30 June	Change	
	2015	2014	\$	(%)
<i>Income</i>				
Lease rental	31.2	26.4	+4.8	+18%
Other	0.5	0.1	+0.4	+400%
<b>Total Operating Income</b>	<b>31.7</b>	<b>26.5</b>	<b>+5.2</b>	<b>+20%</b>
Direct property expenses	(1.3)	(1.1)	-0.2	+18%
Former Responsible Entity Management fees	(1.4)	(2.4)	+1.0	-42%
Administration and other operating expenses	(1.9)	(0.8)	-1.1	+138%
Borrowing costs	(5.0)	(3.7)	-1.3	+35%
<b>Operating Profit / Distributable income</b>	<b>22.1</b>	<b>18.5</b>	<b>+3.6</b>	<b>+19%</b>
Straight-line rental income	0.0	0.4	-0.4	-100%
Revaluation gain on investment properties	39.8	24.5	+15.3	+62%
Change in fair value of derivatives	(1.8)	(1.2)	-0.6	+50%
Profit on sale of investment property	2.2	3.8	-1.6	-42%
Stapling and other asset transaction costs	(1.4)	(1.0)	-0.4	+40%
Other	0.0	(0.4)	+0.4	-100%
<b>Statutory Profit</b>	<b>61.0</b>	<b>44.6</b>	<b>+16.4</b>	<b>+37%</b>
Distributable income per security (cents)	10.2	8.85	+1.35	+15%
Distributions per security (cents)	10.0	8.75	+1.25	+14%

- 18% lease rental growth from asset acquisitions and new developments over FY14 / FY15.
- Responsible Entity Management fees ceased post internalisation (mid-December 2014).
- Administration and other operating expenses now includes management costs and salaries post internalisation.
- Net cashflow savings post internalisation of \$0.8 m compared to previous external management fee regime.
- Higher borrowing costs due to higher average debt balance over the course of FY15 compared to FY14.

## 6.2 Balance sheet

### Secure financial position

\$ million	30 June	30 June	Change	
	2015	2014	\$	%
Cash	10.9	3.9	+7.0	+179%
Receivables and other assets	8.5	15.5	-7.0	-45%
Investment properties	420.5	355.8	+64.7	+18%
Intangibles	10.7	-	+10.7	+100%
<b>Total assets</b>	<b>450.6</b>	<b>375.3</b>	<b>+75.3</b>	<b>+20%</b>
Payables and other liabilities	15.7	11.0	+4.7	+43%
Borrowings <sup>1</sup>	130.8	124.8	+6.0	+5%
Derivatives	0.4	1.3	-0.9	-69%
<b>Total liabilities</b>	<b>147.1</b>	<b>137.1</b>	<b>+10.0</b>	<b>+7%</b>
<b>Net assets</b>	<b>303.5</b>	<b>238.2</b>	<b>+65.3</b>	<b>+27%</b>
Number of securities on issue (million)	228.3	211.5	+16.8	+8%
Net asset value per security (\$)	\$1.33	\$1.13	+0.2	+18%
Gearing <sup>2</sup>	29.1%	33.3%	-4.2%	

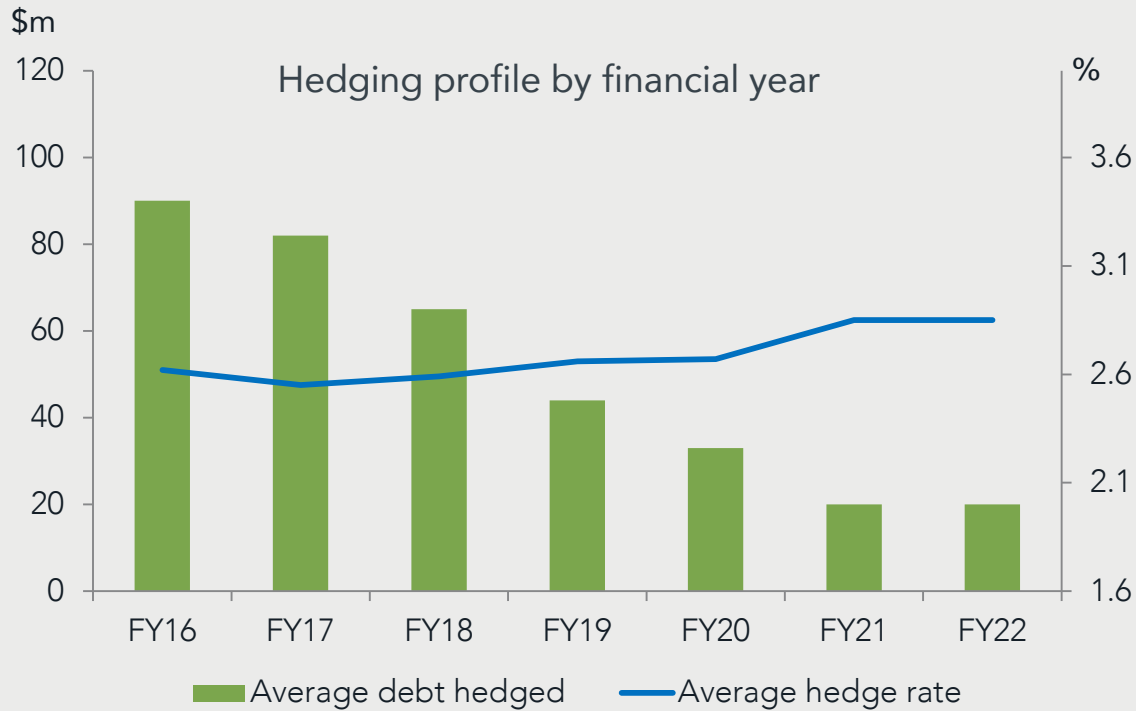
- Cash includes funds for near term property acquisition settlements and development capex, plus liquid funds for AFSL.
- Receivables includes pending asset sale settlements of \$6m, FY14: \$14m) and managed fund accrued performance fees (\$1.2m, FY14: nil).
- Growth in investment property from development capex, net asset acquisitions and sales and asset revaluations.
- Intangibles represent the management rights on internalisation.
- Payables includes \$6m distribution provision and capex accruals.

<sup>1</sup> Borrowings net of loan establishment costs of \$0.2 million (FY14: \$0.2 million)

<sup>2</sup> Gearing calculated as drawn borrowings/total assets.

## 6.3 Interest rate management

### Hedge maturity profile extended



Hedging profile	30 June 2015
Hedge cover	69%
Weighted average hedge interest rate	2.62%
Weighted average hedge term	3.5 years

# Childcare portfolio metrics

Remixing of portfolio has improved portfolio ratios

Portfolio overview	June 2015	June 2014	Change
Leased childcare centres	177	174	+3
Available for sale / lease	2	2	-
Development sites	11	10	+1
<b>Total properties</b>	<b>190</b>	<b>186</b>	<b>+4</b>
WALE (by income) years	9.3	8.5	9.4%
Tenanted occupancy	99%	99%	-
Average passing yield	8.0%	8.8%	-0.8%
Average places / leased centres	85.1	84.0	1.3%
Property portfolio (\$ million)	350	287	22.9%
Average value per place	\$21,115	\$18,237	11.6%
Average rent / leased place	\$1,685	\$1,596	5.6%
Rental growth (like for like)	3.5%	3.1%	12.9%
Metropolitan (by Value)	52.4%	52.4%	-
Regional (by Value)	47.6%	47.6%	-
Purpose Built (by Value)	95.5%	94.5%	1.1%

As at 30 June 2015.

# Childcare state by state passing yields

## Strong cap rate compression

Portfolio overview	Number of assets	Carrying value (\$'000)	Rent (pa) (\$'000)	Passing Yield
<i>Queensland</i>	69	130,567	11,232	8.6%
<i>New South Wales</i>	25	39,105	2,932	7.5%
<i>Victoria</i>	49	87,855	6,609	7.5%
<i>Tasmania</i>	6	9,025	779	8.6%
<i>South Australia</i>	5	10,105	805	8.0%
<i>Western Australia</i>	22	39,970	3,117	7.8%
<i>Northern Territory</i>	1	1,365	121	8.8%
Operating childcare centres	177	317,992	25,594	8.0%
<i>Vacant centres (for lease or sale)</i>	2	1,420	–	–
<b>Total childcare centres</b>	<b>179</b>	<b>319,412</b>	<b>25,594</b>	–
<i>Murarie Office Component (leased)</i>	–	2,390	215	9.0%
<i>Murarie Office Component (vacant)</i>	–	1,020	–	–
<i>Childcare sites and WIP</i>	11	30,114	120	–
<b>Total other property sites</b>	<b>11</b>	<b>33,524</b>	<b>335</b>	–
<b>Total property portfolio</b>	<b>190</b>	<b>352,936</b>	<b>25,929</b>	–



# Portfolio value movement

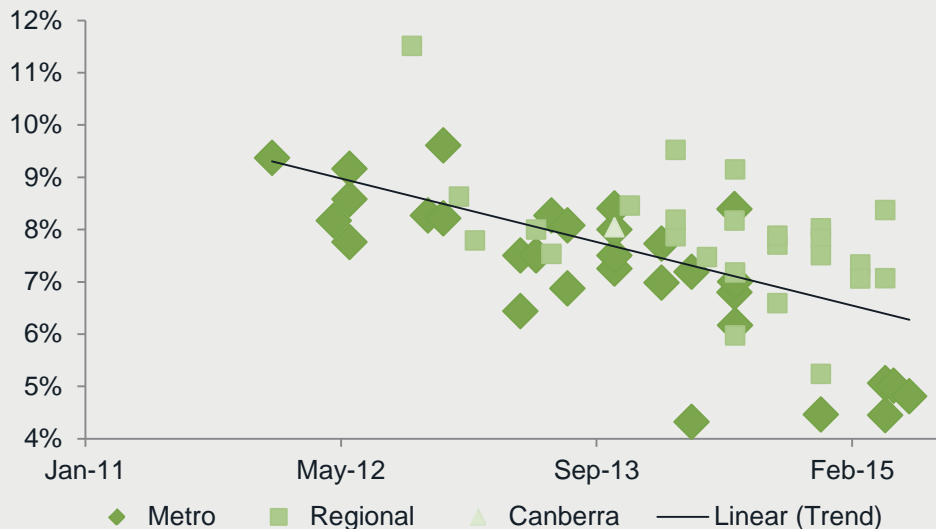
## Second half positive portfolio gains

Independent Valuations	Number of assets	Value (\$'000)	Passing Yield	Movement (%)
Queensland	12	18,870	8.0%	20.7%
Victoria	2	3,790	7.2%	15.0%
South Australia	4	7,200	7.9%	15.8%
<b>Total Independent Valuations</b>	<b>18</b>	<b>29,860</b>	<b>7.9%</b>	<b>18.7%</b>
Director Valuations	Number of assets	Value (\$'000)	Passing Yield	Movement (%)
Queensland	59	116,527	8.4%	6.3%
Victoria	47	84,065	7.5%	8.1%
South Australia	1	2,905	8.0%	13.3%
New South Wales	25	39,105	7.5%	8.2%
Western Australia and Northern Territory	23	41,335	7.8%	3.8%
Tasmania	6	9,025	8.6%	6.5%
Development Sites	11	30,114	–	3.2%
<b>Total Director Valuations – Childcare</b>	<b>172</b>	<b>323,076</b>	<b>8.0%</b>	<b>6.8%</b>
<b>Total Director Valuations – Healthcare</b>	<b>7</b>	<b>67,100</b>	<b>8.2%</b>	<b>2.7%</b>
<b>Total Director Valuations</b>	<b>179</b>	<b>390,176</b>	<b>8.0%</b>	<b>5.8%</b>
<b>Portfolio Value</b>	<b>197</b>	<b>420,036</b>	<b>8.0%</b>	<b>6.6%</b>

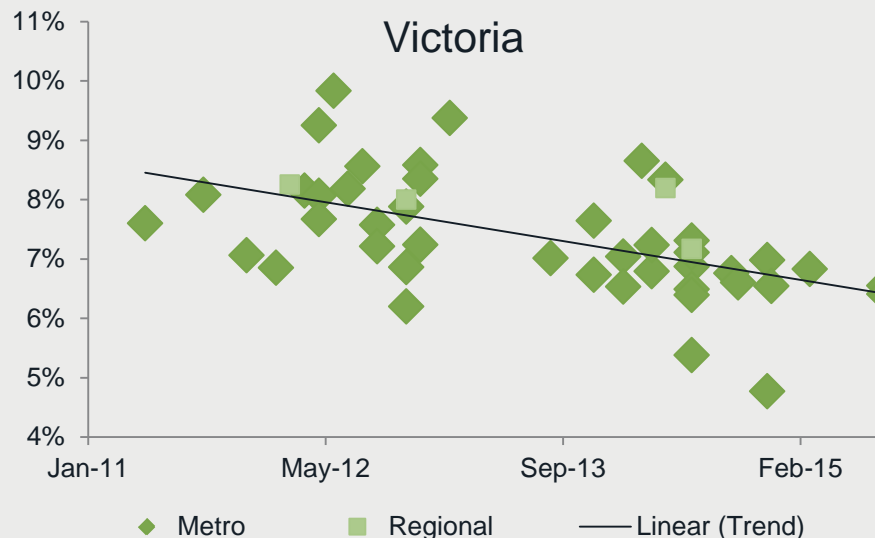
# Market sales evidence

Recent sales show childcare centre yields continuing to firm

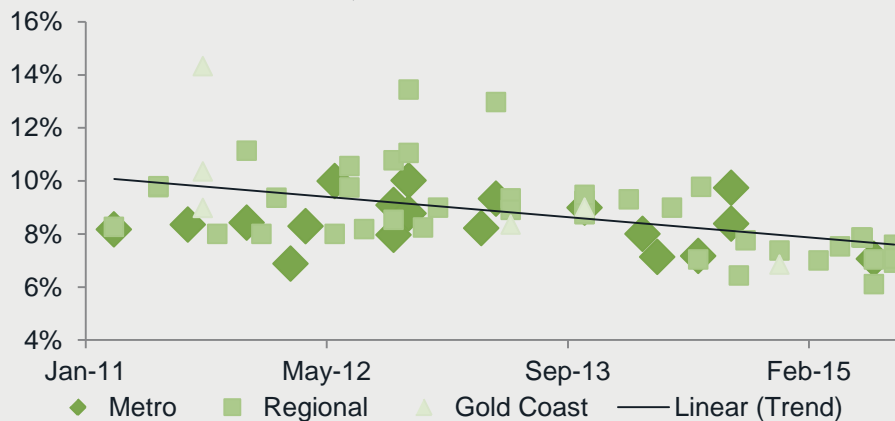
New South Wales



Victoria



Queensland



Arena sales evidence average passing yields by year

State	June 2012	June 2013	June 2014	June 2015
QLD	9.2%	9.6%	8.7%	7.6%
NSW	8.6%	8.4%	7.6%	6.5%
VIC	8.1%	7.8%	7.1%	6.4%
Transactions	31	41	63	36

Source: Actual sales evidence collated by Arena



# Further information

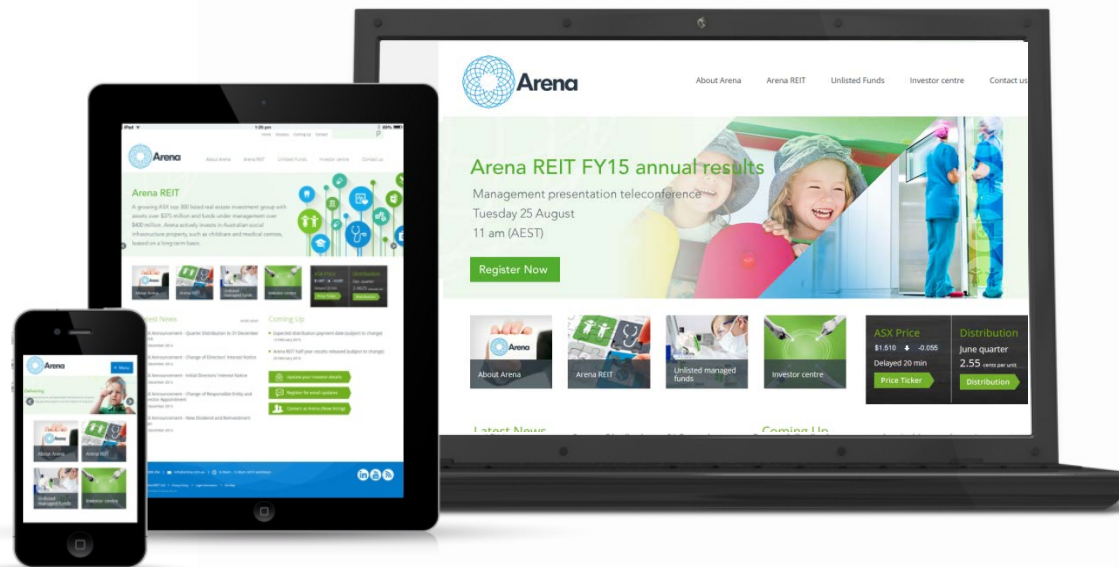
## Bryce Mitchelson

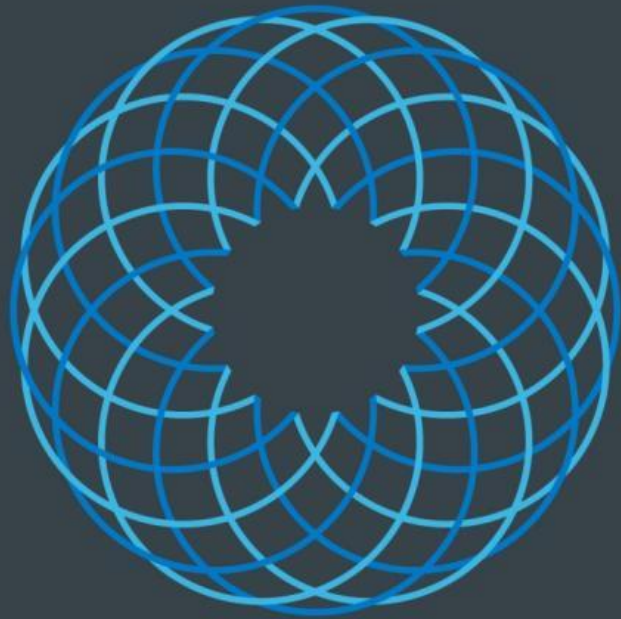
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**Arena**