SCA Property Group

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SCA PROPERTY GROUP ANNOUNCES FY18 RESULTS

SCA Property Group (ASX: SCP) ("SCP" or "the Group") is pleased to announce its results for the twelve months ended 30 June 2018.

Financial highlights:

- Funds From Operations ("FFO") of $114.3 million, up by 5.4% on the prior year
- FFO adjusted for maintenance capex, incentives and leasing costs ("AFFO") of $105.7 million, up by 5.6% on the prior year
- FFO of 15.3 cents per unit ("cpu") (1), up by 4.1% on the prior year
- Distribution of 13.9 cpu, up by 6.1% on the same period last year, representing a payout ratio of 91% (1)
- Statutory net profit after tax of $175.2 million, down by 45.2% compared to the prior year primarily reflecting a smaller increase in property values compared to the prior year
- Weighted average cost of debt stable at 3.8%pa and gearing of 31.2% as at 30 June 2018
- Investment property portfolio value of $2,453.8 million, up by $89.2 million since 30 June 2017, largely due to acquisitions ($40.8 million), development expenditure ($28.9 million) and revaluations ($74.1 million), offset by assets held for sale ($57.9 million) being the four assets sold to the SURF 3 unlisted fund in July 2018
- Net tangible assets of $2.30 per unit as at 30 June 2018, up by 4.5% from $2.20 last year
- Management expense ratio ("MER") of 0.430% as at 30 June 2018, down from 0.452% last year
- FY19 FFO per unit guidance of 15.6 cpu, and FY19 Distribution per unit guidance of 14.3 cpu

Operational highlights:

- Portfolio occupancy of 98.4% by GLA as at 30 June 2018 (unchanged from 30 June 2017)
- Supermarket moving annual turnover ("MAT") growth of 1.9%pa and discount department store MAT growth also 1.9%pa due to an improved performance from Big W stores
- Continuing MAT sales growth for specialty tenants of 3.3%pa, with average rental renewal uplifts of 6.1% achieved on 123 renewals during the period
- Four acquisitions completed during the period for $38.3 million
- Completion of developments at Kwinana WA (Coles third anchor) and Mount Gambier SA (Bunnings replacing Masters). Development at Bushland Beach QLD (new Coles anchored neighbourhood centre) completed in July 2018 and Shell Cove NSW (new Woolworths anchored neighbourhood centre) expected to complete in 1H FY19
- Completion of our third unlisted retail fund "SURF 3" in July 2018

(1) Based on weighted average units on issue of 747.0 million. FFO per unit is calculated as FFO of $114.3 million divided by 747.0 million. Payout ratio is calculated as distribution per unit (13.9 cents) divided by FFO per unit (15.3 cents)

Chief Executive Officer, Anthony Mellowes, said: “We are pleased to report another solid result for the twelve months to 30 June 2018. Our anchor tenants continue to deliver sales growth and our specialty tenants continue to grow well. The return to growth of our discount department store category is also pleasing. Our relatively young centres have a lower specialty rent per square metre than more mature centres and our average specialty occupancy cost is a sustainable 9.8%. These metrics should continue to support increases in rent/sqm over the medium term. During the year we had 123 specialty tenant renewals across 14,969 sqm of GLA, and an average rental uplift of 6.1% was achieved with no incentives paid. Comparable NOI growth of 2.8% is a pleasing result against a backdrop of increased electricity costs. We continue to expect solid comparable earnings growth as we progress through our first specialty rent renewal cycle through to FY20.”

“We completed $38.3 million of acquisitions in the first half. While this is below our historical average, it reflects our disciplined approach to investment in a competitive market. The competition to acquire quality neighbourhood shopping centres remains elevated, and yields remain firm. Nevertheless, we are confident that we can continue to leverage our relationships, management capabilities and knowledge of the sector to source further transactions that meet our investment criteria. Last week we exchanged contracts to acquire Sturt Mall in Wagga Wagga NSW, and we expect that further acquisition opportunities may emerge during FY19.”

“We continue to take advantage of the development opportunities in our portfolio. The developments at Kwinana and Mount Gambier were completed successfully during the year, with significant valuation uplifts achieved at both centres. In July 2018 the new Coles anchored neighbourhood centre at Bushland Beach was completed, and the new Woolworths anchored neighbourhood centre at Shell Cove is progressing to plan with an expected completion date of late 1H FY19. We continue to identify and progress other development opportunities in our portfolio which we plan to complete progressively over the next five years.”

“We successfully launched our third unlisted retail fund “SURF 3” in July 2018, comprising four of our non-core assets for $57.9 million, and plan to launch our fourth fund “SURF 4” late in FY19.”

Chief Financial Officer, Mark Fleming, said: “We remain focused on appropriate capital management. During the last twelve month period, we refinanced our bank debt facilities expiring during 2018, and in June 2018 we successfully completed our second US private placement. We are pleased to have maintained our weighted average cost of debt at 3.8% with over 80% of our drawn debt fixed or hedged. As at 30 June 2018 our gearing is 31.2% which is at the lower end of our target gearing range of 30% to 40%. This is consistent with our preference for gearing to remain below 35% at this point in the cycle. Our distribution reinvestment plan remains active and our unit price has continued to outperform our peer group. We are well placed to take advantage of investment opportunities in the future as they arise.”

Financial performance

Earnings

The Group recorded a statutory net profit after tax of $175.2 million, which was down by 45.2% on the prior year. This was primarily due to a smaller increase in the value of investment properties compared to the prior year.

Excluding non-cash and one-off items, Funds From Operations (“FFO”) was $114.3 million, up 5.4% on the prior year. Key drivers of this solid performance were increase in comparable net operating income (“NOI”), acquisitions and developments. FFO per unit for the period was 15.3 cents, 4.1% above the prior year.

Adjusted Funds From Operations (“AFFO”) was $105.7 million, up by 5.6% on the same period last year. Maintenance capex of $3.4 million was up by $0.3 million, but leasing costs and fitout incentives of $5.2 million were stable compared to the same period last year.

Property valuations

The value of investment properties increased to $2,453.8 million during the period (from $2,364.6 million at 30 June 2017), due to a combination of acquisitions, developments and valuation uplifts. In addition, the SURF 3 properties valued at $57.9 million have been re-classified as "assets held for sale".

Acquisitions contributed $38.3 million. Stamp duty and other transaction costs were $2.5 million. Development expenditure added $28.9 million (including $13.8 million on Shell Cove, $8.6 million on Bushland Beach and $5.2 million on Kwinana). Valuation uplifts contributed $74.1 million, with average capitalisation rates firming by 14 basis points to 6.33%. The remaining $3.3 million uplift was due to maintenance capex, fitout incentives, straight lining and amortisation adjustments.

Net tangible assets

The Group's net tangible assets ("NTA") per unit is $2.30, an increase of 10 cpu or 4.5% from $2.20 as at 30 June 2017. This is primarily due to the increase in property valuations.

Capital management

The Group has maintained a prudent approach to managing its balance sheet. Gearing was 31.2% as at 30 June 2018 (compared to 31.4% as at 30 June 2017), which is within our gearing policy range of 30% to 40%.

During the year we refinanced several bank facilities, cancelling $215.0 million of facilities expiring in November and December 2018 and replacing them with $125.0 million of new facilities expiring in November and December 2022. At 30 June 2018, the Group had cash and undrawn facilities of $130.7 million.

In June 2018 we priced a US private placement ("USPP") with aggregate face value of US$150 million (A$197.3 million), with settlement in September 2018. The maturity profile of these notes is US$30m expiring September 2028 (10 years), US$70 million expiring September 2031 (13 years) and US$50 million expiring September 2033 (15 years). All coupon obligations and the final principal repayment have been swapped back to Australian dollars, with a weighted average floating rate margin of 1.99% above 3-month BBSW.

As at 30 June 2018, our weighted average cost of debt has been maintained at 3.8% (but will increase to approximately 3.9% following settlement of the USPP in September 2018), our weighted average term to maturity was 4.9 years (but will increase to over 6 years following settlement of the USPP), and 81.6% of our debt was fixed or hedged. Our earliest debt maturity is $230.0 million in December 2019 and we expect to be cancelling or extending these facilities during 1H FY19.

Distributions

SCP aims to deliver sustainable and growing distributions to its unitholders. In January 2018, SCP paid an interim distribution in respect of the six month period to 31 December 2017 of 6.8 cpu. In August 2018 SCP will pay a final distribution of 7.1 cpu bringing the full year distribution to 13.9 cpu, an increase of 6.1% on the prior year and representing a payout ratio of 91%. The estimated tax deferred component for FY18 is 21%.

The distribution reinvestment plan ("DRP") remained active for both the August 2017 and January 2018 distributions. The August 2017 DRP raised $6.2 million of new equity at $2.13 per unit, and the January 2018 DRP raised $6.5 million of new equity at $2.25 per unit.

Operational performance

Portfolio occupancy

SCP had a specialty vacancy rate of 4.8% of GLA as at 30 June 2018, in line with the 4.8% as at 30 June 2017 and within our target range of 3% to 5%. The centre acquired during the twelve month period had a specialty vacancy of 12.6% as at 30 June 2018. Excluding the recently acquired centre, the portfolio specialty vacancy rate was 4.6%. Our portfolio occupancy rate is 98.4% and has remained relatively stable since December 2014 at between 98.4% and 98.8%.

Centre optimisation

A key focus continues to be on centre optimisation. This will include some remixing of tenants, and preparation for renewal uplifts as specialty leases expire. Our specialty rent per square metre of $716 is lower than industry benchmarks for our type of centres (reflecting the relatively young age of our portfolio), our specialty occupancy cost is around 9.8%, and specialty sales continue to grow. This should support continuing rental renewal uplifts over coming years. During the twelve month period we completed 123 specialty renewals, with an average rental uplift of 6.1% achieved and no incentives paid.

During FY18 our earnings were negatively impacted by increases in electricity costs. The full year cost of electricity across our portfolio increased by around $1.5 million per annum, of which approximately two-thirds is recoverable from tenants, so the net impact on our earnings in FY18 was approximately $0.5 million. We continue to take steps to mitigate any further increases in electricity costs in the future, including by extending fixed rate contract terms, installing solar panels on our roofs where appropriate and rolling out low-energy LED lighting in our centres. As a result of these initiatives, in FY19 we are not expecting any further negative impact from electricity costs, but managing our electricity expense remains a key focus for the business.

Strong underlying sales growth continues

Our centres continue to experience growth. The comparable store sales MAT growth for the 12 months to 30 June 2018, for stores open more than 24 months, was:

- Supermarkets: 1.9%
- Discount department stores: 1.9%
- Mini Majors: 2.7%
- Specialty stores: 3.3%

Supermarket sales growth remains robust, with both Woolworths and Coles recording positive sales growth. Discount department stores sales have improved, with better performance from our Big W stores which have recorded positive month-on-month sales growth during FY18. Mini Majors sales growth improved due to an improved performance from the discount variety category. In relation to specialty sales, our core non-discretionary categories continue to perform strongly, with MAT for Food/Liquor growing at 2.2%, Retail Services 5.6% and Pharmacy 5.3%.

Acquisitions, disposals and developments

During the period we completed four acquisitions for $38.3 million. We acquired one Coles anchored neighbourhood centre in Cairns QLD (Sugarworld) for $24.8 million representing an implied capitalisation rate of 7.0%. We also acquired one development site at Shell Cove NSW for $1.5 million which will become a Woolworths anchored neighbourhood centre, being developed by Frasers. Finally, we secured the remaining stratum interests at two of our existing neighbourhood centres being Belmont NSW and Coorparoo QLD. In both cases this will enable us to control the sites and open up potential future development opportunities.

On 2 August 2018 we acquired Sturt Mall in Wagga Wagga NSW for $73.0 million, representing a passing yield of 6.3%. Sturt Mall is anchored by a Coles supermarket and a Kmart discount department store and has 49 specialty tenants. The lease for the Coles supermarket expires in December 2018 but Coles have four 5-year options, and we are confident that Coles will exercise the first of these options in December.

During the period we successfully completed our developments at Kwinana in Western Australia and Mount Gambier in South Australia. The Kwinana development involved securing a Coles supermarket as the third anchor, adding associated specialties and other upgrade works, at an all-in cost of $20.0 million. The valuation of the Kwinana centre has increased from $98.0 million as at 30 June 2016 (prior to the development commencing) to $150.1 million as at 30 June 2018.

At Mount Gambier a new Bunnings warehouse has replaced the ex-Masters tenancy. This was our only exposure to Masters. The development cost of this project for SCP was zero, and we did not suffer any lost rental income. The valuation of the Mount Gambier centre has increased from $63.7 million as at 30 June 2016 to $74.5 million as at 30 June 2018.

In July 2018 we completed the Bushland Beach development that involved building a new Coles anchored neighbourhood shopping centre. The total cost of the centre (including land) was $23.6 million which is supported by an independent valuation. The Shell Cove development involves building a new Woolworths anchored neighbourhood shopping centre for an all-in cost of $22.8 million (including $1.5 million to acquire the land), with an expected completion date of November 2018.

We continue to make progress in relation to a number of other potential developments. In total, we have identified 24 centres in our portfolio with development potential amounting to over $125 million of investment over the next 5 years.

Strategy and outlook

A key priority for the Group in FY19 is to optimise the earnings from our centres by continuing to improve our tenancy mix and by ensuring that centre standards are maintained at a high level. This should support ongoing sales growth for our specialty tenants, which in turn should enable further positive rent reversions and increasing rent per square metre over the next few years. We are aware of the pressures facing certain retailers at present, and we continue to evolve our mix toward more resilient retail categories.

We remain committed to our core strategy which is to deliver sustainable earnings and distribution growth to our unitholders by optimising the earnings from the existing portfolio, executing further acquisitions of convenience-based shopping centres, recycling capital from lower growth assets to relatively higher growth assets, investing in value enhancing development opportunities within our existing portfolio and continuing to grow our funds management business.

Earnings guidance

Our guidance for FY19 FFO is 15.6 cpu (2.0% above FY18 actual), and our guidance for FY19 Distributions is 14.3 cpu (2.9% above FY18 actual). The FFO guidance includes the acquisition of Sturt Mall in August 2018 and the launch of SURF 4 in late FY19, but does not include any further acquisitions or divestments.

A webcast of the investor briefing will be available at www.scaproperty.com.au on Tuesday 7 August 2018 at 10:00am (AEST).

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About SCA Property Group

SCA Property Group (SCP) includes two internally managed real estate investment trusts owning a portfolio of quality neighbourhood and sub-regional shopping centres located across Australia. The SCA Property Group invests in shopping centres predominantly anchored by non-discretionary retailers, with long term leases to tenants such as Woolworths Limited and companies in the Wesfarmers Limited group (such as Coles). The SCA Property Group is a stapled entity comprising Shopping Centres Australasia Property Management Trust (ARSN 160 612 626) and Shopping Centres Australasia Property Retail Trust (ARSN 160 612 788).