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Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to the HomeCo Daily Needs REIT FY22 Half-Year Results Briefing. All participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you need to press star key followed by the number one on your telephone keypad. I would now like to have the conference over to Mr Darren Holland, HDN CEO Designate. Please go ahead.

Darren Holland: Thank you, operator. Good morning, everyone ,and welcome to HDN's First-Half FY22 Results Call. My name is Darren Holland and I'm delighted to speak to you today as CEO Designate of HDN. Joining me on the call this morning is HDN CFO Designate Lawrence Wong, HMC Group COO Sid Sharma and HMC Group CFO Will McMicking. Before we commence, we would like to acknowledge the Traditional Custodians of Country throughout Australia and celebrate their diverse culture and connections to land, sea and community. We pay our respects to their Elders past and present and emerging and extend that respect to all Aboriginal and Torres Strait Island people today.

Now turning onto slide 4 of the results presentation. I'll start with a brief update on the merger implementation and the format for the results presented today. Following yesterday's successful court ruling, the merger is on track to complete on time with implementation taking place Friday week. Accordingly, today will be the last day of trading in AVN Securities. Today we present the HDN First-Half FY22 results on a merged pro forma basis, except for the income statement, which has been provided as a standalone for the six months to 31 December 2021. Aventus, also this morning, separately released its appendix 4D for the six months to 31 December ’21 as well.

Now onto slide 5 to share the key highlights for the first half. We are very pleased to deliver a strong result for the merge group. Today's result marks the beginning of a new journey as Australia's leading daily needs REIT. We have maintained strong momentum across both portfolios since the merger was announced in October 2021, despite the ongoing presence of COVID-19. For this, I'd like to acknowledge the hard work and dedication of the two high quality teams who are now joining forces.

Now onto the key highlights. Firstly, on financials. HDN delivered FFO of $0.04 per unit for the first half. That's an equivalent to a 38% increase on the prior corresponding period. Pro forma NTA increased to $1.40 up 13% on FY21, reflecting the strong gross valuation uplift of $391 million. Our capital position is strong with gearing at 32% and this is at the bottom end of our 30% to 40% target range. Finally, we have $205 million of liquidity available to fund our accretive development pipeline.

Moving onto asset management. The portfolio is in great shape. Occupancy is at 99% with 99% unadjusted cash rent collection for the first half. We capitalised on this strong position in our leasing efforts. We achieved positive leasing spreads of 4.9% overall. 69 new leases and renewals and 24 development leases have been signed across the merge group.

On investment, the merger significantly improves our scale and relevance and we are well positioned for the inclusion into the ASX 200. Adding value through development is a key priority. I have visited 47 out of 51 assets in the last month and I'm very excited about this opportunity. We have identified over $0.5 billion dollars of accretive opportunities, including several large-scale projects which we will look to accelerate. Our FY22 developments are all on track and on budget and today we're excited to announce over $60 million of new developments expected to commence in FY23 and deliver a cash return on invested capital over our 7% target.

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Turning now to slide 6. This details key aspects of our model portfolio strategy, which is designed to deliver stable and growing distributions with a strong focus on capital preservation. We do this by investing in a well-diversified portfolio of strategic last mile real estate infrastructure focused on daily needs, large format retail and health and services. Our national portfolio footprint spans 2.5 million square metres of land in Australia's leading metropolitan markets and growth corridors. We have minimal exposure to discretionary retail, such as fashion and we have no department stores and no discount department stores in the portfolio. Finally, our income is secured by long-term leases to predominantly national tenants at sustainable rents of $335 per square metre gross on average.

Slide 7 outlines our five key priorities for the merged group. I'm pleased to say the integration of HDN and AVN is well underway with implementation on track for next week. The AVN team will join HMC to support the expanded platform and maintain business continuity. Operationally, we are focused on accelerating tenant remixing opportunities to reweight the portfolio back to our target sector allocations. This will improve the defensiveness and the resilience of the portfolio. Our highest priority and most compelling investment opportunity lies in the $500 million development pipeline where we can generate the most attractive incremental returns on our capital.

Finally onto credit profile and capital management. We've already taken advantage of the improved scale of the Group and secured an investment grade credit rating of Baa2 stable. Will will speak to this in later detail at a later stage. As I touched on earlier, we expect to benefit from ASX 200 inclusion at the next index 3 balance.

Slide 9 details the key operating metrics of the merge portfolio which stands at $4.4 billion. Firstly, I want to draw your attention to the embedded rental growth in the portfolio. 73% our tenant base is on fixed reviews with a weighted average rent review of 3.6% and a further 20% of the income is CPI linked, which is attractive in the current environment. Secondly, the staggered lease expiry profile and WALE of five years will allow us to actively remix the portfolio and continue to deliver positive leasing spreads to keep growing our net operating income.

Slide 10 illustrates our strategic real estate footprint across the major capital cities of Sydney, Melbourne and Brisbane, where approximately 80% of the portfolio is concentrated. We believe the secular shift to omni-channel retailing is a megatrend. We are well positioned to benefit thanks to our strategically located and underutilised sites with over 28 kilometres of street frontage across the portfolio. Our network can support logistical infrastructure at the bottom end of the retail landlord cost curve. Also, 73% of our tenants already have click and collect capabilities and over 12 million Australians live within a 10-kilometre radius of our new larger portfolio.

Moving now to slide 11 on the portfolio income. HDN's portfolio income is defensive with strong embedded rental growth supported by a diversified national tenant base of over 1200 tenants, which include some of Australia's best performing and growing retailers. 84% are national retailers and of our top ten only account for 25% of our income. Finally, the average rent in the portfolio, as I've mentioned, is affordable. This means there is plenty of opportunity to continue to grow rent sustainably over time.

As I previously mentioned, reweighting the portfolio remains a key operational priority through tenant remixing, developments and acquisitions. In total we've identified 80 remixing opportunities, comprising of 43 neighbourhood and 40 health and service opportunities.

Moving onto slide 13. Our portfolio is in great shape. I want to draw your attention to the strong leasing spreads of 4.9%. These spreads are well in excess of CPI and importantly, have been achieved with low incentives under 4%. Pleasingly, cash collection has remained at or above 99% in each and every month over the first half.

Foot traffic has also rebounded since the easing of restrictions remaining stable for the prior corresponding period. Our customer reach has significantly grown with a portfolio now attracting over 75 million shoppers every year. The supermarkets delivered MAT growth of 1.8% despite cycling abnormally strong growth in the prior 12-month period.

These results demonstrate the attractive nature of our properties, their affordable rents and the resilience of our retailers and tenant base.

I'd now like to hand you over to Sid Sharma to provide further insight into the substantial development program ahead.

Sid Sharma: Thank you, Darren. As you've said earlier, our development strategy is focused on unlocking the latent value in our portfolio to deliver strong FFO and NTA growth. In FY22, we are on track to complete $33 million of development. In FY23, we've provided colour today on $60 million of developments which we are planning on activating. Beyond that, we have identified over $500 million of development opportunities that exist within the significant land bank this portfolio now has.

Moving to slide 16. Here we provide an update on our recently completed and active projects. As many of you know, in December last year, we completed the extension of Gregory Hills Town Centre. We bought Gregory Hills Town Centre for $69 million. We've invested $12 million on the extension and redevelopment of the asset and its recent valuation is $100 million. This development represents an unlevered IRR of approximately 25%. In October last year, we also completed a new superstore for Officeworks at Granville, achieving a return on invested capital of about 10%. Our five remaining active developments for FY22 are 100% pre-committed and on track to complete in the second half and deliver a 10% cash return on invested capital, which is well above our 7% target.

On slide 17, we've included some images that are active developments. Slide 18 is a new slide where we've identified and provided some more details on our development workbook for FY23. We've identified seven projects that we're planning on activating, which add over 23,000 metres of GLA to the portfolio. Our target return on invested capital is over 7% and these projects, as ever, remain tenant demand led. Details on the precise timing and spend of these projects is subject to planning and leasing outcomes and we will aim to provide greater detail later in the year.

Importantly, we stay disciplined and we will only push the button on developments when, (1) we have leasing pre-commence, (2) we have a fixed price D&C and (3) we have development approval for these projects. Importantly, we will only push the button if we're on track to deliver our target ROIC of over 7%.

Moving onto slide 19. This slide shows the significant development opportunities that exist in the portfolio across major town centre redevelopments. With opportunities such as Richlands Town Centre, Jindalee Town Centre, Epping Town Centre, Vincentia Marketplace, there is a clear organic path to recalibrating our portfolio to the model portfolio construction. Again, we look forward to sharing more details about these opportunities with you as we progress our plans.

I'll now turn you over to slide 20, where we're excited to announce four potential acquisitions which are expected to settle this half subject to finalisation of documentation. Three properties are being acquired from HMC and one other from a third party. The three acquisitions from HMC include Gregory Hills Home Centre. This greatly complements our existing Gregory Hills Town Centre Development and takes our total land holding in the fastest growing LGA in Australia to over 70,000 metres squared. This precinct is anchored by Services NSW and Metcash.

Number two, North Lakes, a leading centre that sits in the fast-growing North Lakes community with low site coverage and potential to redevelop and extend. Thirdly, excess land which sits adjacent to HDN's Richlands Neighbourhood Town Centre, that is our first step in consolidating the Richland Town Centre's owned land to create a town centre that spans over 9.5 hectares of land. HMC has agreed to sell the portfolio at a 5% discount to book value, which will result in an immediate value uplift to HDN and further demonstrates HMC's alignment to HDN.

Importantly, these high-quality acquisitions are consistent with HDN's core strategy and objective to deliver consistent and growing distributions. All sites further enhance HDN's development pipeline as well as providing secure stable distributions in the interim. All acquisitions will be funded by existing debt capacity.

Moving onto slide 22. Home Consortium, the external manager of HDN, recently released its Inaugural Sustainability Report. Home Consortium's focus is the creation of healthy communities, where people have access to products, services and experiences to live healthy lives. This report sets out six sustainability commitments towards creating healthy communities and driving long-term value creation across all of the investments managed by Home Consortium. These sustainability commitments include actively reducing carbon emissions and targeting net zero by 2028 and the creation of social value by meeting community needs through our operations. Also, all the while ensuring strong governance, accountability and alignment.

Slide 22 demonstrates how Home Co sustainability commitments are implemented at HDN. We are rolling out smart energy management strategies facilitating energy efficiency savings of greater than 15% as the first step toward our carbon neutral program. We're preparing at first GRESB submission this year and progressing NABERS energy water ratings across the portfolio. We are also facilitating the supply of community Daily Needs through our tenancy mix and servicing offerings.

I will now hand over to Will to discuss the financial results.

Will McMicking: Thanks, Sid. I'll now turn this slide 25 to go through the income statement. Given the merger will be implemented Friday week on 4 March, we've presented the first half FY22 income statement for HDN on a standalone basis. HDN delivered strong earnings growth with FFO of $30.6 million or $0.04 per unit. This equates to an increase of 38% versus the prior corresponding period on an annualised basis and 14% versus the second half of FY21. The largest contributor to the FFO growth came from acquisitions during the period. This was supported by solid underlying income growth from mature properties and the contribution from accretive developments including the Ellenbrook and Richlands properties.

Turning now to the balance sheet on slide 26. Net valuation gains of $350 million across the merged group have resulted in a robust balance sheet, with December 21 total assets of $4.4 billion, net assets of $2.9 billion and gearing of 32.2%. On a merged basis, NTA is $1.40 per unit which is higher than HDN's initial estimate at the time of announcing the AVN transaction back in October 21. This reflects net valuation gains of $225 million across the AVN portfolio.

Moving to slide 27 to talk to capital management. As part of the merger, HDN has entered into a new $1.62 billion secured bank debt facility and now has no debt expiries until FY24 with an average debt tenor of 3.9 years as at December 21. On a merged basis, hedging is 56% of drawn debt as at December on a pro forma basis with an average hedge debt tenor of 3.6 years. This was driven by hedging undertaken by HDN in the first half of FY22, which was 60% hedged as at December. Our weighted average cost of debt as at December 21 is 1.9% per annum on a combined basis.

As part of the ABN transaction, HDN also received an investment grade RAS credit rating from Moody's of Baa2 stable for the merged group. Receiving this credit rating is a key step towards HDN executing on its credit strategy to diversify debt sources, increase debt tenor and lower the cost of debt for HDN.

I'll now move to slide 29, which details changes to the HDN base management fee structure following the merger. HDN's Manager Home Consortium has agreed to improve HDN's cost structure and demonstrate its ongoing commitment to the success of HDN. Given the considerable growth in the scale of HDN following the merger, Home Consortium will reduce the incremental base management fee by 9% from 55 basis points to 50 basis points when HDN's gross asset value exceeds $5 billion. Over time, this will deliver higher earnings and distributions for HDN unit holders.

This proposal builds on HMC's prior initiatives, which have demonstrated strong alignment and include, selling assets to HDN at a discount to independent valuation, fully funding of bonus units and contributing to the AVN merger consideration via the acquisition of management rights. I'll now turn to slide 30 with the outlook and guidance. One of our key priorities is and will continue to be the delivery of strong earnings and dividend growth for our unit holders.

HDN is pleased today to upgrade our FY22 pro forma FFO guidance to $0.093 per unit, which represents a 4.5% upgrade on the prior guidance of $0.089. This upgrade is driven by $100 million of debt-funded new acquisitions expected to complete in the second half of FY22 and the net impact from the refinancing of HDN's debt facility and hedge book. In addition, HDN is pleased to lift its dividend guidance for the fourth quarter of FY22 by 2%. This equates to $0.085 per unit on an annualised basis for the fourth quarter.

I'll now hand it back to you, Darren, for closing remarks.

Darren Holland: Thank you, Will. In closing, we are excited about the merger, which will create a much stronger platform for shareholder value creation and strong total returns. We believe today's update demonstrates the strong rationale for the merger and significant progress has been made across three areas already. Firstly, we are focused on accelerating the $0.5 billion of accretive development pipeline and we've announced over $60 million of new development commencements in FY23.

Secondly, we've leveraged, as we all touched on, our enhanced scale to secure an investment grade credit rating and strengthen our credit profile. Finally, the strong alignment between HDN and HMC has been further demonstrated through the proposed base fee reduction and opportunity to acquire assets at a discountable value. Thank you and I'll hand back to the operator for questions.

Operator: Thank you very much. We will now begin the question-and-answer session. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up the handset to ask your question. First question comes from Sholto Maconochie from Jefferies. Please…

Sholto Maconochie: (Jefferies, Analyst) …and upgraded guidance. A quick question. The guidance upgrade is mainly due to the acquisitions, but I'm just trying to see what was the cost of debt - I've haven't gone to the detail yet, busy day, but what's your cost of debt assumption verse in the prospectus, in the PDS?

Will McMicking: Yes, Sholto, it's Will. The key thing to note on the refinancing is we've probably dropped our margin by about 30 bps. That's the key point there. As you look at the $0.089 to the $0.093, the way to bridge that is the $100 million of acquisitions, the average cap rate's about 6%. Then, our marginal cost of debt is about 1.3%. So as you bridge $0.089 to $0.093, it's about $0.02 from acquisitions and 2% from the refinancing and hedging.

Sholto Maconochie: (Jefferies, Analyst) Okay. [Unclear] How much are your cost of break [unclear] hedges, how much was the below the line cost?

Will McMicking: If you look at the merged group on a December basis, the hedge book is about 70%. There's about $215 million of legacy swaps within AVN that have about a year to run. So as we've reached the [debt centre] on the debt, we've done the same with the swaps so one year to run, it's not a big number; it's $2 million to $3 million below the line.

Sholto Maconochie: (Jefferies, Analyst) Okay. Thank you. That'll be booked in this period, I guess, because you'll do a post-balance [date].

Will McMicking: Yes. It'll be part of the transaction costs of the deal.

Sholto Maconochie: (Jefferies, Analyst) Okay. Operationally, things look pretty strong. Where do you intend, in terms of other acquisitions - is it more focused now on the pipeline and implementing synergies in the merger? Where do you see upside in the merge group versus the PDS?

Sid Sharma: Good day, Sholto, it's Sid, I'll take that. As the presentation's highlighted, there's plenty of reinvestment opportunities within the development pipeline that we've articulated. That's where our focus at the moment is unlocking that latent value. The $60 million for FY23 that we've announced, we're all pretty excited and focused on that and that will be funded within the existing capability of the Group as well.

Sholto Maconochie: (Jefferies, Analyst) Finally, on the cap rate, it's still strong demand for these asset classes. What's your expectation on the direct side of the market where you're seeing in transactions versus the December value? Are you still seeing strong investor demand and asset values rising or cap rates compressing?

Sid Sharma: Yes. I think even post-December, over the last two months, there's probably been another 25 bps movements in daily needs and LSR centres. There doesn't seem to be any slowing in the direct market for demand for these assets - have a bit more to go but we'll just keep focused on this.

[Over speaking]

Sholto Maconochie: Thanks, Sid. Thanks everyone. Cheers.

Operator: Thank you. The next question comes from Ben Brayshaw from Barrenjoey. Please go ahead.

Ben Brayshaw: (Barrenjoey. Analyst) Good morning. Thanks for the presentation. Wanted to get your feedback on the 80 odd remixing opportunities that you called out in the presentation. Could you discuss please the categories that you're looking to increase your exposure to and current thoughts on how the market rent profile for those new user groups compares to the existing space?

Darren Holland: Yes. I'll take that one. It's Darren Holland here. As you can see on that slide, there's over 80 opportunities. There's about 40 of those in Neighbourhood and about 40 in the Health and Services. There's child play centres, there's education, there's a whole bunch of those individual uses. That will take time to work through the portfolio because obviously we're sitting at a strong occupancy of 99%. You can really do the remixing through three levers.

You can do it through remixing of the existing stock, you can build more through the development pipeline that Sid has referred to and then you can do accretive acquisitions over time as well. They're the three leavers and we'll keep you updated as to how we progress. In my experience, daily needs and health and services pay the same if not more as a rate per square metre compared to traditional LFR. So there would be some upsides in those remixing opportunities.

Ben Brayshaw: (Barrenjoey. Analyst) Okay.

Sid Sharma: We've got a bit more colour on slide 12 there, Ben, where we've articulated each of the categories and the opportunities we've identified across the portfolio on the network per category.

Ben Brayshaw: (Barrenjoey. Analyst) Okay. Thanks, guys.

Sid Sharma: Thanks.

Operator: Thank you. The next question comes from Grant McCasker from UBS. Please go ahead.

Grant McCasker: (UBS, Analyst) Good morning. My question actually follows on from that. If we look at those 80 opportunities, then also the FY23 development starts, is there any income disruption across the assets as you execute on the strategy?

Will McMicking: No. The FY23 pipeline grant will have no impact on the existing portfolio or downtime on income and as you know, what we'll always be focused on is as we unlock the development pipeline, we'll be able to manage any short-term income disruption across some of the town centre projects. Given the size of the Group and the scale and expansion opportunities, yes, we think it'll be pretty smooth.

[Over speaking]

Darren Holland: Further to that, FY23, as Sid was saying, the majority of those developments have had sites so they're sitting on excess land and excess car parking anyway so no disruption.

Grant McCasker: (UBS, Analyst) Okay. Then you called out to say there's potentially additional projects in FY23. What could the development starts look like in excess of the $60 million announced today?

Sid Sharma: Grant, as we said, we've identified $500 million of developments across the Group so we'll update the precise timing of how we keep unlocking it. But the $60 million is obviously the step that we've made on FY23, which is new and then we'll come back to you and announce the unlocking of the further $500 million next results.

Grant McCasker: (UBS, Analyst) Okay. Excellent. Thank you.

Operator: Thank you. Participants, to ask a question you may press star and one. Reminder to the participants, anyone who wishes to ask a question may press star and one. There are no further questions at this time, I will now hand back to Mr Holland for closing remarks.

Darren Holland: Thank you, everyone, for your interest today and ongoing support. We look forward to catching up with you in the coming few weeks. Thank you and goodbye.

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