PFI

Property for Industry Limited

Interim Announcement 2020

SECTOR RESILIENCE

HIGHLIGHTS

RESILIENT INTERIM RESULT

DIVIDENDS OF

3.60

CENTS PER SHARE

Interim profit after tax of $15.6M, Funds From Operations (FFO)[1] earnings up 6.5% from the prior interim period to 4.78 cents per share, Adjusted Funds From Operations (AFFO) earnings down 7.8% from the prior interim period to 3.79 cents per share, H1 2020 cash dividends of 3.60 cents per share.

STRONG BALANCE SHEET

GEARING OF

28.7%

Net tangible assets largely unchanged at 204.8 cents per share, additional bank facility secured, almost $130 million of available liquidity, gearing of 28.7%

PORTFOLIO METRICS MAINTAINED

OCCUPANCY OF

99.0%

Weighted average lease term of 5.28 years, occupancy of 99.0%, just 1.9% of contract rent is due to expire in the second half of 2020

DIVIDEND GUIDANCE REINSTATED

7.65-7.70

CENTS PER SHARE

Resilient results, a strong balance sheet, continued high levels of collection in July and August, resulting in the reinstatement of dividend guidance of 7.65 to 7.70 cents per share

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“THE FIRST HALF OF 2020 WILL BE REMEMBERED FOR THE GLOBAL ONSET OF THE COVID-19 PANDEMIC.

Whilst the course of the pandemic continues to unfold, and its full impact will take many years to materialise, PFI has delivered a resilient interim result, maintaining a strong balance sheet and portfolio metrics, and continuing to pay dividends in line with the prior year.” says PFI Chief Executive Officer Simon Woodhams.

COVID-19

Simon Woodhams continues: “The COVID-19 pandemic has resulted in devastating health and economic outcomes across the globe. However, like previous pandemics, COVID-19 is also shaping large changes to society. Across many industries there has been an acceleration of trends that were already in place. For example, a recent report from consultants McKinsey highlighted that, in the United States, there had been the equivalent of the last 10 years’ growth in e-commerce in just the past three months.

Increased e-commerce volumes are expected to drive additional demand for logistics space. We also expect there to be strong demand for industrial assets as businesses look to create more localised and resilient supply chains.

These trends are anticipated to benefit PFI’s long-held strategy of owning, developing and acquiring quality industrial properties in sought-after areas.” ■

For more information on our interim results, please visit :
https://www.propertyforindustry.co.nz/investor-centre/results-centre/

1. Funds From Operations (FFO) and Adjusted Funds From Operations (AFFO) are non-GAAP financial information and are common property investor metrics, which have been calculated in accordance with the guidelines issued by the Property Council of Australia.

H1 2020 FINANCIAL PERFOMANCE

COVID-19 related support for our tenants has included $0.7 million of abatement and $0.7 million of deferral, a combined total of 1.6% of annual rent. This support has been directed to our most vulnerable tenants, as we seek to balance the health of our tenants with our obligations to our other stakeholders.

These abatement and deferral deals resulted in a $1.1 million decrease in net rental income when compared to the prior interim period, but accounting entries required as a result of those same deals resulted in PFI recording $0.9 million of income not received, resulting in a change to reported net rental income of just $0.2 million. When combined with other changes such as acquisitions and disposals, net rental income of $41.6 million was in line with the prior interim period ($41.0 million).

Property costs – net of recoveries from tenants – increased by $0.9 million, including an increase in bad and doubtful debts of $0.4 million.

Interest expense and bank fees decreased $0.3 million or 3.5%: whilst average borrowings increased by $6.0 million or 1.5%, the impact of this was more than offset by a reduction in the Company's weighted average cost of debt[2], down ~46 basis points from the end of the prior year to 4.17%.

Current tax was down $1.6 million or 26%, in part due to a higher level of maintenance capex in the current interim period, and in part due to the New Zealand Government reintroducing depreciation deductions on building structure for commercial and industrial buildings. PFI estimates that this additional depreciation will reduce the Company's FY 2020 current tax expense by approximately $1.85 million.

After allowing for fair value adjustments and deferred tax, profit after tax for the interim period totalled $15.6 million (3.14 cents per share), down from $46.4 million (9.30 cents per share) in the prior interim period. A $7.8 million fair value loss on investment properties, as compared to a $23.4 million fair value gain in the prior interim period, was the main contributor to this reduction in profit. ■

H1 2020 FFO AND AFFO

FFO earnings of 4.78 cents per share were 0.29 cents per share or 6.5% ahead of the prior interim period and 0.20 cents per share or 4.4% ahead of H2 2019. AFFO earnings of 3.79 cents per share were down 0.32 cents per share or 7.8% when compared to the prior interim period but were up 0.11 cents per share or 3.0% when compared to H2 2019.

AFFO adjustments for the interim period totalled $4.9 million, up $3.0 million or 156.0% from the prior interim period. Two key components of AFFO adjustments were maintenance capex and the reversal of accounting entries required as a result of COVID-19 abatement and deferral deals.

H1 2020 maintenance capex totalled $2.2 million or 29 basis points, whereas in H1 2019 maintenance capex totalled $0.4 million or 6 basis points. Despite significant variances in any one period, PFI expects that maintenance capex on its existing portfolio will average 35 basis points per annum.

Accounting entries required as a result of COVID-19 abatement and deferral deals resulted in $0.8 million of AFFO earnings recorded but not received in H1 2020. These amounts have been adjusted out of AFFO earnings, and this adjustment will unwind as this income is received and the accounting entries unwind. ■

"Low interest rates are contributing to a demand for industrial property investment that continues to outstrip supply."

SIMON WOODHAMS,
Chief Executive Officer

"High levels of liquidity from a diverse range of sources, ultra-low interest rates and headroom to covenant levels provide PFI with a strong funding position"

CRAIG PEIRCE,
Chief Finance and Operating Officer

Q2 INTERIM DIVIDEND

Simon Woodhams continues: "As previously announced, it is our current intention to continue to pay dividends on a quarterly basis to the extent that the Company is in a financial position to do so. The second quarter dividend is based on the Company's interim performance, and during this period, FFO and AFFO earnings were materially in line with the prior interim period and the second half of 2019.

That being the case, the PFI Board resolved to pay a second quarter cash dividend of 1.8000 cents per share, in line with the dividend paid for the same period in the prior year."

The dividend will have imputation credits of 0.4906 cents per share attached and a supplementary dividend of 0.2226 cents per share will be paid to non-resident shareholders. The record date for the dividend is 11 September 2020, and the payment date is 22 September 2020.

As was the case with the first quarter dividend, the dividend reinvestment scheme (DRS) will operate with a discount of 2%. The last date for receipt of an application for participation in the DRS is one business day after the record date, being 14 September 2020.

Further details can be found in the DRS Offer Document, which is available on PFI's website.

The second quarter dividend will take cash dividends for the first six months of 2020 to 3.60 cents per share, in line with the prior period, resulting in an FFO dividend pay-out ratio of 80% (H1 2019: 85%) and an AFFO dividend pay-out ratio of 101% (H1 2019: 93%).

Given the level of volatility in AFFO adjustments, PFI remains mindful of the AFFO dividend pay-out ratio over a longer time horizon than any one period when setting dividends, with the average AFFO dividend pay-out ratio being 101.1% since PFI began disclosing AFFO[3] in 2016. ■

H2 2020 TRADING, GUIDANCE

Simon Woodhams, notes: "When we released the 2019 annual result, we advised that we expected to pay a total cash dividend for the 2020 year of 7.65 to 7.70 cents per share. This guidance was withdrawn on 15 April, due to the considerable uncertainty in relation to the operating environment at that time,

2. Weighted average cost of debt comprises float interest rates, hedging, margins and all borrowings related fees.

3. AFFO has been disclosed since the financial year ended 31 December 2016.

and the potential impact of that environment on the Company's earnings and dividends.

However, during the first half of 2020, FFO and AFFO earnings were materially in line with the prior interim period and the second half of 2019, despite a change in the mix of factors contributing to this result, namely, a decrease in rental income, offset by savings in interest and tax. In addition, high levels of collection have continued, with more than 95% of July and August's rent and opex collected."

PFI Chief Finance and Operating Officer, Craig Peirce, continues: "Given that mix of factors, and based on the current outlook, we are pleased to advise that we once again expect to pay a total cash dividend for the 2020 year of 7.65 to 7.70 cents per share, and that we expect that this level of full year cash dividends will approximate 80% to 90% of FFO earnings and 95% to 100% of AFFO earnings, in line with the Company's dividend policy. This guidance is subject to there being no material adverse changes in conditions or unforeseen events, including no material tenant failures or further material COVID-19 restrictions." ■

BALANCE SHEET AND CAPITAL MANAGEMENT

Net tangible assets (NTA) per share at the end of the interim period of 204.8 cents per share was largely unchanged since the beginning of the year. A small reduction of 0.7 cents per share or 0.3% was driven by retained earnings (+0.6 cents per share) and material damage insurance income (+0.5 cents per share), offset by a decrease in the fair value of investment properties (described below, -1.6 cents per share) and a decrease in the fair value of derivative financial instruments (-0.2 cents per share).

In response to the risks associated with the COVID-19 pandemic, in March 2020 PFI secured a new $50 million liquidity facility from the Commonwealth Bank of Australia, New Zealand Branch (CBA). The new 18-month facility is in addition to the bonds and syndicated bank facility PFI already had in place.

Craig Peirce, notes: "PFI has bonds and bank facilities drawn to a total of around $422.3 million. The Company also has capital commitments over the next 24 months totalling $68.8 million, which we had planned to fund using a combination of undrawn bank facilities and the proceeds from the divestment of PFI's remaining non-industrial properties, which have a combined book value as at 30 June 2020 of $112.3 million.

Securing this additional liquidity gives the Company almost $130 million of undrawn facilities, which allows us to meet our capital commitments regardless of the progress of our divestment programme."

A large fall in the three-month Bank Bill Market (BKBM or "float") rate from 1.21% as at 31 December 2019 to 0.33% as at 30 June 2020 contributed to a significant reduction in PFI's weighted average cost of debt, which decreased to 4.17% from 4.63% over the same period. The Company will continue to take advantage of forecasted low BKBM rates: based on current hedging and debt levels, an average of approximately 58% of PFI's debt will be hedged at an average rate of approximately 3.44% for the second half of 2020, with the remainder on low float interest rates.

The weighted average term to expiry of PFI's bonds and bank facilities stands at 3.4 years as at the end of the interim period, and the Company ended the half year with gearing[4] of 28.7% and an interest cover ratio[5] of 4.1 times.

Craig Peirce concludes: "High levels of liquidity from a diverse range of sources, ultra-low interest rates and headroom to covenant levels provide PFI with a strong funding position. And whilst the bank loan market remains supportive of PFI, subject to market conditions, we are considering options such as another bond issue, to further extend and diversify the Company's borrowings." ■

PORTFOLIO PERFORMANCE

Full valuations of 14 properties were completed during the interim period, and an independent desktop review was completed on the remainder of the portfolio. As a result of portfolio and valuation activity, a total write down of $7.8 million or 0.5% was recorded, and PFI's passing yield is now 5.74% (5.84% at the end of 2019). An independent market rental assessment of the entire portfolio was completed as part of the valuation process, this assessment estimates that PFI's portfolio is ~3.5% under-rented.

Simon Woodhams notes: "Low interest rates are contributing to a demand for industrial property investment that continues to outstrip supply. Recent sales of prime industrial property have been completed at yields as low as, and in some cases even lower, than pre-pandemic levels. This has resulted in stable industrial property prices, as evidenced by the results of the Company's interim valuation process."

Nearly 31,000 square metres, representing around 5% of PFI's existing portfolio by rent, was leased during the interim period to 11 new and existing tenants for an average increase in term of 6.4 years. Lease renewals accounted for more than 81% of the contract rent secured. Across these leasing transactions, low levels of incentives and capital expenditure were required to attract and retain tenants, with average leasing costs of less than half a month per year of term.

Leasing demand for PFI's properties remains robust, with transactions totalling more than $4.6 million either secured, or in advanced stages of negotiation, since the end of the interim period. Vacancy is still at historically low levels: CBRE report

4. That is, total borrowings as a percentage of the most recent independent valuation of the property portfolio. Covenant: 50%.
5. That is, the ratio of interest expense and bank fees to operating earnings excluding interest expense and bank fees. Covenant: 2 times.

8 THINGS YOU SHOULD KNOW ABOUT OUR PORTFOLIO PERFORMANCE:

	JUN 2020	JUN 2019	DEC 2019
BOOK VALUE $/M	1,470	1,368.3	1,476.2
NO. OF PROPERTIES	93	94	94
NO. OF TENANTS	140	147	144
CONTRACT RENT $/M	83.6	83.1	84.9
OCCUPANCY %	99.0	99.7	99.0
WEIGHTED AV. LEASE TERM YEARS	5.28	5.71	5.38
AUCKLAND PROPERTY	84.2%	83.8%	84.1%
INDUSTRIAL PROPERTY	91.0%	87.4%	90.0%

in their August 2020 Market Flash that Auckland Prime industrial vacancy is just 1.2%, with Secondary industrial vacancy at 1.5%. Notwithstanding these low levels of vacancy, market levels of incentive have begun to trend up, as landlords – including PFI – focus on securing strong tenant covenants, guarantees and long lease terms to ensure the security of cash flows.

Rent reviews were completed on 53 leases during the interim period, resulting in an average annual uplift of ~4.1% on ~$22.5 million of contract rent. 5 market rent reviews on $1.2 million of contract rent delivered an annualised increase of 7.1% over an average review period of 2.4 years, and these reviews were settled at an average of approximately 2.6% above December 2019 market rental assessments.

At the end of the interim period, the Company's portfolio was 99.0% occupied and just 1.9% of contract rent is due to expire in the second half of 2020. When combined with rent reviews, around 44% of PFI's portfolio is subject to some form of lease event during the second half of 2020. ■

MARKET UPDATE

The New Zealand economy has been able to return to something closer to normal than many other countries, but the outlook is a challenging one. In their July 2020 Quarterly Economic Outlook, ANZ note that: "Households and businesses are cautious, and unemployment is rising. Investment and spending will be weaker, with policy providing an important but only partial offset. Despite our enviable position, the slowdown will be large and the recovery slow."

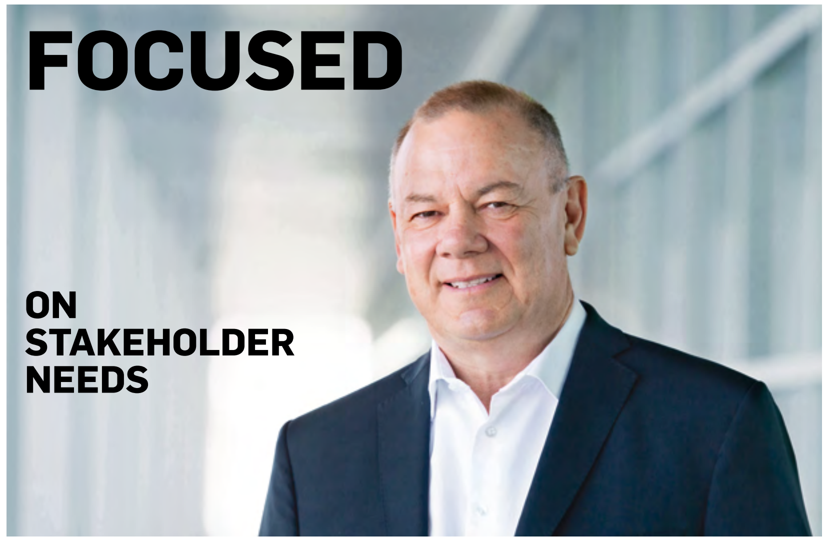
Given these conditions, in July ANZ forecast for 2020 and 2021 to end with an Official Cash Rate (OCR) of just 0.25% (January 2020 forecast: 1.00%), with forecast 10-year Government Bond Rates of 1.00% and 1.25% (January 2020 forecast: 1.30% and 1.20%) respectively, despite the large increase in Government debt. Their view was updated mid-August, and they now forecast an OCR of -0.25% in April 2021.

In their August 2020 "Auckland Market Outlook – Industrial Sector Preview", CBRE predict that the outlook for Auckland vacancy and yields has improved since December 2019.

Prime vacancy is forecast to reach just 1.1% at the end of their five-year forecast period (was 1.4%), and Secondary vacancy is expected to behave in a similar manner, reaching 1.7% at the end of the five-year forecast (was 2.1%). Prime yields are forecast to reach 4.74% (was 4.90%), with Secondary yields expected to contract to 5.65% (was 5.80%).

Their outlook on rental growth over the next five years has softened a little, averaging 2.1% per annum for Prime properties (was 2.5%) and 1.6% per annum for Secondary properties (was 3.0%). CBRE note that their softer outlook for rents is as a result of more generous incentives being offered to prospective tenants. ■

FOCUSED ON STAKEHOLDER NEEDS



"The company has performed consistently because it has kept the expectations of stakeholders front of mind."

DEAN BRACEWELL,
Independent Director

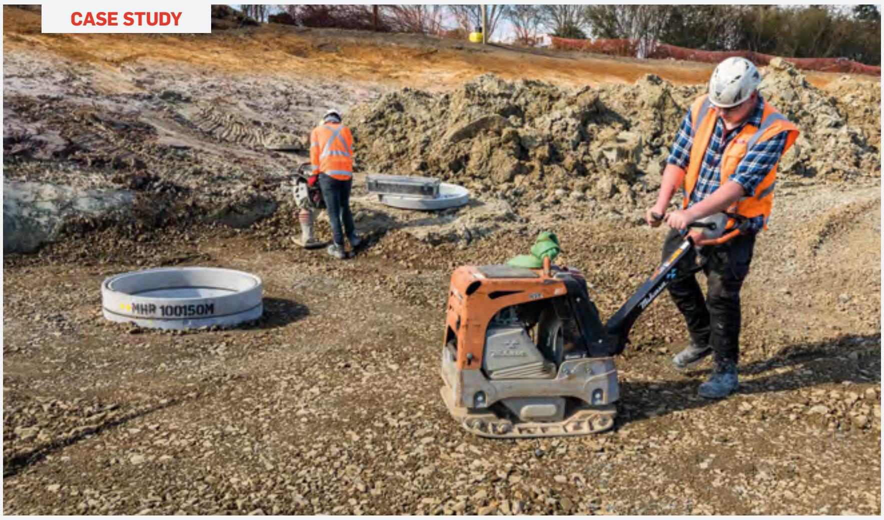
"PFI has successfully balanced yield and growth over many years by sticking to their core strategy. That takes discipline," says Dean Bracewell, who joined the PFI Board as an Independent Director last year. "The Company has performed consistently because it has kept the expectations of stakeholders front of mind and applied the meeting of their needs objectively in its decision making."

Bracewell says that his own experience fuses with the core business of PFI in several ways. "I have worked for many years in industrial New Zealand and in service industries, run a publicly listed company with strong long-term goals and undertaken a range of property transactions. So I have an understanding of what customers will be looking for from PFI, I understand what investors will be looking for and I'm very aware, as we all are today, of the importance of bringing all stakeholders along with us."

PFI's track record speaks for itself, says Bracewell. The Company has used its specialist focus to build sustainable earnings and bolster its balance sheet. It is well positioned to take up the challenges of delivering an acceptable yield whilst managing profitable growth in an extraordinary trading environment. "This tension is not unique to PFI, but I'm confident, given the skills that I see around me in the Board and the Management Team, that the Company will capably navigate what's ahead.

"Environmental, Governance and Social factors have re-set the expectations for boards today. Publicly listed companies are under greater scrutiny and directors need deep and broad knowledge of the intricacies of decisions. Having worked on a number of boards, with different governance styles, under both Australian and New Zealand ownership, I'm confident PFI has the collective talent and experience needed to do right by our customers, investors and other stakeholders."

Dean Bracewell was Managing Director of Freightways from 1999 to 2017. Under his leadership, the company grew to have a market capitalisation of $1.2 billion. He is currently on the boards of Tainui Group Holdings and Air New Zealand, the Executive Board of the Halberg Foundation and involved in an advisory role to the Ministry of Transport. ■



OUR PRIORITIES

"In recent years, we have made significant progress on our pathway to becoming a pure-play industrial listed property vehicle. The COVID-19 pandemic has created fresh challenges for us to navigate, and we have responded accordingly" noted Simon Woodhams.

"For example, we had planned to dispose of PFI's remaining non-industrial properties, including Carlaw Park, but we put these plans on hold while we waited for less volatile conditions. We now expect to bring this asset to market late 2020.

And whilst we have continued to build out three value-add projects, we have put the $8.1 million speculative project at 47 Dalgety Drive on hold, while we work to secure tenant commitment at some of our other speculative projects, like 59 Dalgety Drive and Lot 1, Tidal Road." More details on the 59 Dalgety Drive project can be found in this newsletter.

"We have continued to target acquiring quality industrial properties in sought-after areas but did not transact in the first half of 2020. Target acquisition parameters include an increased Auckland weighting from 84.2%, improving the property and tenancy fundamentals of PFI's portfolio, and decreasing the average age of PFI's portfolio.

Environmental, Social and Governance factors have remained front of mind, and in March we welcomed Sarah Beale to the PFI team as our Sustainability, Risk and Compliance Manager. Sarah has been deepening the work already completed with external consultants, with a particular focus on health, safety and wellbeing, emissions, and climate risk." ■

CLOSING

Simon Woodhams concludes: "PFI has delivered a resilient interim result despite a period of significant volatility and uncertainty. These results not only reflect our ownership of the right industrial properties, in the right locations, filled with quality tenants, managed by an experienced and dedicated team, they also reflect our conservative gearing and dividend pay-out ratios.

In recent years, we have kept our gearing low, accepting that low gearing results in slightly lower returns in the good times, but knowing that low gearing will serve us well in times of crisis. And we have worked hard to ensure that our dividends reflect what we earn, so we don't increase our gearing by paying out more than that which we have earned from our tenants.

Looking forward, strong demand for industrial space due to increased e-commerce volumes and businesses looking to create more localised and resilient supply chains are trends that are anticipated to benefit PFI's long-held strategy of owning, developing and acquiring quality industrial properties in sought-after areas.

Despite the current challenging times, we believe PFI is well placed to respond to these latest challenges, and indeed any opportunities that may arise from them." ■

GETTING READY FOR A NEW LIFE

59
DALGETY DRIVE, WIRI

"New Zealand businesses are looking for properties that are capable of meeting their long-term needs. Creating these quality assets sometimes requires looking beyond what is currently there, to the longer term opportunities that a site presents," says Ewan Cameron, PFI Portfolio Manager.

The buildings at 59 Dalgety Drive were originally purpose built to accommodate food grade production. The specialist fit out comprised refrigerated storage, raised cart docks and food grade manufacturing.

"The site was well designed for a specific type of activity," says Ewan Cameron, "but most of the specialist fit out had been decommissioned for some time now. In February of this year the site was handed back to us at the end of the lease."

Direct Property Fund, who merged with PFI in 2013, acquired this Wiri property in 2008 with a 12-year lease. The property is currently being extensively remodelled into a modern warehouse that will suit large-scale operators looking for room to expand in this prime Auckland industrial location.

The large rectangular 2.15ha flat site offers excellent access to Wiri's Dalgety Drive. The specialist fit out is being systematically removed to provide an open plan 7,000 sqm generic warehouse. Two new canopies installed along the West and North warehouse walls will provide multiple loading options, with each canopy housing four new wide roller doors.

Surplus land at the rear of the site will, in the first instance, be converted to useable yard, offering 2,500 sqm of container storage and heavy vehicle manoeuvring, with the option to convert this area into new warehousing in the future. This extended yard will also allow for full drive-round access. The office area will be refurbished as a generic open plan layout.

"The core elements of this property were right," says Ewan Cameron. "Maximising the potential of this investment started with recognising all the advantages that were inherent in the site. Transforming this specialised site into a versatile property that could meet a wide range of needs was about seeing what must stay and which parts of the site could be redesigned and reallocated."

The 12-month design, demolition, build and refurbishment program will deliver a modern, versatile warehouse. The availability of this larger asset, its location and key operational features are already attracting a high level of interest, and heads of terms have been signed with a supply chain and logistics operator.

PFI looks to deliver shareholders strong, stable returns by investing in quality industrial property. Simon Woodhams concludes: "59 Dalgety Drive is another example of how PFI looks past the existing fit out and configuration of a property to see the broader benefits and long term potential of a site. This is a building that others might have seen as too bespoke, whereas we have been able to reconfigure the property to deliver a quality warehouse designed to meet the needs of today's occupiers." ■

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